Government Relations Committee Meeting

Wednesday, March 22nd
3:00pm – 4:30pm
La Quinta Club & Resort, La Quinta, California

Moderators:
Rohn Grazer, Managing Director-Tax, Prologis, Inc.
Brian Wood, SVP & Chief Tax Officer, Ventas, Inc.

Panelists:
Julanne Allen, Assistant to the Branch Chief-Financial Institutions & Products, Internal Revenue Service
Andrea Hofferson, Branch Chief-Financial Institutions & Products, Internal Revenue Service
Michael Novey, Associate Tax Legislative Counsel, U.S. Treasury Department
Ameek Ponda, Partner & Director- Tax Department, Sullivan & Worcester LLP
Donald Susswein, Principal, RSM US LLP

A BETTER WAY

OUR VISION FOR A CONFIDENT AMERICA

Tax

June 24, 2016

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A BETTER WAY: A PRO-GROWTH TAX CODE FOR ALL AMERICANS

The United States stands at a pivotal moment. Today's policy decisions will have a lasting effect on future generations – for better or worse. If we stay within the bounds of the current tax discussion, we have only three choices for the path forward:

- We can do nothing, leaving our children with the responsibility to clean up the tax code and its ruinous effects.
- We can raise taxes under the existing system, which would levy harsher penalties on hard work, savings, and entrepreneurship.
- We can tinker around with little tax changes while the sun sinks ever lower on the age of American excellence.

The Tax Reform Task Force rejects these false choices and believes it is time to go in a completely new direction. Today we have a once-in-a-generation opportunity to move forward with bold, pro-growth tax reform.

As the Task Force worked to develop smart reforms, we asked ourselves two questions about each policy or provision: *"Will this policy reform grow our economy?"* and *"Is it worth raising taxes on everyone else to include this provision?"* We are committed to growing our economy without increasing the deficit – taking into account the increased Federal revenues that result from economic growth.

This Blueprint is a detailed, credible, fiscally responsible plan to create a modern tax code built for growth – the growth of families' paychecks, the growth of job creators, and the growth of the American economy. **And it is the beginning of our conversation about how to fix our broken tax code.**

This Blueprint will achieve three important goals:

- It will fuel job creation and deliver opportunity for all Americans.
- It will simplify the broken tax code and make it fairer and less burdensome.
- It will transform the broken IRS into an agency focused on customer service.

Simply put, the Tax Reform Task Force Blueprint delivers ***a better way*** on tax reform that will help all Americans have more and better opportunities in their lives.

1. THE TAX REFORM TASK FORCE: DEVELOPING THE CONSENSUS

In January 2016, House Republicans set out to deliver a bold, pro-growth policy agenda focused on addressing the top concerns of the American people. On February 4, 2016, House Speaker Paul D. Ryan announced the creation of six committee-led task forces committed to delivering serious solutions. Each Task Force was charged with developing detailed policy recommendations to serve as the pillars of our pro-growth plan for the future – our plan for a confident America.

As leader of the Tax Reform Task Force, Ways and Means Committee Chairman Kevin Brady of Texas has spearheaded the conference-wide effort to create a 21st century tax code built for growth. The goal of the Task Force was to deliver a strategy to create jobs, grow the economy, and raise wages by reducing rates, removing special interest carve-outs, and making our broken tax code simpler and fairer.

On March 2, 2016, the Tax Reform Task Force kicked off with its first idea forum. These meetings provided opportunities for all Republican Members of Congress to share their ideas for how to fix our broken tax system. Over the course of four months, the Task Force held six Member-driven idea forums that were widely attended by Members from across the House Republican Conference.

The Task Force also held discussions with economic thought leaders to gain a thorough understanding of how various changes to the tax code would affect the American people and our economy as a whole. The collaboration brought to the table new, forward-thinking perspectives on pro-growth tax reform. This was critical in developing solutions that will create jobs, ease the tax burden on American families, make the United States a magnet for investment, and enhance the ability of our businesses to compete and succeed around the globe.

Complementing the efforts of the Tax Reform Task Force, the Committee on Ways and Means held a series of public hearings focused on how to make our tax system work better for the American people. These hearings examined the challenges facing American businesses and workers in the global tax environment, tax-related challenges facing families and small businesses here at home, and Member-driven solutions that would transform our tax code.

2. WHY NOW? ANOTHER HISTORIC MOMENT

Tax Reform – striking similarities between 1986 and 2016

This October will mark 30 years since President Ronald Reagan signed into law the Tax Reform Act of 1986 – landmark legislation that is recognized as the single largest reform of the U.S. tax code in our nation's history.

The world has changed dramatically since 1986 – and so has our tax system. But unlike advances in medicine and technology that have expanded horizons of possibility, the U.S. tax code has expanded to impose excessive burdens that restrict opportunity and economic freedom.

In many ways, our current tax and political environment is remarkably similar to the one that allowed President Reagan to successfully overhaul the tax code three decades ago. As we look to replicate and build upon this achievement, it is important to recognize three key factors that were present in 1986:

> First, the American people were fed up with the tax code. It was a complicated mess of multiple brackets, high rates, and special-interest provisions. As President Reagan described it, the code had become a *"haven for special interests and tax manipulators, but an impossible frustration for everybody else."*

Second, Members of Congress had bold proposals for pro-growth tax reform. Thanks to the hard work and vision of Congressman Jack Kemp, Senator Bill Bradley, and many others, Americans saw the total number of income brackets reduced from 15 to two. In addition, the top income tax rate for individuals was cut from 50 percent to 28 percent, and the top corporate tax rate was reduced by 12 percentage points.

And third, President Reagan was willing to lead on tax reform. As a result of that leadership and three years of difficult work in Congress, the United States emerged with one of the most modern, fair, and competitive tax systems in the developed world – one that laid the foundation for decades of American job growth.

A striking number of these same factors are present today:

First, the American people now are fed up with the tax code. It again has become a complicated mess of multiple brackets, high rates, and special-interest provisions. Once again, Americans are forced to devote their hard-earned dollars and their hard-pressed time to complying with an overly complicated and complex code. And at the end of the process, most people believe that everyone else but them got a better deal.

Second, Members of Congress now are proposing a variety of serious ideas for pro-growth tax reform. Representative Rob Woodall of Georgia is a champion of the Fair Tax, which would repeal the income tax and other taxes, abolish the IRS, and enact a national retail sales tax. Representative Mike Burgess of Texas is a powerful advocate for the Flat Tax, which would give taxpayers the option of having a flat rate of tax applied to their annual income. Representative Devin Nunes of California has designed the American Business Competitiveness (ABC) tax, which would transform the way businesses are taxed in America. And Representative Bob Goodlatte of Virginia is making the case for the Tax Code Termination Act, which would end the current tax code after 2019 and require Congress to adopt a fair and simple Federal tax system to replace it. More broadly, Members of Congress on both sides of the aisle believe that Americans deserve a better tax system and that Congress must deliver it.

And third, every major Republican primary and general election candidate in the 2016 Presidential election introduced a plan to reform our broken tax code.

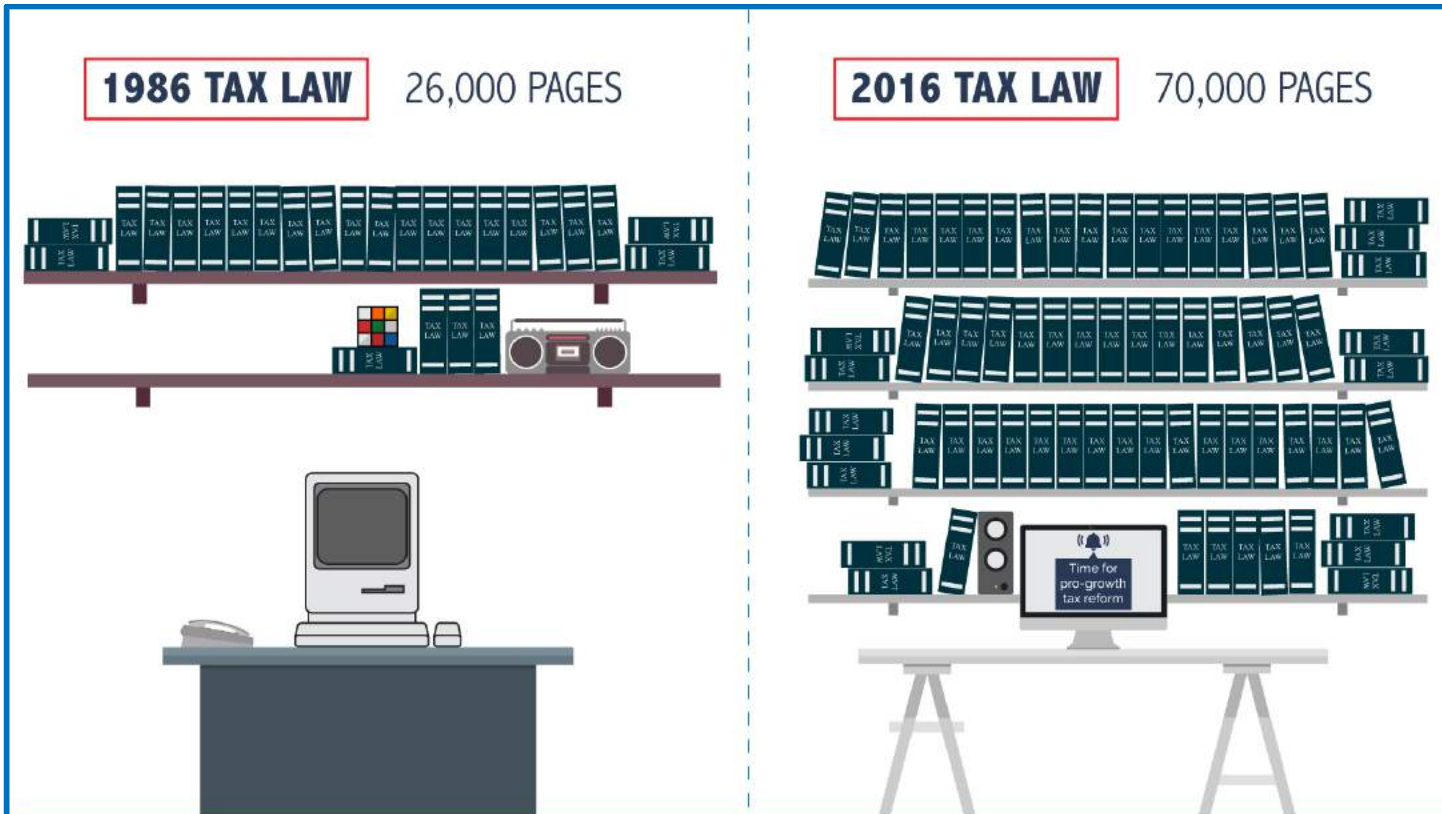
Armed with the bold ideas put forward by our Tax Reform Task Force, House Republicans stand ready to work with America's next president to hit the ground running on pro-growth tax reform in 2017.

3. THE CHALLENGE OF OUR BROKEN TAX CODE AND OUR BROKEN TAX COLLECTOR

As in 1986, America's tax code in 2016 has become completely and totally broken. It imposes burdensome paperwork and compliance costs, delivers special interest subsidies and crony capitalism, penalizes savings and investment, and encourages businesses to move overseas. And it is administered by a broken tax collection agency that continues to fail the American people.

Problem #1: The Current Code Imposes Burdensome Paperwork and Compliance Costs

While the Internal Revenue Code runs over 2,600 pages, the tax code itself represents only a small fraction of the entire body of Federal tax law.[1] Taxpayers must navigate laws and guidance that include Treasury regulations; IRS forms, instructions, publications, and other guidance; and Federal court decisions. When all of these sources are compiled together, the Federal tax laws today fill approximately 70,000 pages – almost triple the number of pages at the time of the Tax Reform Act of 1986.[2] Recent estimates have found that Americans now spend over $409 billion and 8.9 billion hours annually trying to comply with our broken tax code.[3]



With a tax law that has nearly tripled in length in the last 30 years, it is no wonder that 9 out of 10 taxpayers now use either a professional tax preparer or computer software to file their taxees. **This blueprint delivers a simpler, fairer, and flatter tax code to help all Americans.**

= 1,000 PAGES

Real-world frustrations include:

- Families struggling to afford a college education must now wade through over a dozen different tax breaks for higher education and almost 100 pages of IRS instructions just to figure out which education tax benefits could help them meet the demands of growing tuition costs.[4]
- The tax code provides two separate tax benefits related to children: the child tax credit and the personal exemption for dependent children. But the definition of "qualifying child" is different for each benefit, so a family might qualify for one but not the other. A family also might be discouraged from seeking a benefit altogether – even if they are eligible to receive it.
- Even a concept as simple as "married" takes 218 words and five paragraphs to define.[5]

It is no wonder that nine out of ten taxpayers now use either a professional tax preparer or computer software to prepare their tax returns.[6]

Tax complexity and compliance costs are a serious burden for all Americans, but for small businesses – our nation's chief source of job creation – the burden is particularly severe. For example, tax compliance costs the 4 million S corporations in this country more than $46 billion annually, nearly $12,000 per company.[7] Moreover, another significant compliance cost for family-owned businesses is the death tax. While the government collects only about $20 billion in revenues from estate and gift taxes, they represent a cost of $19.6 billion per year to individuals who must comply with these rules.[8]

Tax complexity feeds other problems as well, such as waste, fraud, and abuse. For example, according to the Treasury Inspector General for Tax Administration (TIGTA), over an 11-year period the IRS has sent out almost $150 billion in erroneous Earned Income Tax Credit (EITC) claims.[9] In 2013 alone, the IRS estimated that 24 percent of EITC payments were made in error – nearly one quarter of all payments were erroneous.[10]

House Republicans made a down payment on reducing waste, fraud, and abuse when we included one dozen program integrity provisions in the Protecting Americans from Tax Hikes (PATH) Act of 2015. But we have more work to do. The best way to reduce tax fraud is to simplify the tax code by enacting major tax reform.

Problem #2: The Current Code Delivers Special Interest Subsidies and Crony Capitalism

The tax code is littered with hundreds of preferences and subsidies that pick winners and losers and create complexity. Instead of free-market competition that rewards success, our tax code directs resources to politically favored interests, creating a drag on economic growth and job creation. In fact, Washington encourages individuals and businesses to make investment decisions based not on the most promising new technologies and innovations, but instead on the promise of tax savings. Many of these tax preferences, sometimes referred to as "tax expenditures," are special-interest giveaways that are masked as tax breaks instead of direct grants. For fiscal year 2016, such "spending" through the tax code amounts to more than $1.4 trillion, or almost three-fourths of the amount of revenue raised by the entire Federal income tax. When Washington picks winners and losers with the tax code, the American people ultimately pay higher tax rates and keep less of their hard-earned money.

Problem #3: The Current Code Penalizes Savings and Investment

The United States has one of the highest levels of taxation on capital in the world. We tax capital once at the corporate level and then again at the individual level — with integrated tax rates on certain investment income exceeding 50 percent. The overall taxation of capital in the United States is higher than all but four of the 38 countries that make up the Organization for Economic Co-operation and Development (OECD) and the BRIC countries (Brazil, Russia, India and China).

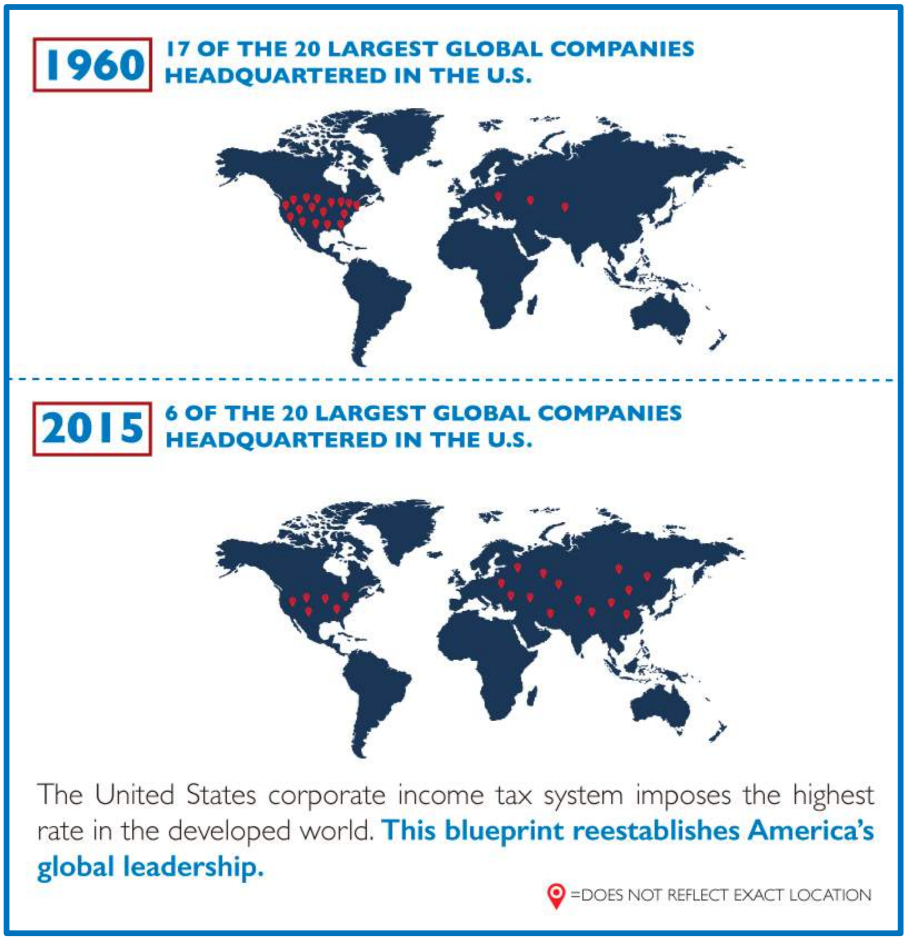
The following example illustrates how the Federal government can take more than half of an individual's savings. Assume an individual purchases shares in a corporation that pays out all of its profits in the form of dividends. The corporation earns $1,000 and pays $350 in corporate income tax, leaving $650 to distribute as dividends. A saver in the top tax bracket must pay the 20-percent dividend rate on that $650 ($130) and the 3.8-percent net investment income tax (which was enacted as part of the "Obamacare" legislation) on the same $650 ($24.70). In addition, the so-called Pease limitation requires the taxpayer to reduce his or her itemized deductions by $3 for every $100 in additional income, or $19.50. That loss of deductions increases taxable income by $19.50, and at a 39.6-percent rate generates $7.72 of additional tax liability. The sum of all these taxes on that original $1,000 in income is $512.42, or an effective tax rate of 51 percent. With State taxes on top of that, savers in some parts of the country pay an effective tax rate of over 60 percent on their investments.

Problem #4: The Current Code Encourages Businesses to Move Overseas

Our corporate income tax system imposes the highest rate in the developed world – 39 percent when the 35-percent Federal rate is combined with the average State corporate tax rate.[11] Globally, only two of 173 countries have a higher corporate tax rate than the United States – Chad and the United Arab Emirates.[12] The corporate tax rate represents the most important tax-related factor in a company's decision to invest and locate jobs in the United States or overseas. In 1960, 17 of the 20 largest global companies located their headquarters in the United States. By 2015, only six of the top 20 were located in the United States.[13]

Meanwhile, owners of small and closely held businesses face a top Federal marginal tax rate as high as 44.6 percent on their activities. As a result, a majority of our small businesses are forced to focus more resources on dealing with the tax code and less on creating jobs and investing in local communities.

Another disadvantage is that the United States still uses a so-called worldwide tax system, which means we tax the earnings of American companies overseas when those earnings are brought back to the United States, with a credit allowed for foreign taxes paid on those earnings. Meanwhile, virtually all of our major trading partners have adopted territorial tax systems, under which these governments generally do not tax the active business income earned overseas by companies headquartered in their countries.



Today, American companies must pay a tax penalty if they want to reinvest foreign earnings in creating jobs and raising wages in the United States. As a result, American worldwide companies currently hold more than $2 trillion in capital overseas – funds that can be reinvested in America only after payment of a hefty U.S. tax bill.

Our high corporate rate, our outdated worldwide tax system, and our origin-basis system that taxes exports have created a perfect storm that has encouraged so many businesses to move their headquarters overseas. That is why the pace of so-called "inversions" – where a larger American company acquires a smaller foreign company, but locates the headquarters of the new company outside the United States – has accelerated dramatically in recent years. From 2003 through 2011, corporations completed only seven such transactions, or less than one per year on average. But just in the period from 2012 through 2015, corporations completed 27 inversions, a pace of almost seven per year. At the same time, we are seeing an increasing number of American companies being taken over by foreign companies.

Problem #5: The Current Code Enables a Broken Tax Collector

Over the past three decades, the IRS has become a prime example of executive branch overreach, blatant misconduct, and government waste. While the structure of the IRS has expanded over the years to create a duplicative, inefficient, and complex bureaucracy with approximately 80,000 employees across the country, the agency continues to fail hard-working American taxpayers.

The ongoing problems at the IRS are many, including the following:

- Customer service at the IRS has reached abysmal levels. In fact, the Government Accountability Office has confirmed that the IRS provided "the lowest level of telephone service during fiscal year 2015," with only 38 percent of callers able to reach an IRS representative.[14] And average wait times have tripled from 2010 to 2015, from 10.8 minutes to more than 30 minutes.[15]

- The IRS has repeatedly abused law-abiding citizens through its use of civil asset forfeiture policies. The agency has taken money from innocent small business owners, many of whom were forced to forfeit their hard-earned dollars to the government without any opportunity for recourse.

