

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF ATMOS ENERGY)
CORPORATION FOR AN ADJUSTMENT OF RATES AND) CASE NO. 2017-00349
TARIFF MODIFICATIONS)

NOTICE OF FILING

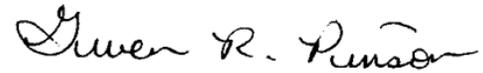
Notice is given to all parties that the following materials have been filed into the record of this proceeding:

- The digital video recording of the evidentiary hearing conducted on March 22, 2018 in this proceeding;
- Certification of the accuracy and correctness of the digital video recording;
- All exhibits introduced at the evidentiary hearing conducted on March 22, 2018 in this proceeding;
- A written log listing, *inter alia*, the date and time of where each witness' testimony begins and ends on the digital video recording of the evidentiary hearing conducted on March 22, 2018.

A copy of this Notice, the certification of the digital video record, hearing log, and exhibits have been served upon all persons listed at the end of this Notice. Parties desiring to view the digital video recording of the hearing may do so at https://psc.ky.gov/av_broadcast/2017-00349/2017-00349_22Mar18_Inter.aspx.

Parties wishing an annotated digital video recording may submit a written request by electronic mail to pscfilings@ky.gov. A minimal fee will be assessed for a copy of this recording.

Done at Frankfort, Kentucky, this 27th day of March 2018.

A handwritten signature in cursive script that reads "Gwen R. Pinson".

Gwen R. Pinson
Executive Director
Public Service Commission of Kentucky

Honorable John N Hughes
Attorney at Law
124 West Todd Street
Frankfort, KENTUCKY 40601

Justin M. McNeil
Office of the Attorney General
Office of Rate Intervention
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

Kent Chandler
Assistant Attorney General
Office of the Attorney General
Office of Rate Intervention
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

Larry Cook
Assistant Attorney General
Office of the Attorney General
Office of Rate Intervention
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

Atmos Energy Corporation
3275 Highland Pointe Drive
Owensboro, KY 42303

Mark R Hutchinson
Wilson, Hutchinson & Littlepage
611 Frederica Street
Owensboro, KENTUCKY 42301

Rebecca W Goodman
Assistant Attorney General
Office of the Attorney General
Office of Rate Intervention
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

Eric Wilen
Project Manager-Rates & Regulatory Affairs
Atmos Energy Corporation
5420 LBJ Freeway, Suite 1629
Dallas, TEXAS 75420

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|---------------------------------|---|------------|
| ELECTRONIC APPLICATION OF ATMOS |) | |
| ENERGY CORPORATION FOR AN |) | CASE NO. |
| ADJUSTMENT OF RATES AND TARIFF |) | 2017-00349 |
| MODIFICATIONS |) | |

CERTIFICATE

I, Pamela Hughes, hereby certify that:

1. The attached DVD contains a digital recording of the Hearing conducted in the above-styled proceeding on March 22, 2018. Hearing Log, Witness List, and Exhibit List are included with the recording on March 22, 2018.

2. I am responsible for the preparation of the digital recording.

3. The digital recording accurately and correctly depicts the Hearing of March 22, 2018.

5. The "Hearing Log" attached to this Certificate accurately and correctly states the events that occurred at the Hearing of March 22, 2018, to the best of my ability, and the time at which each occurred.

Signed this 26th day of March 2018.



Pamela Hughes, Notary Public
State at Large
My Commission Expires: April 22, 2019



Judge: Bob Cicero; Talina Mathews; Michael Schmitt

Witness: Richard Baudino; Joe Christian; Laura Gillham; James H. Vander Weide; Lane Kollen; Mark Martin; Paul Raab; Greg Smith; Jennifer Story; Greg Waller; Dane Watson

Clerk: Pam Hughes

| Date: | Type: | Location: | Department: |
|-----------|---------------|----------------|-----------------------|
| 3/22/2018 | General Rates | Hearing Room 1 | Hearing Room 1 (HR 1) |

| Event Time | Log Event |
|------------|--|
| 8:35:55 AM | Session Started |
| 8:35:57 AM | Session Paused |
| 8:58:10 AM | Session Resumed |
| 8:58:12 AM | Chairman Schmitt preliminary remarks Note: Hughes, Pam 2017-00349 Atmos Energy Note: Hughes, Pam Introductions of Vice Chairman Cicero and Commissioner Mathews. |
| 8:58:47 AM | Introductions of Counsel Note: Hughes, Pam Jack Hughes and Randy Hutchinson for Atmos Energy; Rebecca Goodman, Larry Cook, Kent Chandler and Justin McNeil for the Attorney General; and Quang Nguyen, Angela Goad and Kyle Melloan for the PSC. |
| 8:59:18 AM | Public Notice has been given |
| 8:59:29 AM | No Public Comments |
| 8:59:59 AM | No Outstanding motions |
| 9:00:33 AM | Chairman Schmitt statement about exhibits to other parties. Note: Hughes, Pam Angela Goad states they have one but may not use it. |
| 9:01:28 AM | Chairman Schmitt remarks about one Atmos witness Note: Hughes, Pam Will be done by telephone. Jack Hughes states he is available at any time. |
| 9:02:34 AM | No other matters to be addressed. |
| 9:02:48 AM | Atty Hughes calls Paul Raab via telephone conference line. Note: Hughes, Pam By telephone...sworn in by Chairman Schmitt |
| 9:03:29 AM | Atty Hughes direct of Witness Raab Note: Hughes, Pam No changes to his direct testimony. Note: Hughes, Pam Independent Economic Consultant. |
| 9:04:26 AM | Atty Cook cross of Witness Raab Note: Hughes, Pam Direct testimony, page 5. Lines 3-6. Reads heading and first sentence into the record. Rate design and demand commodity study. Admins. Case 297 of PSC. Note: Hughes, Pam Basis is for increase for product to \$19.45. Based on COS appears to warrant that. Note: Hughes, Pam AG hands out document - Side-by-Side Rate Schedules. Attachment 1 to PSC DR 5 -1. Entered as AG exhibit 1. Witness is logging on to the PSC website to find document. Witness states Mr. Martin is better to answer. Note: Hughes, Pam Customer charge is 20.51 Revised revenue requirement to staff's 5th DR. Now it is 19.45 a month |
| 9:10:51 AM | Witness Raab excused. |
| 9:11:17 AM | Witness Martin called to the stand Note: Hughes, Pam Sworn in by Chairman |
| 9:11:38 AM | Atty Hughes direct of Witness Martin Note: Hughes, Pam Mark Martin, VP of Rates and Regulatory Affairs for the Kentucky/Mid-states Division of Atmos. |

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| 9:12:15 AM | Atty McNeil cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | Regarding the \$19.45 for proposed rate. AG exhibit 1. Line 2 Ask the witness to explain the increase and what comprises it. |
| 9:14:18 AM | Atty McNeil cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | Regarding if Atmos has had any issues earning its ROE in recent years. Regarding amount of new revenues the company is requesting. Currently is \$1.7 million. Regarding primary driver of Atmos in this case. Higher ROE Regarding total gross profit for test year is 92 million dollars. |
| 9:16:09 AM | AG hands out exhibit 2 Note: Hughes, Pam | FR 16(8)(k) Scheduled K - attached to his testimony. |
| 9:17:13 AM | Atty McNeil cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | FR 16 Scheduled K, attached to his testimony. Page 3. Line 99 titled Return on Common Equity Average. Regarding trend increasing. Reads the last 3 years available in the record. 2014 was 10.2%, 2015 was 10.0%, and 2016 was 10.5%. Regarding when started preparing for this rate case. Spring of 2017. Regarding if it was when they were earning this 3.5% Regarding no ROE listed -PHDR needed ROE recommended was 10.3% by Witness Verderame. Witness didn't prepare this document and can't answer. |
| 9:21:46 AM | Atty McNeil cross of Witness Martin Note: Hughes, Pam | Regarding same document. 4.5% was highest number. Line 101 return 5.4% for the forecasted year. Witness Gillum or Witness Waller better to answer. |
| 9:23:00 AM | Atty McNeil cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | Regarding base rate continuing at that rate. Regarding gradual increase. Regarding last rate case forecasted base rate. 100 million increase from base rate. Asks Witness to explain the investments they made. |
| 9:25:17 AM | Atty McNeil cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | Rebuttal, page 5- line 7 to 12. Rate shock likely to occur when company doesn't file for increase over a longer period of time. The PRP has helped to gradually increase rates. Annual filings giving PSC and AG opportunity to stay on top of what the rates are. ARM is about cost recovery for the company. Regarding the annual bill going up for customers. Regarding the 2006, 2009, 2013, 2015 and 2017 rate increases sought.. Regarding annual filings, page 5. Decrease to customer bills. Regarding decreases in Tennessee, witness can't speak to this. Rebuttal testimony, page 5. ARM - adjustment was a reduction. Witness did not participate in this proceeding in Georgia. |
| 9:32:05 AM | Atty McNeil cross of Witness Martin Note: Hughes, Pam | Base rate portion of the bill has gone up. Gas costs down depending on point of reference. Stable for the last 10 years. Regarding if gas prices rose tomorrow, how would it affect Atmos being lowest provider in the state. |
| 9:33:31 AM | Atty McNeil cross of Witness Martin Note: Hughes, Pam | Regarding in theory if it's easier to gain approval of costs that have already been expended than to gain for future costs. |

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| | Note: Hughes, Pam | Regarding the ARM provided. Witness Waller can better answer this. Witness Martin goes into how they go about setting schedules to be transparent to the Commission and others. Traditional rate cases versus the ARM. |
| 9:36:35 AM | Atty McNeil cross of Witness Martin | |
| | Note: Hughes, Pam | Pipeline Replacement Program (PRP) original estimated case. 130 million in 2009. |
| | Note: Hughes, Pam | Rebuttal, page 5. PRP has worked well and Witness explains why he stated that. PRP is a safety program. Regarding if Arm is approved versus the PRP. |
| 9:38:54 AM | AG hands out exhibit 3 | |
| | Note: Hughes, Pam | Atmos Energy Data Request, Case No. 2017-00308, item 1.b. |
| 9:41:39 AM | Atty McNeil cross of Witness Martin | |
| | Note: Hughes, Pam | Total cost of estimated PRP plan. |
| | Note: Hughes, Pam | AG exhibit 3. 124 million was original estimate on PRP program. Response total cost of PRP is \$158,100,000.00. through July 31, 2017. Witness speaks to this. |
| | Note: Hughes, Pam | Regarding Ernest Napier that provided this estimate. He is professional engineer. |
| | Note: Hughes, Pam | Response in Data Request- Regarding how company utilizes a rolling 5 year plan. |
| 9:46:51 AM | Ag hands out exhibit 4 | |
| | Note: Hughes, Pam | 2017-00308 Atmos Energy Response to PSC Dr 2, question 2-01 Page 1 of 2. |
| 9:48:01 AM | Atty McNeil cross of Witness Martin | |
| | Note: Hughes, Pam | Regarding AG exhibit 4. Amounts estimated. |
| 9:49:54 AM | Ag hands out exhibit 5 | |
| | Note: Hughes, Pam | Staff DR 2 Question 2-18 in this case. |
| 9:51:04 AM | Atty McNeil cross of Witness Martin | |
| | Note: Hughes, Pam | 2018-2025 amounts would be 518 million, subject to check. Base rate amounts will have doubled if this rate holds. |
| 9:51:58 AM | Atty McNeil cross of Witness Martin | |
| | Note: Hughes, Pam | Rebuttal testimony concerning that the AG didn't intervene in the PRP filings. Reasons for when the AG would intervene in a PRP filing. |
| 9:53:04 AM | AG hands out exhibit 6 | |
| | Note: Hughes, Pam | PSC order in Case No. 2017-00263 Frontier Gas of Kentucky. |
| 9:54:31 AM | Atty McNeil cross of Witness Martin | |
| | Note: Hughes, Pam | Regarding AG exhibit 6 - KY Frontier Gas, page 12. Pipeline replacement program, page 13, last paragraph. Regarding the PSC requiring an escrow account and reports to be submitted. Questions if Atmos uses an escrow account . |
| | Note: Hughes, Pam | Regarding if no escrow account how do they assure the money is spent in a responsible way. |
| 9:57:51 AM | Atty McNeil cross of Witness Martin | |
| | Note: Hughes, Pam | Funding that rate payers give are not on their bills, but are rolled onto balance sheet item to Tariff rates. Other benefits of that funding, in his rebuttal testimony he listed all the benefits. Atmos does not track the savings form this funding. |
| | Note: Hughes, Pam | Balance sheet item to tariff rates. Funds from GTI is discretionary. |
| | Note: Hughes, Pam | Regarding Funding for GTI from Atmos. Listed in his rebuttal testimony. |
| 10:01:20 AM | Atty McNeil cross of Witness Martin | |
| | Note: Hughes, Pam | Regarding double the rate base doubles the return in dollar amounts |

