Client Update
The Senate Tax Reform Proposal

On November 9, 2017, the Senate Finance Committee released a detailed summary of its tax reform proposal (the "**Senate Bill**"). This follows the release a week earlier by the House Committee on Ways and Means of the legislative language of its proposal (the "**House Bill**"), described in our prior client update. Like the House Bill, the Senate Bill upends many fundamental and long-standing principles of the U.S. income tax system (*e.g.*, **by eliminating most itemized deductions, limiting the deductibility of business interest expense, introducing broad base erosion avoidance measures and changing the taxation of foreign earnings**).

Although there are many conceptual similarities between the Senate Bill and the House Bill, there are also significant differences. The Senate Bill includes a number of provisions (such as changes to deferred compensation) that were originally included in the House Bill, but later dropped or meaningfully revised in amendments.

Our summary below highlights the important aspects of the Senate Bill and notes the key differences between the two bills.

A complex legislative process is ahead. In particular, it remains to be seen how the Senate will comply with its long-standing practice of requiring bills enacted through budget reconciliation not to have a negative revenue effect beyond ten years. Prior legislation, for example, has provided for tax cuts to terminate at the ten year mark, which the Senate Bill does not provide. It is possible that the Republican majority may seek to overturn established practice to enact the Senate Bill with a simple majority notwithstanding its adverse revenue effect beyond year ten. Also, a few Senators have already proposed amendments to the Senate Bill. The unclear path forward for a final bill will add uncertainty to the deal-making environment.

Unless otherwise indicated, all changes are effective for tax years beginning after December 31, 2017.

INDIVIDUALS

Tax Brackets

- *Senate:* Seven individual income tax brackets will be retained, but rates will be lowered through modifications to income levels and tax rates. The top individual rate will be reduced to 38.5% and will apply to taxable income over $1 million for joint filers ($500,000 for any other individual).
- *House:* The seven current individual income tax brackets will be replaced with four brackets, with rates set at 12%, 25%, 35% and with the top individual rate remaining at 39.6%. Consistent with the Senate Bill, the top rate will apply to taxable income over $1 million for joint filers ($500,000 for any other individual).

Alternative Minimum Tax

- *Senate:* The **individual alternative minimum tax** will be repealed.
- *House:* Consistent with the Senate Bill.

Capital Gains

- *Senate:* There will be no changes to current rates for **capital gains, dividends and interest income**.
- *House:* Consistent with the Senate Bill.

Carried Interest

- *Senate:* The beneficial treatment of **carried interest** will be retained, which allows long-term capital gains to flow through to fund principals.
- *House:* The carried interest benefit will be retained only for investments that meet a three-year holding period requirement.

Itemized Deductions

- *Senate:* Most itemized deductions will be eliminated. The **standard deduction** will almost double, and personal exemptions will be repealed. Charitable donations will remain deductible.
- *House:* Consistent with the Senate Bill.

State and Local Tax Deduction

- *Senate:* The deduction for all **state and local taxes** (other than non-income taxes incurred in a trade or business) will be repealed.

  Comment: The elimination of the deduction for all state and local taxes will disproportionately affect taxpayers living in jurisdictions with high state and local tax rates (*e.g.*, New York, New Jersey, Connecticut and California).

- *House:* The only **state and local taxes** (other than non-income taxes incurred in a trade or business) that will be deductible are property taxes. The deduction for property taxes will be capped at $10,000.

Mortgage Interest Deduction

- *Senate:* There will be no changes to the **mortgage interest** deduction. The deduction for home equity indebtedness will be repealed.
- *House:* The limit on loan size for the **mortgage interest deduction** will be lowered from $1 million to $500,000 for houses financed after November 2, 2017. Consistent with the Senate Bill, the deduction for home equity indebtedness will be repealed.

Estate and Gift Tax

- *Senate:* The **estate and gift tax** exemption amount will be doubled to $10 million. The basis step-up upon death will remain.
- *House:* In addition to the change made in the Senate Bill, the estate tax will be **eliminated** after 2023. The top rate for **gift tax** will be reduced from 40% to 35% for gifts made after 2023.

BUSINESSES

Tax Rates**: **Corporations

- *Senate:* The top corporate tax rate will be **20% beginning in 2019**. The corporate alternative minimum tax will be repealed.
- *House:* Consistent with the Senate Bill, but the reduction to the top corporate tax rate will be effective in **2018**.