- The IRS makes billions of dollars in improper payments through the programs it administers, particularly the Earned Income Tax Credit (EITC). At 24 percent, the EITC has the highest level of improper payments of any Federal program, with nearly $15.6 billion in improper payments in fiscal year 2015, nearly double the rate of the next highest program.[16]

- Information technology (IT) systems at the IRS are extremely outdated, but the IRS has been unsuccessful in modernizing them despite spending billions of dollars. In fiscal year 2014, the IRS spent more than 20 percent of its total budget on IT, but many of its projects have been complete failures and actually left taxpayers vulnerable to identity theft-related tax fraud and cyber security attacks.[17] As a result, identity theft-related tax fraud also has been a rapidly growing problem that the IRS has not been successful in combatting. Despite millions of dollars spent by the IRS on systems designed to detect fraud, millions of taxpayers have had their identities stolen and used to file fraudulent tax returns for the purpose of getting refunds. The U.S. Treasury Inspector General for Tax Administration estimated in 2012 that the IRS could pay out $21 billion in identity theft-related tax fraud over five years.[18]

The IRS's mismanagement and lack of accountability have seriously compromised its ability to serve taxpayers and treat them fairly.

4. THE NEED FOR STRONGER ECONOMIC GROWTH: HOW TAX REFORM WILL HELP

The Current Tax Code Stifles Economic Growth

Our broken tax code does more than just impose unnecessarily burdensome paperwork requirements, subsidize some industries at the expense of others, punish savings and investment, and force businesses to move overseas. The broken tax code also undermines economic growth – the growth that has been our country's engine of prosperity for generations.

Promoting robust economic growth is nothing less than a national imperative – it fuels our standard of living, makes balancing our Federal budget less challenging, and ensures that there is opportunity for all Americans. But in recent years the rapid expansion of opportunity that Americans once enjoyed and have come to expect is slipping away. For example, here's how economist Douglas Holtz-Eakin summarized recent economic growth trends at a February 2016 Committee on Ways and Means hearing:[19]

> The trend growth rate of postwar GDP per capita (a rough measure of the standard of living) has been about 2.1 percent. . . . [A]t this pace of expansion an individual could expect the standard of living to double in 30 to 35 years. . . . In contrast, the long-term growth rate of GDP in the most recent CBO projection is 2.0 percent. When combined with population growth of 1.0 percent, this implies the trend growth in GDP per capita will average 1.0 percent. At that pace of expansion, it will take 70 years to double income per person. The American Dream is disappearing over the horizon.

Holtz-Eakin concluded that "Raising the trend rate of growth is central to retaining the American dream and the nation's place on the globe."

How exactly does tax policy affect economic growth?

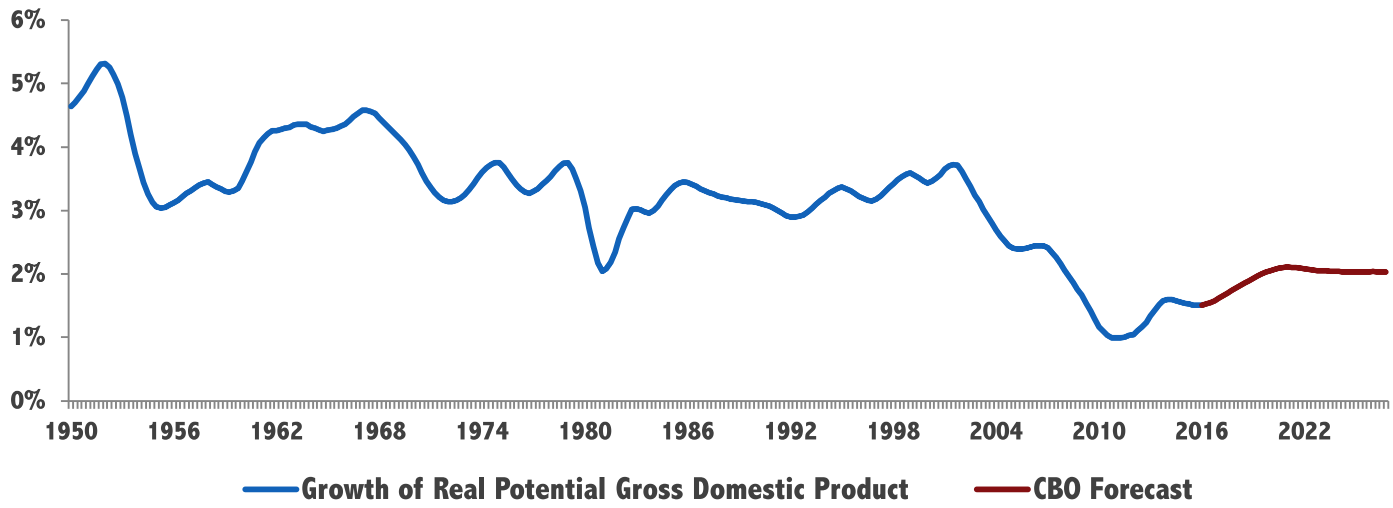
Tax policy may influence economic growth through four principal channels: labor supply, physical capital, human capital, and technological innovation. The non-partisan Joint Committee on Taxation (JCT) provides a helpful framework to think about taxes and growth in broad terms:

> *To understand how tax policy may impact GDP through labor supply, physical capital, human capital, and technological innovation, it is useful to think of GDP as being the product of the amount of labor supplied in the economy and the average productivity of that labor. The productivity of workers in the economy is a reflection of a number of factors, including workers' human capital, the physical capital with which they have to work, and the technology available to them.*
>
> *Tax policy can directly influence the level of labor supply, physical capital, human capital, and technology in an economy by changing the after-tax returns to certain economic activities or changing the cost of pursuing them. Lowering individual tax rates on wages, for example, can increase labor supply by raising the after-tax returns to labor. Reductions in business income tax rates increase the after-tax return to capital and can encourage businesses to invest in physical capital, which could make workers more productive.*

Given currently low levels of labor force participation, capital investment, and productivity growth it is important that tax reform operate on all of these channels to revive economic growth. [20]

Two key factors driving our economic potential are growth in the size of the labor force (those who are employed or seeking work) and the productivity of those workers (the output they can produce per hour). However, recent years have seen sharp declines in each, causing trend growth to sink to historic lows. Even the anemic 2 percent future of growth that the Congressional Budget Office (CBO) projects might be too optimistic.

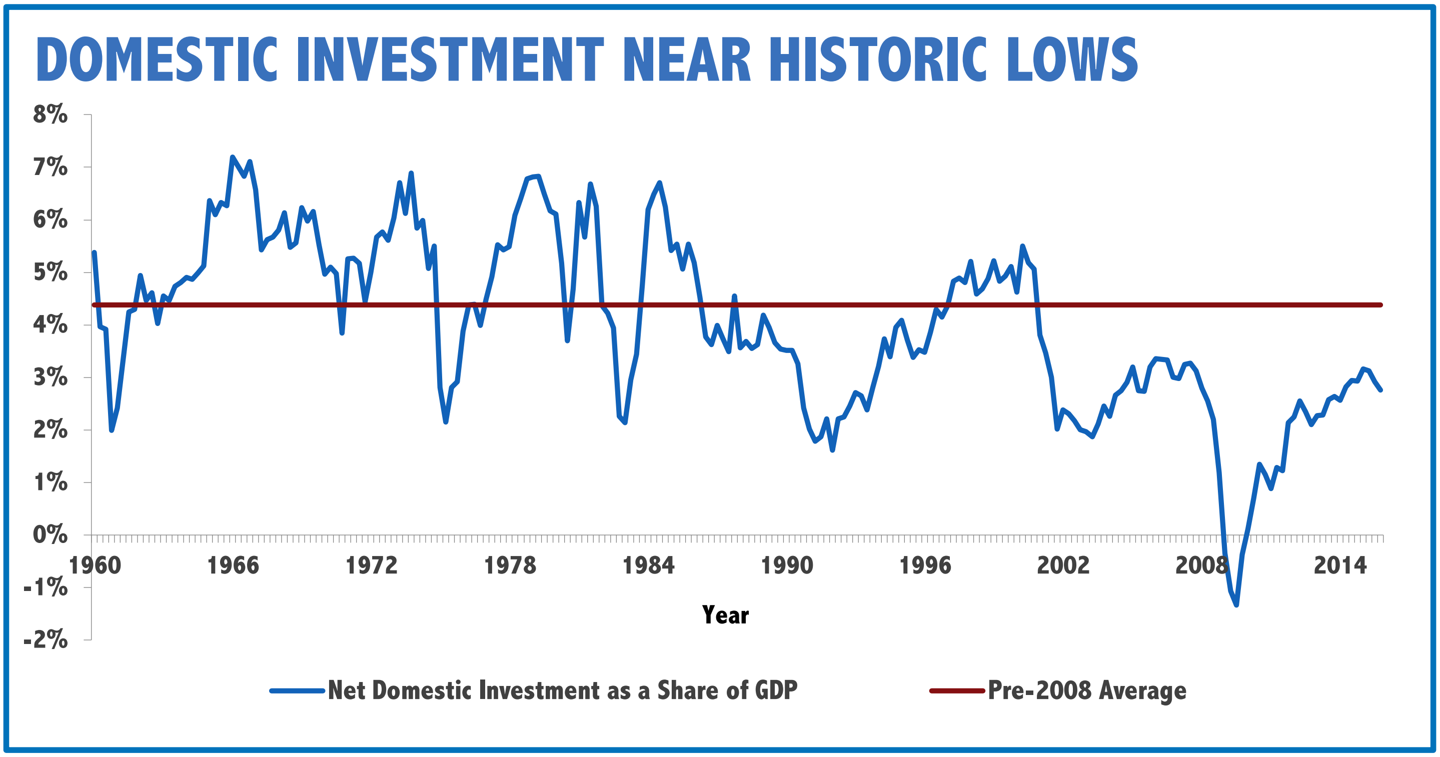
SLOW GROWTH STATUS QUO



Importantly, the recent slowdown in labor-force growth is not related solely to Baby Boomers moving from employment to retirement. As has been noted by a wide array of economic analysts, troubling declines in labor-force participation are occurring even among workers in their prime earning years. This suggests more serious structural problems with the economy.

Productivity growth also has been persistently weak in recent years. Over the past three years, productivity growth has averaged a mere 0.4 percent – a far cry from the historical average of 2.1 percent. And while productivity growth may seem like an abstract economic concept, it is widely accepted as the key to growth in incomes. For example, according to President Obama's Council of Economic Advisers (CEA), if productivity had grown from 1973-2013 at the same rate it had from 1948-1973, the median household income would be $30,000 higher today – an increase of over 50 percent.[21] The effect of worker productivity on incomes dwarfed every other effect that CEA studied.[22]

One likely reason for the productivity slowdown is the fact that current levels of investment are dismal by historical standards. Without sufficient levels of investment, workers will miss out on new innovations and capital that make them able to produce more output per hour. Net domestic investment averaged 4.4 percent of gross domestic product (GDP) per year between 1960 and 2008. Today, however, it is a mere 2.8 percent of GDP – a level that was more commonly associated with recession years during the past two generations.



America's broken tax code discourages investment, which means workers have fewer resources and are less productive. **This Blueprint creates an environment in which job creators and American families can thrive.**

Addressing the Growth Challenge with a New Tax Code

This Blueprint is designed to address all of these problems – slow growth, declining labor force participation, flat productivity, and weak investment. As is described in greater detail below, this Blueprint will dramatically reform our current tax code by reducing the taxation of savings and investment. These reforms will make the United States the most attractive place to invest in the world, which will stimulate much-needed investment, job creation, and wage growth. By replacing a broken tax code that diverts investment away from promising entrepreneurial endeavors and that discourages work, and delivering an efficient tax code that interferes as little as possible with the growth of businesses and preserves the value of work for individuals, this Blueprint will facilitate an environment in which American businesses – and more importantly American families – can thrive.

To get a sense of what is at stake, consider how increases in growth from tax reform could translate into higher incomes for a family of four. For example, over the next ten years, growth is expected to average 2.1 percent – far below the pre-recession average of 3.5 percent. If instead, as a result of tax reform, we average 3 percent growth, the level of GDP would be over 9 percent higher in 2026, and income for a family of four would be about $23,000 higher than it otherwise would be (measured in GDP per capita terms and in 2016 inflation-adjusted dollars).

Similarly, more rapid economic growth would significantly improve our nation's gloomy fiscal outlook. The same boost in growth described in the example above would reduce projected Federal budget deficits over the coming decade by almost $3 trillion.[23]

Savings and Investment Incentives Are Better for Growth

Movement toward a consumption-based system need not involve a shift to an explicit consumption tax, such as a retail sales tax, but instead could result from reforms which exclude certain features of the income tax base. Those changes would achieve similar economic results albeit through different administrative rules.

Consumption-based tax systems are widely regarded to be more pro-growth than income-based tax systems like the current tax code. The reason involves the treatment of capital income – that is, the return to saving. An income tax includes saving in the tax base and thus penalizes saving, whereas a consumption-based system – as the name suggests – taxes only what is consumed, not what is saved.

As a result, income-based systems discourage savings and investment, which means slower capital accumulation, lower productivity, and therefore slower economic growth. The current tax code is mainly an income-based system (with limited features meant to mitigate the double taxation of savings, such as tax-preferred savings accounts). This broken tax code, however, does not go nearly far enough to mitigate the double taxation of saving. Substantial empirical evidence shows that moving more in the direction of consumption taxation would have significant economic benefits.

5. A 21st Century tax system built for growth

Overview

This Blueprint represents a dramatic reform of the current income tax system. This Blueprint does not include a value-added tax (VAT), a sales tax, or any other tax as an addition to the fundamental reforms of the current income tax system. The reforms reflected in this Blueprint will deliver a 21st century tax code that is built for growth and that puts America first.

For families and individuals, the new tax system will simplify and lower tax rates. It also will provide for reduced but progressive tax rates on capital gains, dividends, and interest income. In addition, the changes will significantly reduce the complexity and compliance burdens of the current system. The approach reflected in this Blueprint will be simple enough to fit on a postcard for most Americans.

For businesses both small and large, the focus of the new tax system will be on the growth and competitiveness of all job creators. It represents the largest corporate tax rate cut in U.S. history. It also will bring the lowest tax rate since before World War II to small businesses operated as sole proprietorships or pass-through entities such as partnerships or S corporations. And for the first time ever, all businesses will have the benefit of a full and immediate write-off of their investments in tangible and intangible assets.

From the perspective of America's place in the global economy, the new tax system will focus on investment in America and investment for America. The focus on business cash flow, which is a move toward a consumption-based approach to taxation, will allow the United States to adopt, for the first time in history, the same destination-based approach to taxation that has long been used by our trading partners. This will end the self-imposed unilateral penalty for exports and subsidy for imports that are fundamental flaws in the current U.S. tax system. The new tax system also will end the U.S. taxation of the worldwide income of American-based global businesses, which dates back to the first Civil War-era income tax. Under the territorial tax approach reflected in this Blueprint, for the first time American companies will be free to bring their foreign earnings home to invest in America without tax penalty. The new international tax rules also will be significantly simpler, reducing compliance burdens and the potential for controversy.

An integral part of this Blueprint is a new IRS for the 21st century that will be aligned with the new tax code for the 21st century. The new IRS will be built for customer service. With the new structure of the tax code, the new IRS will have a unit that will serve families and individuals and a separate unit that will serve businesses. And there will be an independent function designed to resolve small business disputes quickly, efficiently, and appropriately.

Tax reform should not be used to bail out Washington's spending problem. Fixing our broken tax code is about having a simpler, fairer, and flatter tax system –not about increasing taxes. This Blueprint will deliver a new tax system under which no income group will see an increase in its Federal tax burden. Furthermore, it envisions tax reform that is revenue neutral.

This standard, however, raises the question: how do we project the level of revenue that we expect the current tax code to raise? As of March 2016, the Congressional Budget Office (CBO) projects that Federal revenues will total $42.089 trillion over fiscal years 2017 through 2026. The CBO baseline (also called the "current law baseline"), however, assumes that the remaining temporary tax provisions will expire on schedule, resulting in a tax increase of more than $400 billion over the ten-year budget window if Congress fails to act. House Republicans reject the notion that tax reform should conceal a $400 billion tax increase, and therefore the current law baseline is not the proper standard for determining whether tax reform is revenue neutral. Because an assumption that Congress, in fact, will continue to extend current policy more closely resembles historical experience, House Republicans measure revenue neutrality by reference to a "current policy baseline" – i.e., achieving a level of Federal revenues that is approximately $400 billion less over the ten-year window than the current law baseline.

In addition, at the beginning of the 114th Congress, House Republicans approved clause 8 of Rule XIII, requiring the Joint Committee on Taxation to estimate the macroeconomic effects of major tax legislation and to include changes in Federal revenues resulting from changes in the size of the economy to be included as part of the official revenue estimate. Consistent with this rule, House Republicans achieve revenue neutrality in part by including the positive revenue effects from the economic growth that would result from a simpler, more pro-growth tax code.

Finally, this Blueprint assumes that the substantial tax increases enacted as part of the Obamacare law will be repealed as part of the proposal of the Health Care Task Force. Repeal of economically damaging tax increases such as the additional 3.8 percent tax on net investment income, the additional 0.9 percent payroll tax, the medical device tax, the health insurance tax, and others should not be paid for with other economically damaging tax increases. Rather, they should be paid for by repealing the massive new entitlement program created by Obamacare. Thus, this Blueprint envisions a pro-growth tax code without either those Obamacare taxes or other taxes to replace them.

Simplification for American Families and Individuals

Highlights

This Blueprint will simplify, flatten, and lower tax rates for families and individuals. In addition it will provide for reduced and progressive tax rates on capital gains, dividends and interest income, to encourage savings and investment. This Blueprint will eliminate the alternative minimum tax, so that people no longer will be required to calculate their tax twice every year. This Blueprint also will eliminate the estate tax and the generation-skipping transfer tax, so that the death of a family member or loved one no longer will be a taxable event.

Because these changes will significantly reduce the complexity and compliance burdens of the current system, the approach reflected in this Blueprint will mean that the revised tax filings for most Americans will be simple enough to fit on a postcard.

Individual Income Tax Rates

Today, there are seven different regular tax brackets for individuals, with a top individual income tax rate of 39.6 percent. The Tax Reform Blueprint will make the individual tax system simpler, flatter, and fairer. This Blueprint will consolidate the current seven tax brackets to three brackets and will lower the top individual income tax rate to 33 percent. Going forward, these income tax brackets will be indexed for inflation.

INDIVIDUAL INCOME TAX BRACKETS UNDER THE BLUEPRINT

Current Law	Blueprint
10%	0%/12%*
15%	
25%	25%
28%	
33%	33%
35%	
39.6%	

*As described below, the new standard deduction is larger than the current-law standard deduction and personal exemptions combined. This, in effect, creates a larger 0 percent bracket. As a result, taxpayers who are currently in the 10-percent bracket *always will pay lower taxes than under current law.*

Millions of small and closely held businesses are organized as pass-through entities – such as partnerships and S corporations – that are taxed under the individual rate structure rather than at the corporate rate. These businesses often compete directly with businesses that are subject to the corporate tax, with the differential in tax treatment creating potential distortions and inequities. As discussed below, the Tax Reform Blueprint will create a new business tax rate for small businesses that are organized as sole proprietorships or pass-through entities, which means that small business income will no longer be subject to the top individual tax rate – not even the lower 33 percent top rate in this Blueprint – thus leading to a maximum tax rate of 25 percent on small business income. This approach to the tax treatment of business income will build on concepts developed by Rep. Vern Buchanan of Florida in his Main Street Fairness Act (H.R. 5076).

Individual Alternative Minimum Tax

The alternative minimum tax (AMT) requires families and individuals to compute both their regular income tax and their AMT, and then pay the greater of the two. In effect, the AMT is a second tax system. The requirement that taxpayers compute their income for purposes of both the regular income tax and the AMT is one of the complexities of the current tax code that is most far-reaching, with roughly 4 million American families subject to AMT in 2016, and millions more required to do the complex calculations to determine whether or not they are subject to it. The AMT is particularly burdensome for small business owners, who often do not know whether they will be affected by the AMT until they file their tax returns and therefore must maintain a reserve for potential AMT liability – funds not being used to create jobs or grow their businesses.

As the National Taxpayer Advocate, Nina Olson, said in her 2013 annual report to Congress:

> The AMT penalizes middle income taxpayers for having children, getting married, or paying state and local taxes. The AMT is also unnecessarily complicated and burdensome, even for those who are not subject to it. Many taxpayers must fill out a lengthy form only to find they owe little or no AMT after all.[24]

The National Taxpayer Advocate's recommendation to Congress was simple: "Permanently repeal the AMT." This echoed the recommendation to repeal the AMT that was included in a report on tax simplification issued by the Joint Committee on Taxation in 2001.

This Blueprint follows these recommendations and repeals the individual AMT.

Income from Savings and Investment

Under an income tax, income from savings and investment is subject to double taxation, with investments made out of after-tax earnings and the returns on those investments also subject to tax. Thus, an income tax creates a bias against savings. The current tax code only partially mitigates this double taxation by providing a special rate structure for certain types of investment income. This rate structure applies to adjusted net capital gain and qualified dividends, with a top statutory tax rate of 20 percent. When the 3.8-percent tax on net investment income and the effects of the so-called Pease limitation on itemized deductions are taken into account, the top effective tax rate on capital gains and dividends reaches roughly 25 percent (exclusive of corporate-level income taxes).

This Blueprint provides for reduced tax on investment income. Families and individuals will be able to deduct 50 percent of their net capital gains, dividends, and interest income, leading to basic rates of 6 percent, 12.5 percent, and 16.5 percent on such investment income depending on the individual's tax bracket. This approach is similar to how relief from double taxation of savings and investment was structured for several years after the enactment of the first round of Reagan tax cuts in 1981. However, this Blueprint also includes interest income within the reduced tax on investment income, as part of the move in the direction of a cash-flow tax.