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| 10:01:43 AM | Atty McNeil cross of Witness Martin Note: Hughes, Pam | Referring to AG exhibit 1. Column F - higher PRP approved is in this customer charge |
| 10:02:55 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | Regarding the fairness to all classes between fixed and volumetric components Regarding what rate Atmos would propose to customer charge if the Commission approved a lower amount. Less than the 19.45 Regarding other customer classes |
| 10:05:11 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam | Regarding a decrease by the Commission, what would Atmos propose for customer rates. He can't give a good answer to that. |
| 10:06:03 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam | PSC 5th DR, item 1. Updated billing analysis and rates Atmos would propose on revised revenue requirements needed in a PHDR. |
| 10:06:59 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | Regarding if Atmos paying dividends. Response to PSC DR1, question 1.06. Fiscal year 2017 dividends. PHDR for the dividends paid for 2017, 2018, base period and test period. |
| 10:09:16 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | Would Atmos require a longer time frame if known what the PRP was going to be. PSC DR 2, item 18. Pipeline replacement program. Smith's rebuttal testimony page 8. Explain why the differences in PRP capital expenses being higher.. Regarding if PRP charges will go to unreasonable charges on customers in order to meet the 15 year time frame. PHDR - Provide PRP program per mile to replace pipe since 2009. PHDR - number of bare steel miles |
| 10:11:38 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | Regarding PRP spending in the upcoming year. Regarding which projects are determined to be most important in pipeline replacement. Mr Smith could answer this. |
| 10:12:40 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | Atmos submits bids for PRP. Cost savings or improvements since the inception of the PRP. Number of leaks have been reduced. |
| 10:13:34 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | 12% used PSC DR2, item 18.b. replacement expenditures through 2025. |
| 10:14:28 AM | VC cross of Witness Martin Note: Hughes, Pam | Regarding Witness statement about using 12% factor for the PRP program. |
| 10:16:44 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | Atmos comparison in KY to any other Atmos jurisdictions. Comparison of other utilities to replace pipeline. If they do not compare, they won't know how it compares in cost component |
| 10:17:57 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam | PSC 4th DR, item 9. PRP cap at 45 million and Atmos would need more for the 15 years. |
| 10:19:02 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam | If Commission was to place a cap on the PRP. |

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| 10:20:36 AM | Note: Hughes, Pam Atty Goad cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | Rebuttal testimony. Page 10. Regarding PRP cap PSC DR4, item 9, attachment 1. Annual PRP capital spending in 2019. How much if extended past 2025 - 39.4 million; Past 2035 would be 27.8 million and past 2040 it would be 21.5 million. PSC DR2, item 18.b Regarding never spent 45 million on there PRP. |
| 10:23:07 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam | Reason to file the ARM is less costly. Will Atmos file more frequent rate cases? |
| 10:24:34 AM | Note: Hughes, Pam Atty Goad cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | Regarding the annual review mechanism (ARM) How this ARM benefits customers. Regarding Proposed ARM will be better for the Commission and the AG to understand this. |
| 10:27:02 AM | Note: Hughes, Pam Note: Hughes, Pam Atty Goad cross of Witness Martin Note: Hughes, Pam | Reason for coming in more frequently for rate cases. Regarding filing rate cases prior to 2013. |
| | Note: Hughes, Pam | Why local distribution companies have provisions for R&D in their Tariffs. |
| | Note: Hughes, Pam | Regarding if all Atmos Utility Companys in other states have R&D riders. If no, explain. |
| | Note: Hughes, Pam | Research and Development Rider. Impact of residential customer bills. 7 cents a month. |
| 10:29:35 AM | Post Hearing Data Request Note: Hughes, Pam | Operating divisions in other states and R&D riders and what the rates are. |
| 10:29:59 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | Do any Shareholders contribute? 100% rate payer funded Regarding other entities of Atmos that don't pay the R&D rider, then why do KY customers pay this? |
| | Note: Hughes, Pam | Regarding benefits Ky customers receive. In his rebuttal testimony, page 11, starting line 5. |
| | Note: Hughes, Pam | Colorada and Kansas that don't pay into the R&D rider, do they receive same benefits. |
| 10:34:24 AM | Atty Goad cross of Witness Martin Note: Hughes, Pam | Regarding 400 % increase proposed. Would customers receive other benefits |
| | Note: Hughes, Pam | If Commission discontinued GTI funding for the R&D rider |
| 10:35:09 AM | Break | |
| 10:35:17 AM | Session Paused | |
| 10:46:17 AM | Session Resumed | |
| 10:46:19 AM | VC cross of Witness Martin Note: Hughes, Pam | Net plant increase, change of 28% being used. |
| 10:47:00 AM | VC cross of Witness Martin Note: Hughes, Pam | Regarding the PRP program and not being certain how much still needs to be replaced. What makes it standard O&M and not part of PRP. |
| 10:48:58 AM | VC cross of Witness Martin Note: Hughes, Pam | Regarding committment and what is projected to be in the future. 2009 numbers no longer valid |
| 10:49:47 AM | VC cross of Witness Martin Note: Hughes, Pam | Total amount of lines to be replaced, another 122% to be asked for, 15 year window that was approved in 2009 rate case. |

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| 10:50:56 AM | VC cross of Witness Martin Note: Hughes, Pam | Regarding the ARM savings and Average expected rate cost savings |
| 10:51:38 AM | VC cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | Regarding the R&D rider. Refers to a Cost benefits analysis Regarding asking the Commission to approve a 400% increase if they can't show what the benefits are. |
| 10:56:10 AM | VC cross of Witness Martin Note: Hughes, Pam | Regarding shareholders not contributing to this at all. Witness is aksed why they haven't looked at this. |
| 10:57:14 AM | Comm cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | Committed to a 15 year timeframe. Is expectation that the Commission expects you to meet that. Not all miles are created equal as far as costs for different reasons. Not all utilities in Ky are looking the same. Safety and reliabilty improvements in terms of dollars. GTI research |
| 10:59:42 AM | Comm cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | Regarding it not just being a bare steel program in 2009. In 2011 another 100 miles found. 2014 Staff opinion was sought. Regarding moving from the 2009 and finding another 100 miles in 2011. Deadline from 15 years originally put in place. Regarding personnel on safety and reliability being experts. If Atmos had to finance would it cost more than .7 cents per customer a month. |
| 11:02:52 AM | Chairman cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | PRP - how does Atmos determine what pipes need to be replaced. Regarding a GTI facility in Chicago or any other group that offers this . |
| 11:03:52 AM | Chairman cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | Regarding Atmos gas explosions in Ky. AG exhibit 5, page 4 chart. Jan. 2011 to Aug, 2017. Leak surveys taken every year. PRP began in June 2011. Goes over the leaks found on the surveys. Atmos has declined in leaks over this period. How many miles of natural gas pipe does Atmos have in KY. 4200 miles. |
| 11:06:31 AM | Chairman cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | Regarding an Order in KY Frontier Gas Case No. 2017-00263. Is he aware of the PRP the Commission approved in that case. Regarding the escrow account to KY Frontier to spend that money on the PRP. |
| 11:08:58 AM | Chairman cross of Witness Martin Note: Hughes, Pam | Regarding other natural gas utilities that have R&D Riders. Delta Natural Gas and Columbia Gas of KY. Regarding how they compare to Atmos Energy. Atmos is volumetric rate that is lower than the other companies. |
| 11:11:00 AM | Atty Hughes re direct of Witness Martin Note: Hughes, Pam | Regarding Commission approval on Riders and projects. |
| 11:11:43 AM | Atty McNeil re cross of Witness Martin Note: Hughes, Pam Note: Hughes, Pam | Regarding if company doubles its rate base. Regarding why Atmos is trying to recover PRP cost after it has been put in the base rate in the fixed charge. |
| 11:15:44 AM | Atty McNeil re cross of Witness Martin Note: Hughes, Pam | Will the ARM meet minimum filing requirements as they currently are. |

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| | Note: Hughes, Pam | Regarding the ARM being streamlined and simplified, witness explains. |
| 11:17:53 AM | Atty McNeil re cross of Witness Martin | |
| | Note: Hughes, Pam | Regarding the 15 year timeline to the PRP but not to the original estimate. |
| 11:18:43 AM | VC re cross of Witness Martin | |
| | Note: Hughes, Pam | Regarding why Duke and LGE do not charge customers the R&D charges. |
| | Note: Hughes, Pam | Line loss reduction since PRP has begun. |
| 11:20:11 AM | Witness excused | |
| 11:20:19 AM | Atty Hughes calls Witness Watson to the stand | |
| | Note: Hughes, Pam | Sworn in by the CHairman |
| 11:20:58 AM | Atty Hughes direct of Witness Watson | |
| | Note: Hughes, Pam | Dane Watson - Managing Partner at Alliance Consulting Group. Adopts his rebuttal testimony. |
| 11:21:34 AM | AG exhibit 7 | |
| | Note: Hughes, Pam | 2017-00179 Ky Power final Order. |
| 11:22:54 AM | Atty Cook cross of Witness Watson | |
| | Note: Hughes, Pam | In the Ky Power case. Non-unanimous settlement, page 10. Was he aware that KY Power removed terminal net salvage costs from its depreciation rates. |
| 11:23:42 AM | Atty Cook cross of Witness Watson | |
| | Note: Hughes, Pam | Regarding terminal net salaries before 2009 |
| 11:24:05 AM | AG Post Hearing Data Requests | |
| | Note: Hughes, Pam | Terminal amounts before the 2009 rate case |
| 11:24:24 AM | Witness excused | |
| 11:24:47 AM | Witness Vander Weide called to stand | |
| | Note: Hughes, Pam | Sworn in by the Chairman |
| 11:25:16 AM | Atty Hughes direct Witness Vander Weide | |
| | Note: Hughes, Pam | Adopts his testimony. |
| | Note: Hughes, Pam | James H. Vander Weide, PH.D - President of Financial Strategy Associates. |
| 11:25:44 AM | Atty Chandler cross of Witness Vander Weide | |
| | Note: Hughes, Pam | Page 28 of the KY Power Order. Reads the first full sentence through block quote to next sentence. Rebuttal testimony, page 20. Reads lines 14 and 15. |
| | Note: Hughes, Pam | AG exhibit 7 - KY Power Order. Rebuttal, pages 20 -22. Page 21, reads lines 20 - 22 into the record. Forecasted rates |
| | Note: Hughes, Pam | Regarding Mr. Baudino's testimony lines up with the Cmmission in that case. |
| 11:32:25 AM | Atty Chandler cross of Witness Vander Weide | |
| | Note: Hughes, Pam | Regarding how long he has been consulting on the ROE. Is it healthy for all parties that the Commission has excluded this position in other cases that other utilities get to argue this point. |
| 11:34:40 AM | AG exhibit 8 | |
| | Note: Hughes, Pam | Mr. Baudino's testimony (one page) page 35. |
| 11:35:56 AM | Atty Chandler cross of Witness Vander Weide | |
| | Note: Hughes, Pam | Regarding AG exhibit 8. |
| | Note: Hughes, Pam | Page 22 of rebuttal , lines 1-5. Reads this. He cited page 35 in his testimony. Interest rates could not go higher according to Mr. Baudino's testimony. Line 15 - 19. |
| 11:39:30 AM | Atty Chandler cross of Witness Vander Weide | |
| | Note: Hughes, Pam | Regarding if he had reviewed the KY Power Order prior to his testimony, Witness states that he has not. |

11:39:56 AM Atty Goad cross of Witness Vander Weide
Note: Hughes, Pam Based on the Regulatory research in 2016 average was 9%
Note: Hughes, Pam Regarding Regulatory Research Associates (RRA) . 9.72% in 2017
and if you remove outlier it would be 9.63%

11:42:30 AM AG asks for copy of the document being used in the cross examination
Note: Hughes, Pam Atty Goad says it is confidential and will need to take it back up
after finished.

11:44:41 AM Atty Goad cross of Witness Vander Weide
Note: Hughes, Pam Regarding the RRA, 3rd paragraph on first page. 9.72% in 2017
and 9.54?% in 2016. in 2017, 9.63% . Next paragraph median
was 9.63% in 2017 and explain difference in 2016 and 2017. He
states he hasn't studied this.
Note: Hughes, Pam Regarding average ROE for gas utilities. Atmos proposed ROE was
changed to 10.4% and he doesn't think it was inflated. He explains
his position.
Note: Hughes, Pam Regarding investor risks.

11:48:52 AM Atty Goad cross of Witness Vander Weide
Note: Hughes, Pam Regarding an update of the ROE in his rebuttal testimony.
Note: Hughes, Pam Regarding risk factors of Atmos and if they are different than those
of LGE/KU

11:51:23 AM VC cross of Witness Vander Weide
Note: Hughes, Pam Regarding methodologies used to determine an ROE, and his
comments about risks. Regulatory proceedings. Regarding that all
variables have to be considered.

11:54:38 AM Comm cross of Witness Vander Weide
Note: Hughes, Pam Regarding update from 10.3 to 10.4. It would be 10.6 if he
updated through today. Regarding what happened in February
that made him come to this conclusion. PHDR needed

11:56:13 AM Atty Chandler re cross of Witness Vander Weide
Note: Hughes, Pam Regarding looking at these in context.
Note: Hughes, Pam RRA report, page 13. Page 11 of report
Note: Hughes, Pam Regarding importance of Commissioners looking at other
authorized returns and evidence on required returns in the
marketplace

11:58:14 AM Private Recording Activated

12:04:46 PM Public Recording Activated

12:04:50 PM Witness excused

12:04:59 PM Break

12:05:08 PM Session Paused

1:01:09 PM Session Resumed

1:01:13 PM Chairman Schmitt questions to AG about witnesses.