Tax Rates**: **Pass-Through Entities

- *Senate:* Creates a **17.4% deduction for qualified business income** received from pass-through entities (partnerships, LLCs, or S corporations) or proprietorships. The deduction also applies to ordinary dividends received from a **REIT**.

  Comment: The deduction is limited to 50% of a taxpayer's W-2 wages, but it is not clear how this limitation applies to a person that performs services for a partnership in which they also own equity. The deduction generally does not apply to income received from a personal service business (such as a law firm, accounting firm, investment advisory business or consulting firm).

- *House:* **Passive business income** and a portion of **active business income** earned through pass-through entities or by proprietorships will be taxed at a maximum rate of **25%**. The House Bill generally presumes that 30% of active income is taxed at 25%, and the balance is taxed at ordinary rates. An anti-abuse rule limits the amount of wages and income from the provision of services that may be treated as business income.

Comment: Active business income of a taxpayer from a personal service business (such as a law firm, accounting firm, investment advisory business or consulting firm) generally will not be eligible for the 25% rate.

Tax Deductions: Depreciable Property

- *Senate:* **New business investment** in qualified depreciable property (not including structures, intangible assets or property used in certain public utility businesses) will be **expensed** (written off entirely in the year of acquisition). This favorable provision is to stay in place for **five years**, with an additional year for certain property with a longer production period.

  Comment: The Senate version of the deduction is not likely to create the transaction incentives for M&A buyers and sellers that we expect from the House Bill, because it only applies to property when it is first placed in service.

- *House:* Generally consistent with the Senate Bill, but more favorable because it permits immediate expensing even if the depreciable property was not originally placed in service by the taxpayer.

  Comment: Under the House Bill, M&A buyers will be incentivized to purchase assets or businesses in **flow-through form** so that they can immediately expense the cost of depreciable property. M&A sellers (including private equity firms holding businesses in transparent form) will be incentivized to sell before the provision **sunsets** at the end of **2022** so that they can share in the accelerated tax benefit to buyers.

Tax Deductions**:** ***Interest Expense***

- *Senate:* The deduction for **net interest expense** (business interest expense less business interest income) will be **limited** to 30% of a business's adjusted taxable income (computed before interest, net operating losses, and the 17.4% deduction for pass-through income). For partnerships, the limitation will be determined at the partnership level. Any disallowed amounts will be **carried forward indefinitely**. The limitation does not apply to certain **real estate businesses** that elect out of the rule or to a business with average gross receipts of $15 million or less. Special rules will allow a pass-through business's unused limitation to be used by its owners.

- *House:* Similar to the Senate Bill in many respects, but disallowed interest deductions will be carried forward for only **five years** and adjusted taxable income also adds back depreciation and amortization. The exemption for small businesses applies to businesses with up to $25 million of gross receipts.

  Comment: The House Bill provides a **larger base for adjusted taxable income**, because it increases adjusted taxable income by depreciation and amortization. This may substantially increase the amount of deductible interest for taxpayers that own significant depreciable or amortizable tangible or intangible property.

Comment: Neither bill provides any special rules for financial services companies such as banks, insurance companies and leasing companies. It is unclear how interest income earned by insurance companies will be taken into account for purposes of the limitation (that is, whether it will be viewed as business interest income).

Comment: The disallowance of interest expense might encourage **alternative forms of financing** such as leasing if rental expense is deductible. However, leased property cannot be expensed (in contrast to purchased property).

Tax Deductions*: *Net Operating Losses

- *Senate:* **Net operating losses** will be carried forward indefinitely. A net operating loss carryforward may offset only 90% of taxable income determined before the carryforward. The Senate Bill also eliminates the carryback of net operating losses.
- *House:* Consistent with the Senate Bill, but increases net operating loss carryforwards by an interest factor.

Tax Deductions*: *Dividends Received Deduction

- *Senate:* **Reduces the dividends received deduction** from 80% to 65% for dividends received from a 20%-owned corporation and from 70% to 50% for dividends received from any other non-consolidated corporation. These changes are intended to reflect the reduction in the corporate rate from 35% to 20%.
- *House:* Consistent with the Senate Bill.

Tax Credits

- *Senate:* **Preserves most business tax credits**, though it eliminates the deduction for unused business credits. It only modifies the rehabilitation credit and the credit for clinical testing for certain drugs.
- *House:* Calls for the repeal or modification of most business credits, other than the credits for **research and development** and **low-income housing**.