Simplification for Families

SIMPLE, FAIR "POSTCARD" TAX FILING

1	Wage and compensation income	1	
2	Add 1/2 of investment income	2	
3	Subtract contributions to specified savings plans	3	
4	Subtract standard deduction OR	4	
5	Subtract mortgage interest deduction	5	
6	Subtract charitable contribution deduction	6	
7	Taxable income	7	
8	Preliminary tax (from tax table)	8	
9	Subtract child credit	9	
10	Subtract earned income credit	10	
11	Subtract higher education credit	11	
12	Total tax	12	
13	Subtract taxes withheld	13	
14	**Refund due / taxes owed**	14	

The tax code currently includes five basic family tax deductions and credits, each with its own rules, eligibility criteria, and calculations. Three benefits – the basic standard deduction, additional standard deduction, and personal exemption for taxpayer and spouse – are intended to protect a minimum level of income from Federal income taxation, with the level depending on whether the taxpayer is single or married. The other two – the personal exemptions for children and dependents and the child tax credit– are intended to deliver additional tax benefits to households with children and dependents. Consolidating these five benefits into two simpler benefits – a larger standard deduction and an enhanced child and dependent tax credit – will achieve the same policy and distributional goals as current law while making the tax code much simpler for low- and middle-income families.

Under current law, an individual determines his or her taxable income by reducing adjusted gross income (AGI) by any personal exemption deductions and either the applicable standard deduction or his or her itemized deductions. For 2016, the amount of the standard deduction is $6,300 for single individuals, $9,300 for heads of households, and $12,600 for married individuals filing a joint return. An additional standard deduction ($1,250 in 2016) is allowed with respect to any individual who is elderly or blind. In addition, a taxpayer generally may claim personal exemptions for the taxpayer, the taxpayer's spouse, and any dependents. For 2016, taxpayers may deduct $4,050 for each personal exemption.

In addition, under the current-law child tax credit, an individual may claim a $1,000 tax credit for each qualifying child under the age of 17. The credit starts phasing out for single filers earning over $75,000 and for joint filers earning over $110,000. To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (equal to 15 percent of earned income in excess of $3,000). The taxpayer is not required to provide a Social Security number to claim the refundable portion of the credit (unlike the earned income tax credit today), which has led to substantial fraud and erroneous overpayments with respect to the refundable portion.

The Tax Reform Blueprint will consolidate the basic standard deduction, the additional standard deduction, and the personal exemptions for families and individuals. The new larger standard deduction will be $24,000 for married individuals filing jointly, $18,000 for single individuals with a child in the household, and $12,000 for other individuals. These amounts will be adjusted annually for inflation.

In addition, the Blueprint will consolidate the child credit and personal exemptions for dependents into an increased child credit of $1,500. The first $1,000 will be refundable as under current law. A non-refundable credit of $500 also will be allowed for non-child dependents.

The marriage penalty that exists in the current-law phase-out of the child credit will be eliminated, so that married couples will be able to earn up to $150,000 before their child credits start phasing out. This elimination of the marriage penalty reflects a proposal developed by Rep. Lynn Jenkins of Kansas, as part of the Child Tax Credit Improvement Act of 2014 (H.R. 4935, 113th Cong.).

To reduce waste, fraud, and abuse, a taxpayer will be required to provide his or her Social Security number to claim the refundable portion of the child credit. Rep. Sam Johnson of Texas has advanced this anti-abuse measure and it is reflected in his Refundable Child Tax Credit Eligibility Verification Reform Act of 2016 (H.R. 4722). The Committee on Ways and Means will continue to work to reform the child credit to reduce fraud and erroneous overpayments.

SIMPLIFICATION OF FAMILY TAX BENEFITS

<table>
<tr><th>Current Law</th><th>Blueprint</th></tr>
<tr><td>Basic Standard Deduction</td><td rowspan="3">Larger Standard Deduction</td></tr>
<tr><td>Additional Standard Deduction</td></tr>
<tr><td>Personal Exemption for Taxpayer and Spouse</td></tr>
<tr><td>Child Tax Credit</td><td rowspan="2">Larger Child and Dependent Tax Credit</td></tr>
<tr><td>Personal Exemption for Children and Dependents</td></tr>
</table>

These changes will simplify tax filing for families substantially, and the Tax Reform Blueprint aims to reduce the number of taxpayers who itemize their deductions from about one-third under current law to approximately 5 percent under our simpler, fairer, and flatter tax system.

Earned Income Tax Credit
The Blueprint will continue the earned income tax credit (EITC), which rewards work by low-income individuals, encouraging them to enter the workforce and have the opportunity to move up the income scale. The Committee on Ways and Means will continue to work to reform the EITC to reduce fraud and erroneous overpayments. In addition, the Committee will develop options for providing a more effective and efficient incentive to work.

Simplification of Tax Benefits for Higher Education
Under current law, there are over a dozen different overlapping tax benefits relating to education. These tax benefits are so complicated that many taxpayers cannot determine the tax benefits for which they are eligible. In fact, the IRS publication on tax benefits for education is almost 100 pages long. Streamlining education tax benefits will enable taxpayers to understand better the tax benefits for which they qualify.

This Blueprint will simplify the current array of tax benefits for families looking to make education more affordable for their children. The Committee on Ways and Means will work to simplify and consolidate the current-law provisions to provide a more effective and efficient package of higher education tax benefits that will cover both college and vocational training programs, including a savings incentive, such as 529 plans, and tax relief targeted at helping low- and middle-income families with the costs of higher education, such as the American Opportunity Tax Credit (which was made permanent in 2015).

Individual Exclusions and Deductions
Under this Blueprint, the core component of the individual tax base will be compensation received. As discussed below, businesses will deduct compensation paid to their employees and workers. Generally, the tax system should use the same definition for taxable compensation of employees as it does for compensation employers may deduct.

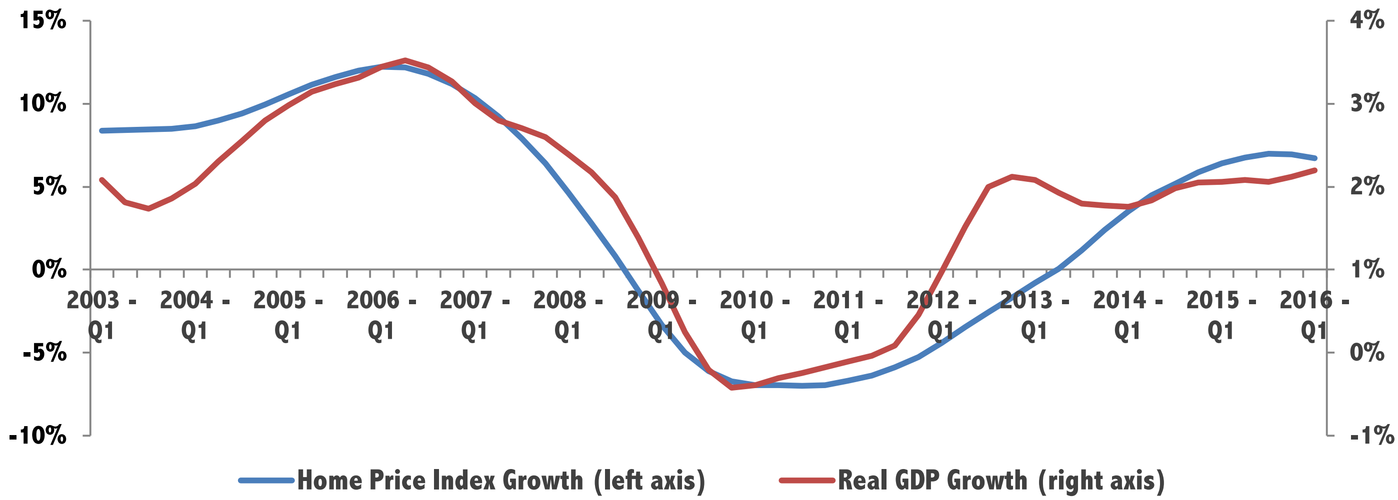
Families and individuals generally will include in income any compensation received related to employment or self-employment. Two pressing national priorities – quality health care and retirement security – require exceptions to this general rule. The exclusion for employer-provided health insurance and related health provisions in the tax code (such as health savings accounts and flexible spending arrangements) are major components of our nation's health care system and therefore are being addressed in the context of the work of the Health Care Task Force. Second, this Blueprint will continue tax incentives for retirement savings. The Committee on Ways and Means will examine existing tax incentives for employer-based retirement and pension plans in developing options for an effective and efficient overall approach to retirement savings.

To simplify tax filings further for middle-income families, this Blueprint reflects the elimination of all itemized deductions except the mortgage interest deduction and the charitable contribution deduction. These two provisions help accomplish two important goals that strengthen civil society: homeownership and charitable giving.

Homeownership
Historical data show that the strength of the nation's housing market is tied more closely to the health of the overall economy than to any specific tax policies that might be in place. The best way to promote a thriving housing market is to improve the overall economy, which is precisely what comprehensive tax reform will achieve.

Today, a taxpayer may claim an itemized deduction for mortgage interest paid with respect to a principal residence and one other residence of the taxpayer. A taxpayer who itemizes deductions may deduct interest payments on up to $1 million in acquisition indebtedness (for acquiring, constructing, or substantially improving a residence), and up to $100,000 in home-equity indebtedness. Under the alternative minimum tax (AMT), however, the deduction for home equity indebtedness is disallowed.

THE DIRECT CORRELATION BETWEEN ECONOMIC GROWTH AND HOUSING PRICES



Data: Year-Over-Year Growth, 12-Quarter Moving Average

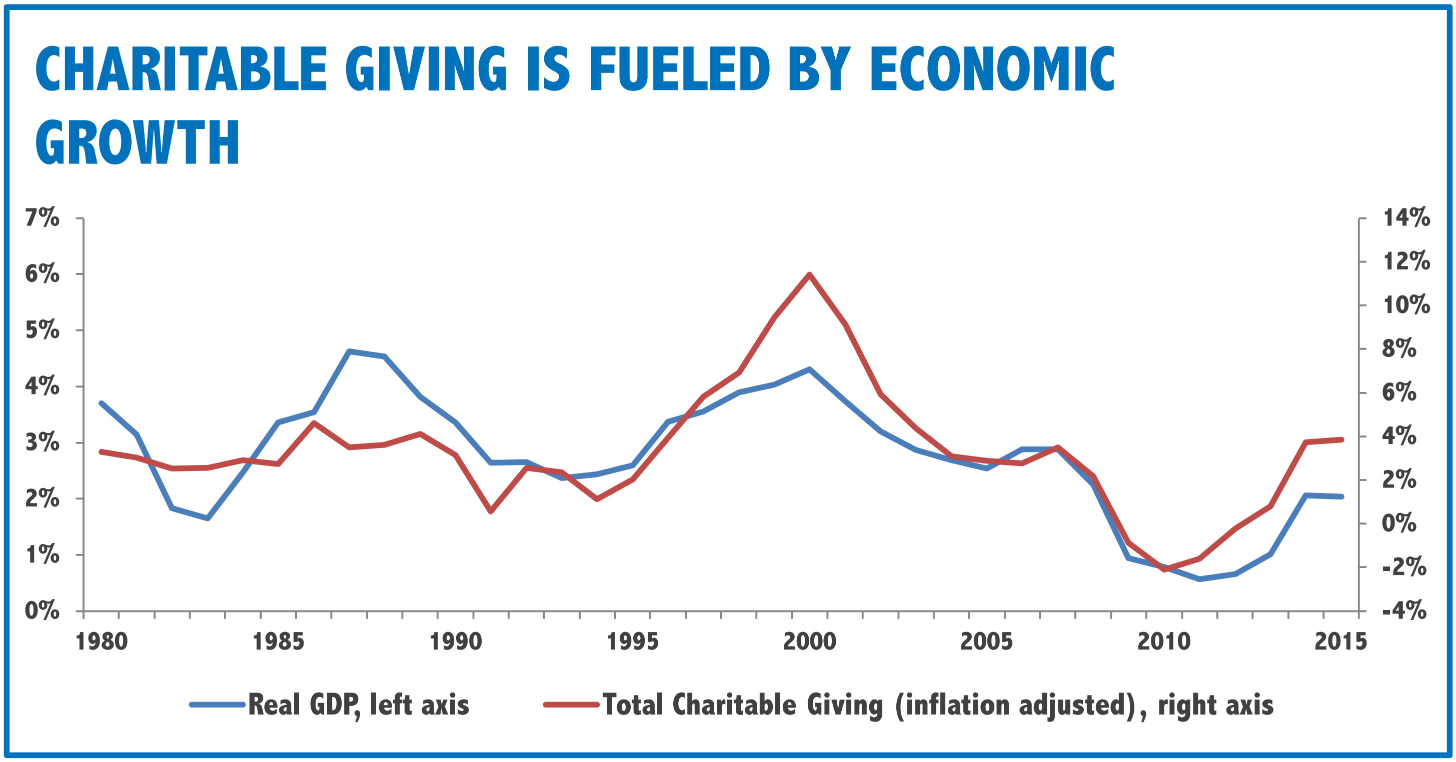
America's housing market is most closely tied to the health of the national economy. **By improving the overall economy, this Blueprint promotes a thriving housing market.**

This Blueprint will preserve a mortgage interest deduction for homeowners. The Committee on Ways and Means will evaluate options for making the current-law mortgage interest provision a more effective and efficient incentive for helping families achieve the dream of homeownership. For those taxpayers who continue to itemize deductions, no existing mortgage will be affected by any changes in the tax code. Similarly, no changes will affect re-financings of existing mortgages. But just as importantly, because of the other provisions included in the new tax system, far fewer taxpayers will choose to itemize deductions, with the vast majority of taxpayers finding they are better off by taking advantage of the larger, simpler standard deduction instead.

Charitable giving

Americans are generous people who want to help their neighbors in need. For this reason, this Blueprint encourages charitable giving through a tax incentive.

Today, a taxpayer may claim an itemized deduction for charitable contributions. Because a taxpayer must itemize to claim a charitable deduction, however, only about 25 percent of taxpayers benefit from the current charitable contribution deduction. Moreover, historical data show that the total amount of charitable giving is tied more closely to the health of the overall economy than to any specific tax policies that might be in place. The best way to promote charitable giving to the organizations doing so much good in communities across the country is to improve the overall health of the American economy, which is precisely what this Blueprint will achieve.[25]



Data: Year-Over-Year Growth in Real GDP and Real Charitable Giving, Five-Year Moving Average

Experts and advocates for charitable organizations have presented many policies over the years for reforming the deduction for charitable contributions to make it more effective and efficient. The Committee on Ways and Means will develop options to ensure the tax code continues to encourage donations, while simplifying compliance and record-keeping and making the tax benefit effective and efficient.

Retirement Savings

Today, individuals may contribute to Individual Retirement Accounts (IRAs), including traditional IRAs and Roth IRAs, subject to a variety of rules providing for contribution limits and income phase-outs. Individuals who are covered by a 401(k) or another employer-based retirement plan may have options for traditional accounts or Roth accounts within the plan. These accounts are subject to maximum elective contribution amounts.

The Committee on Ways and Means will explore the creation of more general savings vehicles, using as a model the retirement accounts that have proven so successful. Universal Savings Accounts have been proposed by many people over the years as a way to eliminate the double taxation of savings and investment for families, most recently by Rep. Dave Brat of Virginia (H.R. 4094). These are accounts to which individuals could contribute cash and over which they would have full control of investment decisions. Account holders could withdraw both contributions and earnings at any time, and for any reason, without penalty.

This Blueprint will continue the current tax incentives for savings. The Committee on Ways and Means will work to consolidate and reform the multiple different retirement savings provisions in the current tax code to provide effective and efficient incentives for savings and investment.

Other Provisions Affecting Individuals

Numerous other exemptions, deductions, and credits for individuals riddle the tax code, making it less fair for those who cannot take advantage of such provisions and more complicated for everyone. These special-interest provisions require higher tax rates to compensate for the lost revenue, thus raising taxes on others and hurting the economy by reducing the incentives to work, save, and invest. This Blueprint will repeal these special-interest provisions to make the system simpler, fairer, and flatter for all families and individuals.

Estate and Generation-Skipping Transfer Taxes

Under current law, the estate tax applies under specified circumstances to transfers of wealth when a person dies. An additional tax may apply to generation-skipping transfers, which generally involve a person making a gift that skips one or more generations – for example a gift from a grandfather to a grandchild or great grandchild.

This Blueprint will repeal the estate and generation-skipping transfer taxes. This will eliminate the Death Tax, which can result in double, and potentially even triple, taxation on small businesses and family farms.

Competitiveness and Growth for All Job Creators

Highlights

This Blueprint will bring historic reductions in the tax rates for businesses of all sizes and greater parity in the tax treatment of all businesses regardless of size or legal form. Instead of having some of the highest tax rates on entrepreneurship and business activity in the world, the United States will leapfrog many of its trading partners and offer globally competitive rates.

Today, businesses that invest to create jobs and grow their operations cannot recover the full present value of the capital investments they make, which means they effectively are taxed on funds they reinvest in the business. This stifles their ability to invest and grow, adversely affecting their contribution to American job creation and the growth of the American economy. This Blueprint will, for the first time ever, provide all businesses with the benefit of full and immediate write-offs of their investments in both tangible and intangible assets. This approach to cost recovery is equivalent to a 0 percent marginal effective tax rate on new investment. The new tax system will be a move toward taxation based on business cash flow.

The combination of the dramatic reduction in business tax rates and the effective elimination of current tax on business investments will mean a tax system that drives growth – growth of jobs, growth of American workers' paychecks, and growth of the American economy.

Tax Rate Structure for Small Businesses

Today, 95 percent of businesses in the United States are operated as sole proprietorships or pass-through entities such as partnerships, limited liability companies (which are taxed in the same manner as partnerships), and S corporations. Moreover, more than 50 percent of business income in the United States is earned through sole proprietorships or pass-through entities.

Business income earned through a sole proprietorship or a pass-through entity today is reported by the owner or owners of the business on their individual tax returns and is taxed at an income tax rate as high as 44.6 percent.

This Blueprint will limit the tax rate that applies to small business and pass-through income to the 25 percent bracket. In other words, the 33 percent bracket will not apply to the active business income of sole proprietorships and pass-through entities. This represents the lowest top tax rate on the income of such businesses since before World War II.

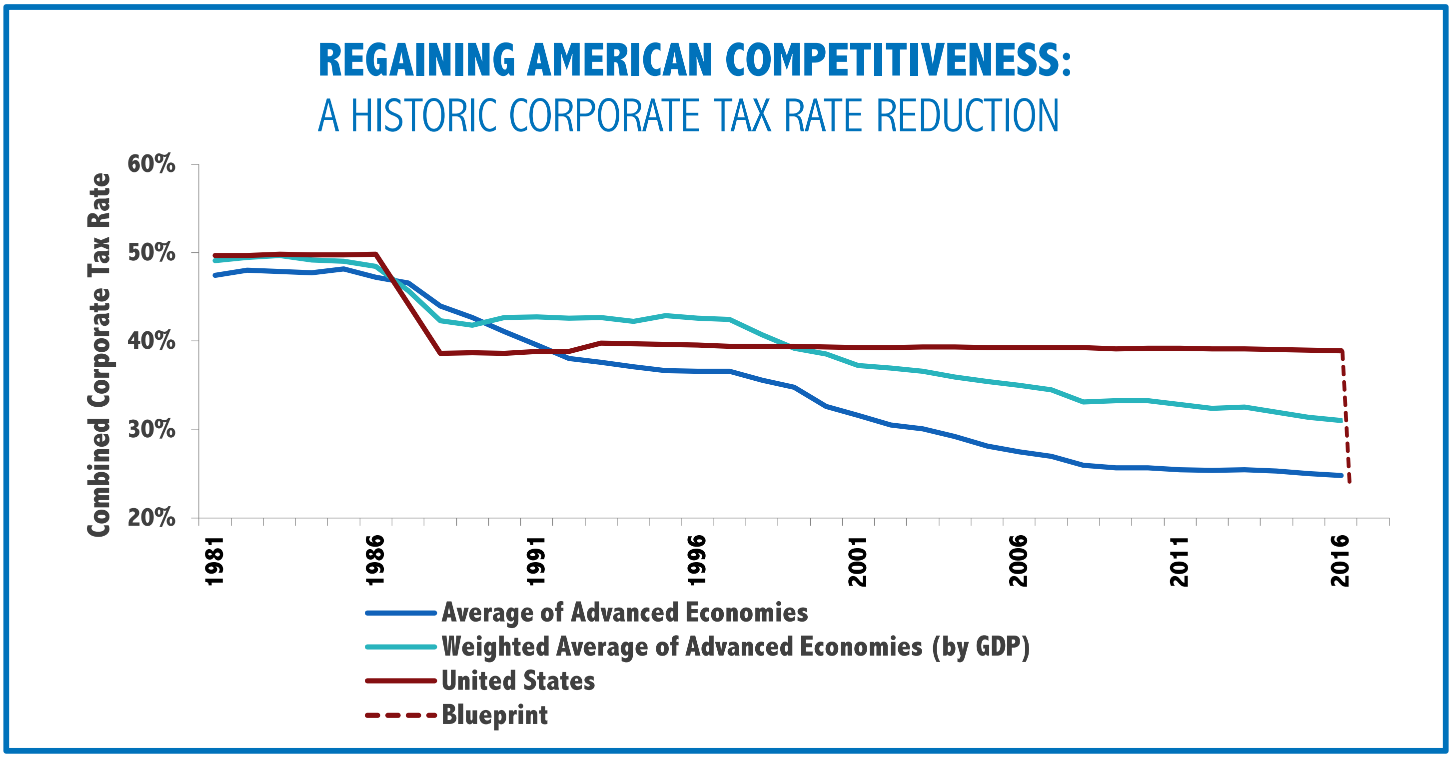
Under this new approach for taxing small businesses, sole proprietorships and pass-through businesses will pay or be treated as having paid reasonable compensation to their owner-operators. Such compensation will be deductible by the business and will be subject to tax at the graduated rates for families and individuals. The compensation that is taxed at the lowest individual tax bracket rate of 12 percent effectively will further reduce the total income tax burden on these small businesses and pass-through entities.

Two significant reforms with respect to the taxation of families and individuals that are discussed above will be critically important to the tax treatment of small businesses. With the elimination of the individual AMT, these businesses will no longer be burdened by the cost and complexity of this second tax system. In addition, the elimination of the estate and generation-skipping transfer taxes will allow family-owned businesses to transition smoothly from generation to generation, without the burden of the estate tax that today can leave grieving families with no choice but to liquidate the family business to satisfy the estate tax obligation owed to the government upon the death of their loved one. And, during the small business owner's life, the elimination of these taxes will save him or her from having to divert scarce capital to hire accountants and lawyers to ensure that the business survives to the next generation.