1:01:59 PM Witness Gillham called
Note: Hughes, Pam Sworn in by the Chairman

1:02:21 PM Atty Hughes direct of Witness Gillham
Note: Hughes, Pam Laura A. Gillham - Director of Accounting Aervices for Atmos. No
changes to her testimony.

1:02:50 PM VC cross of Witness Gillham
Note: Hughes, Pam Growth seen in the asset base. Increase in that base. Defers to
Mr. Waller.

1:03:44 PM Witness excused

1:03:52 PM Witness Smith called
Note: Hughes, Pam Sworn in

1:04:11 PM Atty Hughes direct of Witness Smith
Note: Hughes, Pam Rebuttal testimony, no changes.

1:04:50 PM Note: Hughes, Pam Greg Smith - Manager of Engineering Service for Atmos.
 Atty McNeil cross of Witness Smith
 Note: Hughes, Pam Rebuttal testimony, page 3, line 10. Reads into the record.
 Note: Hughes, Pam Regarding his knowledge of rate making.
 Note: Hughes, Pam Rebuttal testimony, regarding prior to PRP and after

1:06:37 PM Atty McNeil cross of Witness Smith
 Note: Hughes, Pam Rebuttal, page 8. Expanded scope of the project, extra miles they found. Cost estimates and the mistakes in them.
 Note: Hughes, Pam Example of original estimate based on the 2009 case before it had been bid to contractors.
 Note: Hughes, Pam Accelerated PRP in Kentucky, number of miles they are replacing

1:09:54 PM Atty Goad cross of Witness Smith
 Note: Hughes, Pam Regarding the PRP and how it is prioritized.
 Note: Hughes, Pam References maps to find bare steel, etc. GIS mapping system is used.

1:12:46 PM Atty Goad cross of Witness Smith
 Note: Hughes, Pam Regarding cost components Atmos considers when determining the PRP.
 Note: Hughes, Pam Regarding how they determine the prioritizing the spending
 Note: Hughes, Pam Regarding bids for contract labor or in-house crews.

1:14:33 PM Atty Goad cross of Witness Smith
 Note: Hughes, Pam Does Atmos compare to other utilities for PRP. Competitively bid all their PRP.
 Note: Hughes, Pam Regarding Staff's DR2, item 18.B. Atmos response, part b, page 3 of 4. Estimated expenditures through 2025. Projects designed in advance of the work being done,
 Note: Hughes, Pam Cost savings that have incurred since the inception of the PRP.

1:19:44 PM VC cross of Witness Smith
 Note: Hughes, Pam Do other divisions help prepare these projects.
 Note: Hughes, Pam Regarding why submitting info for PRP for 12.5% annual rate.
 Note: Hughes, Pam Regarding project estimates for the PRP. Regarding how far out they plan projects. What goes into this planning?

1:24:10 PM Comm cross of Witness Smith
 Note: Hughes, Pam Regarding meeting the 15 year deadline they have to replace more pipe this year.

1:24:49 PM Comm cross of Witness Smith
 Note: Hughes, Pam Regarding bids and planning, more of engineering than accounting?

1:25:51 PM Chairman cross of Witness Smith
 Note: Hughes, Pam Regarding who is responsible for hiring the contractors. Robert Arnold is the man responsible. Are contractors pre-qualified and have master service agreements.

1:27:15 PM Chairman cross of Witness Smith
 Note: Hughes, Pam Regarding historical cost of year that Atmos has spent in the PRP. Unit rate projects, scheduled for work being done. Set contract rate. Atmos provides the pipe. Atmos has actual costs of each project.

1:30:07 PM Witness excused

1:30:20 PM Witness Waller to the stand
 Note: Hughes, Pam Sworn in by the Chairman

1:30:53 PM Atty Hughes direct of Witness Waller
 Note: Hughes, Pam Greg Waller - Manager of Rates and Regulatory Affairs with Atmos
 Note: Hughes, Pam Change to DR2, item 21. Part A. Rate case expense and amortization was part of that settlement as opposed to inadvertently left out.

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| 1:32:29 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | Regarding traditional rate cases are more transparent and comprehensive. Witness disagrees. |
| | Note: Hughes, Pam | ARM methodologies, file revenue requirement |
| | Note: Hughes, Pam | Regarding ARM and what it provides for. Regarding intervening parties and Commission to look at fair and just and reasonable to rate payers. |
| | Note: Hughes, Pam | ARM would allow Atmos to get a return on its investment |
| 1:37:03 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | If ARM approved, would Atmos have any incentives to control its costs. |
| | Note: Hughes, Pam | If ARM approved, there would be an expedited review. All Atmos books in the ARM would be open for in discovery. |
| | Note: Hughes, Pam | In the ARM atmos would be???? Regarding rate payers and regulatory lag. |
| 1:39:57 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | For KY operations Atmos benefits for its PRP and gas costs. |
| | Note: Hughes, Pam | Regarding costs going up for Atmos. |
| | Note: Hughes, Pam | Regarding the majority of growth in Atmos KY. Page 7 of his direct testimony. 53% is for the PRP. |
| 1:41:36 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | Regarding West Ky Gas supplying safe gas. |
| | Note: Hughes, Pam | Regarding regulatory investment owned utilities. |
| | Note: Hughes, Pam | If approved, the ARM would give Atmos a guaranteed rate of return |
| | Note: Hughes, Pam | Page 9 of Direct testimony, line 15. Reads into record. |
| 1:43:59 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | Total rate base today is 427 million dollars. |
| | Note: Hughes, Pam | Regarding projected cost escalations under the PRP. 2017-00308 Needs of the system, and where will it all end. 80 years |
| | Note: Hughes, Pam | 2009 PRP following the 15 years was how it was designed. |
| 1:46:42 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | Regarding the company making a capital expenditure under the PRP program, the company is guaranteed a recovery of investment and a return on that investment. |
| | Note: Hughes, Pam | Regarding the leakage, and has company returned any money to rate payers. O&M and PRP filing formula approved in 2009, actual savings could be higher or lower, |
| 1:49:46 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | PRP primary purpose. |
| 1:50:10 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | Regarding number of customers over past three years. PHDR needed. |
| 1:50:39 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | Mr. Kollens adjustment. Rebuttal testimony page 9. Line 18 - reads into the record. Base period and projected O&M. Regarding something more current. |
| | Note: Hughes, Pam | Regarding cost escalations that the Commission was concerned about. Differences if the ARM is approved or not. |
| | Note: Hughes, Pam | Regarding actual expenses and not a comparison of base rate expenses. |
| | Note: Hughes, Pam | Replacement in leased vehicles |
| 1:55:15 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | 2016 is for most recent full calendar year. |
| | Note: Hughes, Pam | Regarding budgeted expense. 4.534 million total allocated for 4 entities for the fiscal year. |

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| | Note: Hughes, Pam | Mr. Kollens adjustment for O&M. Witness rebuttal says he ignores the base period completely. |
| 1:57:03 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | Regarding the ad valorem tax declining over last 3 years. |
| 1:57:36 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | For all other employees. Some are in cash balance in defined benefit plan and some are in 401k benefit plan. |
| | Note: Hughes, Pam | Regarding defined benefit plan and combined benefit plan for Directors |
| | Note: Hughes, Pam | Companies match in rate base. Answer is in data requests |
| 1:59:14 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | Direct testimony. page 12 at line 21. reads into the record |
| | Note: Hughes, Pam | Direct testimony, page 12, line 24. The two most recent 5 year plans were given in data requests |
| 2:01:32 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | Rebuttal page 3, line 19. Reads into the record. Was growth based on any projected project costs? Regarding why it is higher than previous year. |
| | Note: Hughes, Pam | Proposal for capital expenditures in the current test year and it exceeds that in future years. Adjusted for inflation. |
| 2:03:14 PM | Atty Cook cross of Witness Waller | |
| | Note: Hughes, Pam | Regarding if Directors change their compensation, some have put in stocks. |
| | Note: Hughes, Pam | Regarding if company stock goes up. |
| 2:04:54 PM | Atty Goad cross of Witness Waller | |
| | Note: Hughes, Pam | Benefits in the PRP since its inception. What witness can answer this question? Identify benefits or savings in reliability since the PRP began. |
| 2:07:14 PM | Atty Goad cross of Witness Waller | |
| | Note: Hughes, Pam | PHDR for Director stock expense included in revenue requirement |
| | Note: Hughes, Pam | AG response to Atmos DR, Question No. 20 Regarding Director expenses. The Directors get an award of stock in the retainer fee. |
| 2:10:16 PM | Atty Goad cross of Witness Waller | |
| | Note: Hughes, Pam | Regarding Atmos budget being prepared one year at a time. |
| 2:11:02 PM | Atty Goad cross of Witness Waller | |
| | Note: Hughes, Pam | Attachment 3 of question 24. What were the total ad valorem taxes in 2015. For fiscal year 2016, and 2017. Why taxes decreased? |
| | Note: Hughes, Pam | Staff's DR2, question 27, Atmos response. Regarding primary driver for the increase was for ad valorem tax increases. |
| | Note: Hughes, Pam | AG DR, item 24 attachment 1 and 3 - Ad vorem tax. 8% increase from 2017 to test year. Answer breaks it in 5 and 3, in a data response that describes this increase. (AG DR2 item 7) |
| 2:19:53 PM | Atty Goad cross of Witness Waller | |
| | Note: Hughes, Pam | Regarding impact on Tax Cut and Job Act for Western Ky Gas and WKG Storage. |
| 2:20:46 PM | Atty Goad cross of Witness Waller | |
| | Note: Hughes, Pam | Regarding rate making in Mississippi. |
| 2:21:55 PM | Atty Goad cross of Witness Waller | |
| | Note: Hughes, Pam | Explains how the band or range works in Mississippi. |
| | Note: Hughes, Pam | How an ROE band would benefit Atmos or its customers |
| 2:23:53 PM | Atty Goad cross of Witness Waller | |
| | Note: Hughes, Pam | Regarding formulas used in other states as the one in Mississippi. |

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| 2:24:30 PM | VC cross of Witness Waller Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | First page in this exhibit is Ky related. The other is Atmos as a whole, not KY specific Increasing investment in the PRP on ROE. Investing in the state of Ky and pipeline has to be replaced. PRP filed annually other investments not filed regularly. AG exhibit 2- Net plant services from 2016 to forecasted year. Line 13. What type of projects are going into this besides PRP. His chart in testimony. System integrity, improvements, IT investments, Equipment investments. Large capital projects that made up that money over the 3 years. Spending a significant amount on the system. Regarding Line 34, operating revenues. Change in margin. Line 41 operating income. |
| 2:35:40 PM | VC cross of Witness Waller Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | 3 million form 2011 to 88 million in 2025? Plastic pipe design spec is 50 years. Regarding the 12% for the PRP... Build the 5 year plan and allocate capital to determine on how much to invest in each state. Capital investment in Ky growing 12% investment. Specific projects looked at and they have to determine what they can do. Annual specific budget and what they need for PRP or non PRP. |
| 2:41:21 PM | VC cross of Witness Waller Note: Hughes, Pam Note: Hughes, Pam | Regarding pension plans of the company. 401k for all employees. in 2010 they got away from the cash balance contribution plan. If prior to 2010 they had the right to stay in both plans. (Grandfathered in) If not in defined benefit plan, after 2010 get a 401k to put 4% in and a match of 4% and an additional 4%, Total 12%? |
| 2:46:51 PM | Atty Hughes re direct of Witness Waller Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | Is ad valorem tax based on rate base? Assuming no change in tax rate, the ad valorem tax will increase. Accruals not final tax payments. 2015 is last known ad vorem tax payment |
| 2:48:20 PM | Atty Cook re cross of Witness Waller Note: Hughes, Pam Note: Hughes, Pam | AG exhibit 2. Subject to check, State regulation 807KAR5:001 Section 16(8)(k) Subpart k in this regulation. Why can't this be Ky specific data only. Attachment to his rebuttal testimony shows Ky data. Provide all the ROE's for just to KY specific. Don't calculate a return on state specific unless in a rate case. They are in exhibit GKW-1 in rebuttal |
| 2:53:07 PM | Witness excused | |
| 2:53:14 PM | Break | |
| 2:53:20 PM | Session Paused | |
| 3:07:51 PM | Session Resumed | |
| 3:07:58 PM | Witness Story called Note: Hughes, Pam | Sworn in by the Chairman |
| 3:08:14 PM | Atty Hughes direct of Witness Story Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | AG objects Jennifer Story. Director of Income Tax. Addition to rebuttal page 27 have provide example of benefit to NOLC. Handed out as Atmos Exhibit 1 Atty Hughes statement |
| 3:11:36 PM | Atty Chandler comment about cross examination. | |

3:12:07 PM Atty Chandler cross of Witness Story
Note: Hughes, Pam Page 42 of Rebuttal testimony. Read lines 2-4. Regulatory liability. Difference of protected or unprotected excess ADIT.