Like-Kind Exchanges

- *Senate:* Eliminates the ability to engage in a tax-free **like kind exchange** of any property other than real property, with grandfathering rules for exchanges that are in progress in 2017.
- *House:* Consistent with the Senate Bill.

Private Activity Bonds

- *Senate:* No change in current law, *i.e.*, it retains the exemption for interest on **private activity bonds**.
- *House:* Eliminates the exemption for interest on **private activity bonds** issued after 2017.

Comment: Under the House Bill, tax-exempt financing will no longer be available for airports, toll roads and other transportation and infrastructure projects that are leased or operated by private businesses.

Unrelated Business Taxable Income

- *Senate:* Tax-exempt organizations that are subject to tax on **UBTI** may not **apply losses or deductions against income** if they arose from different unrelated trades or businesses.
- *House:* Certain tax-exempt state and local entities, including **state and local pension plans**, will be subject to tax on **UBTI**.

Comment: Most government-sponsored pension plans take the position that they are exempt from UBTI under current law. The House Bill will have a meaningful impact on public pension plans investing in private equity and other funds that generate UBTI and may cause public pension plans to reconsider current investment structures.

INTERNATIONAL

Territorial System

- *Senate:* Prospectively, the U.S. will adopt a "**territorial system**," under which the U.S. will **allow a deduction** for dividends received by a U.S. corporation from a 10% or greater owned foreign subsidiary to the extent attributable to foreign source income. A one-year holding period is required, and the 10% shareholder's basis in the foreign subsidiary is adjusted to avoid taking artificial losses.
  - A "**hybrid dividend**" rule **denies** this deduction to the extent the foreign payor of a dividend is allowed a tax benefit in its home jurisdiction in connection with the payment, even if the tax benefit cannot be used by the payor or the benefit is of negligible value.

Comment: Many tax structures include instruments that could generate hybrid dividends (*e.g.*, preferred equity certificates issued by a Luxembourg holding company).

- *House:* Similar to the Senate Bill, but the House Bill does not include the hybrid dividend restriction and only requires a six-month holding period.

One-Time Tax on Repatriated Foreign Earnings

- *Senate:* To transition to the new "territorial" system, 10% or greater U.S. shareholders will be required to pay a **one-time tax** on all existing foreign earnings. Foreign earnings held in illiquid assets will be taxed at **5%**, and cash equivalents will be taxed at **10%**. Payment of the resulting tax liability can be spread over eight years in increasing installments.

- *House:* The House Bill contains a similar provision, but the rate is **7%** for illiquid assets and **14%** for cash equivalents. Payment of the resulting tax liability can be spread over eight years in equal installments.

Comment: The one-time tax is likely to be burdensome for minority U.S. shareholders that will need U.S. tax information from foreign entities that normally do not report such information.

Comment: The Senate Bill also includes a "recapture" rule under which a U.S. shareholder that subsequently engages in an "**inversion**" within ten years will lose the benefit of the 5/10% tax rate (*i.e.*, the one-time tax will be at a **35% rate**). This will disincentivize future inversions.

Base Erosion Taxes

- *Senate:* The Senate Bill imposes a **10% minimum tax** on U.S. corporations' taxable income determined without regard to deductions for "base erosion" payments to foreign affiliates (including interest and purchases of depreciable assets, but excluding payments to the extent subject to U.S. withholding tax). Companies that have "**inverted**" must also treat the cost of goods imported from related foreign affiliates as a "base erosion" payment. The minimum tax applies for taxable years beginning **after December 31, 2017**.
    - The minimum tax applies to a corporation if it (and its affiliates) has average annual gross receipts of at least $500 million and at least 4% of its deductions are "base erosion" payments.
- *House:* The House Bill imposes a **20% excise tax** on deductible or capitalized payments (other than interest) made by a U.S. corporation to a foreign affiliate. The excise tax applies to payments made or accrued **after December 31, 2018**.
    - The House Bill applies to groups that prepare consolidated financial statements and make, on average, more than $100 million in annual payments within the scope of the excise tax.
    - Payments of **effectively connected income** ("**ECI**") and payments to foreign corporations that are subject to U.S. withholding tax are exempted from the excise tax (pro-rated in the case of a reduced rate). The excise tax cannot be deducted by the U.S. payor (but may be reduced by a foreign tax credit).
    - Alternatively, the recipient may elect to treat the payments as U.S.-source ECI subject to tax at regular corporate rates (and requiring a U.S. tax return filing). Recipients making this election are allowed to reduce ECI by certain "deemed expenses" and are allowed an 80% credit against foreign taxes paid. However, the ECI also appears to be subject to branch profits tax of up to 30%.