As discussed in more detail below, under this Blueprint, both small businesses organized as sole proprietorships or pass-through entities and larger businesses organized as C corporations will benefit from the approach that focuses on business cash flow and provides the benefit of the full and immediate write-off of business investments in tangible and intangible assets.

Tax Rate Structure for Large Businesses

Today, businesses operated through C corporations are subject to corporate tax at a statutory rate of 35 percent. The Tax Reform Act of 1986 reduced the top corporate tax rate from 46 percent to 34 percent. The corporate tax rate was increased to 35 percent several years later and has remained there ever since. This stands in stark contrast to what our major trading partners have done over the past 30 years. In 1986, when the United States enacted tax reform that significantly reduced the top U.S. corporate tax rate, the average corporate tax rate in the other OECD countries was 47.2 percent. Today, that average has dropped to 24.8 percent while the U.S. corporate tax rate remains at 35 percent.



Note: Chart reflects the Federal and average State tax Rates; Advanced Economies denotes members of Organisation for Economic Co-operation and Development.

In addition, income earned through a C corporation today is subject to double taxation, with a second layer of tax imposed on such income at the shareholder level through the individual tax on dividends and capital gains recognized on disposition of corporate shares. At the top effective individual tax rate applicable to dividends and capital gains, this yields a total tax burden on the earnings of C corporations that exceeds 50 percent today.

Finally, corporations today face the added burden of the corporate alternative minimum tax (AMT), which requires a second, separate tax calculation. The corporate AMT is imposed at a rate of 20 percent and generally applies above an exemption amount of $40,000, with an exemption for certain small corporations. The tax base for the corporate AMT reflects the effective add-back of many business tax deductions that are allowed for regular tax purposes but not AMT purposes. Corporations are required to pay the higher of the regular tax and the AMT and receive a credit for AMT paid that is carried forward to be applied to offset regular tax in future years.

This Blueprint will lower the corporate tax rate to a flat rate of 20 percent. This represents the largest corporate tax rate cut in U.S. history. The Tax Reform Act of 1986 reduced the corporate tax rate by 26 percent (12 percentage points). This Blueprint will reduce the corporate tax rate by 43 percent (15 percentage points). Economists at the OECD and elsewhere have identified the corporate income tax as the most harmful of all forms of taxation in terms of the adverse effect on growth. This dramatic reduction in the corporate tax rate will mean a dramatic reduction in the drag on American economic growth that results from the corporate income tax. (For further discussion, see the Appendix.)

At the same time, the effective double taxation of corporate income will be reduced through the reduction in the tax on dividends and capital gains of individual shareholders. As discussed above, individuals will be taxed at just half the regular individual tax rate on both dividends paid on corporate shares and capital gains recognized on dispositions of corporate shares.

In addition, this Blueprint will repeal the corporate alternative minimum tax (AMT). Like the individual AMT, the corporate AMT imposes burdens in the form of both direct tax costs and the cost of complexity. In its 2001 tax simplification report, the Joint Committee on Taxation concluded that the AMT "no longer serves the purposes for which it was intended" and recommended its repeal. The Blueprint follows that recommendation, putting an end to the unnecessary burdens of the corporate AMT.

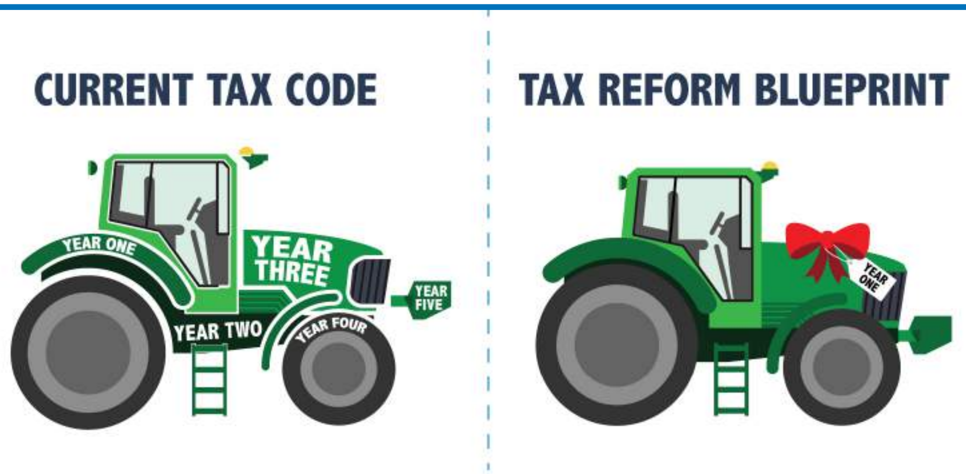
Benefit of Immediate Write-off of Business Investments

Today, job creators face a complex array of schedules and systems of cost recovery for their investments in tangible and intangible assets to maintain and grow their operations. For each asset, they must determine the period over which the asset may be depreciated or amortized and the method that must be used to determine the annual allowance with respect to the asset. For many assets, the cost must be spread over many years for tax purposes. This means that businesses are taxed today on the earnings they reinvest in growing their operations and can recover the cost of that investment only many years later.

Current depreciation rules imperfectly measure the actual decline in the value of the asset in comparison to economic depreciation. The result effectively is different tax rates on different forms of investment, which distorts the allocation across asset classes. Today's cost recovery rules also fail to take into account inflation. This means that investors do not recover the full value of their investments, because inflation erodes the value of their deductions over time.

This Blueprint will provide businesses with the benefit of fully and immediately writing off (or "expensing") the cost of investments. This represents a 0 percent marginal effective tax rate on new investment. Elimination of the tax on business investment as a means to drive growth is the centerpiece of the legislation introduced by Rep. Devin Nunes of California, the American Business Competitiveness Act (H.R. 4377), which would introduce a business cash-flow tax.

This system of immediate cost recovery will apply to both investments in tangible property (such as equipment and buildings) and intangible assets (such as intellectual property). It will not apply to land.



When American job creators buy new equipment, they face confusing depreciation rules, which lead businesses to write off purchases over time. **This Blueprint allows job creators to immediately write off the full cost of new equipment in the first year (instead of five years under the current law) freeing up tax dollars to invest back into their business.**

Other Business Deductions and Credits

Under this Blueprint, job creators will be allowed to deduct interest expense against any interest income, but no current deduction will be allowed for net interest expense. Any net interest expense may be carried forward indefinitely and allowed as a deduction against net interest income in future years.

The benefit of immediate expensing of business investment operates as a more beneficial and more neutral substitute for the deduction of interest expense associated with debt incurred to finance such investment. Allowing investments to be immediately written off provides a greater incentive to invest than is provided through interest deductions under current law; allowing both together would be distortive as it would result in a tax subsidy for debt-financed investment.

The elimination of deductions for net interest helps to equalize the tax treatment of different types of financing and reduces tax-induced distortions in investment financing decisions. Providing neutrality takes the tax code out of marginal business decisions, letting market forces more efficiently allocate investment where it is most productive. It also eliminates a tax-based incentive for businesses to increase their debt load beyond the amount dictated by normal business conditions. A business sector that is leveraged beyond what is economically rational is more risky than a business sector with a more efficient debt-to-equity composition.

The Committee on Ways and Means will work to develop special rules with respect to interest expense for financial services companies, such as banks, insurance, and leasing, that will take into account the role of interest income and interest expense in their business models.

Net operating losses (NOLs) will be allowed to be carried forward indefinitely and will be increased by an interest factor that compensates for inflation and a real return on capital to maintain the value of amounts that are carried forward. Carrybacks of net operating losses will not be permitted and the deduction allowed with respect to an NOL carryforward in any year will be limited to 90 percent of the net taxable amount for such year determined without regard to the carryforward.

With respect to inventory, the Blueprint will preserve the last-in-first-out (LIFO) method of accounting. The Committee on Ways and Means will continue to evaluate options for making the treatment of inventory more effective and efficient in the context of this new tax system.

Today, the tax code is littered with special-interest deductions and credits that are designed to encourage particular business activity. These provisions create incentives for businesses to make decisions because of the tax consequences rather than because of the underlying economics. This tax-motivated shifting of resources causes a misallocation of productive capital and therefore slows economic growth. These special-interest provisions are a source of both complexity and controversy. Moreover, the proliferation of such provisions adversely affects the public's confidence in the fairness of the tax system as they can contribute to taxpayers' believing that everyone but them is getting special tax breaks. Finally, the existence of special-interest provisions reduces revenue and therefore requires growth-stunting higher tax rates on businesses across the board.

This Blueprint generally will eliminate special-interest deductions and credits in favor of providing lower tax rates for all businesses and eliminating taxes on business investment. This will allow business decisions to be made based on the economic potential rather than the availability of targeted tax benefits. A tax code that is more neutral will be more efficient and will facilitate economic growth. This will put the decision-making for both small and large businesses right where it belongs – in the hands of the men and women who build the businesses that employ American workers and supply customers around the world, as they have the best vision for how to grow those businesses for the future.

For example, the domestic production ("section 199") deduction would no longer be necessary. Section 199 effectively provides a small rate reduction for income from certain specific activities, including domestic manufacturing, production, growing, and extraction. For corporations, the deduction effectively reduces the rate on such income from 35 percent to about 32 percent. For pass-through entities, the top rate is reduced from 39.6 percent to about 36 percent. But section 199 is highly complex, often frustrating both those businesses that fail to qualify as well as businesses that do qualify but only after navigating a substantial paperwork burden. By cutting the corporate rate to 20 percent, and by cutting the top rate on the active business income of pass-through entities to 25 percent, the Blueprint makes section 199 unnecessary.

This Blueprint will provide a business credit to encourage research and development (R&D). America is a country of innovators and risk takers and historically the United States has been a world leader in technological advances. Today, however, our trading partners are using tax benefits and other incentives to attract research activity to their countries. The work done by Congress last year to make the R&D credit permanent was an important step in ensuring the viability of the United States as a location for R&D activity. The Blueprint will include an R&D credit in similar form so that America will continue to be an attractive place to conduct research. The Committee on Ways and Means will evaluate options for making the R&D credit more effective and efficient.

Pro-America Approach for Global Competitiveness

Highlights

This Blueprint eliminates the existing self-imposed export penalty and import subsidy by moving to a destination-basis tax system. Under a destination-basis approach, tax jurisdiction follows the location of consumption rather than the location of production. This Blueprint achieves this by providing for border adjustments exempting exports and taxing imports, not through the addition of a new tax but within the context of the transformed business tax system. The Blueprint also ends the uncompetitive worldwide tax approach of the United States, replacing it with a territorial tax system that is consistent with the approach used by our major trading partners. These two fundamental structural changes in turn allow other important aspects of the international tax rules to be simplified and streamlined significantly.

Taken together, a 20 percent corporate rate, a switch to a territorial system, and border adjustments will cause the recent wave of inversions to come to a halt. American businesses invert for two reasons: to avail themselves of a jurisdiction with a lower rate, and to access "trapped cash" overseas. Those problems are solved by the lower corporate rate and the territorial system, respectively. In addition, border adjustments mean that it does not matter where a company is incorporated; sales to U.S. customers are taxed and sales to foreign customers are exempt, regardless of whether the taxpayer is foreign or domestic.

Treatment of Cross-Border Sales, Services and Intangibles

Today, all of our major trading partners raise a significant portion of their tax revenues through value-added taxes (VATs). These VATs include "border adjustability" as a key feature. This means that the tax is rebated when a product is exported to a foreign country and is imposed when a product is imported from a foreign country. These border adjustments reduce the costs borne by exported products and increase the costs borne by imported products. When the country is trading with another country that similarly imposes a border-adjustable VAT, the effects in both directions are offsetting and the tax costs borne by exports and imports are in relative balance. However, that balance does not exist when the trading partner is the United States. In the absence of border adjustments, exports from the United States implicitly bear the cost of the U.S. income tax while imports into the United States do not bear any U.S. income tax cost. This amounts to a self-imposed unilateral penalty on U.S. exports and a self-imposed unilateral subsidy for U.S. imports.

Because this Blueprint reflects a move toward a cash-flow tax approach for businesses, which reflects a consumption-based tax, the United States will be able to compete on a level playing field by applying border adjustments within the context of our transformed business and corporate tax system. For the first time ever, the United States will be able to counter the border adjustments that our trading partners apply in their VATs. The cash-flow based approach that will replace our current income-based approach for taxing both corporate and non-corporate businesses will be applied on a destination basis. This means that products, services and intangibles that are exported outside the United States will not be subject to U.S. tax regardless of where they are produced. It also means that products, services and intangibles that are imported into the United States will be subject to U.S. tax regardless of where they are produced. This will eliminate the incentives created by our current tax system to move or locate operations outside the United States. It also will allow U.S. products, services, and intangibles to compete on a more equal footing in both the U.S. market and the global market.

The rules of the World Trade Organization (WTO) include longstanding provisions regarding the use of border adjustments. Under these rules, border adjustments upon export are permitted with respect to consumption-based taxes, which are referred to as indirect taxes. However, under these rules, border adjustments upon export are not permitted with respect to income taxes, which are referred to as direct taxes. This disparate treatment of different tax systems is what has created the historic imbalance between the United States, which has relied on an income tax – or direct tax in WTO parlance – for taxing business transactions, and our trading partners, which rely to a significant extent on a VAT – or indirect tax in WTO parlance – for taxing business transactions. Under WTO rules, the United States has been precluded from applying the border adjustments to U.S. exports and imports necessary to balance the treatment applied by our trading partners to their exports and imports. With this Blueprint's move toward a consumption-based tax approach, in the form of a cash-flow focused approach for taxing business income, the United States now has the opportunity to incorporate border adjustments in the new tax system consistent with the WTO rules regarding indirect taxes.

Territorial Taxation of Global American Companies

This Blueprint will replace the existing outdated worldwide tax system with a 100-percent exemption for dividends from foreign subsidiaries. This will allow American-based companies to compete in global markets on an equal footing. It also will eliminate the "lock-out effect" of current law, allowing American-based companies to bring home their foreign earnings to be reinvested in United States without additional tax cost.

The existing U.S. international tax regime has led to trillions of dollars in foreign earnings of American-based companies being "stranded" overseas because the tax rules discourage companies from bringing those earnings back to reinvest at home. As part of the move to the modern territorial approach to international taxation, this Blueprint will provide rules that will allow foreign earnings that have accumulated overseas under the old system to be brought home. Accumulated foreign earnings will be subject to tax at 8.75 percent to the extent held in cash or cash equivalents and otherwise will be subject to tax at 3.5 percent (with companies able to pay the resulting tax liability over an eight-year period). This will free up the more than $2 trillion in foreign earnings that have been locked out of the United States by the current tax rules. And no such build-up will occur under the international tax rules provided in this Blueprint, as businesses will be free to bring home their foreign earnings to be invested to create American jobs and grow their U.S. operations.

Simplification of International Tax Rules

The destination-based, territorial approach for international taxation reflected in this Blueprint will allow the subpart F rules of the current international tax regime, which are some of the most complex rules in the tax code, to be significantly streamlined and simplified. These rules were designed in the 1960s to police our worldwide system of international taxation. However, they impose restrictions and burdens on American-based companies that further impair their competitiveness in today's highly integrated global economy.

A key component of these rules, the so-called foreign base company income rules, creates traps for the unwary and effectively drives American companies to pay higher foreign taxes. Because this Blueprint adopts a destination-based approach for cross-border transactions that levels the playing field and eliminates the tax incentives for moving jobs and profits offshore in the first place, there no longer is a need for this web of archaic technical rules. Under the Blueprint, the bulk of the subpart F rules, which were designed to counter tax incentives to locate overseas, will be eliminated because there no longer will be any tax incentive to locate outside the United States. Businesses will be able to make location decisions based on the economic opportunities, not the tax consequences. Only the so-called foreign personal holding company rules, which counter the potential for truly passive income to be shifted to low-tax jurisdictions, will continue to play a role in addressing potential abuse and will be retained under this Blueprint.

In addition to these important reforms that will create a modern international tax system for businesses, the Committee on Ways and Means will consider the appropriate treatment of individuals living and working abroad in today's globally integrated economy.

A New IRS for the 21st Century

A New Tax Administrator for a New Tax Code

An integral element of this Blueprint will be to rebuild the IRS into a modern and efficient 21st century administrator of the nation's tax system. The new IRS will have a streamlined structure aligned with the simpler and fairer tax system for families and individuals and businesses of all sizes.

Streamlined Taxpayer Service Agency

With a dramatically simpler tax code, the Blueprint will create a new streamlined IRS dedicated to delivering world-class customer service. The new IRS will be centered on three major units: families and individuals, businesses, and an independent "small claims court" unit.

- The **families and individuals** unit will focus on providing state of the art customer service so that taxpayers can get efficient help and answers to their tax questions.
- The **business** unit will focus on administering the new tax code for businesses of all sizes and types, including specialists with expertise on the issues facing start-up entrepreneurs and small businesses and specialists with expertise on the issues facing large domestic companies and American-based global corporations.
- The **"small claims court"** unit will be independent of the new IRS. This will allow routine disputes to be resolved more quickly, so that small businesses no longer spend more in legal fees to resolve a dispute with the IRS than the amount of tax that was at stake.

Together, these three units will be the core of the new IRS's commitment to *Service First.* Each will have an efficient and accountable workforce specially trained to handle matters relevant to taxpayers in their particular area of responsibility. And each of these units will have access to a modern taxpayer records system and internal communications that are secure and comply with record-retention requirements.

The new IRS will be headed by a newly appointed Administrator whose sole objective will be to manage the agency and administer the new tax code in an impartial, non-political manner for the benefit of American taxpayers. The Administrator will be appointed by the President with the advice and consent of the U.S. Senate and will have a term of three years. The President may reappoint the Administrator only once, which will ensure new management perspectives and prevent entrenchment of bureaucrats.

The new IRS will have a team of legal professionals dedicated to providing guidance and other information so taxpayers can apply the new tax code to the particular circumstances of their lives and businesses. While much of the current-law complexity can be eliminated under the new simpler, fairer, flatter code, questions will certainly arise about how the new rules apply in certain cases, especially as the economy continues to develop new business models. The new IRS will be prepared to provide that guidance in a thorough and timely fashion.

A Service First Mission

The new IRS will have a singular mission: Service First. Taxpayers will be able to count on an agency that will administer the nation's tax laws in a fair, consistent, and efficient manner while recognizing that Americans pay their taxes voluntarily and that their tax dollars fund the Federal government. To that end, all employees of the new IRS will be held accountable to the Taxpayer Bill of Rights, which includes the right of all taxpayers to:

- Be informed;
- Quality service;
- Pay no more than the correct amount of tax;
- Challenge the position of the IRS and be heard;
- Appeal a decision of the IRS in an independent forum;
- Finality;
- Privacy;
- Confidentiality;
- Retain representation; and
- A fair and just tax system.

By respecting these rights, the new IRS will perform its role without undue burdens and interference in the lives of American families, workers, and business owners.

Commitment to Taxpayer Assistance:

The new IRS will have modern and effective information systems that reflect the Service First mission. The agency must have options for taxpayers to communicate with the new IRS in an easy and efficient manner tailored to the taxpayer, not a one-size-fits-all approach. This will include easily accessible online resources for all taxpayers as well as printed information for those who prefer it. In addition, modern and secure systems will be needed to process the new simplified tax returns and maintain taxpayer account records in accordance with Federal law – all with the priority of protecting taxpayer privacy and ensuring information security.

An Efficient and Effective Use of Taxpayer Resources

Administering the nation's tax laws can be done in a fair, efficient, and effective manner that respects the hard-earned taxpayer dollars used to finance it. In addition to the streamlined service units, modernized dispute resolution resources, and the workforce and information systems focused on taxpayer service, the Blueprint will implement several other improvements with the new IRS. First, the ineffective and inefficient Oversight Board will be eliminated, and those resources will dedicated to the *Service First* mission. Second, the new tax code will ensure that the agency does not have to waste time and energy directing unrelated government policy objectives embodied in complex special-interest deductions and credits. Finally, the simpler, fairer, flatter tax code will enable the new IRS to eliminate thousands of pages of regulations and guidance, and myriad forms, schedules, worksheets, and instructions that will no longer needed.

As the new tax code will be designed to foster economic growth and endure for years to come, the new IRS must do the same. The new agency must be forward looking and must continually adapt to the ever changing economy. And, by adhering to the core principle of *Service First*, the new IRS will be able to administer the new tax code efficiently and effectively without becoming a ubiquitous fixture in the lives of Americans.

6. THE PATH FORWARD

After the release of this Blueprint, the Committee on Ways and Means will turn its attention to the work of building the tax reform legislation that will encapsulate the policies and provisions reflected in the Blueprint. The legislation that the Committee will develop will be ready for legislative action in 2017.

Consultation

As the Committee on Ways and Means drafts this tax reform legislation, it will have an ongoing dialogue with stakeholders – including families, workers, and job creators. The Committee welcomes and encourages robust comments on this Blueprint because it understands that tax reform will touch the lives of all Americans. These comments will affect our final legislation and determine the final product. Detailed information and feedback about the practical effects of the concepts reflected in the Blueprint will be invaluable in the process of transforming the Blueprint into legislation that will build a pro-growth, 21st century tax code.

Transition

The Blueprint lays out the vision for a new tax system that is built for growth. As with any changes to the tax code, especially changes of the magnitude of the reforms set forth in this Blueprint, a smooth transition from the current system to the new system will be necessary. The Committee on Ways and Means will craft clear rules to serve as an appropriate bridge from the current tax system to the new system, with particular attention given to comments received from stakeholders on this important matter.

Going Bolder

Building from this Blueprint, the Committee on Ways and Means is committed to continuing to explore and develop bold ideas for tax reform that will best accomplish the objectives of creating jobs, growing the economy and raising wages. The Blueprint identifies many ideas for tax system improvements that Members of Congress have devoted time and resources to develop and advance. These ideas have contributed to the vision reflected in the Blueprint. And the tax ideas of the Members of the House Republican Conference will be considered carefully as the Committee works on development of the bold legislation that will be built from the Blueprint.