3:14:36 PM Atty Chandler cross of Witness Story
Note: Hughes, Pam Rebuttal page 45. Property protected. Reverse South Georgia

3:15:45 PM AG exhibit 9
Note: Hughes, Pam Tac Cut and Job Act

3:17:04 PM Atty Chandler cross of Witness Story
Note: Hughes, Pam HR1-143 in the Tax Act document AG exhibit 9. Normalization of accounting that should be used. HR143-HR145 those apply to utilities and Atmos specifically. HR146 specifically. D. Normalization requirements -Witness reads this into the record. Sections 167 &168 deal with depreciation only. Repair allowances is 162 subject to check.
Note: Hughes, Pam Unprotected up to the Commission to return. Regarding if the Protected is different from the un-protected On PHDR, break it down in protected or unprotected, Witness states they can't break it down that detailed.
Note: Hughes, Pam Rebuttal 47, line 14. Excess ADITS is 31.3 million total. Are the unprotected and protected provided? PHDR

3:24:33 PM Atty Chandler cross of Witness Story
Note: Hughes, Pam What is her position on the unprotected ADITS and how long to return them. PHDR
Note: Hughes, Pam Regarding her position that Unprotected ADITS over a 20 year period.

3:26:38 PM Witness excused

3:26:46 PM Joe Christian called to the stand
Note: Hughes, Pam Sworn in by the Chairman

3:27:34 PM Atty Hughes direct of Witness Christian
Note: Hughes, Pam Adopts testimony
Note: Hughes, Pam Joe Christian - Director of Rates and Regulatory Affairs

3:28:00 PM Atty Cook cross of Witness Christian
Note: Hughes, Pam New stocks since 2013.
Note: Hughes, Pam Regarding the 2013 rate case and what the Commission approved. In current case 52.57% increase. Explains the large increase

3:29:30 PM Atty Cook cross of Witness Christian
Note: Hughes, Pam If Commission does not approve proposed ARM that it would increase the equity component.
Note: Hughes, Pam Rebuttal testimony page 7. line 3. If the Commission doesn't approve the ARM. Why is the 52.57 % equity level reasonable compared to the prior 49%.

3:32:07 PM Atty Cook cross of Witness Christian
Note: Hughes, Pam Baudino's recommendation from 1.99% down to 0.92%
Note: Hughes, Pam Regarding Baudino's proposal to remove the 2.6 million in commitment fees and have them under the O&M expense for recovery.
Note: Hughes, Pam Regarding Atmos' senior note of 450 million dollars for Atmos that matures in less than a year. What is average yield for a long-term utility bond. Baudino's testimony regarding Moody's Credit Outlook on page 30. Cost of long term debt.

3:35:52 PM Atty Cook cross of Witness Christian
Note: Hughes, Pam Regarding Mr. Kollen's testimony about the debt over a 10 year period. Refinancing Amortization that Mr. Kollen proposed to capture the cost not to refinance.
Note: Hughes, Pam Company did a half month study

Note: Hughes, Pam Regarding Atmos did not annualize down to the 4% that is present to date.

3:40:04 PM Atty Cook cross of Witness Christian
Note: Hughes, Pam Regarding that Mr. Kollen's testimony, Page 61. Line 17. Witness reads section into the record.

3:43:29 PM Atty Goad cross of Witness Christian
Note: Hughes, Pam Regarding dividends paid for fiscal year 2017, 2018 to date, test year. PHDR

3:45:00 PM Atty Goad cross of Witness Christian
Note: Hughes, Pam Regarding blended rate of 5.9% calculated for rebuttal.
Note: Hughes, Pam Rebuttal testimony page 5, lines 7 -13. Exhibit JTC-R-2 If Commission does not approve the ARM why would the 5.9% be used.

3:47:37 PM Atty Goad cross of Witness Christian
Note: Hughes, Pam Capitol structure of Dec 31 be used if the Commission doesn't approve the ARM.
Note: Hughes, Pam Are these capitol structures 13 mon averages.
Note: Hughes, Pam Regarding if the June 30, 2017 capital structure over the forecasted year is what is used in this case
Note: Hughes, Pam Rebuttal 7, lines 3 through page 8 line 4. JCT-R-3 Capital structures in the exhibit 13 months.

3:50:25 PM Atty Goad cross of Witness Christian
Note: Hughes, Pam Mr. Baudino's testimony. 8.5% to 4%. Why has Atmos not refinanced this debt yet.

3:51:54 PM Atty Goad cross of Witness Christian
Note: Hughes, Pam Rebuttal testimony, page 5. If ARM not approved Is 4% actual representation of the interest rate. PHDR in support

3:52:52 PM Witness excused

3:53:16 PM Witness Baudino called to the stand
Note: Hughes, Pam Sworn in by the Chairman

3:53:44 PM Atty Chandler direct of Witness Baudino
Note: Hughes, Pam Richard Baudino. Consultant with J. Kennedy and Assoc.
Note: Hughes, Pam Adopts his testimony and Data responses

3:54:42 PM Atty Melloan cross of Witness Baudino
Note: Hughes, Pam Direct testimony, page 30. Line 9 Reason for proposing long term debt.

3:57:15 PM Atty Melloan cross of Witness Baudino
Note: Hughes, Pam Estimate is 4.1% Interest rates are current cost of debt today.

3:57:55 PM Atty Melloan cross of Witness Baudino
Note: Hughes, Pam PHDR for support of interest rates
Note: Hughes, Pam Regarding if Witness Smith Blended the 8.5% and the 4% for the half month

3:58:54 PM Atty Melloan cross of Witness Baudino
Note: Hughes, Pam Regarding that investors look at risk.
Note: Hughes, Pam Regarding If ROE of 8.8 is approved, Atmos might find it difficult to get investor funds. Best to use current market data.

4:02:46 PM Atty Melloan cross of Witness Baudino
Note: Hughes, Pam Referring to the Increased Govt. spending and Tariffs, does that have any affect on his opinion of the 8.8 ROE
Note: Hughes, Pam Regarding the Federal Reserve affecting his decision of the 8.8 ROE

4:05:37 PM Atty Melloan cross of Witness Baudino
Note: Hughes, Pam Regarding unemployment changes and increased tariffs. Witness Baudino is staying with his 8.8% decision.

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| 4:08:01 PM | VC cross of Witness Baudino Note: Hughes, Pam | Regarding how many rate cases has he been involved in the last year? How many settled for below 9%. None below 9% |
| 4:09:25 PM | Atty Chandler re direct of Witness Baudino Note: Hughes, Pam | Outcomes of % rates being below 9%. Withdraws question |
| 4:10:24 PM | Atty Chandler re direct of Witness Baudino Note: Hughes, Pam | Regarding if he is aware of any case where the Commission giving a below average ROE and that company had trouble raising capital. NO |
| 4:11:00 PM | Atty Chandler re direct of Witness Baudino Note: Hughes, Pam Note: Hughes, Pam Note: Hughes, Pam | Regarding Capital structure. If ARM is denied the capital structure should be raised according to Atmos witness. The 57% was the equity component at the start he would not have looked at that. He agreed with the 52.6 % Equity component was 52.57 % in June vs Dec it was 57.28 Not proper to change in middle of case. |
| 4:13:32 PM | Witness excused | |
| 4:14:24 PM | Break | |
| 4:14:37 PM | Session Paused | |
| 4:25:59 PM | Session Resumed | |
| 4:26:08 PM | Witness Kollen called to the stand Note: Hughes, Pam | Lane Kollen was sworn in by the Chairman. |
| 4:26:30 PM | Atty Chandler direct of Witness Kollen Note: Hughes, Pam Note: Hughes, Pam | J. Kennedy and Associates.. Adopts his testimony and DR's no changes |
| 4:27:24 PM | Atty Chandler direct of Witness Kollen Note: Hughes, Pam Note: Hughes, Pam | Regarding what does this show. That 8 million will be used. Line 16. Being used to reduce that excess ADIT. They have 26 million left Atmos exhibit 1 - Concerns with methodologies, no. Shows accumulated deffered income taxes after the Tax Cut and Jobs Act. Amount of ADIT total. |
| 4:30:47 PM | Atty Chandler direct of Witness Kollen Note: Hughes, Pam Note: Hughes, Pam | Regarding company proposing NOL in rate base 14 million and 26 million, reduce by 8 million. They have more taxable income in the test year. Regarding testimony about negative side effects on utilities. They now have positive taxable income. |
| 4:33:04 PM | Atty Chandler direct of Witness Kollen Note: Hughes, Pam Note: Hughes, Pam | Regarding if Commission approves the NOL ADIT to rate base, what are the recommendations to reflect this. Regarding if the NOL ADIT is temporary. Will be used in 3 to 5 years. |
| 4:37:00 PM | Atty Chandler direct of Witness Kollen Note: Hughes, Pam Note: Hughes, Pam | Affect on the companies proposal is an increase of revenue requirement. Regarding Atmos exhibit 1. Company has used amortization of excess NOL ADIT as an asset. |
| 4:39:03 PM | Atty Chandler direct of Witness Kollen Note: Hughes, Pam | Referring Mr. Christian's spreadsheet in the tax cut case. Went from 9 million to 14 million NOL ADIT. |
| 4:41:41 PM | Atty Chandler direct of Witness Kollen Note: Hughes, Pam | Regarding the Proposal of the protected and unprotected excess ADIT. |

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| | Note: Hughes, Pam | Regarding accounting of tax cut and job acts and 167 and 168 only deals with depreciation. |
| | Note: Hughes, Pam | 24 year is remaining life asset |
| 4:43:36 PM | Break | |
| 4:43:46 PM | Session Paused | |
| 5:01:01 PM | Session Resumed | |
| 5:01:07 PM | Atty Hughes no cross exam of Witness Kollen | |
| | Note: Hughes, Pam | Would like to call Witness Story back on to discuss what Mr. Kollen said. |
| 5:01:53 PM | Atty Melloan cross of Witness Kollen | |
| | Note: Hughes, Pam | Why reject the 12 % out right, projected is 2 to 3 % |
| | Note: Hughes, Pam | Opinion of the 12 % escalation rate. |
| | Note: Hughes, Pam | Change to revenue requirements |
| 5:03:52 PM | Atty Melloan cross of Witness Kollen | |
| | Note: Hughes, Pam | Regarding Atmos proceedings that use formula ratemaking. |
| | Note: Hughes, Pam | Regarding ARM and formula ratemaking. Explain other states that use these. |
| 5:05:13 PM | Atty Melloan cross of Witness Kollen | |
| | Note: Hughes, Pam | Regarding formula ratemaking that provides benefits to customers. |
| 5:07:28 PM | Atty Melloan cross of Witness Kollen | |
| | Note: Hughes, Pam | Regarding Mr. Waller's rebuttal testimony page 12 and 13. His recommendations in his rebuttal testimony. |
| | Note: Hughes, Pam | Regarding modifications would be improvements |
| | Note: Hughes, Pam | Regarding if satisfied the AG's position in this case. |
| 5:10:05 PM | Atty Melloan cross of Witness Kollen | |
| | Note: Hughes, Pam | Regarding against R&D Riders in principle. |
| | Note: Hughes, Pam | Direct testimony, page 76. R&D Rider. Rebuttal testimony of Mr. Martin and did it satisfy his position. |
| 5:12:03 PM | Atty Melloan cross of Witness Kollen | |
| | Note: Hughes, Pam | Regarding a way to Quantify those benefits. |
| | Note: Hughes, Pam | Regarding if any Benefits to Atmos' R&D Rider |
| 5:13:58 PM | Atty Melloan cross of Witness Kollen | |
| | Note: Hughes, Pam | Regarding the market with account for the market for safety and efficiency and also for the pipeline improvements. |
| | Note: Hughes, Pam | Atmos still pay for the improvements |
| 5:15:20 PM | Atty Melloan cross of Witness Kollen | |
| | Note: Hughes, Pam | Regarding if aware of any regulation entity that has refused an R&D Rider. |
| 5:16:25 PM | Chairman cross of Witness Kollen | |
| | Note: Hughes, Pam | Reason to question that GTI is a first rate research organization. Any other labs in the U.S. comparable to GTI. |
| | Note: Hughes, Pam | Regarding if he had ever been to GTI's place of business in Chicago |
| | Note: Hughes, Pam | Louisiana and Mississippi had highest dollar collections on the Atmos system. They are on the coast. |
| 5:18:39 PM | Atty Chandler re direct of Witness Kollen | |
| | Note: Hughes, Pam | Regarding Mr. Christian's understanding of Mr. Kollen's proposal of amortization of long term debt. |
| | Note: Hughes, Pam | Formula rates in Louisiana and Mississippi |
| | Note: Hughes, Pam | 4% of A rated bond yield |
| 5:21:27 PM | Atty Chandler re direct of Witness Kollen | |
| | Note: Hughes, Pam | Regarding if recovering 8.5% would be unreasonable. It's a one time expense. |
| 5:22:20 PM | Atty Chandler re direct of Witness Kollen | |
| | Note: Hughes, Pam | Esculation costs |

5:23:13 PM Witness excused

5:23:27 PM Witness Story called back to the stand
 Note: Hughes, Pam Still under oath

5:23:46 PM Atty Hughes direct of Witness Story
 Note: Hughes, Pam Regarding the normalization requirements only apply to depreciation. AG exhibit 9. She reads from this document.
 Note: Hughes, Pam Consequences to Atmos for a normalization violation.
 Note: Hughes, Pam Would failing to amortize the NOL ADIT be a violation?

