

115TH CONGRESS }
1st Session

HOUSE OF REPRESENTATIVES {

REPORT
115—

TAX CUTS AND JOBS ACT

_____, 2017.—Ordered to be printed

Mr. Brady of Texas, from the committee of conference,
submitted the following

CONFERENCE REPORT

[To accompany H.R. 1]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 1), to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment, insert the following:

Senate Amendment

The Senate amendment follows the House bill, except with the following modifications. The application of the Senate amendment is treated as a change in the taxpayer's method of accounting for purposes of section 481, initiated by the taxpayer, and made with the consent of the Secretary. The Senate amendment is applied on a cutoff basis to research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2025 (hence there is no adjustment under section 481(a) for research or experimental expenditures paid or incurred in taxable years beginning before January 1, 2026). In addition, the Senate amendment makes conforming changes to sections 41 and 280C.

Effective date.—The provision applies to amounts paid or incurred in taxable years beginning after December 31, 2025.

Conference Agreement

The conference agreement follows the Senate amendment.

Effective date.—The provision applies to amounts paid or incurred in taxable years beginning after December 31, 2021.

17. Certain special rules for taxable year of inclusion (sec. 13221 of the Senate amendment and sec. 451 of the Code)

Present Law

In general

Under section 61(a), gross income generally includes all income from whatever source derived, except as otherwise provided in Subtitle A of the Code. Thus, gross income generally includes income realized in any form, whether in money, property, or services, except to the extent provided in other sections of the Code.⁸⁵² Once it is determined that an item of gross income is clearly realized for Federal income tax purposes, section 451 and the regulations thereunder provide the general rules as to the timing of when such item is to be included in gross income.⁸⁵³

A taxpayer generally is required to include an item in gross income no later than the time of its actual or constructive receipt, unless the item properly is accounted for in a different period under the taxpayer's method of accounting.⁸⁵⁴ If a taxpayer has an unrestricted right to demand

⁸⁵² Treas. Reg. sec. 1.61-1.

⁸⁵³ Treas. Reg. sec. 1.61-1(b)(3).

⁸⁵⁴ Sec. 451(a).

the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment.⁸⁵⁵

In general, for a cash basis taxpayer, an amount is included in gross income when actually or constructively received. For an accrual basis taxpayer, an amount is included in gross income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy (*i.e.*, when the “all events test” is met), unless an exception permits deferral or exclusion, or a special method of accounting applies.⁸⁵⁶

A number of exceptions that exist to permit deferral of gross income relate to advance payments. An advance payment is when a taxpayer receives payment before the taxpayer provides goods or services to its customer. The exceptions often allow tax deferral to mirror financial accounting deferral (*e.g.*, income is recognized as the goods are provided or the services are performed).⁸⁵⁷

Interest income

A taxpayer generally must include in gross income the amount of interest received or accrued within the taxable year on indebtedness held by the taxpayer.⁸⁵⁸

Original issue discount

The holder of a debt instrument with original issue discount (“OID”) generally accrues and includes the OID in gross income as interest over the term of the instrument, regardless of when the stated interest (if any) is paid.⁸⁵⁹

The amount of OID with respect to a debt instrument is the excess of the stated redemption price at maturity over the issue price of the debt instrument.⁸⁶⁰ The stated redemption price at maturity is the sum of all payments provided by the debt instrument other than qualified stated interest payments.⁸⁶¹ The holder includes in gross income an amount equal to the sum of the daily portions of the OID for each day during the taxable year the holder held

⁸⁵⁵ See Treas. Reg. sec. 1.451-2.

⁸⁵⁶ See Treas. Reg. secs. 1.446-1(c)(1)(ii) and 1.451-1(a).

⁸⁵⁷ For examples of provisions permitting deferral of advance payments, see Treas. Reg. sec. 1.451-5 and Rev. Proc. 2004-34, 2004-1 C.B. 991, as modified and clarified by Rev. Proc. 2011-18, 2011-5 I.R.B. 443, and Rev. Proc. 2013-29, 2013-33 I.R.B. 141.

⁸⁵⁸ Secs. 61(a)(4) and 451.

⁸⁵⁹ Sec. 1272.

⁸⁶⁰ Sec. 1273(a)(1).

⁸⁶¹ Sec. 1273(a)(2) and Treas. Reg. sec. 1.1273-1(b).

such debt instrument. The daily portion is determined by allocating to each day in any accrual period its ratable portion of the increase during such accrual period in the adjusted issue price of the debt instrument.⁸⁶² The adjustment to the issue price is determined by multiplying the adjusted issue price (*i.e.*, the issue price increased by adjustments prior to the accrual period) by the instrument's yield to maturity, and then subtracting the interest payable during the accrual period. Thus, to compute the amount of OID and the portion of OID allocable to a period, the stated redemption price at maturity and the term must be known. Issuers of OID instruments accrue and deduct the amount of OID as interest expense in the same manner as the holder.⁸⁶³