In developing the legislation that will create a 21st century tax code, the Committee will consider all ideas and is committed to ensuring that the new tax code will encourage job growth and opportunity for all Americans.

APPENDIX: TAX REFORM CONCEPTS AND ECONOMIC GROWTH

Broaden the Base and Lower the Rates

One major goal of tax reform is to make the code simpler, fairer, and flatter. When carve-outs and loopholes are built into the tax code, they increase complexity, undermine the principle of fairness, and create economic distortions that draw resources away from more productive uses and therefore reduce economic growth. Additionally, carve-outs reduce tax revenue. This, in turn, typically requires increases in marginal tax rates to make up for lost revenue – which further discourages economic activity. In particular, because the current individual tax schedule applies to both workers and pass-through businesses, increased marginal rates discourage work, job creation, savings, and investment. Reversing these effects requires reform that broadens the tax base and lowers tax rates.

Evidence for the pro-growth nature of these reforms is well established. Even the conservative estimates by the Joint Committee on Taxation (JCT) demonstrate significant benefits of base broadening and rate reduction. For example, in 2005, the JCT simulated a proposal that would greatly expand the tax base while lowering individual tax rates across the board by about 25 percent.[26] Using a variety of models and assumptions, the JCT found that this proposal would increase GDP between 1.1 percent and 1.9 percent in the second half of the budget window and up to 3.5 percent in the long run. That increase in growth in the second half of the budget window, implies a $2,500 to $5,000 increase in income for a family of four. Further, using the Congressional Budget Office's (CBO) revenue rule of thumb, the growth from this proposal could be expected to generate between $300 billion and $800 billion in new revenues. In addition to faster economic growth, the JCT found that the policy would significantly increase the non-residential capital stock and private-sector employment.

However, a new and growing literature featured in the most prominent academic journals, summarized by Kevin Hassett, finds even more substantial growth effects of tax changes of this sort.[27] Summarizing the work of numerous authors studying the historical relationship between taxes and growth in multiple countries, Hassett finds a consistent pattern: Tax decreases of 1 percent of GDP will raise output by as much as 3 percent over 10 quarters. These large short-run effects imply large long-run effects. As Hassett explains: "the estimates suggest that the growth rate of output following a tax cut increases relative to what it would have been in the absence of the tax shock—and these elevated growth rates are not fully offset by output developments in later time periods. Thus, there is a permanent effect on the level of output, just as the tax models would suggest."[28] In other words, an increase in GDP induced by supply-side factors, even if it does not improve growth rates thereafter, will yield large growth effects in the long run as baseline rates of growth accumulate off of a higher base.

Hassett also identifies significant improvements in the theoretical and empirical understanding of the relationship between taxes and the labor supply.[29] These improvements further support the growth argument for rate-reducing reforms. This is borne out by model simulations that account for this larger labor response. For example, DeBacker et al. (2015) simulated a 10-percent across-the-board reduction in individual tax rates and found an immediate increase in GDP of 1.6 percent (reflecting the strong labor supply response) as well as a long run increase in GDP of about 1.5 percent - not to mention substantial gains in investment, employment, and wages.[30] This estimate can be viewed as a likely upper bound estimate for the positive growth effects of individual rate cuts of that magnitude.

An Internationally Competitive Corporate Tax System

The United States has the highest corporate tax rate in the industrialized world. Given the fact that the United States operates in a global economy in which capital is highly mobile across countries, having the highest corporate tax in the developed world is a recipe for slower growth, weaker investment, and reduced innovation. A high corporate tax rate discourages foreign businesses from locating and investing in the United States and puts U.S. firms at a competitive disadvantage with the rest of the world. For these reasons, the OECD states that the corporate tax is the most economically harmful type of tax.[31]

In addition to making U.S. firms less competitive than their foreign counterparts, the corporate income tax is also a hidden tax on consumers and workers. Part of this has to do with the fact that capital is mobile and labor is relatively immobile. When the corporate tax causes capital to flee the United States in order to seek a better rate of return in a more lightly taxed jurisdiction, workers in the United States have less capital to work with and are less productive. Over time, this slows productivity growth and therefore reduces wages. Moreover, when capital flees it tends to take jobs with it. And those are just the direct effects – there are indirect effects as well. Although businesses do indeed pay taxes (and a lot of them) they are generally able to recover those costs by passing them on to consumers through higher prices and on to their employees through lower wages. These effects are so well known that the JCT, the CBO, and the Treasury Department all incorporate them in some form in their analyses. The JCT, the CBO, and the Treasury Department all conservatively assume that about 25 percent of the burden of corporate taxes is borne by labor.[32] However, other academic literature finds even higher burdens on labor. For example, one study by the CBO finds that domestic labor bears 70 percent of the burden of the corporate tax.[33] Other research by Hassett and Mathur finds that a 1 percent increase in corporate taxation reduces wages by half a percent.[34] And these effects are only going to grow because the more mobile capital becomes, the more labor will bear the burden.

Therefore, lowering the corporate tax rate would have significant economic benefits – faster growth and higher employment, investment, productivity, and wages. One particularly noteworthy example of the benefits of reform comes from a 2013 National Bureau of Economic Research (NBER) paper that simulated the repeal of the entire corporate income tax.[35] Unlike many attempts by other economists before them, these economists made an attempt to model the rest of the world in such a way that they could accurately depict how capital would flow into the United States as a result of corporate tax repeal. According to one of the authors, "fully eliminating the corporate income tax and replacing any loss in revenues with somewhat higher personal income tax rates leads to a huge short-run inflow of capital, raising the United States' capital stock (machines and buildings) by 23 percent, output by 8 percent, and the real wages of unskilled and skilled workers by 12 percent."[36] Under this scenario, repealing the corporate income tax would generate so much new economic activity in the United States that it would finance a third of the revenue lost by repealing the corporate tax. (For perspective, the CBO projects that the corporate tax will raise $4 trillion in revenue over the next decade).[37] Although repealing the corporate income tax is clearly a pro-growth policy, simply lowering the rate to get closer to the international average would increase U.S. competitiveness and have similar economic benefits (albeit of a lower magnitude). Moreover, because U.S. rates are so high relative to our international competitors, the room for growth is significant.

Minimizing the Taxation of Savings and Investment: Proposals Reflecting a Consumption Base

Consumption-based tax systems are widely regarded to be more pro-growth than income-based tax systems. The reason has to do with the treatment of the return to saving. Whereas a consumption tax is neutral to saving (by excluding capital income from the tax base), an income tax actively penalizes saving (by including capital income in the tax base). As a result, income-based systems discourage savings and investment which means slower capital accumulation, lower productivity, and therefore slower economic growth. One way to get at this issue is to move toward a consumption-based system or to adopt one entirely. There is substantial empirical evidence that moving to or toward a consumption-based tax would have significant economic benefits.

For example, in 2001 a group of highly respected economists simulated five different tax reforms, including a proportional income tax, a proportional consumption tax, and a so-called "X Tax."[38,39] Each of these reforms broadened the tax base and lowered rates while moving toward (or to) a consumption-based system by including features such as the full-expensing of investment. The authors found substantial economic benefits in the short run and long run. These reforms would increase economic output by about 3 percent to 6 percent over the budget window and by 6 percent to 9 percent in the long run. Gains this large could supply roughly $1 trillion to $2 trillion in extra revenue for deficit reduction within the budget window and would lead to substantial gains in GDP per capita. For example, under the consumption tax example, if applied to the current economic baseline, income for a family of four could be up to $16,500 higher after 10 years.

In 2005, economists at the Treasury Department simulated two deficit-neutral and distributionally-neutral proposals of interest: a Progressive Consumption Tax (X Tax) and the Growth and Investment Tax (GIT). The X Tax would couple a progressive wage tax with a business cash flow tax set at the highest marginal rate of 35 percent. The GIT would build on that approach by layering on a flat capital income tax of 15 percent that would allow the top marginal rate to fall to 30 percent. Using macroeconomic models similar to those in use at the CBO and the JCT today, the Treasury economists found that the X Tax would increase economic output by as much as 2.3 percent within the budget window and 6 percent in the long run. They also found that the GIT would increase output by as much as 1.9 percent within the budget window and by 4.8 percent in the long run.[40] The authors of this study noted that their models could have even understated growth effects because some or all of the models do not capture the benefits of the reduced cost of compliance from a simpler tax system, efficiency gains from reducing debt and equity distortions, better allocation of capital across sectors, and an improved allocation of capital across different types of assets.

Building off of these efforts, in 2007, economists Diamond and Zodrow modeled a flat consumption tax and a stylized GIT. Diamond and Zodrow found that the flat tax would increase GDP by about 4 percent within the budget window and by up to 4.9 percent in the long run. Meanwhile, the stylized GIT would increase GDP by around 3 percent in the budget window and by 3.9 percent in the long run.[41] Diamond and Zodrow found that these reforms would significantly increase employment, investment, and pre-tax wages.

The examples above show the effects of significant steps toward consumption-based systems as well as the growth effects of moving to a pure consumption tax. However, there are other reforms that can be very pro-growth – namely adopting full expensing of depreciable property.

Full expensing would allow businesses to deduct the full cost of any new investment immediately. In other words, full expensing would levy a 0 percent marginal effective tax rate on eligible investment. If the treatment of the returns on saving is the key difference between an income and consumption base, as established above, then exempting a significant amount of investment income from the tax base via full-expensing would be a significant step toward a consumption-based system.

Many analysts believe that full expensing offers more "bang for the buck" with respect to government revenues and economic growth than any other policy – even a reduction in the corporate tax rate. The reason this can be true is that full expensing applies only to new investment, whereas a reduction in rates would benefit both new and old capital. In other words, expensing is a more targeted pro-investment provision. At the high end, some estimates show that enacting full expensing could increase long-run GDP by 5 percent in addition to increasing the capital stock, employment, and wages.[42]

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MAY 17,2016

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Hatch Statement at Finance Hearing on Corporate Integration

WASHINGTON – Senate Finance Committee Chairman Orrin Hatch (R-Utah) today delivered the following opening statement at a hearing to examine corporate integration, and specifically, how allowing corporations to deduct dividends could create a more efficient and fairer system of taxation of corporate profits:

I'd like to welcome everyone here this morning.

Even a cursory examination of the business tax system demonstrates clearly the problems that arise from our out-of-step corporate tax, which contributes significantly to our anti-competitive business climate and leads sophisticated tax planners to engage in costly efforts – which some would call gamesmanship or tax avoidance – to either minimize their taxes or manage competitive tax pressures from abroad. Without significant reforms to the corporate tax system, we will continue to see an erosion in our overall tax base along with diminished *growth and investment.*

Among the most significant – and inexplicable – inefficiencies in our business tax system is the fact that a significant portion of U.S. business income is taxed more than once. Under the current system, income earned only once by corporations – on behalf of its shareholders – is taxed twice, thanks to a fiction created in the law that treats a business and its owners as two separate, taxable entities.

Specifically, when a corporation turns a profit, those earnings are taxed under the corporate income tax system, generally at a rate of 35 percent. When the corporation distributes a portion of those earnings to its shareholders in the form of dividends, we tax those earnings a second time at the individual level, with a maximum dividend tax rate approaching 25 percent.
This, put simply, is a problem.

We have this problem, in large part, due to the fact that rules for taxing corporations were written without taking into account the rules for taxing individuals, and vice versa. A better, more efficient system would be one that integrated the taxation of corporate and individual income.

That's what we're here to discuss today.

The current system of double taxation has resulted in a number of unintended economic distortions that wouldn't exist under a more integrated system. I'll discuss just a few of those distortions here this morning.

For example, the current system creates a bias in the choice of business entity, disfavoring the corporate model versus others. Of course, businesses – small and start-up businesses in *particular – should have the flexibility to determine how to organize themselves. But, our tax code shouldn't punish ANY particular business with double taxation simply because it was organized a certain way.*

Double taxation also discourages savings and investment and is a major factor in our current domestic savings and investment shortage. Savings and investment are essential to capital formation, increased job productivity, wage growth, and adequate retirement savings. Yet, we've created a system that essentially punishes those who save and invest.

In addition, the current system explicitly favors debt-financed investment over equity-financed investment. In the U.S., corporations can deduct interest paid to bond-holders, but no similar deduction exists for dividends paid to stockholders. Now, in some situations, there may be strong reasons for a company to opt for debt-financing, but there is no real reason why the tax code should favor debt over equity.

Double taxation also contributes to the problem of lock-out – that is, it discourages businesses from bringing income earned overseas back into the U.S. As many have already noted, with the highest corporate tax rate in the developed world, American multinational companies are often loathe to repatriate their foreign earnings and subject them to U.S. taxes on top of the taxes they've already paid in foreign jurisdictions. And, their shareholders rarely demand that they do so because those earnings will be taxed again if and when they are ever paid out as dividends. As a result, experts estimate that U.S. corporations have over $2 trillion in earnings that are locked out of the U.S. due, in large part, to our tax system.

These problems – and there are many others – have been observed for years. And, as a result, many have argued for the elimination of double taxation and in favor of integrating the individual and corporate tax systems. We're going to continue that discussion here today.

In any discussion of an integrated system, the fundamental design choice that has to be made is whether the single instance of taxation should fall on the corporation or the shareholders.

Given the substantial burdens our corporate tax system already imposes on U.S. businesses, coupled with the relatively high-mobility of corporate residence in the age of globalization, as illustrated by the recent wave of inversions and foreign takeovers, some have questioned the wisdom of collecting the tax on the corporation side.

Another method of integrating the two systems would be to impose a single layer of tax at the shareholder level by allowing companies to deduct any dividends they pay out.

As I see it, there are a number of benefits to this approach. I'll mention just a few.

First, a deduction for dividends paid would allow businesses to cut their own effective tax rates. There is bipartisan agreement on the need to bring down corporate tax rates. A dividends-paid deduction could accomplish the same goal without many of the trade-offs associated with a reduction in the statutory tax rate.

Second, this type of deduction would create greater parity between debt and equity. As I noted earlier, current law generally allows corporations to deduct earnings paid out as interest on debt obligations. A dividends-paid deduction would provide similar tax treatment for earnings paid out as dividends to investors, allowing companies to make debt-vs.-equity decisions after considering market conditions instead of simply referencing biases in the tax code.

Third, a dividends paid deduction could help with some of our international tax problems by reducing the pressure on companies to invert and greatly reducing the lock-out effect.

To hopefully take advantage of these and other benefits, I've been working for over a year now on a tax reform proposal that would eliminate double taxation of corporate income by providing this type of deduction. While I plan to unveil that proposal here in the next several weeks, I'm hoping we can inform this ongoing effort by having a more detailed discussion of these concepts and others during the course of today's hearing.

Before I conclude, I want to acknowledge that some groups – including tax-exempt entities and retirement plans – may have some concerns with a dividends paid deduction. However, at the end of the day, I believe we can craft a system where these parties will be treated in a manner that is comparable to current law, in fact, in many cases will likely be better off. And at the same time, our overall tax system will, in the opinion of many, be very much improved.

Still, I want everyone to know that, as I am preparing my integration proposal, I am aware of the concerns that these and other groups might raise and I am studying them very closely. Today, and going forward, we seek your comments and suggestions.

With that, I just want to say that I appreciate this fine panel of witnesses being here today, sharing their knowledge and expertise with the committee. I think this is going to be a very informative hearing.

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02/28/17 Hatch Statement on President Trump’s Address to Congress

02/27/17 Hatch Announces Executive Session to Consider CMS Nominee

02/16/17 Hatch, Rubio & Paulsen Introduce Bill to Enhance HSAs, FSAs

Internal Revenue Service

Number: **201620001**
Release Date: 5/13/2016

Index Number: 856.00-00, 856.01-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B02
PLR-103094-15

Date:
February 09, 2016

Legend

Taxpayer	=
Operating Partnership	=
Company X	=
Company Y	=
Manager	=
LLC	=
State A	=
State B	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=

a =

b =

c =

d =

e =

f =

Dear :

This is in response to your letter dated January 13, 2015, and supplemental submissions, regarding the treatment of the Taxpayer's allocable share of management fees for purposes of the gross income tests under section 856(c)(2) and (c)(3) of the Internal Revenue Code ("Code").

FACTS

Taxpayer is a State A corporation. Taxpayer was formed during Date 1, and will elect to be taxed as a real estate investment trust ("REIT") beginning with the taxable year ended Date 2.

Taxpayer conducts substantially all of its investment activities through Operating Partnership, a State B limited partnership, which is treated as a partnership for federal income tax purposes.

Taxpayer owns the sole general partnership interest in Operating Partnership through its wholly owned subsidiary Company X, a State B limited liability company. Company X is disregarded for federal income tax purposes. Taxpayer also directly owns a limited partnership interest in Operating Partnership. Taxpayer completed an initial public offering ("IPO") of its stock on Date 3. As of Date 5, Taxpayer's collective ownership percentage in Operating Partnership is a%.

Operating Partnership is the sole owner of Company Y, a State B limited liability company, which elected to be treated as a corporation for federal income tax purposes. Company Y and Taxpayer jointly elected to treat Company Y as a taxable REIT subsidiary. Company Y owns b% of Manager, a State B limited liability company treated as a partnership for federal income tax purposes. Manager owns c% of Taxpayer.

Operating Partnership's primary business is to acquire, invest in, and manage a portfolio of re-performing and non-performing mortgage loans secured by single-family residences, and, to a lesser extent, loans secured by multi-family residential and commercial mixed use retail/residential properties (collectively, the "Mortgages"). Taxpayer represents that Operating Partnership owns 100% of the investments. Operating Partnership's portfolio predominantly consists of re-performing loans. With respect to the non-performing loans, Operating Partnership will often acquire the underlying properties securing the Mortgages through foreclosure (such properties referred to as "real estate owned" or "REOs") (collectively, the Mortgages and REOs are the "Investments"). REOs acquired by Operating Partnership will be either rented or sold to third parties soon after they are acquired.

On Date 4, Manager entered into a management agreement with Taxpayer and Operating Partnership ("Management Agreement"). Pursuant to the Management Agreement, Manager implements Operating Partnership's business strategy and manages Operating Partnership's business and investment activities and day-to-day operations. Manager also provides Operating Partnership and Taxpayer with management, corporate governance, administrative and other services related to finance and accounting, human resources, legal, investment company exemption, risk management, corporate services, vendor management operations, operations support, and REIT qualification (collectively, the "Services"), including a management team and necessary administrative and support personnel to run the daily operations of Operating Partnership and Taxpayer.[1] Taxpayer represents that the Services provided by Manager will be usual and customary asset management of investments in mortgages and REOs. Manager does not currently provide Services to any persons (as defined in section 7701(a)(1)) other than Operating Partnership. The Management Agreement provides that Manager may provide Services in the future to third parties under the condition that its Services provided to Taxpayer are not impaired. Neither Taxpayer nor Manager, however, anticipates that Manager will provide Services to or invest on behalf of third parties.

Manager will not be the servicer of the Mortgages or provide any services to the tenants of any REOs. LLC will service the mortgages and provide any necessary property management, lease management, and renovation management required for the REOs. Taxpayer represents that LLC is an independent contractor within the meaning of section 856(d)(3) with respect to Taxpayer.

Manager is compensated through fees paid by Operating Partnership. Operating Partnership pays a base management fee and an incentive fee to Manager (collectively,

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[1] Taxpayer anticipates the rental of real property to constitute a small part of its business. If Taxpayer provides any services to its tenants, Taxpayer will use an independent contractor or taxable REIT subsidiary as described under section 856(d)(7)(C) to ensure that any impermissible tenant service income does not exceed the de minimis amount in section 856(d)(7)(B).

the “Management Fees”). The base management fee is d% of Taxpayer’s consolidated stockholders’ equity per annum. Taxpayer’s consolidated stockholders’ equity is the sum of the net proceeds from any issuances of equity by Taxpayer or Operating Partnership since inception, plus Taxpayer’s and Operating Partnership’s retained earnings less (i) any amount Taxpayer or Operating Partnership has paid to repurchase its common stock or units since inception, (ii) any unrealized gains and losses and other non-cash items that have affected consolidated stockholder’s equity, (iii) any amount related to one-time events caused by changes in GAAP, and (iv) certain non-cash items not otherwise discussed above. The base management fee will be paid in a combination of cash and shares of Taxpayer’s common stock.

The incentive fee will be payable quarterly in an amount equal to e% of the dollar amount by which the sum of (A) aggregate cash dividends declared out of the REIT taxable income of Taxpayer and (B) distributions declared out of the taxable income of Operating Partnership (without duplication) exceeds the product of f% and the book value per share of Taxpayer’s common stock as of the end of each quarter. The incentive fee is payable in cash.

Taxpayer intends to restructure its operations. Company Y will distribute its b% interest in Manager to Operating Partnership. Thus, Operating Partnership will directly own the b% interest in Manager. Manager will continue to manage the Investments and be compensated as provided in the Management Agreement (as described above). Because Operating Partnership will be a partner in Manager and Taxpayer is a partner in Operating Partnership, Taxpayer will be allocated a portion of the fees that Manager receives from Operating Partnership. Therefore, Taxpayer, through its partnership interest in Operating Partnership, will have gross income that includes Taxpayer’s proportionate share of both the Investment Income from Operating Partnership’s assets and Operating Partnership’s b% share of the Management Fees.

LAW

Section 856(c)(2) of the Code provides that at least 95 percent of a REIT’s gross income must be derived from dividends, interest, rents from real property, gain from the sale or other disposition of stock, securities, and real property (other than property in which the corporation is a dealer), abatement and refunds of taxes on real property, income and gain derived from foreclosure property, commitment fees, and gain from certain sales or other dispositions of real estate assets.

Section 856(c)(3) of the Code provides that at least 75 percent of a REIT’s gross income must be derived from rents from real property, interest on obligations secured by real property, gain from the sale or other disposition of real property (other than property in which the corporation is a dealer), dividends from REIT stock and gain from the sale of REIT stock, abatements and refunds of taxes on real property, income and gain derived from foreclosure property, commitment fees, gain from certain sales or other disposition of real estate assets, and qualified temporary investment income.