5:27:04 PM Atty Chandler cross of Witness Story
 Note: Hughes, Pam Regarding normalizartion requirements of Atmos

5:27:48 PM Witness excused

5:28:02 PM Break

5:28:14 PM Session Paused

5:35:27 PM Session Resumed

5:35:36 PM Witness Kollen called back
 Note: Hughes, Pam Still under oath

5:35:52 PM Atty Chandler direct of Witness Kollen
 Note: Hughes, Pam Consistency rule explanation

5:36:46 PM Atty Chandler direct of Witness Kollen
 Note: Hughes, Pam Does he believe this would cause a normalization violation due to the consistency rule?

5:37:44 PM VC statement
 Note: Hughes, Pam PHDR

5:38:21 PM Witness excused

5:38:30 PM Post Hearing Data Requests
 Note: Hughes, Pam Filing briefs. By April 17th. Atmos to file something from the IRS about the mormalization rule and violations.
 Note: Hughes, Pam Staff and the AG's office to get Data Requests out by Mar. 28th, then Atmos to respond by April 6th

5:41:05 PM Atty Cook states that he can provide copy of Consistency rule

5:41:22 PM Atty Goad statement that the confidential paper handed out earlier are now back with her.

5:41:39 PM Adjourned

5:41:46 PM Session Paused

5:41:56 PM Session Ended



Judge: Bob Cicero; Talina Mathews; Michael Schmitt

Witness: Richard Baudino; Joe Christian; Laura Gillham; James H. Vander Weide; Lane Kollen; Mark Martin; Paul Raab; Greg Smith; Jennifer Story; Greg Waller; Dane Watson

Clerk: Pam Hughes

| Name: | Description: |
|-------------------|---|
| AG Exhibit 01 | Attachment 1 to Staff's DR No. 5-01 |
| AG Exhibit 02 | Comparable Financial Data - FR 16(8)(k) |
| AG Exhibit 03 | Atmos' Data Request response by Mark Martin in Case No. 2017-00308 DR item 1.b. |
| AG Exhibit 04 | 2017-00308, Atmos' Response to Staff's DR2, Question No. 2-01. |
| AG Exhibit 05 | Case No. 2017-00349. Staff DR 2, Question 2-18 |
| AG Exhibit 06 | PSC Order in Case No. 2017-00263 - Kentucky Frontier Gas |
| AG Exhibit 07 | PSC Order in Case No. 2017-00179 - Kentucky Power |
| AG Exhibit 08 | Page 35 of response to Data Request of J. Kennedy and Associates. Lane Kollen. |
| AG Exhibit 09 | The Tax Cut and Job Act |
| Atmos' Exhibit 01 | Atmos Energy's FR 16(8)(k) - Schedule E (Modified) - Witness Waller |

TEST YEAR - ADJUSTED

ATMOS ENERGY CORPORATION - KENTUCKY
SIDE-BY-SIDE RATE SCHEDULES
TEST YEAR ENDING MAR, 31 2019

| Line No. | Billing Component | Applicable Tariffs | Current Base Rates | Current PRP Rate | Current Total Rate | Proposed Rate | Filed Proposed Rates | Billing Component | Current Rate Norm Hrs | After Hrs | Proposed Rate Norm Hrs | After Hrs | | |
|----------|---------------------------------|--------------------|--------------------|------------------|--------------------|---------------|----------------------|------------------------------|-----------------------|-----------|------------------------|-----------|-----|-----|
| | | (a) | (b) | (c) | (d) | (e) | (f) | (g) | (h) | (i) | (j) | (k) | (l) | (m) |
| 1 | CUSTOMER CHARGES, \$/month | | | | | | | | SERVICE CHARGES | | | | | |
| 2 | Firm Services - Residential | G-1 | \$17.50 | \$1.56 | \$19.06 | \$19.45 | | Meter Set | \$34.00 | \$44.00 | \$34.00 | \$44.00 | | |
| 3 | Firm Services - Non-Residential | G-1 | \$44.50 | \$5.24 | \$49.74 | \$50.75 | | Turn On | \$23.00 | \$28.00 | \$23.00 | \$28.00 | | |
| 4 | Interruptible Sales | G-2 | \$375.00 | \$18.35 | \$393.35 | \$400.00 | | Read | \$12.00 | \$14.00 | \$12.00 | \$14.00 | | |
| 5 | Firm Transportation | T-4 | \$375.00 | \$21.49 | \$396.49 | \$400.00 | | Reconnect Delinquent Service | \$39.00 | \$47.00 | \$39.00 | \$47.00 | | |
| 6 | Interruptible Transportation | T-3 | \$375.00 | \$23.04 | \$398.04 | \$400.00 | | Seasonal Charge | \$65.00 | \$73.00 | \$65.00 | \$73.00 | | |
| 7 | DISTRIBUTION CHARGES, \$/Mcf | W/o PRP> | \$350.00 | \$350.00 | \$375.00 | 375.00 | | Special Meter Reading Charge | \$0.00 | N/A | \$0.00 | N/A | | |
| 8 | Firm Sales | G-1 | | | | | | Meter Test Charge | \$20.00 | N/A | \$20.00 | N/A | | |
| 9 | 1-300 Mcf | \$0.03600 | \$1.5340 | \$0.0000 | \$1.5340 | \$1.5700 | | Returned Check Charge | \$25.00 | N/A | \$25.00 | N/A | | |
| 10 | 301-15000 Mcf | \$0.04500 | \$0.9500 | \$0.0000 | \$0.9500 | \$0.9950 | | Late Payment Charge | 5% | 5% | 5% | 5% | | |
| 11 | Over 15000 | \$0.04000 | \$0.7400 | \$0.0000 | \$0.7400 | \$0.7800 | | Class 1 EFM Equipment Charge | \$75.00 | N/A | \$75.00 | N/A | | |
| 12 | Firm Transportation | T-4 | | | | | | Class 2 EFM Equipment Charge | \$175.00 | N/A | \$175.00 | N/A | | |
| 13 | 1-300 Mcf | | \$1.53400 | \$0.08930 | \$1.6233 | \$1.5700 | | | | | | | | |
| 14 | 301-15000 Mcf | | \$0.95000 | \$0.05530 | \$1.0053 | \$0.9950 | | | | | | | | |
| 15 | Over 15000 | | \$0.74000 | \$0.04310 | \$0.7831 | \$0.7800 | | | | | | | | |
| 16 | Interruptible Sales | G-2 | | | | | | | | | | | | |
| 17 | 1-15000 Mcf | \$0.02600 | \$0.85000 | \$0.05900 | \$0.9090 | \$0.9350 | | | | | | | | |
| 18 | Over 15000 | \$0.02100 | \$0.64050 | \$0.04440 | \$0.6849 | \$0.7059 | | | | | | | | |
| 19 | Interruptible Transportation | T-3 | | | | | | | | | | | | |
| 20 | 1-15000 Mcf | | \$0.85000 | \$0.05310 | \$0.9031 | \$0.9350 | | | | | | | | |
| 21 | Over 15000 | | \$0.64050 | \$0.04000 | \$0.6805 | \$0.7059 | | | | | | | | |
| 22 | OTHER CHARGES | | | | | | | | | | | | | |
| 23 | Transp. Adm. Fee, \$/Mcf | T-2, T-3, T-4 | \$50.00 | \$50.00 | \$50.00 | \$50.00 | | | | | | | | |
| 24 | Parking, \$/Mcf | T-4, T-3 | 0.10 | 0.10 | 0.10 | 0.10 | | | | | | | | |

26 SUMMARY OF PROPOSED VS. CURRENT RATES:

| 27 | Base Monthly Charges | | | Transp Adm/Parking/ EFM Charges | | | Distribution Charges | | | TOTAL | | | | |
|----|-----------------------|------------|------------|---------------------------------|----------|----------|----------------------|------------|------------|------------|------------|------------|-----------|-------|
| | Current | Proposed | % Change | Current | Proposed | % Change | Current | Proposed | % Change | Current | Proposed | Difference | % Change | |
| 28 | Total Class | | | | | | | | | | | | | |
| 29 | Residential | 35,954,155 | 36,689,838 | 2.05% | - | - | 15,380,475 | 15,741,425 | 2.35% | 51,334,630 | 52,431,263 | 1,096,633 | 2.14% | |
| 30 | Commercial Firm | 10,395,212 | 10,606,293 | 2.03% | - | - | 7,172,415 | 7,353,252 | 2.52% | 17,567,627 | 17,959,545 | 391,918 | 2.23% | |
| 31 | Industrial Firm | 120,818 | 123,272 | 2.03% | - | - | 681,029 | 704,410 | 3.43% | 801,848 | 827,682 | 25,834 | 3.22% | |
| 32 | Public Authority Firm | 924,318 | 943,087 | 2.03% | - | - | 1,391,404 | 1,427,401 | 2.59% | 2,315,722 | 2,370,488 | 54,766 | 2.36% | |
| 33 | Com/Ind Interruptible | 55,856 | 56,800 | 1.69% | | | 364,298 | 374,799 | 2.88% | 420,153 | 431,599 | 11,446 | 2.72% | |
| 34 | Transportation | 932,279 | 939,200 | 0.74% | 244,230 | 244,230 | 0.00% | 14,025,580 | 14,188,302 | 1.16% | 15,202,088 | 15,371,732 | 169,643 | 1.12% |
| 35 | Special Contracts | 62,475 | 62,475 | 0.00% | 86,159 | 86,159 | 0.00% | 2,125,425 | 2,125,425 | 0.00% | 2,274,060 | 2,274,060 | - | 0.00% |
| 36 | Sub-total Revenue | 48,445,114 | 49,420,965 | 2.01% | 330,389 | 330,389 | 0.00% | 41,140,626 | 41,915,015 | 1.88% | 89,916,128 | 91,666,368 | 1,750,240 | 1.95% |
| 37 | | | 975,851 | | | | | | | | | | | |
| 38 | Other Gas Revenues | | | | | | | 774,389 | | 2,104,018 | 2,117,754 | 13,736 | 0.65% | |
| 39 | Total Revenue | | | | | | 7,192,244 | 7,109,656 | | 92,020,147 | 93,784,122 | 1,763,975 | 1.92% | |

Atmos Energy Corporation, Kentucky/Mid-States Division
 Kentucky Jurisdiction Case No. 2017-00349
 Comparative Financial Data
 Base Period: Twelve Months Ended December 31, 2017
 Forecasted Test Period: Twelve Months Ended March 31, 2019
 and 10 Most Recent Calendar Years

Data: Base Period Forecasted Period
 Type of Filing: _____ Original _____ Updated Revised
 Workpaper Reference No(s): _____