Comment: These provisions sharply reduce the tax benefit derived from making deductible payments (including, under the Senate Bill, interest) and, under the House Bill, capitalized payments, to foreign affiliates. These provisions could impose a significant economic burden on **foreign insurance companies** that

reinsure business written by U.S. affiliates and, under the House Bill, **foreign entities that export products** to U.S. affiliates.

Comment: Under the Senate Bill, U.S. corporations can in effect **reduce their taxable income by 50%** through base erosion before the 10% minimum tax applies. The House Bill imposes a tax at a 20% rate but it does not apply to payments of interest and offers an election to treat base-erosion payments as ECI.

Tax on Profitable Foreign Subsidiaries/Intangible Income

- *Senate:* U.S. shareholders of a CFC will be taxed on the CFC's net active income in excess of a "routine" return of **10%** on the CFC's investment in depreciable **tangible property**.
  - The Senate Bill defines the base for the tax as "global intangible low-taxed income" or the subtle acronym **"GILTI**." GILTI is treated in the same manner as Subpart F income, meaning that it will be taxed currently. Shareholders of a CFC with a high proportion of intangible assets will be most exposed to the tax.
  - GILTI is effectively taxed at **12.5%** (after a 37.5% deduction), and a limited foreign tax credit is available. The Senate Bill also incentivizes keeping intangible assets in the U.S. by effectively applying the same **12.5%** rate to a U.S. corporation's "foreign-derived intangible income" (income from selling property or providing services to foreigners in excess of a "routine" return of 10% on the corporation's investment in depreciable tangible property).
- *House:* U.S. shareholders of CFCs will be **taxed on 50% of the CFC's net active income** (effectively a **10%** tax rate) in excess of a "routine" return of **7% plus the short-term AFR** on the CFC's investment in depreciable **tangible property**. A limited tax credit is available for foreign taxes paid on income captured by this provision.

Comment: Both bills are targeted at CFCs that generate income from **intangible assets** (regardless of whether those assets were migrated from the U.S. or actually created offshore). However, they will also apply to income from successful operating businesses that generate high returns on tangible assets.

Comment: Both bills discourage the migration of assets and personnel to foreign jurisdictions by subjecting "excess returns" to U.S. tax on a current basis. Given a U.S. rate of just 20%, the costs (including a few percentage points of foreign taxes) of operating offshore and the new U.S. tax on excess offshore returns, U.S. companies will question whether a migration is worth the trouble.

Limitations on Interest Deductibility

- *Senate:* **Net interest deductions** of U.S. corporations with foreign affiliates will be **limited** to the extent U.S. corporations in the group (in the aggregate) are liable for more than 110% of their share of the group's **total indebtedness** (determined by reference to the group's overall debt-to-equity ratio). Disallowed interest deductions can be carried forward **indefinitely**.

- The Senate Bill also denies U.S. payors a deduction for interest or royalties paid to a related party in a **hybrid transaction** where the payments are not included in income (or are deductible) under the recipient jurisdiction's tax law or to a related **hybrid entity** (entities that are fiscally transparent under U.S. law but not fiscally transparent under foreign tax law or vice versa).

- *House:* **Net interest deductions** of a U.S. corporation with foreign affiliates will be **limited** to the extent the U.S. corporation's net interest **expense** exceeds 110% of its share of the group's net interest expense (determined by reference to the group's EBITDA). The provision also applies to interest expense of foreign corporations engaged in a U.S. trade or business. Disallowed interest deductions can be carried forward for **five years**.

    - The House Bill's limitation is determined separately for each non-consolidated U.S. corporation in the group. As a result, the House Bill could limit interest deductions of a U.S. corporation if interest expense is not allocated proportionately among the group's members. Further, the House Bill looks to relative amounts of interest expense (rather than total indebtedness), and so will be affected to the extent indebtedness is incurred at different interest rates.

    - The limitation in the House Bill only applies to groups of entities that prepare consolidated financial reporting statements which report average annual gross receipts in excess of $100 million.