Section 856(c)(5)(J) of the Code provides, in relevant part, that to the extent necessary to carry out the purposes of part II of subchapter M of the Code, the Secretary is authorized to determine, solely for purposes of such part, whether any item of income or gain which—(i) does not otherwise qualify under section 856(c)(2) or (c)(3) may be considered as not constituting gross income for purposes of section 856(c)(2) or (c)(3), or (ii) otherwise constitutes gross income not qualifying under section 856(c)(2) or (c)(3) may be considered as gross income which qualifies under section 856(c)(2) or (c)(3).

Section 1.856-3(g) of the Income Tax Regulations provides that a REIT that is a partner in a partnership is deemed to own its proportionate share of each of the assets of the partnership and is deemed to be entitled to the income of the partnership attributable to such share. For purposes of section 856, the interest of a partner in the partnership's assets is determined in accordance with the partner's capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership retain the same character in the hands of the partners as in the hands of the partnership for all purposes of section 856.

Section 1.856-4(b)(5)(ii) of the Income Tax Regulations provides that the directors or trustees of a REIT are not required to delegate or contract out their fiduciary duty to manage the REIT itself, as distinguished from rendering or furnishing services to the tenants of the REIT's property or managing or operating the property. Thus, the trustees or directors may do all things necessary, in their fiduciary capacities, to manage and conduct the affairs of the trust itself. For example, the trustees or directors may establish rental terms, choose tenants, enter into and renew leases, and deal with taxes, interest, and insurance, relating to the REIT's property.

Section 61(a) of the Code provides that, except as otherwise provided, gross income includes all income from whatever source derived.

The legislative history underlying the tax treatment of REITs indicates that the central concern behind the gross income restrictions is that a REIT's gross income should largely be composed of passive income. For example, H.R. Rep. No. 86-2020, 2d Sess. 4, at 6 (1960), 1960-2 C.B. 819, at 822-823 states, "[o]ne of the principal purposes of your committee in imposing restrictions on types of income of a qualifying real estate investment trust is to be sure the bulk of its income is from passive income sources and not from the active conduct of a trade or business." The legislative history also indicates that Congress intended to equate the tax treatment of REITs with the treatment accorded regulated investment companies. Id.

The staff of the Joint Committee on Taxation in its General Explanation of the Tax Legislation Enacted in the 110th Congress describes section 856(c)(5)(J) as follows: "The provision authorizes the Treasury Department to issue guidance that would allow other items of income to be excluded for purposes of the computation of qualifying gross income under either the 75 percent or the 95 percent test, respectively, or to be included as qualifying income for either of such tests, respectively, in appropriate cases consistent with the purposes of the REIT provisions." Footnote 309 of the General Explanation provides that income that is statutorily excluded from a REIT's gross income computations is not intended to be within the authority granted to the Treasury Department to include amounts as qualifying income. Staff of the Joint Committee on Taxation, 111th Cong., General Explanation of the Tax Legislation Enacted in the 110th Congress, 1st Sess., at 239 (2009).

ANALYSIS

In the instant case, Manager will be providing Services to Operating Partnership that promote Operating Partnership's investment strategy through the management of investment activities as well as Operating Partnership's day-to-day operations. Manager is managing the Operating Partnership's investments in mortgages and REOs. Taxpayer represents that the activities that Manager performs are activities that a REIT may, under the Code and Regulations, perform in managing the assets of the REIT as well as the trust itself without adverse tax consequences. All mortgage servicing and all services provided in connection with the REOs are done by LLC, an independent contractor.

In the instant case, in the ordinary course of Operating Partnership's investment activities, Operating Partnership will receive interest income and income from the sale or rental of REO foreclosure property (collectively, "Investment Income"), and Operating Partnership will pay Management Fees to Manager. At the same time, Operating Partnership will be allocated b% of the Management Fees it pays to Manager because it is a b% partner in Manager. Thus, Operating Partnership's gross income will include both the Investment Income from its assets and its b% share of the Management Fees. Furthermore, Taxpayer, as a partner of Operating Partnership and, through its partnership interest in Operating Partnership, an interest holder in Manager, will include as income both its proportionate share of the Investment Income from its direct interest in Operating Partnership and the Management Fee income from its indirect interest in Manager. Because the Management Fees are derived from the same Investments that generate the Investment Income, including the Management Fees in Taxpayer's gross income would cause the amounts to be counted twice for purposes of the gross income tests under section 856(c). Accordingly, under the authority of section 856(c)(5)(J)(i), to the extent that Manager earns Management Fees from managing Operating Partnership's wholly owned Investments, we conclude that Taxpayer may exclude from its gross income (for purposes of section 856(c)(2) and (c)(3)) Taxpayer's allocable pro rata share (a%) of Operating Partnership's allocable pro rata share (b%) of

Management Fees that Manager receives from Operating Partnership. Under the facts of the instant case, excluding the Management Fees (as described above) from Taxpayer's gross income for purposes of section 856(c)(2) and (c)(3) does not interfere with Congressional policy objectives in enacting the income tests under those provisions.

CONCLUSION

Based on the facts and representations submitted by Taxpayer, we rule that to the extent that Manager earns Management Fees from managing Operating Partnership's wholly owned Investments, Taxpayer may exclude from its gross income (for purposes of section 856(c)(2) and (c)(3)) Taxpayer's allocable pro rata share of Operating Partnership's allocable pro rata share of Management Fees that Manager receives from Operating Partnership.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied as to whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code. No opinion is expressed or implied regarding whether Taxpayer's pro rata allocable share of the Investment Income is qualifying REIT income under either section 856(c)(2) or (3). Additionally, no opinion is expressed or implied regarding whether the REOs qualify as foreclosure property or whether the sale of an REO is a prohibited transaction under section 857(b)(6).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Andrea M. Hoffenson
Andrea M. Hoffenson
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)

Internal Revenue Service

Number: **201623007**
Release Date: 6/3/2016

Index Number: 860G.00-00; 857.02-02

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B03
PLR-133446-15

Date:
March 3, 2016

LEGEND:

Taxpayer =

State =

Property =

Original Borrower =

Lender =

Original Borrower Principal =

Borrower =

Borrower Principal =

Servicer =

Town =

State Agency =

Engineers	=
Startup Day	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=
Date 9	=
Date 10	=
Date 11	=
Date 12	=
Date 13	=
Date 14	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
a	=

b =

c =

d =

e =

f =

Dear :

This ruling responds to a letter dated September 30, 2015, requesting a ruling that the completion of the "Replacement Plant" as described below will not cause the Property to cease to be treated as "foreclosure property" for purposes of § 860G(a)(8) of the Internal Revenue Code.

FACTS

Taxpayer represents that it is a trust that has made an election to be treated as a real estate mortgage investment conduit ("REMIC") under the provisions of §§ 860 et seq. of the Code. Taxpayer's method of accounting is an accrual method. Taxpayer uses the calendar year as its taxable year.

Original Borrower executed and delivered to Lender a promissory note dated Date 1 ("Note"), which evidenced a loan ("Mortgage Loan") made by Lender to Original Borrower. To secure the repayment of the Note, Original Borrower, among other things, executed a Mortgage, Assignment of Leases and Rents and Security Agreement also dated Date 1 ("Security Instrument"), granting a lien on the Property. Original Borrower was liable for the payment and performance of all Original Borrower's obligations under the Note, the Security Instrument, a Loan Agreement (the "Loan Agreement"), and all other documents evidencing, securing, guaranteeing, or otherwise pertaining to the Mortgage Loan ("Mortgage Loan Documents").

Taxpayer represents that Taxpayer holds numerous qualified mortgages and related loan documents, including the Mortgage Loan and the Mortgage Loan Documents. Taxpayer represents that all of the qualified mortgages were either (i) assigned by Original Lender to Taxpayer on Startup Day in exchange for regular or residual interests in Taxpayer, or (ii) purchased by Taxpayer within the three-month period beginning on Startup Day pursuant to a fixed-price contract in effect on Startup Day.

Taxpayer represents that as of the date the Mortgage Loan was assigned to Taxpayer, Original Borrower was current on its obligations under the terms of the Mortgage Loan. In addition, Taxpayer represents that there was no evidence suggesting that Original Borrower would not remain current on the Mortgage Loan until maturity, and no interest in Property acquired as a result of the foreclosure defined below was granted to Taxpayer at a time when Taxpayer knew or had reason to know that Original Borrower would not remain current on its obligation under the terms of the Mortgage Loan.

Pursuant to an Assumption and Release Agreement effective Date 2, by and among Original Borrower Principal, Borrower, Borrower Principal, and Taxpayer, the Taxpayer consented to the transfer of the Property to the Borrower and the assumption by the Borrower and Borrower Principal of the obligations of Original Borrower and Original Borrower Principal under the Mortgage Loan Documents.

As a result of a determination that a default on the Loan was imminent, in accordance with the Pooling and Servicing Agreement, the Loan was transferred to Servicer for special servicing on Date 3 ("Imminent Default Date"). At the time of this transfer, the operator of Property was facing significant economic pressures due to numerous tenants having filed for Chapter 11 bankruptcy protection, and the expenditures, as described below, for the necessary improvements to Property's wastewater treatment plant that were required to maintain compliance with state and local requirements. Servicer, on behalf of Taxpayer, issued a Notice of Default, Acceleration, and Demand for Payment on Date 4.

Taxpayer acquired title to Property on Date 5, through a foreclosure proceeding in accordance with State law ("the Foreclosure"). In addition to the real property making up Property, Taxpayer acquired through the Foreclosure all ancillary personal property relating to Property. Taxpayer represents that each of these ancillary items is personal property that is related to and used in the operation of business conducted on the real property making up Property, or the use of the personal property is otherwise an ordinary and necessary corollary of the use of the real property.

Upon the Foreclosure, Taxpayer represents that Property qualified as "foreclosure property" within the meaning of § 860G(a)(8) of the Code. Sixty days before the close of the initial grace period under § 856(e)(2), Taxpayer filed a request for an automatic extension of the grace period in accordance with § 856(e)(3) and § 1.856-6(g)(5) of the Income Tax Regulations (the "Regulations") for one additional period of three years ending Date 6.

Property includes a retail shopping mall ("the Mall") built in Year 1, consisting of inline stores, anchor stores, outparcel stores, parking areas, access roads, utility equipment and facilities, other infrastructure, as well as signs and sign structures.

Property is located in Town, which does not have a public sewer system. Accordingly it was necessary for the original developer of Property to construct on Property a wastewater treatment plant ("Existing Plant") to serve Property. The design capacity of the Existing Plant was f gallons per day. Furthermore, it has been necessary for all subsequent owners of Property, including Taxpayer, to maintain the Existing Plant in compliance with all federal, state, and municipal environmental rules and regulations. Private wastewater treatment plants that operate in State, such as the Existing Plant, require a Groundwater Discharge Permit from State Agency. The Existing Plant treats the wastewater generated by tenants and other occupants of Property, who have no other means of disposing of their wastewater. Furthermore, two existing tenants have provisions in their respective leases, which were executed prior to the Foreclosure, that permit expansion rights that would require additional wastewater treatment capacity that the Existing Plant cannot accommodate.

The Existing Plant contains two main features: (1) the collection/treatment system and initial treatment equipment, which is located next to the Mall; and (2) the leaching areas, which are located at a distance of approximately a from the Mall on land that is also part of Property. A gravity system allows the wastewater to flow from the collection/treatment system to the leaching fields, which include sand filter beds.

In Year 2, the then-owner of Property obtained a modification of the groundwater discharge permit then in effect to increase the capacity of the Existing Plant. In Year 3, the owner of the Property at that time submitted a Groundwater Discharge Permit Renewal application to State Agency, which was not granted until Date 7 (the "Renewal Permit"). The Renewal Permit included an expiration date of Date 8, which was extended by State law to Date 9.

Following the acquisition of Property by Borrower, Engineers advised Borrower that the Existing Plant had many components that needed to be replaced or repaired to keep the Existing Plant operational and to meet the requirements of the Renewal Permit. Engineers also advised that the existing capacity would need to be increased to allow for leasing to new tenants with larger wastewater disposal needs, in particular restaurants and fast food providers.

On Date 10, Engineers submitted a letter outlining a four-year plan to either replace or repair the existing tanks at the Existing Plant as well as to increase the capacity of the sand filter beds (the "Sand Beds") in the existing leaching areas for the Existing Plant. The letter also detailed the current condition of the Existing Plant's equipment. All of the tanks at the Existing Plant were described as being in "poor or very poor condition," except one tank that had been refurbished in Year 4, and was described as "average."

On Date 11, a request for a Groundwater Discharge Permit Modification was submitted by the Borrower to State Agency, seeking to add grease/pretreatment tanks to the Existing Plant and to increase the capacity of the Existing Plant.

On Date 12, Engineers submitted a second letter which revised the schedule contained in their Date 10 letter, changing to a five-year plan to either reconstruct or repair the existing structures, replace existing structures with new structures, and/or a combination of both. After reviewing Engineer's second letter, Borrower began work on a project to improve the Existing Plant (the "Improvement Project").

Taxpayer also represents that, based on proposals submitted by the Borrower's professional advisors and not including architect's fees, administrative costs of the developer or builder, lawyers' fees, and expenses incurred in connection with obtaining zoning approval or building permits, the Improvement Project had a maximum estimated total direct cost of b. This amount represented the direct costs of the Improvement Project and includes the cost of labor and materials which were directly connected with the Improvement Project. Taxpayer represents that, not including architect's fees, administrative costs of the developer or builder, lawyers' fees, and expenses incurred in connection with obtaining zoning approval or building permits, the total direct cost of labor and materials incurred with respect to the Improvement Project as of the Imminent Default Date were not less than c. This amount consisted of the following: (1) installation of an electrical conduit to provide a future power source as part of the renovation of the Sand Beds; (2) installation of two pretreatment/grease tanks at the Existing Wastewater Treatment Plant; and (3) demolition and removal of existing equipment and an existing structure. Taxpayer represents that the estimated total direct cost of the Improvement Project was reasonable, done in good faith, and was based on all of the data reasonably available to Taxpayer when Taxpayer undertook completion of the Improvement Project.

After the Imminent Default Date, State Agency conducted an on-site inspection on Date 13 of the Existing Plant. Shortly thereafter, State Agency issued a Notice of Noncompliance with Groundwater Discharge Permit (the "Notice"). The Notice included the following findings:

- "[P]ermittee has failed to properly maintain all facilities and equipment"
- "[S]ignificant corrosion of key process tanks."
- "[P]rocess piping and valves need to be maintained."
- "[S]ignificant refurbishment or replacement may be necessary."

The Notice also included the following "Action Items Required":

- Comply with the Renewal Permit and State Agency's Groundwater Discharge Regulations.

- Within three months of the date of the Notice, Permittee (Borrower as predecessor-in-interest) is to contract with a professional engineer, licensed by State, to prepare an engineering report.
- Within nine months of date of the Notice, Permittee (Borrower as predecessor-in-interest) is to submit an engineering report, prepared by a professional engineer, licensed by State, that outlines in sufficient detail what modifications (if any) to the Existing Wastewater Treatment Plant or other changes are required to insure that the Existing Plant can remain in compliance with the Renewal Permit and other applicable requirements.
- If State Agency's approval is required for any modifications to the Existing Plant or other changes identified in such engineering report, Permittee (Borrower as predecessor-in-interest) must submit an application therefor no later than nine months from the date of the Notice.

Engineers, a firm of professional engineers that are licensed by State, then undertook a review of the findings and required actions set forth in the Notice. Engineers concluded that it would not be possible to repair or rehabilitate the collection and treatment portion of the Existing Plant at its current location.

Taxpayer and its advisors concluded that the only option available that would meet the current standards of State Agency would involve the construction of a new structure to be located at a wastewater treatment facility that would replace the Existing Plant (the "Replacement Plant"). The recommended site for the Replacement Plant is d acres of land located at a distance of approximately a from the Existing Plant, and adjacent to the existing leaching areas. The site is part of Property and is accessible to and from Mall by existing easements that benefit the owner of Property.

On Date 14, State Agency issued a Groundwater Discharge Permit (the "Replacement Discharge Permit"), which supersedes the Renewal Permit. The Replacement Discharge Permit applies only to the Replacement Wastewater Treatment Plant. The estimated cost of the Replacement Wastewater Treatment Plant is e. The construction and operation of the Replacement Wastewater Treatment Plant has also been approved by Town.

The Replacement Discharge Permit expired on Date 9. In cases where a Notice of Noncompliance has been issued, State Agency typically allows a facility to continue to operate pursuant to an expired permit, provided a new permit has been issued, construction is underway, and a completion date is known. Although State Agency issued the Replacement Discharge Permit, construction of the Replacement Wastewater Treatment Plant is not currently proceeding.

If the Existing Plant fails or if State Agency does not permit the Existing Plant to continue to operate, then the only immediate solution for Mall to stay open is to have the untreated wastewater hauled by tanker trailers on a daily basis to another wastewater treatment plant for treatment and disposal. This arrangement, however, would be expensive and only temporary, because State Agency limits the length of time that the wastewater can be transported by trucks to an off-site location.

LAW AND ANALYSIS

The REMIC provisions were added to the Code by the Tax Reform Act of 1986. Among the conditions an entity must satisfy to be treated as a REMIC is the requirement under § 860D(a)(4) that as of the close of the third month beginning after the startup day and at all times thereafter, substantially all of the entity's assets be "qualified mortgages and permitted investments."

Section 860G(a)(5) lists "permitted investments," which include foreclosure property. Under § 860G(a)(8), foreclosure property is defined as property that is acquired in connection with the default of a qualified mortgage and that would be foreclosure property under § 856(e) if acquired by a real estate investment trust ("REIT").

Section 856(e)(1) generally defines "foreclosure property" as any real property, and any personal property incident to such real property, acquired by a REIT as a result of having bid in such property at foreclosure or having otherwise reduced such property to ownership or possession by agreement or process of law, after there was a default or default was imminent on the mortgage loan secured by the property.

Under § 856(e)(5), property is treated as foreclosure property only if a REIT makes an election to treat it as such prior to the due date for the REIT's tax return for the taxable year in which it acquires such property.

Section 856(e)(2) provides that, except as provided in § 856(e) (3), property ceases to be foreclosure property as of the close of the third taxable year following the taxable year in which the REIT acquired such property.

Section 856(e)(3) provides that, if the REIT establishes to the satisfaction of the Secretary that an extension of the grace period is necessary for the orderly liquidation of the trust's interests in such property, the Secretary may grant one extension of the grace period for such property.

Under § 856(e)(4) property will cease to qualify as foreclosure property on the first day (occurring on or after the day on which the REIT acquired the property) on which any construction takes place on such property (other than completion of a building, or completion of any other improvement, where more than 10 percent of the construction of such building or other improvement was completed before default became imminent), among other activities.

Section 1.856-6(e)(1) of the Regulations provides, in part, that under § 856(e)(4)(B), all real property (and any incidental personal property) for which a particular election has been made ceases to be foreclosure property on the first day (occurring on or after the day on which the REIT acquired the property) on which any construction takes place on the property, other than completion of a building (or completion of any other improvement) where more than 10 percent of the construction of the building (or other improvement) was completed before default became imminent.

Under § 1.856-6(e)(2), the determination of whether the construction of a building or other improvement was more than 10 percent complete when default became imminent is made by comparing the total direct costs of construction incurred with respect to the building or other improvement as of the date default became imminent with the estimated total direct costs of construction as of such date. If the building or other improvement qualifies as more than 10 percent complete under this method, the building or other improvement shall be considered to be more than 10 percent complete. For these purposes, direct costs of construction include the cost of labor and materials which are directly connected with the construction of the building or improvement. However, architect's fees, administrative costs of the developer or builder, lawyers' fees, and expenses incurred in connection with obtaining zoning approval or building permits are not considered to be direct costs of construction. In addition, generally, the REIT's estimate of the total direct costs of completing construction as of the date the default became imminent will be accepted, provided that the estimate is reasonable, done in good faith, and is based on all of the data reasonably available to the REIT when the REIT undertakes completion of construction of the building or other improvement.

Section 1.856-6(e)(3) provides that generally, the terms "building" and "improvement" in section 856(e)(4)(B) mean the building or improvement (including any integral part thereof) as planned by the mortgagor or lessee (or other person in possession of the property, if appropriate) as of the date default became imminent. In addition, § 1.856-6(e)(3) permits a REIT to make subsequent modifications which increase the direct cost of construction of the building or improvement if such modifications (i) are required by a Federal, State, or local agency, or (ii) are alterations that are either required by a prospective lessee or purchaser as a condition of leasing or buying the property or are necessary for the property to be used for the purpose planned at the time default became imminent.

Taxpayer represents that the Property was acquired by Taxpayer in connection with the default of a qualified mortgage held by Taxpayer and thus qualifies as "foreclosure property" within the meaning of §§ 860G(a) and 856(e)(1).

Taxpayer represents that as of the date default became imminent, the total estimated allowable direct costs of the Improvement Project was b; and that the total amount spent on the allowable direct costs of the Improvement Project was c. Thus, based on a comparison between the estimated allowable direct costs and the amount spent on allowable direct costs, more than 10 percent of the Improvement Project was completed before the Imminent Default Date.

Taxpayer represents that any additional direct costs incurred by Taxpayer, as well as the need to locate the Mall's Wastewater Treatment Plant at the site of the Replacement Plant, are modifications to the Improvement Project taken in response to the Notice, which was issued by a State government agency. Subsequent modifications that increase the "direct cost of construction of the building or improvement" are permitted under § 1.856-6(e)(3) because State Agency is a state government agency.

Accordingly, the Improvement Project as described is an improvement to the Property that was more than 10 percent complete before the Imminent Default Date. Thus, completion of the "Replacement Plant" will not cause the Property to cease to be treated as "foreclosure property" for purposes of § 860G(a)(8).

CONCLUSION

Based on the facts submitted and representations made by Taxpayer, we rule that the transactions described above will not cause the Property to cease to be treated as "foreclosure property" for purposes of § 860G(a)(8).