FR 16(8)(k)
 Schedule K

Witness: Gillham, Martin, and Waller

| Line No. | Description | Forecasted Period | Base Period | Most Recent Ten Calendar Years - as Reported | | | | | | | | | |
|----------|--|-------------------|-------------|--|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| | | | | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 |
| 1 | <u>Plant Data: (\$000)</u> | | | | | | | | | | | | |
| 2 | Plant in Service by functional class: | | | | | | | | | | | | |
| 3 | Intangible Plant | 779 | 779 | 128 | 128 | 128 | 128 | 128 | 128 | 128 | 128 | 128 | 128 |
| 4 | Production & Gathering Plant | 0 | 0 | 0 | 0 | 636 | 901 | 901 | 901 | 901 | 901 | 901 | 901 |
| 5 | Underground Storage | 14,280 | 15,024 | 12,454 | 11,560 | 10,792 | 9,630 | 10,104 | 9,388 | 7,731 | 7,540 | 6,950 | 6,878 |
| 6 | Transmission Plant | 31,808 | 31,784 | 31,814 | 31,808 | 31,877 | 32,962 | 32,836 | 33,144 | 31,189 | 31,202 | 28,807 | 28,746 |
| 7 | Distribution Plant | 588,244 | 517,179 | 472,849 | 413,302 | 381,623 | 340,200 | 323,036 | 296,493 | 283,474 | 271,463 | 260,621 | 251,843 |
| 8 | General Plant | 44,021 | 39,867 | 21,271 | 18,126 | 16,683 | 15,589 | 15,238 | 16,000 | 15,103 | 14,696 | 15,422 | 15,166 |
| 9 | Acquisition Adjustments | | | 3,279 | 3,279 | 3,279 | 3,279 | 3,279 | 3,279 | 3,337 | 3,337 | 3,337 | 3,337 |
| 10 | | | | | | | | | | | | | |
| 11 | Gross Plant | 679,132 | 604,632 | 541,795 | 478,203 | 445,018 | 402,689 | 385,522 | 359,333 | 341,863 | 329,267 | 316,166 | 306,998 |
| 12 | Less: Accumulated depreciation | 199,949 | 189,077 | 167,228 | 165,298 | 160,839 | 158,300 | 151,849 | 150,795 | 147,462 | 144,016 | 139,212 | 134,463 |
| 13 | Net plant in Service | 479,183 | 415,555 | 374,567 | 312,905 | 284,179 | 244,389 | 233,673 | 208,538 | 194,401 | 185,251 | 176,954 | 172,535 |
| 14 | | | | | | | | | | | | | |
| 15 | Construction Work in Progress | 27,493 | 32,864 | 10,146 | 26,310 | 12,708 | 16,578 | 6,006 | 3,306 | 7,197 | 4,851 | 5,215 | 1,897 |
| 16 | | | | | | | | | | | | | |
| 17 | Total CWIP | 27,493 | 32,864 | 10,146 | 26,310 | 12,708 | 16,578 | 6,006 | 3,306 | 7,197 | 4,851 | 5,215 | 1,897 |
| 18 | | | | | | | | | | | | | |
| 19 | Total | 506,676 | 448,419 | 384,713 | 339,215 | 296,887 | 260,967 | 239,679 | 211,844 | 201,598 | 190,102 | 182,169 | 174,432 |
| 20 | | | | | | | | | | | | | |
| 21 | % of Construction financed internally | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| 22 | | | | | | | | | | | | | |
| 23 | | | | | | | | | | | | | |
| 24 | <u>Capital structure: (Total Company)</u> | | | | | | | | | | | | |
| 25 | <u>(based on year-end accounts)</u> | | | | | | | | | | | | |
| 26 | Short-term debt (\$000) | 242,504 | 524,449 | 829,811 | 457,927 | 196,695 | 367,984 | 570,929 | 206,396 | 126,100 | 72,550 | 350,542 | 150,599 |
| 27 | Long-term debt (\$000) | 3,066,734 | 3,067,469 | 2,438,779 | 2,437,515 | 2,455,986 | 2,455,671 | 1,956,305 | 2,206,117 | 1,809,551 | 2,169,400 | 2,119,792 | 2,126,315 |
| 28 | Preferred stock (\$000) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 29 | Common equity (\$000) | 3,668,227 | 4,563,620 | 3,463,059 | 3,194,797 | 3,086,232 | 2,580,409 | 2,359,243 | 2,255,421 | 2,178,348 | 2,176,761 | 2,052,492 | 1,965,754 |
| 30 | | | | | | | | | | | | | |
| 31 | Total | 6,977,466 | 8,155,538 | 6,731,649 | 6,090,239 | 5,738,913 | 5,404,064 | 4,886,477 | 4,667,934 | 4,113,999 | 4,418,711 | 4,522,826 | 4,242,668 |
| 32 | | | | | | | | | | | | | |
| 33 | <u>Condensed Income Statement data: (\$000)</u> | | | | | | | | | | | | |
| 34 | Operating Revenues | 170,729 | 164,102 | 147,431 | 170,468 | 196,882 | 162,968 | 134,778 | 149,662 | 156,816 | 190,356 | 244,308 | 203,287 |
| 35 | Operating Expenses (excludes Federal and State Taxes, includes gas cost) | 132,952 | 124,246 | 113,447 | 141,526 | 166,452 | 139,358 | 112,027 | 126,219 | 136,649 | 176,587 | 224,348 | 187,733 |
| 36 | State Income Tax (current) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 37 | Federal Income Tax (current) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 38 | Federal and State Income Tax - net | 11,799 | 13,536 | 9,516 | 9,884 | 9,671 | 7,060 | 8,157 | 8,094 | 5,654 | 2,889 | 6,985 | 4,307 |
| 39 | Investment tax credits | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 40 | Operating Income | 25,979 | 26,320 | 24,468 | 19,058 | 20,759 | 16,550 | 14,594 | 15,349 | 14,513 | 10,880 | 12,976 | 11,247 |
| 41 | AFUDC | 0 | 0 | 179 | 182 | 139 | 88 | 101 | 22 | 286 | 199 | 160 | 94 |
| 42 | | | | | | | | | | | | | |

Atmos Energy Corporation, Kentucky/Mid-States Division
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 Forecasted Test Period: Twelve Months Ended March 31, 2019
 and 10 Most Recent Calendar Years

Data: Base Period Forecasted Period
 Type of Filing: Original Updated Revised
 Workpaper Reference No(s).

FR 16(8)(k)
 Schedule K

Witness: Gillham, Martin, and Waller

| Line No. | Description | Forecasted Period | Base Period | Most Recent Ten Calendar Years - as Reported | | | | | | | | | |
|----------|---|-------------------|-------------|--|---------|---------|--------|--------|--------|--------|--------|--------|--------|
| | | | | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 |
| 43 | Other Income net | 2,514 | 2,514 | 2,087 | 2,063 | 2,019 | 2,033 | 2,046 | 2,657 | 1,748 | 2,278 | 2,529 | 1,547 |
| 44 | Income available for fixed charges | 28,492 | 28,834 | 26,734 | 21,303 | 22,917 | 18,671 | 16,741 | 18,026 | 16,547 | 13,357 | 15,865 | 12,888 |
| 45 | Interest charges | 9,960 | 7,573 | 7,556 | 6,926 | 6,559 | 6,524 | 5,612 | 5,792 | 6,270 | 6,633 | 6,138 | 6,155 |
| 46 | Net Income | 18,533 | 21,261 | 19,178 | 14,377 | 16,358 | 12,147 | 11,129 | 12,236 | 10,277 | 6,724 | 9,527 | 6,733 |
| 47 | Preferred dividends accrual | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| 48 | Earnings available for common equity | 18,533 | 21,261 | 19,178 | 14,377 | 16,358 | 12,147 | 11,129 | 12,236 | 10,277 | 6,724 | 9,527 | 6,733 |
| 49 | | | | | | | | | | | | | |
| 50 | AFUDC - % of Net Income | 0.00% | 0.00% | 0.93% | 1.27% | 0.85% | 0.72% | 0.91% | 0.18% | 2.78% | 2.96% | 1.68% | 1.40% |
| 51 | AFUDC - % of earnings available for common equity | 0.00% | 0.00% | 0.93% | 1.27% | 0.85% | 0.72% | 0.91% | 0.18% | 2.78% | 2.96% | 1.68% | 1.40% |
| 52 | | | | | | | | | | | | | |
| 53 | | | | | | | | | | | | | |
| 54 | | | | | | | | | | | | | |
| 55 | | | | | | | | | | | | | |
| 56 | <u>Costs of Capital (1)</u> | | | | | | | | | | | | |
| 57 | Embedded cost of short-term debt (%) | 1.99% | 2.20% | 1.12% | 1.09% | 1.49% | 1.17% | 1.22% | 1.03% | 3.23% | 6.80% | 4.40% | 5.60% |
| 58 | Embedded cost of long-term debt (%) | 5.11% | 5.20% | 5.89% | 5.90% | 6.03% | 6.26% | 6.51% | 6.75% | 6.88% | 6.90% | 6.10% | 6.10% |
| 59 | Embedded cost of preferred stock (%) | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| 60 | | | | | | | | | | | | | |
| 61 | <u>Fixed Charge Coverage: (1)</u> | | | | | | | | | | | | |
| 62 | Pre-Tax Interest Coverage | 4.05 | 5.59 | 5.75 | 5.39 | 4.69 | 3.91 | 3.06 | 2.97 | 3.00 | 2.84 | 3.06 | 2.75 |
| 63 | Pre-Tax Interest Coverage (Excluding AFUDC) | 4.05 | 5.59 | 5.77 | 5.41 | 4.70 | 3.92 | 3.04 | 2.95 | 2.99 | 2.80 | 3.12 | 2.81 |
| 64 | After Tax Interest Coverage | 2.86 | 3.81 | 3.24 | 3.71 | 3.24 | 2.89 | 2.36 | 2.26 | 2.23 | 2.20 | 2.26 | 2.12 |
| 65 | SEC Coverage | 4.01 | 5.51 | 5.17 | 4.89 | 4.32 | 3.60 | 2.84 | 2.78 | 2.78 | 2.55 | 2.76 | 2.69 |
| 66 | After Tax Interest Coverage (Excluding AFUDC) | 2.86 | 3.81 | 4.04 | 3.73 | 3.25 | 2.81 | 2.35 | 2.24 | 2.21 | 2.16 | 2.31 | 2.16 |
| 67 | Indenture Provision Coverage | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| 68 | After Tax Fixed Charge Coverage | 6.22 | 8.61 | 3.65 | 3.39 | 3.02 | 2.60 | 2.21 | 2.13 | 2.08 | 2.18 | 2.15 | 2.04 |
| 69 | | | | | | | | | | | | | |
| 70 | <u>Stock and Bond Ratings: (1)</u> | | | | | | | | | | | | |
| 71 | Moody's Bond Rating | N/A | A2 | A2 | A2 | A2 | Baa1 | Baa1 | Baa1 | Baa2 | Baa2 | Baa3 | Baa3 |
| 72 | S&P Bond Rating | N/A | A | A | A- | A- | A- | BBB+ | BBB+ | BBB+ | BBB+ | BBB | BBB |
| 73 | Moody's Preferred Stock Rating | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| 74 | S&P Preferred Stock Rating | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| 75 | | | | | | | | | | | | | |
| 76 | <u>Common Stock Related Data: (1)</u> | | | | | | | | | | | | |
| 77 | Shares Outstanding Year End (000) | N/A | N/A | 103,931 | 101,479 | 100,388 | 90,640 | 90,240 | 90,296 | 90,164 | 92,552 | 90,814 | 89,326 |
| 78 | Shares Outstanding - Weighted Average (Monthly) (000) | N/A | N/A | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 79 | Average (Monthly) (000) | N/A | N/A | 103,524 | 101,892 | 97,608 | 91,711 | 91,172 | 90,652 | 92,422 | 91,620 | 89,941 | 87,486 |
| 80 | Earnings Per Share - Weighted Avg. (\$) | N/A | N/A | 3.38 | 3.09 | 2.96 | 2.64 | 2.37 | 2.27 | 2.20 | 2.07 | 1.99 | 1.91 |
| 81 | Dividends Paid Per Share (\$) | N/A | N/A | 1.68 | 1.56 | 1.48 | 1.40 | 1.38 | 1.36 | 1.34 | 1.32 | 1.30 | 1.28 |
| 82 | Dividends Declared Per Share (\$) | N/A | N/A | 1.68 | 1.56 | 1.48 | 1.40 | 1.38 | 1.36 | 1.34 | 1.32 | 1.30 | 1.28 |
| 83 | Dividend Payout Ratio (Declared Basis) (%) | N/A | N/A | 50% | 50% | 50% | 53% | 58% | 60% | 61% | 64% | 65% | 67% |
| 84 | | | | | | | | | | | | | |
| 85 | Market Price - High (Low) | N/A | N/A | | | | | | | | | | |

Atmos Energy Corporation, Kentucky/Mid-States Division
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Data: Base Period Forecasted Period
 Type of Filing: Original Updated Revised
 Workpaper Reference No(s):