Debt instruments subject to acceleration

Special rules for determining the amount of OID allocated to a period apply to certain instruments that may be subject to prepayment. If a borrower can reduce the yield on a debt by exercising a prepayment option, the OID rules assume that the borrower will prepay the debt.⁸⁶⁴ In addition, in the case of (1) any regular interest in a real estate mortgage investment conduit ("REMIC") or qualified mortgages held by a REMIC or (2) any other debt instrument if payments under the instrument may be accelerated by reason of prepayments of other obligations securing the instrument, the daily portions of the OID on such debt instruments are determined by taking into account an assumption regarding the prepayment of principal for such instruments.⁸⁶⁵

The Taxpayer Relief Act of 1997⁸⁶⁶ extended these rules to any pool of debt instruments the payments on which may be accelerated by reason of prepayments.⁸⁶⁷ Thus, if a taxpayer holds a pool of credit card receivables that require interest to be paid only if the borrowers do not pay their accounts by a specified date ("grace-period interest"), the taxpayer is required to accrue interest or OID on such pool based upon a reasonable assumption regarding the timing of the payments of the accounts in the pool. Under these rules, certain amounts (other than grace-period interest) related to credit card transactions, such as late-payment fees,⁸⁶⁸ cash-advance

⁸⁶² Sec. 1272(a)(1) and (3).

⁸⁶³ Sec. 163(e).

⁸⁶⁴ Treas. Reg. sec. 1.1272-1(c)(5).

⁸⁶⁵ Sec. 1272(a)(6).

⁸⁶⁶ Pub. L. No. 105-34, sec. 1004(a).

⁸⁶⁷ Sec. 1272(a)(6)(C)(iii).

⁸⁶⁸ Rev. Proc. 2004-33, 2004-1 C.B. 989.

fees,⁸⁶⁹ and interchange fees,⁸⁷⁰ have been determined to create OID or increase the amount of OID on the pool of credit card receivables to which the amounts relate.⁸⁷¹

House Bill

No provision.

Senate Amendment

The provision revises the rules associated with the timing of the recognition of income.⁸⁷² Specifically, the provision requires an accrual method taxpayer subject to the all events test for an item of gross income to recognize such income no later than the taxable year in which such income is taken into account as revenue in an applicable financial statement⁸⁷³ or another financial statement under rules specified by the Secretary, but provides an exception for

⁸⁶⁹ Rev. Proc. 2005-47, 2005-2 C.B. 269.

⁸⁷⁰ *Capital One Financial Corp. and Subsidiaries v. Commissioner*, 133 T.C. No. 8 (2009); IRS Chief Counsel Notice CC-2010-018, September 27, 2010.

⁸⁷¹ See also Rev. Proc. 2013-26, 2013-22 I.R.B. 1160, for a safe harbor method of accounting for OID on a pool of credit card receivables for purposes of section 1272(a)(6).

⁸⁷² The provision does not revise the rules associated with when an item is realized for Federal income tax purposes and, accordingly, does not require the recognition of income in situations where the Federal income tax realization event has not yet occurred. For example, the provision does not require the recharacterization of a transaction from sale to lease, or vice versa, to conform to how the transaction is reported in the taxpayer's applicable financial statement. Similarly, the provision does not require the recognition of gain or loss from securities that are marked to market for financial reporting purposes if the gain or loss from such investments is not realized for Federal income tax purposes until such time that the taxpayer sells or otherwise disposes of the investment. As a further example, income from investments in corporations or partnerships that are accounted for under the equity method for financial reporting purposes will not result in the recognition of income for Federal income tax purposes until such time that the Federal income tax realization event has occurred (e.g., when the taxpayer receives a dividend from the corporation in which it owns less than a controlling interest or when the taxpayer receives its allocable share of income, deductions, gains, and losses on its Schedule K-1 from the partnership).

⁸⁷³ For purposes of the provision, the term "applicable financial statement" means: (A) a financial statement which is certified as being prepared in accordance with generally accepted accounting principles and which is (i) a 10-K (or successor form), or annual statement to shareholders, required to be filed by the taxpayer with the United States Securities and Exchange Commission ("SEC"), (ii) an audited financial statement of the taxpayer which is used for (I) credit purposes, (II) reporting to shareholders, partners, or other proprietors, or to beneficiaries, or (III) any other substantial nontax purpose, but only if there is no statement of the taxpayer described in clause (i), or (iii) filed by the taxpayer with any other Federal agency for purposes other than Federal tax purposes, but only if there is no statement of the taxpayer described in clause (i) or (ii); (B) a financial statement which is made on the basis of international financial reporting standards and is filed by the taxpayer with an agency of a foreign government which is equivalent to the SEC and which has reporting standards not less stringent than the standards required by such Commission, but only if there is no statement of the taxpayer described in subparagraph (A); or (C) a financial statement filed by the taxpayer with any other regulatory or governmental body specified by the Secretary, but only if there is no statement of the taxpayer described in subparagraph (A) or (B). If the financial results of a taxpayer are reported on the applicable financial statement for a group of entities, such statement is treated as the applicable financial statement of the taxpayer.

taxpayers without an applicable or other specified financial statement.⁸⁷⁴ In the case of a contract which contains multiple performance obligations, the provision allows the taxpayer to allocate the transaction price in accordance with the allocation made in the taxpayer's applicable financial statement.