This ruling's application is limited to the facts, representations, Code sections, and Regulations cited herein. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed concerning whether Taxpayer otherwise qualifies as a REMIC under subchapter M of the Code or whether the Property otherwise qualifies as foreclosure property for purposes of §§ 860G(a)(8) or 856(e) (without regard to paragraph (5) thereof).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

____
Julanne Allen
Assistant to the Branch Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

Internal Revenue Service

Number: **201628020**
Release Date: 7/8/2016

Index Number: 856.07-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
ID No.
Telephone Number:

Refer Reply To:
CC:FIP:B01
PLR-148681-13
Date:
March 29, 2016

Legend

Taxpayer =

REIT A =

LLC 1 =

LLC 2 =

GP =

TRS 1 =

TRS 2 =

Company =

Operator =

Building 1 =

Building 2 =

Parking Garage =

City =

State A =

State B =

Year 1 =

Year 2 =

Year 3 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

a =

b =

c =

d =

e =

f =

g =

h =

Dear :

This responds to a letter dated November 22, 2013, and subsequent correspondence, requesting rulings on behalf of Taxpayer. Taxpayer requests rulings with respect to the qualification of certain items of income under section 856 of the Internal Revenue Code ("Code") in connection with the parking garage described below.

FACTS

Taxpayer is a State A limited liability company that has elected to be an association taxable as a corporation for Federal income tax purposes and has elected to be treated as a real estate investment trust ("REIT") since its inception for Federal income tax purposes. Taxpayer is an affiliate of GP, a State B publicly traded REIT.

Taxpayer and REIT A, another affiliate of GP, own a percent and b percent, respectively, of the interests in LLC 1, a State A limited liability company treated as a partnership for Federal income tax purposes. TRS 1, a taxable REIT subsidiary ("TRS") of Taxpayer, and TRS 2, a TRS of REIT A, own a percent and b percent, respectively, of the interests in LLC 2, a State A limited liability company treated as a partnership for Federal income tax purposes.

On Date 2, LLC 1 acquired the fee interest in Building 1, an office building, from an unrelated, third party seller, and LLC 2 acquired the fee interest in Parking Garage, the parking facility adjacent to Building 1. Building 1 and Parking Garage are more fully described, below.

Office Park

Building 1, Parking Garage, and an adjacent office building, Building 2, make up Office Park. The owners of Building 1, Building 2, and Parking Garage are referred to as "Office Park Owners."

Building 2 is owned by an unrelated third party, Company, who originally built Building 1, Parking Garage, and Building 2 as one integrated office park. Company kept Building 2, and sold Building 1 and Parking Garage in Year 1.

Parking Garage, a parking structure adjacent to Building 1, was built to accommodate the tenants of Building 1 and Building 2, as well as their employees, customers, and guests, as required under the City Municipal Code.

Office Park contains certain common areas; various equipment, including a central chilled water plant and a central power plant station located in Building 2, which serve Building 1, Building 2, and Parking Garage; and a fire control room that serves Building 1, Building 2, and Parking Garage, located in Parking Garage. The HVAC Systems and other systems that serve Office Park are controlled by the central power plant station and central chilled water plant in Building 2.

Easement Agreement

In Year 1, Office Park Owners entered into an easement agreement ("Easement Agreement"). Easement Agreement requires Parking Garage's owner to maintain the number of spaces in Parking Garage required to satisfy the legal onsite parking requirements under the City Municipal Code for Building 1 and Building 2, and to make Parking Garage available for the nonexclusive use of the owners and occupants of Building 1 and Building 2. Under Easement Agreement, Parking Garage's owner is required to use a parking manager to operate Parking Garage.

Management Agreement

In Year 2, the owner of Parking Garage entered into an agreement with Operator, a third party contractor, to operate Parking Garage (as amended, "Management Agreement"). Under Management Agreement, Operator operates Parking Garage to offer unreserved and reserved parking. Operator is responsible for managing and operating parking services at Parking Garage, including issuing parking passes and providing for the general security of vehicles in Parking Garage. Operator employs all of the individuals who manage and operate Parking Garage and is directly responsible for providing all salary, wages, benefits, administration, and supervision of its employees. Operator's employees do not park or service cars. Operator collects the gross parking revenues and receives arm's-length compensation under the terms of Management Agreement.

Parking Agreement

Parking in Parking Garage is provided to the tenants of Building 1, Company (as owner and occupant of Building 2), their guests, customers, and subtenants, and the general public. Except for a small number of reserved spaces, the floors and spaces in parking garage are not assigned. However, use by the general public is *de minimus*. All buildings in the vicinity of Office Park have their own parking facilities as required by the City Municipal Code.

When LLC 1 acquired Building 1 on Date 2, LLC 1 assumed the obligation to provide parking to the tenants of Building 1 under their leases. Accordingly, LLC 1 and LLC 2 entered into Parking Agreement in Year 3, under which LLC 2 agreed to provide parking in Parking Garage to Building 1's tenants, and to charge Building 1's tenants directly for such parking. Operator bills Building 1's tenants on behalf of LLC 2.

Parking Lease

Company, owner of Building 2, entered into a long-term lease ("Parking Lease") with the owner of Parking Garage pursuant to which Company must lease between c and d parking spaces within Parking Garage (that is, up to e percent of the total number of parking spaces within Parking Garage). Under Parking Lease, Company uses its leased parking spaces to provide parking for Company employees and Company invitees. Parking Lease began on Date 1, and will expire on Date 4, with the opportunity for f extensions. Company pays a fixed, monthly rent under Parking Lease and is billed directly by Operator on behalf of Parking Garage's owner. The rent is adjusted for inflation (increased by f percent annually) and for any changes in the number of parking spaces leased by Company.

Pursuant to Parking Lease, Company, as lessee, must carry commercial general liability insurance covering claims of injury and property damage arising out of the use of the Parking Garage by Company's employees and invitees. Company, as lessee, indemnifies owner of Parking Garage for all loss, cost, damage, expense, and liability arising from any of Company's employees' or invitees' use of the garage. Additionally, Company has the right under Parking Lease to assign, sublease, or transfer all or part of its interest in Parking Lease to any space tenant or ground lessee of Company, or to any successor owner of Building 2, without the owner of Parking Garage's consent.

As of Date 3, Company leases c parking spaces in Parking Garage of which g are used by Company employees. Company's remaining leased spaces (h parking spaces) are used by Company's new employees, temporary employees, and invitees.

One Company employee, or a designee acting in his or her absence, ("Company Representative") deals directly with Operator under Parking Lease in connection with all parking space arrangements. Company Representative handles the distribution of all monthly parking passes to Company's employees. Company Representative holds the monthly parking passes associated with the remaining leased spaces (h spaces), and provides these passes (h passes) to Company's new employees, Company's temporary employees, and Company's invitees to use when parking in Parking Garage. This procedure allows Company quick and easy access to and control of all of the parking spaces it leases under Parking Lease for use by its employees and invitees.

If at any time Company wishes to increase the number of parking spaces it leases under Parking Lease (to any number of parking spaces greater than the minimum number of c parking spaces up to the maximum number of d parking spaces), Company Representative informs Operator, and Operator activates the requested number of monthly parking passes and provides the passes to Company Representative. Operator reflects the revised monthly rent (based on the new number of "activated" passes) in Company's rent invoice for the following month.

In almost all cases Company Representative provides Company's invitees with the monthly passes using the procedures described above. In the unlikely event that Company needs additional parking passes, Company Representative can purchase daily parking passes from Operator which Company Representative can provide directly to Company invitees. Operator includes the cost of these purchased passes in Company's monthly rent invoice for the following month.

In the rare instance where an invitee of Company neglects to obtain a parking pass from Company Representative, such invitee must pay for parking in Parking Garage and then may seek reimbursement from Company Representative.

No other Company employee or invitee of Company deals with Operator in connection with the use of space in Parking Garage; all parking matters and issues are handled between Company Representative and Operator.

Parking Services

Parking Garage has two unmanned entry/exit locations with electronic gates that open and close automatically for entry and exit into Parking Garage. During weekday business hours, one Operator employee ("Parking Manager") is present at Parking Garage, while at all other times, no Operator employee is onsite. Parking Manager spends most of his or her time in an office located near the main gate of the Parking Garage. A couple of times a day, Parking Manager walks through Parking Garage to ensure everything is in order and there are no safety concerns such as lighting issues, debris, and equipment safety and function issues. Parking Manager does not park or service any cars.

Tenants of Building 1 and Company's employees and invitees issued a parking pass by Company Representative, use their parking pass to activate the automatic gates to enter or leave Parking Garage. Customers and guests of tenants of Building 1 and, on the rare occasion when an invitee of Company neglects to obtain a parking pass from Company Representative, Company's invitees, must receive a ticket from the unmanned, electronic gates to enter Parking Garage and must pay or submit a validation at the unmanned, electronic gates to exit Parking Garage. Validations can be purchased by tenants of Building 1 from Operator for their customers and guests, and by Company Representative for Company's invitees, but validations cannot be purchased by a parker directly from Parking Manager.

If the electronic, unmanned equipment breaks, Parking Manager handles the situation either in person while at Parking Garage during business hours or from offsite during non-business hours. If a parking pass or validation does not work, the parker must pay to exit Parking Garage and seek reimbursement from the parker's employer or the tenant the parker was visiting. Parking Manager may not assist with non-working parking passes or validations other than to direct the parker to pay and seek reimbursement from the tenant responsible for paying.

Operator hires a third party contractor unrelated to Taxpayer to provide the following services: (1) quarterly cleaning of Parking Garage, (2) semiannual cleaning of the drain around Parking Garage, and (3) certain repairs and maintenance of Parking Garage, including one-time projects, updating and striping parking spots, and elevator repainting.

Storage Agreement

On Date 1, Company entered into a long-term agreement ("Storage Agreement") with the owner of Parking Garage pursuant to which Company leases storage space in Parking Garage ("Storage Space"). Storage Agreement commenced on Date 1 and will expire on Date 4. Company pays a fixed amount for Storage Space. The amount paid is increased for inflation by f percent annually.

When LLC 2 acquired Parking Garage on Date 2 subject to Easement Agreement, Parking Lease, Storage Agreement, and other obligations, it assumed the obligations of Parking Garage's owner under Parking Lease and Storage Agreement.

Proposed Transaction

Taxpayer proposes to have LLC 1 acquire Parking Garage from LLC 2, subject to Easement Agreement, Parking Lease, Storage Agreement, and other obligations. Taxpayer represents that LLC 1 will continue to have Parking Garage operated by Operator under Management Agreement, in the same manner as prior to the proposed transaction.

Taxpayer represents that after the proposed transaction, Taxpayer and REIT A will continue to collectively own all the interests in LLC 1, which will own Building 1 and Parking Garage. LLC 1 will also lease a portion of Parking Garage to Company under Parking Lease and Storage Agreement. After the proposed transaction, Company, owner of Building 2, will be a tenant of LLC 1 as a tenant of Parking Garage through both Parking Lease and Storage Agreement.

Taxpayer represents that Parking Garage is appropriate in size for the number of tenants, their guests, customers, and sub-tenants of Office Park. Additionally, Taxpayer represents that the portion of space in Parking Garage available to the tenants of Building 1 (not including the amount of space leased to Company under Parking Lease), is appropriate in size for the number of tenants of Building 1 and their guests, customers, and subtenants who are expected to use Parking Garage. Taxpayer further represents that Parking Garage is used and will continue to be used predominantly by Building 1's tenants and their guests, customers, and subtenants; and by Company, Company employees, and Company invitees under the terms of Parking Lease and Storage Agreement. Taxpayer represents that it does not expect members of the general public to use Parking Garage because all other buildings in the area are required under the City Municipal Code to have their own parking facilities.

Taxpayer represents that after the proposed transaction, Parking Garage will continue to be managed by Operator, an independent contractor as defined under section 856(d)(3), for arm's-length compensation. Taxpayer represents further that Taxpayer and LLC 1 will not derive or receive any income from Operator within the meaning of section 856(d)(7)(C)(i) and section 1.856-4(b)(5)(i). Taxpayer further represents (1) that all services furnished or rendered in Parking Garage under Parking Lease and Storage Agreement are customarily furnished or rendered in connection with the rental of space in parking garages in the geographic area in which Office Park is located, and (2) that all services furnished or rendered in Parking Garage to tenants of Building 1 are customarily furnished or rendered in connection with the rental of space in office buildings in the geographic area in which Office Park is located.

Taxpayer represents that after the proposed transaction, Taxpayer, acting through LLC 1, will engage independent contractors as defined in section 856(d)(3) under service agreements to perform building maintenance, repair, cleaning, lighting, and certain fiduciary functions. Taxpayer will not derive or receive any income from independent contractors with whom Taxpayer and LLC 1 enter into service agreements. Activities performed by these independent contractors include (i) daily cleaning of the garage; (ii) basic sweeping and removal of trash and debris; and (iii) infrequent small jobs, such as painting the curbs surrounding Parking Garage a bright color for safety purposes. Taxpayer further represents that the only functions that Taxpayer or LLC 1 will perform directly (rather than through independent contractors) are fiduciary functions permitted by section 1.856-4(b)(5)(ii), such as dealing with taxes and insurance. Taxpayer represents that no other activities will be performed directly by Taxpayer or LLC 1 in connection with Parking Garage. Accordingly, all services furnished or rendered and management or operation provided at Parking Garage (discussed above) will be furnished, rendered, or provided by Operator or another independent contractor, and Taxpayer will only perform certain fiduciary functions as permitted by section 1.856-4(b)(5)(ii).

LAW AND ANALYSIS

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, "rents from real property."

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, "rents from real property."

Section 856(d)(1) provides that "rents from real property" include (subject to exclusions provided in section 856(d)(2)): (A) rents from interests in real property; (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated; and (C) rent attributable to personal property leased under, or in connection with, a lease of real property, but only if the rent attributable to the personal property for the taxable year does not exceed 15 percent of the total rent for the tax year attributable to both the real and personal property leased under, or in connection with, such lease.

Section 1.856-3(g) provides that a REIT that is a partner in a partnership is deemed to own its proportionate share of each of the assets of the partnership, and to be entitled to the income of the partnership attributable to that share. For purposes of § 856, the interest of a partner in the partnership's assets shall be determined in accordance with the partner's capital interest in the partnership. The character of the various assets in the hands of the partnership, and items of gross income of the partnership, shall retain the same character in the hands of the partners for all purposes of § 856.

Section 1.856-4(b)(1) provides that, for purposes of sections 856(c)(2) and (c)(3), the term "rents from real property" includes charges for services customarily furnished or rendered in connection with the rental of real property, whether or not the charges are separately stated. Services rendered to tenants of a particular building will be considered customary if, in the geographic market in which the building is located, tenants in buildings of a similar class are customarily provided with the service. Parking facilities are listed as an example of services which are customarily furnished to the tenants of a particular class of buildings in many geographic marketing areas. In particular geographic areas where it is customary to furnish electricity or other utilities to tenants in buildings of a particular class, the submetering of those utilities to tenants in the buildings will be considered a customary service. To qualify as a service customarily furnished, the service must be furnished or rendered to the tenants of the REIT or, primarily for the convenience or benefit of the tenant, to the guests, customers, or subtenants of the tenant. The service must be furnished through an independent contractor from whom the REIT does not derive or receive any income.

Section 856(d)(2)(C) provides that any impermissible tenant service income is excluded from the definition of "rents from real property". Section 856(d)(7)(A) defines "impermissible tenant service income" to mean, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for services furnished or rendered by the REIT to tenants at the property, or for managing or operating the property.

Section 856(d)(7)(B) provides that if the amount of impermissible tenant service income exceeds one percent of all amounts received or accrued during the tax year directly or indirectly by the REIT with respect to the property, the impermissible tenant service income of the REIT will include all of the amounts received or accrued with respect to the property. Section 856(d)(7)(D) provides that the amounts treated as received by a REIT for any impermissible tenant service shall not be less than 150 percent of the direct cost of the REIT in furnishing or rendering the service.

Section 856(d)(7)(C) provides certain exclusions from impermissible tenant service income. Section 856(d)(7)(C)(i) provides that for purposes of section 856(d)(7)(A), services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT does not derive or receive any income or through a TRS of the REIT shall not be treated as furnished, rendered, or provided by the REIT.

Section 1.856-4(b)(5)(i) provides that no amount received or accrued, directly or indirectly, with respect to any real property qualifies as "rents from real property" if the REIT furnishes or renders services to the tenants of the property or manages or operates the property, other than through an independent contractor from whom the trust itself does not derive or receive any income.

Section 1.856-4(b)(5)(ii) provides that the trustees or directors of a REIT are not required to delegate or contract out their fiduciary duty to manage the REIT itself, as distinguished from rendering or furnishing services to the tenants of its property or managing or operating the property. Thus, the trustees or directors may do all those things necessary, in their fiduciary capacities, to manage and conduct the affairs of the REIT itself. For example, the trustees and directors may deal with taxes, interest, and insurance relating to the REIT's property.

Rev. Rul. 2004-24, 2004-1 C.B. 550, identifies circumstances in which a REIT's income from providing parking facilities at its rental real properties qualifies as rents from real property under section 856(d). In Situation 1, the REIT provides unattended parking lots for the use of the tenants of its buildings and their guests, customers, and subtenants. Each parking facility is located in or adjacent to a building occupied by tenants of the REIT and is appropriate in size for the number of tenants and their guests, customers, and subtenants who are expected to use the facility. The parking facilities do not have parking attendants. The REIT maintains, repairs, and lights the parking facilities as well as performs certain fiduciary functions, such as dealing with taxes and insurance, as permitted by section 1.856–4(b)(5)(ii). In Situation 2, the facts are the same as in Situation 1 except that at some of the REIT's parking facilities, parking spaces are reserved for use by particular tenants. The REIT assigns and marks the reserved spaces in connection with leasing space in the buildings to the tenants, and any recurring functions unique to the reserved spaces (such as enforcement) are provided by an independent contractor from whom the REIT does not derive or receive any income. In Situation 3, the facts are the same as in Situations 1 and 2 except that some of the parking facilities are available for use by the general public and have parking attendants. An independent contractor from whom the REIT does not derive or receive any income manages and operates the parking facilities under a management contract with the REIT whereby the independent contractor remits the parking fees from those using the parking facilities to the REIT and receives arm's-length compensation. The independent contractor employs all of the individuals who manage and operate the parking facilities, including the parking attendants and is directly responsible for providing all salary, wages, benefits, administration, and supervision of its employees. In addition to collecting parking fees from those using the parking facilities, the parking attendants may park cars, without charging a separate fee, and may provide minor, incidental, emergency service at a parking facility.

Rev. Rul. 2004-24 quotes from the conference report underlying the 1986 revision of section 856(d) ("the 1986 conference report").[1] The 1986 conference report provides guidance on services performed directly by REITs, as well as services performed through an independent contractor, and it provides, in part:

> The conferees intend, for example, that a REIT may provide customary services in connection with the operation of parking facilities for the convenience of tenants of an office or apartment building, or shopping center, provided that the parking facilities are made available on an unreserved basis without charge to the tenants and their guests or customers. On the other hand, the conferees intend that income derived from the rental of parking spaces on a reserved basis to tenants, or income derived from the rental of parking spaces to the general public, would not be considered to be rents from real property unless all services

[1] 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-220 (1986), 1986-3 (Vol. 4) C.B. 220.

> are performed by an independent contractor. Nevertheless, the conferees intend that the income from the rental of parking facilities properly would be considered rents from real property (and not merely income from services) in such circumstances if services are performed by an independent contractor.

Rev. Rul. 2004-24 holds that amounts received by the REIT for furnishing unattended parking facilities, under the circumstances described in Situations 1 and 2, and for furnishing attended parking facilities, under the circumstances described in Situation 3, qualify as rents from real property under section 856(d).

After the proposed transaction, LLC 1 will be Parking Garage's owner, and, under Management Agreement and certain other agreements, discussed above, all services furnished or rendered and management or operation provided relating to the operation of Parking Garage will be performed by Operator or another independent contractor hired by Taxpayer or LLC 1. Taxpayer has represented that Operator is an independent contractor as defined under section 856(d)(3), and that Operator will perform services for an arm's-length management fee. The only activities with relation to the Parking Garage that Taxpayer or LLC 1 will perform directly will be certain fiduciary functions that are permitted by section 1.856-4(b)(5)(ii) and, therefore, do not give rise to impermissible tenant service income under section 856(d)(7)(A). All other services, management, and operations of Parking Garage will be performed by Operator or another independent contractor from whom taxpayer does not derive or receive any income, and, therefore, do not give rise to impermissible tenant service income under section 856(d)(7)(C).

Operator will operate a parking facility within Parking Garage for Building 1's tenants, their employees, customers, and guests, as well as the general public. Taxpayer has represented that the portion of space in Parking Garage available to the tenants of Building 1 is appropriate in size for the number of tenants of Building 1 and their guests, customers, and subtenants who are expected to use Parking Garage. The parking facilities services provided in connection with Building 1 leases are similar to those provided in Situation 3 in Rev. Rul. 2004-24. In Situation 3 of Rev. Rul. 2004-24, an independent contractor, as defined in section 856(d)(3), manages and operates the parking facilities at REIT's rental real properties under a management contract with the REIT, and the REIT's income from providing parking facilities at its rental real properties qualifies as rents from real property under section 856(d).

In this case, Taxpayer has represented that all services furnished or rendered in Parking Garage to tenants of Building 1 are customarily furnished or rendered in connection with the rental of space in office buildings in the geographic area in which Office Park is located. Similar to Situation 3 in Rev. Rul. 2004-24, the services furnished or rendered, or management or operation provided by Operator or another independent contractor in connection with Building 1 tenant leases will not be considered furnished, rendered, or provided by Taxpayer or LLC 1, and Taxpayer's income from providing parking facilities to its Building 1 tenants will qualify as rents from real property.