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 Schedule K

Witness: Gillham, Martin, and Waller

| Line No. | Description | Forecasted Period | Base Period | Most Recent Ten Calendar Years - as Reported | | | | | | | | | |
|----------|--|-------------------|-------------|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| | | | | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 |
| 86 | 1st Quarter - High (\$) | N/A | N/A | 64,250 | 58,080 | 47,080 | 36,860 | 35,400 | 31,720 | 30,060 | 27,880 | 29,460 | 33,010 |
| 87 | 1st Quarter - Low (\$) | N/A | N/A | 57,820 | 47,350 | 41,080 | 33,200 | 30,970 | 29,100 | 27,390 | 21,170 | 26,110 | 28,450 |
| 88 | 2nd Quarter - High (\$) | N/A | N/A | 74,330 | 58,810 | 48,010 | 42,690 | 33,150 | 34,980 | 29,620 | 25,950 | 28,980 | 33,000 |
| 89 | 2nd Quarter - Low (\$) | N/A | N/A | 61,740 | 52,020 | 44,190 | 35,110 | 30,800 | 31,510 | 26,520 | 20,200 | 25,090 | 30,630 |
| 90 | 3rd Quarter - High (\$) | N/A | N/A | 81,320 | 56,410 | 53,400 | 44,870 | 35,070 | 34,940 | 29,980 | 26,370 | 28,540 | 33,110 |
| 91 | 3rd Quarter - Low (\$) | N/A | N/A | 70,600 | 51,280 | 46,940 | 38,590 | 30,910 | 31,340 | 26,410 | 22,810 | 25,810 | 29,380 |
| 92 | 4th Quarter - High (\$) | N/A | N/A | 81,160 | 58,180 | 52,680 | 45,190 | 36,940 | 34,320 | 29,810 | 28,800 | 28,250 | 30,660 |
| 93 | 4th Quarter - Low (\$) | N/A | N/A | 71,880 | 51,480 | 47,010 | 39,400 | 34,940 | 28,870 | 26,820 | 24,650 | 25,490 | 26,470 |
| 94 | Book Amount Per Share (Year-end) (\$) | N/A | N/A | 33,450 | 31,350 | 31,620 | 28,140 | 25,877 | 24,880 | 23,570 | 23,759 | 22,820 | 22,469 |
| 95 | | | | | | | | | | | | | |
| 96 | (1) Based on fiscal year-end of parent company | | | | | | | | | | | | |
| 97 | | | | | | | | | | | | | |
| 98 | Rate of Return Measures (1) | | | | | | | | | | | | |
| 99 | Return On Common Equity (Average) | N/A | N/A | 10.5% | 10.0% | 10.2% | 9.8% | 8.3% | 8.6% | 8.7% | 8.7% | 8.8% | 8.8% |
| 100 | Return On Total Capital (Average) | 0.4% | 0.3% | 5.5% | 5.2% | 5.2% | 4.8% | 4.0% | 4.3% | 4.4% | 4.3% | 4.3% | 4.3% |
| 101 | Return On Net Plant in Service (Average) | 5.4% | 6.3% | 4.5% | 4.5% | 4.5% | 4.3% | 3.6% | 3.8% | 4.1% | 4.3% | 4.5% | 4.5% |
| 102 | | | | | | | | | | | | | |
| 103 | Other Financial and Operating Data: | | | | | | | | | | | | |
| 104 | Mix of Sales: (MMcf) | | | | | | | | | | | | |
| 105 | Residential | 10,026 | 8,350 | 9,094 | 9,826 | 11,729 | 10,695 | 8,433 | 10,187 | 10,735 | 10,261 | 10,855 | 10,385 |
| 106 | Commercial | 4,896 | 4,416 | 4,538 | 4,845 | 5,650 | 5,143 | 3,972 | 4,642 | 5,049 | 4,659 | 5,017 | 4,793 |
| 107 | Industrial | 973 | 1,265 | 1,048 | 693 | 810 | 811 | 995 | 821 | 724 | 960 | 1,715 | 1,757 |
| 108 | Public authority & Other Sales | 963 | 825 | 916 | 1,025 | 1,234 | 1,179 | 980 | 1,111 | 1,192 | 1,176 | 1,253 | 1,195 |
| 109 | Unbilled | 0 | 0 | | | | | | | | | | |
| 110 | Total Mix of Sales | 16,858 | 14,856 | 15,596 | 16,389 | 19,423 | 17,828 | 14,380 | 16,761 | 17,700 | 17,056 | 18,839 | 18,130 |
| 111 | | | | | | | | | | | | | |
| 112 | Mix of Fuel: (MMcf) | | | | | | | | | | | | |
| 113 | Other | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 114 | Other | 17,178 | 15,138 | 15,417 | 18,606 | 21,324 | 18,367 | 17,441 | 16,748 | 17,596 | 17,034 | 18,790 | 19,493 |
| 115 | | | | | | | | | | | | | |
| 116 | Total MIX of Fuel (2) | 17,178 | 15,138 | 15,417 | 18,606 | 21,324 | 18,367 | 17,441 | 16,748 | 17,596 | 17,034 | 18,790 | 19,493 |
| 117 | | | | | | | | | | | | | |
| 118 | Composite Depreciation Rate | 3.17% | 2.96% | 3.33% | 3.68% | 3.50% | 3.31% | 3.49% | 3.58% | 3.40% | 3.43% | 3.17% | 3.48% |

(1) Based on fiscal year-end of parent company, except for Base Period & Test Period which are based on Atmos Energy Corporation, Kentucky.
 (2) Kentucky gas purchases by accounting month.

**ATMOS ENERGY CORPORATION
DATA REQUEST
CASE NO. 2017-00308
DR Item 1(b)**

**WITNESS: Mark A. Martin
Vice President of Rates and Regulatory Affairs
Atmos Energy Corporation, Kentucky/Midstates Division**

b. Refer to the Application, Volume 1 of 6, Direct Testimony of Earnest B. Napier, P.E., page 13.

- i. To date, what is the total cost of the Pipeline Replacement Program?
- ii. What is the estimated total cost of the program from now until expected completion?
- iii. How does the total cost to date, and the expected cost from now until expected completion compare with the estimate of \$124 million provided for on page 13 of Mr. Napier's testimony?
- iv. Provide the annual capital investment amounts for each year to date for the PRP and the estimated capital investment amounts for each year from now until expected completion.

RESPONSE:

- i. Through July 31, 2017, the total cost of the PRP is approximately \$158,100,000.
- ii. The Company has been investing significant dollars into its PRP to proactively replace all known pipe referenced in Mr. Napier's testimony in Case No. 2009-00354. The Company utilizes a rolling five year plan to forecast capital spend. The Company anticipates spending approximately \$280,000,000 from October 1, 2017 through September 30, 2022 in its PRP.
- iii. The estimate referenced in Mr. Napier's testimony is no longer valid. As stated in response to 1.a.i, an additional 100 miles have been added to the program as well as the "Shelbyville Line" and the "Lake City Line".
- iv. Below is a table that summarizes the annual capital investment made per year since inception as well as the estimated capital spend per year through September 30, 2022. The Company's PRP is timed with its fiscal year which runs October 1st through September 30th. As stated in response to 1.b.ii, the Company utilizes a rolling five year plan to forecast capital spend. Please note that for the period October 1, 2016 through July 31, 2017, the Company has spent approximately \$30.3m and will reach its target of \$40.2m.

| Fiscal Year | Approximate Investment |
|-------------|------------------------|
| 2011 | \$3,700,000 |
| 2012 | \$17,300,000 |
| 2013 | \$17,200,000 |
| 2014 | \$22,700,000 |
| 2015 | \$36,900,000 |
| 2016 | \$30,000,000 |
| 2017 | \$40,200,000 |
| 2018 | \$44,900,000 |
| 2019 | \$51,100,000 |
| 2020 | \$56,900,000 |
| 2021 | \$63,200,000 |
| 2022 | \$63,100,000 |

Docket No. 2017-00308
Atmos Energy Corporation, Kentucky Division
Staff DR Set No. 2
Question No. 2-01
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REQUEST:

Refer to Atmos's September 26, 2017 response to Commission Staff's Informal Conference Memorandum ("IC DR"), Item 1, and the response to the Attorney General's First Request for Information ("AG DR 1"), Items 1.b. and 1.d.

- a. The response to AG-DR 1, Item 1.b.i. states that through July 31, 2017, the total cost of the Pipeline Replacement Program ("PRP") is approximately \$158.1 million. The question in AG-DR 1, Item 1.b.iii. references the original \$124 million estimate for the total 15 years of the program. State whether Atmos has considered extending the number of years for pipeline replacement pursuant to its PRP beyond 15 years, given that the projected annual increase in customer charges shown in the IC DR, and the \$438 million in total capital investment amounts shown in the AG DR 1, Item 1.b.iv. table for the years 2011 through 2022.
- b. Provide any available estimates for expected annual PRP expenditures for the years 2023 through 2025.
- c. State whether there are safety concerns inherent in extending the PAP for longer than the originally contemplated 15 years. If so, enumerate the safety concerns in detail.

RESPONSE:

- a. The Company has not considered extending the number of years for bare steel pipeline replacement beyond the fifteen years asked for and granted in Case No. 2009-00354. The Company takes great pride in being a low-cost provider, but our ultimate goal is to be the safest provider. The ultimate goal of the Company's PRP program is the accelerated replacement of aging infrastructure that has outlived its useful life and/or poses a possible safety and/or reliability concern.
- b. As stated in the Company's response to AG 1.b.ii and 1.b.iv, the Company utilizes a rolling five year plan to forecast capital spend. Below are additional estimates for years 2023 through 2025. Please note that these amounts are purely estimates at this point in time.

2023 - \$70,700,000
2024 - \$79,200,000
2025 - \$88,700,000

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- c. As stated previously, the goal of the Company's PRP program is the accelerated replacement of aging infrastructure that has outlived its useful life and/or poses a possible safety and/or reliability concern. The Company is of the belief that delaying the replacement of such facilities would inherently create safety concerns. When the Company proposed its PRP program which was approved in Case No. 2009-00354, the bare steel pipe had been in the ground approximately 50-75 years. The longer bare steel pipe remains in service, the more susceptible the pipe is to corrosion and leaks. As of January 2011, the Company had approximately 1,440 underground leaks. As of August 2017, underground leaks are down to approximately 530. The majority of the reduction can be directly correlated to the accelerated replacement of bare steel lines. The accelerated replacement of aging infrastructure allows the Company to modernize its distribution system. The Company does not believe that the replacement of these facilities should be delayed any more than necessary.

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REQUEST:

Refer to the Waller Testimony, page 14, lines 18-26, and to Atmos's most recent Pipe Replacement Program ("PRP") rider rate proceeding, Case No. 2017-00308.⁵

- a. Provide for the record in this proceeding a comparison of Atmos's original PRP investment as approved in Case No. 2009-00354⁶ with actual annual experience with the PRP. The comparison should include the actual realized cost of projects, the factors causing unanticipated additions to the original program, and the reasons for the initial underestimation of cost upon which the Commission relied in approving the PRP over a period of 15 years.
- b. Provide for the record in this proceeding an update to the Direct Testimony of Earnest B. Napier from Case No. 2009-00354 with regard to the replacement of remaining bare steel mains and appurtenances, and the anticipated cost per year for the remainder of the 15-year period.
- c. Provide a discussion of how Atmos prioritizes annual replacements through the PRP.
- d. Provide the number of leaks on Atmos's Kentucky system for each year since it began replacing pipe using the PRP.
- e. Refer to Case No. 2017-00308, Atmos's September 26, 2017 response to Commission Staff's Informal Conference Memorandum Data Request, Item 1, and its response to the Attorney General's Second Request for Information, Item 1, which collectively show expected PRP rates through 2025 assuming no rate case activity. Provide a discussion of any safety issues that are likely to arise if Atmos's pipeline replacements and resulting cost recovery were to be extended over a longer period in order to alleviate the impact of higher-than-anticipated cost on its customers.

RESPONSE:

- a) As stated in the Company's response in Case No. 2017-00308 to AG DR No. 1-01 subpart (b)iii, "The estimate referenced in Mr. Napier's testimony is no longer valid." The original estimate of \$124 million (see page 13 of the Napier testimony in 2009-00354) provided for filing of the PRP program based on Atmos Energy construction procedures, comparative projects, and industry regulation that are now over 10 years old. Additionally, there were assumptions made within this original estimate that have proved to be incorrect in order to manage a program of this size. A few of the more significant differences relate to (1) the cost of service line and meter loop replacement; (2) the cost of Crossbore

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Inspection Services; (3) the estimated engineering design, project management, and mapping cost associated with these replacement projects; (4) the underestimation of the cost of large diameter high-pressure and transmission lines within the program. In general, these construction cost were all estimated at \$400k / mile and our actual cost for replacement has been approximately \$628k / mile for distribution and range from \$1,100k to \$2,000k / mile for HPD/Transmission depending on the size of pipeline being installed. Please see part b of this response for the Company's actual and projected investment.

- b) The PRP program started in FY11 for Atmos Energy with minimal pipe replacement occurring this first year and work being assigned and contracted using existing Master Service Agreements. Atmos Energy solicited bids for dedicated PRP Contractors and began filling internal PRP inspection positions during FY11 and FY12 as our PRP budget and spend necessitated the positions. Additionally, Atmos Energy created and assigned (2) internal construction crews in FY13 and FY14 as the program grew and logistical needs presented themselves for work on isolated projects.

Success of the program and the ability to stay on target with the original projected timeline has been accomplished while also including additional field-identification of bare-steel systems, the Lake City and Shelbyville pipe segments, replacement of aging and at-risk infrastructure such as regulator and metering stations, inclusion of network and critical valves, and remote monitoring of pressure and flow at critical stations by Atmos Energy SCADA and measurement departments.

As provided in the Company's response to AG DR No. 1-01 subpart (b)iv and Staff DR No. 2-01 subpart (b) in Case No. 2017-00308, below is the estimated PRP spend for FY 2018 to 2025.

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| Year | Annual PRP Investment |
|-----------|-----------------------|
| 2011 | \$3,741,125 |
| 2012 | \$17,300,344 |
| 2013 | \$17,171,794 |
| 2014 | \$22,691,182 |
| 2015 | \$36,926,441 |
| 2016 | \$29,968,709 |
| 2017 | \$39,898,050 |
| 2018 Est. | \$44,900,000 |
| 2019 Est. | \$51,100,000 |
| 2020 Est. | \$56,900,000 |
| 2021 Est. | \$63,200,000 |
| 2022 Est. | \$63,100,000 |
| 2023 Est. | \$70,700,000 |
| 2024 Est. | \$79,200,000 |
| 2025 Est. | \$88,700,000 |

c) PRP Program Management works continuously with local management and engineering to identify which bare steel projects will be scheduled for replacement each fiscal year. Based on approved capital dollars, filed annually with the Kentucky PSC, we plan projects according to many factors including:

- Analysis of recent leak surveys and leak history on remaining bare steel systems
- Recommendations by local SME and engineering on what would be the best use of capital for reduced O&M and system improvement
- Where contract crews, inspection, and warehouse materials are currently deployed and their ability to mobilize between separate locations
- The local impact to city and municipality based on local resources needed to support (locating, planning and zoning inspection, local plans for street overlay / downtown revitalization, and logistical issues such as availability of asphalt for street repairs, etc.)