In addition, the provision directs accrual method taxpayers with an applicable financial statement to apply the income recognition rules under section 451 before applying the special rules under part V of subchapter P, which, in addition to the OID rules, also includes rules regarding the treatment of market discount on bonds, discounts on short-term obligations, OID on tax-exempt bonds, and stripped bonds and stripped coupons.⁸⁷⁵ Thus, for example, to the extent amounts are included in revenue for financial statement purposes when received (*e.g.*, late-payment fees, cash-advance fees, or interchange fees), such amounts generally are includable in income at such time in accordance with the general recognition principles under section 451. The provision provides an exception for any item of gross income in connection with a mortgage servicing contract. Thus, under the provision, income from mortgage servicing rights will continue to be recognized in accordance with the present law rules for such items of gross income (*i.e.*, "normal" mortgage servicing rights will be included in income upon the earlier of earned or received under the all events test of section 451 (*i.e.*, not averaged over the life of the mortgage),⁸⁷⁶ and "excess" mortgage servicing rights will be treated as stripped coupons under section 1286 and therefore subject to the original issue discount rules⁸⁷⁷).

The provision also codifies the current deferral method of accounting for advance payments for goods, services, and other specified items provided by the IRS under Revenue

⁸⁷⁴ The Committee intends that the provision apply to items of gross income for which the timing of income inclusion is determined using the all events test under present law. Under the provision, an accrual method taxpayer with an applicable financial statement will include an item in income under section 451 upon the earlier of when the all events test is met or when the taxpayer includes such item in revenue in an applicable financial statement. For example, under the provision, any unbilled receivables for partially performed services must be recognized to the extent the amounts are taken into income for financial statement purposes. However, accrual method taxpayers without an applicable or other specified financial statement will continue to determine income inclusion under the all events test, unless an exception permits deferral or exclusion. See sec. 451(a) and Treas. Reg. sec. 1.451-1(a). The Committee intends that the financial statement conformity requirement added to section 451 not be construed as preventing the use of special methods of accounting provided elsewhere in the Code, other than part V of subchapter P (special rules for bonds and other debt instruments) excluding items of gross income in connection with a mortgage servicing contract. For example, it does not preclude the use of the installment method under section 453 or the use of long-term contract methods under section 460. See Treas. Reg. sec. 1.446-1(c)(1)(iii).

⁸⁷⁵ Secs. 1271 – 1288.

⁸⁷⁶ See Rev. Rul. 70-142, 1970-2 C.B. 115.

⁸⁷⁷ See Rev. Rul. 91-46, 1991-2, C.B. 358, and Rev. Proc. 91-50, 1991-2 C.B. 778.

Procedure 2004-34.⁸⁷⁸ That is, the provision allows accrual method taxpayers to elect⁸⁷⁹ to defer the inclusion of income associated with certain advance payments to the end of the tax year following the tax year of receipt if such income also is deferred for financial statement purposes.⁸⁸⁰ In the case of advance payments received for a combination of services, goods, or other specified items, the provision allows the taxpayer to allocate the transaction price in accordance with the allocation made in the taxpayer's applicable financial statement. The provision requires the inclusion in gross income of a deferred advance payment if the taxpayer ceases to exist.

The application of these rules is a change in the taxpayer's method of accounting for purposes of section 481. In the case of any taxpayer required by this provision to change its method of accounting for its first taxable year beginning after December 31, 2017, such change is treated as initiated by the taxpayer and made with the consent of the Secretary. In the case of income from a debt instrument having OID, the related section 481(a) adjustment is taken into account over six taxable years.

Effective date.—The provision generally applies to taxable years beginning after December 31, 2017. In the case of income from a debt instrument having OID, the provision applies to taxable years beginning after December 31, 2018.

Conference Agreement

The conference agreement follows the Senate amendment.

18. Denial of deduction for certain fines, penalties, and other amounts (sec. 13306 of the Senate amendment and sec. 162(f) and new sec. 6050X of the Code)

Present Law

The Code denies a deduction for fines or penalties paid to a government for the violation of any law.⁸⁸¹

House Bill

No provision.

⁸⁷⁸ 2004-1 C.B. 991, as modified and clarified by Rev. Proc. 2011-18, 2011-5 I.R.B. 443, and Rev. Proc. 2013-29, 2013-33 I.R.B. 141.

⁸⁷⁹ The election shall be made at such time, in such form and manner, and with respect to such categories of advance payments as the Secretary may provide. For these purposes, the recognition of income under such election is treated as a method of accounting.

⁸⁸⁰ Thus, the provision is intended to override any deferral method provided by Treasury Regulation section 1.451-5 for advance payments received for goods.

⁸⁸¹ Sec. 162(f).