In addition, Taxpayer, through LLC 1, will lease a portion of Parking Garage to Company, the owner and occupant of Building 2, through Parking Lease and Storage Agreement. Storage Agreement is a rental of storage space similar to the rental of space in a building. Parking Lease, while not for use of the entire Parking Garage, is for the use of a specified number of parking spaces within Parking Garage that are leased to Company under the terms of Parking Lease, and is consistent with the terms of the 1986 conference report: "[t]he conferees intend that the income from the rental of parking facilities properly would be considered rents from real property (and not merely income from services) [in the case of the rental of parking spaces on a reserved basis to tenants or the rental of parking spaces to the general public] if services are performed by an independent contractor." Provided that Parking Garage is an inherently permanent structure and, therefore, real property, Parking Lease and Storage Agreement are agreements for the rental of real property.

Taxpayer has also represented that all services furnished or rendered in Parking Garage under Parking Lease and Storage Agreement are customarily furnished or rendered in connection with the rental of space in parking garages in the geographic area in which Office Park is located. Storage Agreement represents the lease of a specified amount of storage space by Company, and the amount charged under Storage Agreement is based on the amount of space rented by Company. Parking Lease represents an obligation of LLC 1 to provide a specified number of parking spaces within Parking Garage for parking by Company's employees and invitees. The amount charged under Parking Lease is based on the number of parking spaces that Company rents within Parking Garage. Although parking spaces in Parking Garage are generally rented on an unreserved and nonexclusive basis (except for a small number of reserved spaces), this feature does not change the character of the income as rents from real property, because, under Parking Lease, Company maintains the use of a specified number of parking spaces at all times and the fact that the majority of spaces are not specifically assigned has no bearing on the passive nature of the income from renting the space. Accordingly, income derived under Parking Lease and Storage Agreement from the rental of a portion of Parking Garage to Company qualifies as "rents from real property" for purposes of section 856(d).

CONCLUSION

Based on the information submitted and the representations made, and provided that Parking Garage is an inherently permanent structure, we conclude that after the proposed transaction, under the circumstances described above:

(1) Taxpayer's allocable share of rents received from LLC 1 with respect to Building 1's tenants will not fail to qualify as "rents from real property" for purposes of

section 856(d) because of the parking services described above that such tenants may receive from the use of Parking Garage.

(2) Taxpayer's allocable share of income received from LLC 1 with respect to Parking Lease rents and Storage Agreement fees from Parking Garage will qualify as "rents from real property" for purposes of section 856(d).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed concerning whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code. Further, no opinion is expressed concerning whether Taxpayer's allocable share of income received from LLC1 with respect to Building 1's tenants otherwise qualifies as "rents from real property" for purposes of section 856(d) of the Code. Additionally, we express no opinion as to whether Operator qualifies as an independent contractor under section 856(d)(3) of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

____

Andrea M. Hoffenson
Branch Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc:

Internal Revenue Service

Number: **201649013**
Release Date: 12/2/2016

Index Number: 856.01-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B2
PLR-123011-16

Date:
August 24, 2016

Legend:

Taxpayer =

State =

Dear :

This is in reply to a letter dated July 20, 2016, in which Taxpayer requests rulings in connection with certain income attributable to its investment in foreign subsidiaries under section 856 of the Internal Revenue Code of 1986, as amended (the "Code").

Facts:

Taxpayer is a corporation organized under the laws of State that will elect to be taxed as a real estate investment trust ("REIT") beginning with its first taxable year. Taxpayer was organized for the purpose of making direct and indirect investments in commercial timberland businesses.

Taxpayer operates in foreign countries through one or more foreign corporate subsidiaries and associated intermediate holding companies (each, a "Foreign Sub"). Taxpayer has jointly elected with certain Foreign Subs that are qualified REIT subsidiaries under section 856(i) to treat each of those Foreign Subs as a taxable REIT subsidiary ("TRS") for federal income tax purposes under section 856(l) (each, a "Foreign TRS").

Taxpayer expects that each Foreign TRS will be either (i) a controlled foreign corporation (a “CFC”) within the meaning of section 957(a), with respect to which Taxpayer will be a United States shareholder within the meaning of section 951(b) (a “United States Shareholder”), (ii) a passive foreign investment company (a “PFIC”) within the meaning of section 1297(a), for which Taxpayer has made or intends to make an election under section 1295(a) to treat as a qualified electing fund (a “QEF”) for all taxable years during which the corporation was a PFIC that is included in the Taxpayer’s holding period of the PFIC stock (“a pedigreed QEF”), or (iii) a PFIC for which Taxpayer has not made a mark-to-market election and which is not a pedigreed QEF with respect to Taxpayer.

As a United States Shareholder with respect to the CFCs, Taxpayer is required under section 951(a)(1)(A) to include in gross income its pro rata share of each CFC’s subpart F income, as defined in section 952(a). Taxpayer expects that the subpart F income of each CFC will consist of items that are foreign personal holding company income (“FPHCI”) within the meaning of section 954(c). Taxpayer’s inclusions under section 951(a)(1)(A) that are attributable to each CFC deriving (i) interest; (ii) dividends; (iii) gains from the sale or other disposition of stock, securities, or real property that is not property described in section 1221(a)(1); and (iv) items that also would constitute “rents from real property” under section 856(d) if received by a REIT are referred to hereinafter as the “Subpart F Inclusions.”

As a shareholder in PFICs for which Taxpayer has made a QEF election, Taxpayer is required under section 1293(a) to include in gross income its pro rata share of the ordinary earnings and net capital gain of each QEF. Taxpayer expects to include amounts in income under section 1293(a) with respect to a PFIC for which it has made a QEF election. Taxpayer’s inclusions under section 1293(a) that are attributable to the QEF deriving (i) interest; (ii) dividends; (iii) gains from the sale or other disposition of stock, securities, or real property that is not property described in section 1221(a)(1); and (iv) items that also would constitute “rents from real property” under section 856(d) if received by a REIT are referred to hereinafter as the “QEF Inclusions.”

As a shareholder in a PFIC for which Taxpayer has not made a mark-to-market election and which is not a pedigreed QEF with respect to Taxpayer, Taxpayer is required under section 1291(a)(1) to include certain amounts in gross income under section 61. Taxpayer expects to include amounts in income under section 1291(a)(1) with respect to such PFICs (the “Non-QEF Inclusions” and, together with QEF Inclusions, the “PFIC Inclusions”). Taxpayer represents that the majority of the gross income that each of these PFICs will derive while owned by Taxpayer will be comprised of one or more of the following items: (i) interest; (ii) dividends; (iii) gains from the sale or other disposition of stock, securities, or real property that is not property described in section 1221(a)(1); and (iv) items that also would constitute “rents from real property” under section 856(d) if received by a REIT.

Taxpayer expects to recognize foreign currency gains with respect to distributions of previously taxed earnings and profits ("PTI") as described in section 986(c)(1) attributable to the Subpart F Inclusions and QEF Inclusions (the "Section 986(c) Gains").

Taxpayer requests the following rulings:

1) The Subpart F Inclusions and the PFIC Inclusions will be treated as qualifying income under section 856(c)(2).

2) The Section 986(c) Gains will not be taken into account for purposes of section 856(c)(2).

Law and Analysis:

Ruling #1: Whether the Subpart F Inclusions and PFIC Inclusions will be treated as qualifying income under section 856(c)(2).

Section 856(c)(2) provides that, in order for a corporation to qualify as a REIT, at least 95 percent of the corporation's gross income must be derived from certain enumerated sources, which include dividends, interest, rents from real property, gain from the sale or other disposition of stock, securities, and real property (other than section 1221(a)(1) property), abatements and refunds of taxes on real property, income and gain derived from foreclosure property, and certain commitment fees.

Section 856(c)(5)(J) provides that to the extent necessary to carry out the purposes of part II of subchapter M of the Code, the Secretary is authorized to determine, solely for purposes of such part, (i) whether any item of income or gain that does not otherwise qualify under sections 856(c)(2) or (3) may be considered as not constituting gross income for purposes of sections 856(c)(2) or (3), or (ii) whether any item of income or gain that otherwise constitutes gross income not qualifying under sections 856(c)(2) or (3) may be considered as gross income which qualifies under sections 856(c)(2) or (3).

The legislative history underlying the tax treatment of REITs indicates that a central concern behind the gross income restrictions is that a REIT's gross income should largely be composed of passive income. For example, H.R. Rep. No. 2020, 86th Cong., 2d Sess. 4 (1960) at 6, 1960-2 C.B. 819, at 822-23 states, "[o]ne of the principal purposes of your committee in imposing restrictions on types of income of a qualifying [REIT] is to be sure the bulk of its income is from passive income sources and not from the active conduct of a trade or business."

Subpart F Inclusions

Section 957 defines a CFC as a foreign corporation in which more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or the total value of the stock, is owned by United States Shareholders on any day during the corporation's taxable year. A United States Shareholder is defined in section 951(b) as a United States person who owns 10 percent or more of the total voting power of the foreign corporation.

Section 951(a)(1)(A)(i) generally provides that if a foreign corporation is a CFC for an uninterrupted period of 30 days or more during a taxable year, every person who is a United States Shareholder of the corporation and who owns stock in the corporation on the last day of the taxable year in which the corporation is a CFC shall include in income the shareholder's pro rata share of the CFC's subpart F income for the taxable year.

Under section 952, subpart F income includes foreign base company income. Under section 954(a)(1), foreign base company income includes FPHCI, which is defined under section 954(c)(1) to mean certain enumerated types of income. Subject to certain exceptions, FPHCI includes (i) dividends, interest, royalties, rents, and annuities under section 954(c)(1)(A); and (ii) the excess of gains over losses from the sale or exchange of certain property under section 954(c)(1)(B).

Taxpayer's Subpart F Inclusions will be attributable to subpart F income of CFCs that consists of: (i) interest; (ii) dividends; (iii) gains from the sale or other disposition of stock, securities, or real property that is not property described in section 1221(a)(1); and (iv) items that also would constitute "rents from real property" under section 856(d) if received by a REIT. Therefore, treatment of the Subpart F Inclusions attributable to such income as qualifying income for purposes of section 856(c)(2) does not interfere with or impede the policy objectives of Congress in enacting the income test under section 856(c)(2).

PFIC Inclusions

Section 1297(a) provides that a foreign corporation is a PFIC if either (1) 75 percent or more of the gross income of such corporation for the taxable year is passive income, or (2) the average percentage of assets (as determined in accordance with section 1297(e)) held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent. Section 1297(b) defines the term "passive income" as income of a kind that would be FPHCI under section 954(c), subject to certain exceptions.

Section 1295(a) provides that a PFIC will be treated as a QEF with respect to a shareholder if (1) an election by the shareholder under section 1295(b) applies to such

PFIC for the taxable year; and (2) the PFIC complies with such requirements as the Secretary may prescribe for purposes of determining the ordinary earnings and net capital gains of such company and otherwise carrying out the purposes of the PFIC provisions. Section 1293(a) provides that every United States person who owns (or is treated under section 1298(a) as owning) stock of a QEF at any time during the taxable year of such fund shall include in gross income (A) as ordinary income, such shareholder's pro rata share of the ordinary earnings of such fund for such year, and (B) as long-term capital gain, such shareholder's pro rata share of the net capital gain of such fund for such year.

Section 1291(a)(1) provides that if a United States person receives an excess distribution (as defined in section 1291(b)) in respect of stock in a PFIC that is a section 1291 fund (as defined in §1.1291-1T(b)(2)(v)), then (A) the amount of the excess distribution shall be allocated ratably to each day in the shareholder's holding period for the stock, (B) with respect to such excess distribution, the shareholder's gross income for the current year shall include (as ordinary income) only the amounts allocated under section 1291(a)(1)(A) to (i) the current year, or (ii) any period in the shareholder's holding period before the 1st day of the 1st taxable year of the company which begins after December 31, 1986, and for which it was a PFIC, and (C) the tax imposed by chapter 1 of the Code for the current year shall be increased by the deferred tax amount (determined under section 1291(c)). Under section 1291(a)(2), the rules of section 1291(a)(1) apply to any gain recognized on the disposition of stock of a section 1291 fund as if the gain were an excess distribution.

Taxpayer's QEF Inclusions will be attributable to income of PFICs (with respect to which a QEF election has been made) that consists of: (i) interest; (ii) dividends; (iii) gains from the sale or other disposition of stock, securities, or real property that is not property described in section 1221(a)(1); and (iv) items that also would constitute "rents from real property" under section 856(d) if received by a REIT. Taxpayer's Non-QEF Inclusions are derived with respect to PFICs that will generate the same types of passive income. Therefore, treatment of the PFIC Inclusions as qualifying income for purposes of section 856(c)(2) does not interfere with or impede the policy objectives of Congress in enacting the income test under section 856(c)(2).

Ruling #2: Whether the Section 986(c) Gains will be taken into account for purposes of section 856(c)(2).

In general, sections 959(d) and 1293(c) provide that when a taxpayer includes in income a Subpart F Inclusion or QEF Inclusion, the subsequent distribution to the shareholder of the PTI attributable to the inclusion is not treated as a dividend for purposes of chapter 1 of the Code.

Section 986(c)(1) provides that foreign currency gain or loss with respect to distributions of PTI (as described in section 959 or section 1293(c)) attributable to movements in exchange rates between the times of the deemed and actual distribution shall be recognized and treated as ordinary income or loss from the same source as the associated income inclusion.

Section 856(n)(1)(A) provides that “passive foreign exchange gain” for any taxable year shall not constitute gross income for purposes of section 856(c)(2).

Section 856(n)(3) defines passive foreign exchange gain as: (A) real estate foreign exchange gain (as defined in section 856(n)(2)); (B) foreign currency gains (as defined in section 988(b)(1)) which is not real estate foreign exchange gain and is attributable to (i) any item of income or gain described in section 856(c)(2), (ii) the acquisition or ownership of obligations (other than foreign currency gains attributable to any item of income or gain described in clause (i)), or (iii) becoming or being the obligor under obligations (other than foreign currency gain attributable to any item of income or gain described in clause (i)); and (C) any other foreign currency gains determined by the Secretary.

While the Section 986(c) Gains are not foreign currency gains defined in section 988(b)(1), such Section 986(c) Gains are attributable to the Subpart F Inclusions and QEF Inclusions, items of income that are qualifying income for purposes of section 856(c)(2). This Section 986(c) Gain is substantially similar to passive foreign exchange gain described in section 856(n)(3)(B)(i). Therefore, pursuant to section 856(n)(3)(C), the Section 986(c) Gains are excluded from gross income for purposes of section 856(c)(2) because these foreign currency gains are considered passive foreign exchange gain that is excluded from gross income for purposes of section 856(c)(2).

Conclusion:

Based on the facts and representations set forth above, we rule that (i) under section 856(c)(5)(J)(ii), the Subpart F Inclusions are considered gross income that qualifies for purposes of section 856(c)(2), (ii) under section 856(c)(5)(J)(ii), the PFIC Inclusions are considered gross income that qualifies for purposes of section 856(c)(2), and (iii) under section 856(n)(3)(C), the Section 986(c) Gains are excluded from gross income for purposes of section 856(c)(2).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed concerning whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Andrea M. Hoffenson
Branch Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions and Products)

OFFICE OF MANAGEMENT AND BUDGET

Memorandum for the Heads of Executive Departments and Agencies; Regulatory Freeze Pending Review

January 20, 2017.

FROM: Reince Priebus, Assistant to the President and Chief of Staff.

SUBJECT: Regulatory Freeze Pending Review.

The President has asked me to communicate to each of you his plan for managing the Federal regulatory process at the outset of his Administration. In order to ensure that the President's appointees or designees have the opportunity to review any new or pending regulations, I ask on behalf of the President that you immediately take the following steps:

1. Subject to any exceptions the Director or Acting Director of the Office of Management and Budget (the "OMB Director") allows for emergency situations or other urgent circumstances relating to health, safety, financial, or national security matters, or otherwise, send no regulation to the Office of the Federal Register (the "OFR") until a department or agency head appointed or designated by the President after noon on January 20, 2017, reviews and approves the regulation. The department or agency head may delegate this power of review and approval to any other person so appointed or designated by the President, consistent with applicable law.

2. With respect to regulations that have been sent to the OFR but not published in the **Federal Register**, immediately withdraw them from the OFR for review and approval as described in paragraph 1, subject to the exceptions described in paragraph 1. This withdrawal must be conducted consistent with OFR procedures.

3. With respect to regulations that have been published in the OFR but have not taken effect, as permitted by applicable law, temporarily postpone their effective date for 60 days from the date of this memorandum, subject to the exceptions described in paragraph 1, for the purpose of reviewing questions of fact, law, and policy they raise. Where appropriate and as permitted by applicable law, you should consider proposing for notice and comment a rule to delay the effective date for regulations beyond that 60-day period. In cases where the effective date has been delayed in order to review questions of fact, law, or policy, you should consider potentially proposing further notice-and-comment rulemaking. Following the delay in effective date:

(a) For those regulations that raise no substantial questions of law or policy, no further action needs to be taken; and

(b) for those regulations that raise substantial questions of law or policy, agencies should notify the OMB Director and take further appropriate action in consultation with the OMB Director.

4. Exclude from the actions requested in paragraphs 1 through 3 any regulations subject to statutory or judicial deadlines and identify such exclusions to the OMB Director as soon as possible.

5. Notify the OMB Director promptly of any regulations that, in your view, should be excluded from the directives in paragraphs 1 through 3 because those regulations affect critical health, safety, financial, or national security matters, or for some other reason. The OMB Director will review any such notifications and determine whether such exclusion is appropriate under the circumstances.

6. Continue in all circumstances to comply with any applicable Executive Orders concerning regulatory management.

As used in this memorandum, "regulation" has the meaning given to "regulatory action" in section 3(e) of Executive Order 12866, and also includes any "guidance document" as defined in section 3(g) thereof as it existed when Executive Order 13422 was in effect. That is, the requirements of this memorandum apply to "any substantive action by an agency (normally published in the **Federal Register**) that promulgates or is expected to lead to the promulgation of a final rule or regulation, including notices of inquiry, advance notices of proposed rulemaking, and notices of proposed rulemaking," and also covers any agency statement of general applicability and future effect "that sets forth a policy on a statutory, regulatory, or technical issue or an interpretation of a statutory or regulatory issue."

This regulatory review will be implemented by the OMB Director. Communications regarding any matters pertaining to this review should be addressed to the OMB Director.

The OMB Director is authorized and directed to publish this memorandum in the **Federal Register**.

[FR Doc. 2017–01766 Filed 1–23–17; 2:00 pm]

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March 22 – 24, 2017

Partnership Audit Update

Presenter

- Don Susswein, National Leader, Partnership Consulting Group, RSM US LLP

Don Susswein leads RSM's Washington National Tax group in the areas of partnerships and financial instruments. Don has decades of experience as a private practitioner and has also served as a tax advisor to the U.S. government. Don is an active member of the Tax Policy Advisory Committee of the Real Estate Roundtable, and played a leading role in their efforts to improve recent tax legislation and legislative proposals affecting real estate and other structured investments.

Don can be reached at don.susswein@rsmus.com or at 202-370-8216.

Potential Sources of Guidance

- Statutory provisions as enacted in 2015
- Joint Committee Bluebook (post-enactment)
- Proposed 2016 Technical Corrections (likely to be enacted)
- Proposed IRS Regulations

Major Technical Corrections

- Push-out is available throughout the tiers of a multi-tiered arrangement, and partner overpayments are also taken into account.
- Partnership may also avoid entity-level tax to the extent its partners pay amounts due on “limited scope” amended returns.
- Scope of unified audit is much broader, including any “partnership-related item.”
- “Netting” rule for entity-level tax is overridden to take into account theoretical partner-level limitations (e.g., 212 deductions vs. 162 deductions).

Planning Advice?

- Assume that 2016 Technical Corrections will be enacted
  - Supersedes 2015 statute and JCT Bluebook explanation
  - Confirms “push-out” through the tiers will be allowed, avoiding any risk of entity-level tax
  - Even if push-out is *not* elected, entity-level tax computations are affected by all theoretical/potential partner-level issues
- Most of the Proposed Regulations will mainly affect ministerial or mechanical issues arising in the audit, and are not of *urgent* importance

To amend or not to amend?

- The basic structure of the new rules is now apparent, and little will change by regulations, assuming the technical corrections bill is enacted.
- New, unitary resolution of all partnership issues will raise potential conflicts of interest and other business issues. Much more important than mechanical changes – like changing TMP to “Partnership Representative.”
- Although audits may not occur until 2019 or 2020, the business issues will arise as early as January 2018, as uncertain tax issues arise in real time.

Now or later?

- Some conflicts may be easier to resolve now, in the abstract, than later, when real dollars are at stake.
- At a minimum, disclosure of risks may be prudent, together with requirement that partnership keep partners informed of audit-related developments.
- Also, various parties may need reassurance or indemnification now, before making new investments or taking on managerial tasks.

Selected Business Issues (i)

- Should partnership documents *require* a push-out election?
  - This will ensure that “current” partners do not bear the costs of underpayments of “former” partners.
  - Or should some, possibly small or immaterial items be addressed at the entity level?
  - Should “reserves” be considered in some cases?
- Will partnership representative be authorized to make any compromises or concessions? Or will consent of all affected partners be required? What kind of indemnifications will be needed? Who will control, and bear the administrative costs of, a unified, partnership-level controversy?

Selected Business Issues (ii)

- Would restructuring make sense to avoid application of the new rules?
  - Note that REITs are permissible investors in “exempt” partnerships with 100 or fewer partners.
  - REITs are also permissible assets for “exempt” partnerships with 100 or fewer partners.
- With tiered partnerships, will it be necessary to ensure prompt information flow, so that push-out can be timely and effective through the tiers?

For more information

- Don Susswein, National Leader, Partnership Consulting Group, RSM US LLP

Don Susswein leads RSM's Washington National Tax group in the areas of partnerships and financial instruments. Don has decades of experience as a private practitioner and has also served as a tax advisor to the U.S. government. Don is an active member of the Tax Policy Advisory Committee of the Real Estate Roundtable, and played a leading role in their efforts to improve recent tax legislation and legislative proposals affecting real estate and other structured investments.

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