Comment: Both bills prevent U.S. members of a multinational group from benefiting from debt to the extent it is more than 10% above the group's average leverage ratio/interest expense. They apply even to **third-party debt** incurred for non-tax reasons, such as financing an acquisition, and they do not include a "grandfathering" exception for existing debt. As a result, these provisions will disrupt existing structures.

Comment: The hybrid limitation in the Senate Bill may disrupt existing investment fund "blocker" structures capitalized in part with debt.

Controlled Foreign Corporation ("CFC") Rules

- *Senate:* **U.S. shareholders** owning 10% or more of the **value** (as opposed to just **voting power** under current law) of a foreign corporation's stock will count towards the CFC ownership test and may be required to have CFC income inclusions. The scope of the CFC rules will be dramatically expanded so that **almost all** foreign corporations in a multinational group that includes a U.S. entity will be treated as CFCs.

- *House:* Similar to the Senate Bill, but the House Bill does not contain the rule expanding the definition of U.S. shareholder to persons owning 10% or more of the value of stock.

Comment: These provisions will impose an additional tax burden on 10% U.S. owners of CFCs. Voting cutback provisions, which are very common for foreign insurance companies, will no longer be sufficient to avoid CFC status.

Comment: Companies that have adopted structures designed to avoid the CFC rules (such as certain "inverted" groups) will either be forced to restructure or pay tax on certain offshore earnings.

Gain on Partnership Sales

- *Senate:* Gain recognized by a foreign person on the sale of an interest in a partnership engaged in business in the U.S. is treated as ECI on a "look-through" basis (*i.e.*, by reference to the character of gain that would have been recognized if the partnership had instead sold all its assets).
- *House:* No equivalent provision.

Comment: This provision is designed to reverse a recent Tax Court decision (in the *Grecian Magnesite Mining* case), which ruled that a foreign investor did not have to pay U.S. federal income tax on gain recognized on the sale of an interest in a partnership engaged in a U.S. business.

INSURANCE COMPANIES

Income Tax Rates

- *Senate:* Regular corporate income tax rates, *i.e.*, 20%, will apply to insurance companies beginning in 2019. The Senate Bill does not include the House surtax on life insurance companies.
- *House:* Under the House Bill, life insurance companies are subject to regular 20% corporate income tax plus a surtax of 8%. The surtax replaces the punitive reduction in life insurance reserve tax deductions from the original House Bill and substantial changes to the dividends received deduction ("**DRD**") and the treatment of deferred acquisition costs ("**DAC**").

Comment: House Ways and Means Chairman Kevin Brady commented that he thought there were unintended consequences to the insurance industry from an earlier draft of the House Bill.

The Ways and Means Committee describes the surtax as a "placeholder." It appears that the Ways and Means Committee is in the process of reevaluating the effect of the House Bill on life insurers. It is possible that the tax reserve, DRD and DAC changes will be reinstated in a modified form instead of the surtax.

Deferred Acquisition Costs

- *Senate:* DAC rates will increase to 3.17% for annuity contracts, 3.72% for group contracts and 13.97% for all other contracts. The DAC amortization period will be extended from 10 years to **50 years**.

Comment: The change will result in a significant negative cash tax effect, as insurers will have more upfront taxable income in exchange for deductions spread over 50 years. The 5x increase in the amortization period drastically reduces the present value of the deferred deductions and is likely to have a negative effect on the admissibility of deferred tax assets on statutory financial statements.

- *House:* The earlier House draft also increased DAC rates, including a 5x increase for annuity contracts. The 8% surtax replaces this change for now.

Deduction for Life Tax Reserves

- *Senate:* No change to current law. Tax deduction is determined by discounting statutory reserves.
- *House:* Consistent with the Senate Bill. The earlier draft provided that the deduction for tax reserves would be decreased to a fixed 76.5% of statutory reserves. The 8% surtax replaces this change for now.

Deduction for P&C Unpaid Losses

- *Senate:* No change to current law.
- *House:* Property and casualty companies' deduction for unpaid losses will be reduced. P&C companies will discount unpaid losses using less favorable discount rates and payment assumptions. Changes to unpaid losses will be phased in over seven years.

Comment: The changes will have the effect of accelerating taxable income for P&C companies.

Dividends Received Deduction

- *Senate:* No change to current law for life insurance companies. The adjustment to a P&C insurance company's taxable income to add back a portion of the DRD, tax-exempt interest and the cash value of insurance will be increased from 15% to 26.25%.

Comment: Unlike the change to unpaid losses, this change creates a permanent tax difference for P&C companies. P&C companies with large allocations to tax-exempt bonds will be particularly affected.

- *House:* Consistent with the Senate Bill. The earlier draft provided that life insurance companies would be able to claim 40% of the DRD. The 8% surtax replaces this change for now.

Net Operating Losses ("NOLs")

- *Senate:* The special loss carryover rules for insurers will be repealed. Regular NOL carryover rules (including the repeal of carrybacks) will apply instead.

Comment: Insurance companies are particularly affected by this change, as the current law carryback period is longer than that of regular corporations, and under

Statement of Statutory Principles No. 101, it is easier to admit a tax asset for a carryback than for a carryforward.

- *House:* Consistent with the Senate Bill.

Passive Foreign Investment Company ("PFIC") Rules

- *Senate:* Establishes a bright line test for foreign insurance companies that rely on the active insurance business exception to the PFIC rules. To qualify for the exception, an insurance company must have "applicable insurance liabilities" (measured by loss and loss adjustment expenses, life and health reserves and loss reserves under P&C, life, health and annuity contracts) that exceed 25% of its total assets.

  Comment: The exclusion of unearned premiums from the definition of applicable insurance liabilities could pose difficulties for catastrophe and other property and casualty reinsurers, regardless of how active they are. Insurance companies should also consider the treatment of "modified coinsurance" transactions that do not transfer reserves.

- *House:* Similar to the Senate Bill, except P&C and annuity reserves are not specifically mentioned in the House definition of applicable insurance liability.

COMPENSATION

Deferred Compensation

- *Senate:* It will **no longer be possible to defer compensation**, except for qualified plans and restricted property. Nonqualified deferred compensation will generally be taxable in the year in which it vests (*i.e.*, the right to the compensation is no longer conditioned on continued services).

  Comment: Section 409A (which imposes strict limitations on when compensation may be deferred and paid) and Section 457A (which applies to deferred compensation of certain tax-indifferent entities) will no longer apply.

  Comment: Performance conditions standing alone (*e.g.*, EBITDA targets or a change in control event) without a service requirement will **not** be a permitted vesting trigger for deferred compensation. This will fundamentally change how many companies compensate their employees.

  Comment: **Stock options** and **stock appreciation rights** will be taxable when they become vested. This will dramatically alter employers' use of these popular equity awards and make such awards unattractive to employees.

  Comment: There will be a transition rule for amounts that are "attributable to services" performed before January 1, 2018 so long as these amounts are taken into income the later of either when they vest or ***2027***. However, the proposed

rule does **not** include a transition rule for **current** compensation arrangements that vest based on services performed **after** December 31, 2017.

- *House:* Originally included the same rule, but has been amended to ***remove*** these provisions.

Compensation Deduction Limitation

- *Senate:* Provides that the **$1 million** deduction limitation under Section 162(m) **that applies to public companies** will be expanded to deny a deduction to **more** companies for **more** compensation payable to a **larger** group of employees.
- *House:* Consistent with the Senate Bill.

Comment: Performance-based compensation, including equity awards, will no longer be exempt from the 162(m) deduction limitation. This is likely to have a significant impact on how public companies compensate their top executives.

Comment: The "covered employees" to whom the deduction limitation will apply include the CEO, the CFO and the next three most highly compensated executive officers (whether or not serving as executive officers as of the end of the year). In addition, once considered a "covered employee" for a given year, the individual will be treated as a "covered employee" for all subsequent years.

Comment: The employers subject to the 162(m) deduction will be expanded to include **Section 15(d) filers** (*i.e.*, companies that issued equity or debt securities to the public in a registered public offering, but have not listed on a securities exchange, such as foreign private issuers and debt issuers).

Excess Tax-Exempt Organization Executive Compensation

- *Senate:* A new **20% excise tax** on "excessive compensation" paid by **tax-exempt organizations** will be imposed on compensation paid to each of the five highest-paid employees ("covered employees") to the extent such compensation exceeds $1 million in any year and on severance payments to any such individual to the extent the severance payments exceed the average of the individual's last five years of compensation. Once considered a "covered employee" for a given year, the individual will be treated as a "covered employee" for all subsequent years.
- *House:* Contains similar provisions, except it applies to severance payments that exceed **three times** the average of the individual's last five years of compensation. The House Bill does **not** provide that once considered a "covered employee" for a given year, the individual will be treated as a "covered employee" for all subsequent years.

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