There are some outside factors which may cause us to delay PRP projects into later years. The ability/difficulty in getting easements from landowners, construction that is weather sensitive such as the replacement of regulator stations and high-pressure pipelines, low pressure systems that require temporary feeds that (in turn) depend on a preceding project to be accomplished are examples.

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- d) In 2011, Atmos Energy was managing over 1,100 below ground leaks within the state of Kentucky. This number of leaks was on the increase as the program ramped up, peaking within the 2012-2013 operating years at over 1,300. Since this time, we have seen a significant decrease in the number of leaks found, monitored, and scheduled for repair. Atmos Energy currently has 530 leaks scheduled for repair (refer to the Company's response to Staff DR No. 2-01 subpart (c) in Case No. 2017-00308). Although reports will show slight variations based on timing scheduled leak surveys, our overall leak count continues to trend downward as infrastructure replacement continues.

It is important to note that the number of below ground leaks within the Atmos Energy distribution system continues to decline in spite of more stringent regulation, Atmos Energy O&M requirements, and newer leak survey technologies. Per the Atmos Energy DIM plan, we now leak survey all systems in Kentucky with bare steel annually. We have continuously invested in new infra-red and laser leak survey equipment that is able to detect methane at lower trace levels than before.

| Date | # Leaks |
|-----------|---------|
| Jan, 2011 | 1,127 |
| Jan, 2012 | 1,308 |
| Jan, 2013 | 1,354 |
| Jan, 2014 | 1,169 |
| Jan, 2015 | 1,076 |
| Jan, 2016 | 677 |
| Jan, 2017 | 600 |
| Aug, 2017 | 528 |

- e) Please see the Company's response to Staff DR No. 2-01 subpart (c) in Case No. 2017-00308.

Respondent: Mark Martin

⁵ Case No. 2017-00308, Electronic Application of Atmos Energy Corporation for PRP Rider Rates (Ky. PSC Oct. 27, 2017).

⁶ Case No. 2009-00354, Application of Atmos Energy Corporation for an Adjustment of Rates (Ky. PSC May 28, 2010).

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|----------------------------------|---|------------|
| APPLICATION OF KENTUCKY FRONTIER |) | CASE NO. |
| GAS, LLC FOR ALTERNATIVE RATE |) | 2017-00263 |
| ADJUSTMENT |) | |

ORDER

On June 30, 2017, Kentucky Frontier Gas, LLC ("Frontier") tendered its application ("Application") to adjust its base gas rates pursuant to 807 KAR 5:076. Frontier is a Kentucky corporation regulated by the Commission as a utility under KRS 278.010(3)(b), and operates facilities that supply natural gas to approximately 5,117 customers residing in Breathitt, Floyd, Johnson, Knott, Lawrence, Lee, Letcher, Magoffin, Martin, Morgan, Perry, Pike, and Wolfe counties.¹ Frontier has acquired ten small gas systems since 2005 and has operated them as one company. Frontier most recently acquired Public Gas Company ("Public") and has been serving its customers under a separate tariff as approved by the Commission in Case No. 2015-00299.² Frontier seeks to increase its rates in this case and unify the rates for the former Public customers. Frontier also seeks to increase the surcharge in the Pipeline Replacement Program ("PRP").

¹ *Annual Report of Kentucky Frontier Gas, LLC to the Public Service Commission for the Calendar Year Ended December 31, 2016* ("2016 Annual Report") at 4 and 5.

² Case No. 2015-00299, *Joint Application of Kentucky Frontier Gas, LLC and Public Gas Company for Approval of Transfer and Acquisition of Assets and Financing* (Ky. PSC Nov. 24, 2015).

Frontier determined that its pro forma operations support an increase in revenue requirement from base rates of \$603,810.³ Frontier's application set out proposed base rates which produced annual base rate revenues of \$2,335,384 based on 5,049 customers,⁴ an increase of \$372,060, or 18.9 percent, over normalized test-year base rate revenues of \$1,963,324.

PROCEDURAL

To ensure the orderly review of the Application, the Commission established a procedural schedule by Order dated July 28, 2017. The Commission found that pursuant to 807 KAR 5:076, Section 11, a staff report would not be issued, and that the information needed to process this case would be obtained through the Application and Commission Staff's Requests for Information.

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG") is the only intervenor in this proceeding. Frontier responded to four requests for information issued by Commission Staff, and to two requests for information issued by the AG. The procedural schedule provided Frontier and the AG until October 20, 2017, either to request a formal hearing or submit a statement that this case may be submitted for Commission decision based on the existing record. Neither Frontier nor the AG requested a hearing, although the AG requested to submit comments to further develop the record. On October 26, 2017, the Commission on its own motion scheduled a hearing on November 21, 2017. On October

³ Application, ARF Form 1 – Attachment RR-OR – January 2014, Revenue Requirement Calculation – Operating Ratio Method.

⁴ Response to the Commission's Order of July 28, 2017, Item 8.

31, 2017, Frontier filed a motion to reschedule the hearing, stating that one of its witnesses would be unavailable to attend the hearing. The Commission rescheduled the hearing for November 27, 2017. After the hearing, the Commission set a schedule for replying to post-hearing data requests and the filing of any briefs. On December 18, 2017, the AG and Frontier filed briefs.

BRIEFS

According to the record, Steve Shute, Robert Oxford, Larry Rich, and Industrial Gas Services (“IGS”) are the member owners of Frontier. The AG asserted that businesses the member owners of Frontier own individually or jointly meet the definition of affiliates as defined in KRS 278.010(18): “‘Affiliate’ means a person that controls or that is controlled by, or is under common control with, a utility.” The AG argued in his brief that the Commission should require Frontier to provide evidence of compliance with the affiliate transaction statutes in KRS 278, as well as require proper documentation and allocation of those transactions in the future.

The AG stated that Steve Shute is the majority owner and a managing member of Frontier, and is also the sole owner of Pipeline Solutions, Inc., (“PSI”) and the owner of Pinedale Natural Gas Company; Robert Oxford is a minority owner of Frontier, and the sole owner of IGS; and Larry Rich and IGS are member owners of Frontier. Further, Frontier is the sole owner of Auxier Road Gas Company, which it operates under contract. The four Frontier member owners own DLR Enterprises, Inc., which is operated under contract by Frontier, while PSI and IGS perform consulting services for Frontier. The AG argues that these companies are affiliates of Frontier based upon KRS Chapter 278, and that they should be required to comply with pricing requirements as described

in KRS 278.2207. Finally, the AG contends that the Commission should place higher scrutiny on Frontier's PRP program, and that if any acceleration of the program is granted, to do so in accordance with the principles of gradualism.

Frontier argued in its brief that there is no affiliated interest among the independent companies owned by Frontier's member owners. Frontier further states that it has no ownership interest in or control over Pinedale Natural Gas, PSI, or IGS, and that similarly, none of those companies individually or collectively own any interest in Frontier or have any control over it. Frontier concludes that it has no affiliated interest in any of the previously discussed companies. In the alternative, Frontier states that if the Commission determined there were affiliated interests, it would then still be in compliance with the applicable statutes because it provided invoices verifying that the charges by Shute, Oxford, and IGS are all below market price. Finally, Frontier contends that the PRP program has contributed to the improvement of line loss and pipeline safety, and any increase in the proposed surcharge will only magnify the benefits of the program.

Since the AG is not requesting that any costs be disallowed in the current rate case due to his affiliate transactions argument, the Commission's Order on rates will not be affected. However, to properly address the AG's question of whether the various entities are affiliates of Frontier, and as such should be required to comply with the affiliate transaction rules, the present case will remain open in order to further develop the record on this issue. The Commission intends to issue a procedural schedule in the future to allow for further limited discovery on the affiliate transactions issue. Finally, with regard to the PRP, the Commission's finding concerning the need for greater

scrutiny of the program and gradualism in granting increases in Frontier's fixed monthly charges are discussed later in this Order.

TEST YEAR

The calendar year ended December 31, 2016, is being used as the test year to determine the reasonableness of Frontier's existing and proposed base rates, as required by 807 KAR 5:076, Section 9.

INCOME STATEMENT

Frontier reported actual test-year operating revenues and expenses of \$3,923,854 and \$3,937,812, respectively.⁵ Frontier proposes several adjustments to test-year revenues and expenses to reflect current and anticipated operating conditions, resulting in pro forma operating revenues of \$3,828,976 and pro forma operating expenses of \$3,984,205.⁶ The Commission's review of Frontier's pro forma operating revenues and expenses are set forth below.

Gas Cost Revenues and Expenses

Frontier based its requested rate increase on its total gas service revenues and operating expenses of \$3,717,294⁷ and \$3,984,205, respectively. Included in the gas service revenues are \$1,753,970 of revenues that were recovered through Frontier's

⁵ Application, ARF Form 1 – Attachment RR-OR – January 2014, Revenue Requirement Calculation – Operating Ratio Method.

⁶ *Id.* ARF Form 1 – Attachment SAO-G – September 2011, Schedule of Adjusted Operations – Gas Utility, TYE 12/31/2016.

⁷ *Id.* \$3,123,110 (Total Sales of Gas) + \$594,184 (Revenue Customer Charge) = 3,717,294.

Gas Cost Recovery (“GCR”) mechanism and operating expenses included natural gas purchases of \$1,984,808.⁸

The Commission’s established ratemaking practice is to exclude gas costs that are recovered through the GCR mechanism from the calculation of a gas utility’s base rates. Consistent with this established ratemaking practice, the Commission is reducing operating revenues and expenses by \$1,753,970 and \$1,984,808, respectively.

Other Operating Revenues

Frontier reported other operating revenues of \$111,682 in the test year. Based on the number of instances of Non-Recurring Charges being charged in the test year, and on the increase in the Reconnect Fee to \$96 as approved herein, other operating revenues has been increased by \$19,545.

Farm Tap Expense

In the Farm Tap Rate Case No. 2011-00513,⁹ the Commission approved an allocation of \$150,850, or 12 percent of the operating costs, to farm taps based on the ratio of farm-tap customers to the total gas customers. Frontier proposes to allocate the same amount to the farm taps in this case to reduce the cost of this current case and to simplify the filing.

In Frontier’s response to a Commission Staff request for information, Frontier stated that in the test year, farm taps represent 10.2 percent of its total customer base.¹⁰ Using its test-year unadjusted operating expenses and including only 25 percent of

⁸ Application, Pro Forma Operations

⁹ Case No. 2011-00513, *Application of Kentucky Frontier Gas Company, LLC for Approval of Adjustment of Farm Tap Rates* (Ky. PSC May 30, 2012).

¹⁰ Response to Staff’s Second Request, Item 8

distribution expenses in the calculation, Frontier estimates that a farm tap allocation would be \$149,958, less than a 1 percent difference from the proposed adjustment.

The Commission finds that the reduction for the farm tap expense should be \$162,920 as follows:

| | |
|---|---------------------|
| Commission Pro Forma Operating Expenses | \$ 1,597,258 |
| Multiplied by: Farm Tap Customer Ratio | <u>-10.2%</u> |
| Farm Tap Adjustment | <u>\$ (162,920)</u> |

Uncollectible expenses

Frontier recorded an uncollectible expense of \$35,701 in the test year. Frontier states that its test-year level was lower than the amounts that it had recorded in the prior years because the employee responsible for administering bad debts retired, and that some of the debts that were subsequently not timely written off. Frontier proposes to adjust uncollectible debts by \$14,432 to reflect a five-year average for this account. The Commission finds that this adjustment is reasonable and should be accepted.

Wage Adjustments

Frontier proposes an adjustment to wages of \$7,051. Frontier explains that only \$602,648 of wages are included in expenses after \$45,995 was capitalized, and its W-2 data indicates that it incurred a total of \$655,694. In response to Staff's First Request for Information, Frontier shows total wages paid of \$662,089.¹¹ Additionally, the annual report for Frontier for 2016 shows \$654,981.

Frontier also proposes to normalize wages for partial-year workers. One employee was out on disability for two months and then ceased employment. A

¹¹ Frontier's response to Staff's First Request for Information, Item 23.

temporary employee was hired to replace the worker and Frontier proposes to add \$8,169 in wages for the worker plus a gross-up of 8.35 percent for a total of \$8,851. Frontier proposes to offset this adjustment by crediting the outside services account.

Frontier also proposes to adjust wages by \$5,442 for an employee who left in October but was replaced in 2017. This adjustment would normalize wages to reflect 12 months of employment. Frontier also had a human resources contractor that is now an employee and proposes to adjust wages by \$25,000 with a corresponding offset to outside services account.

Frontier also proposes to adjust wages for pay increases that were awarded in 2017. Frontier states that no raises had been awarded since 2015. The amount of the increase is \$34,380 and with tax gross-up equals \$40,689.

Outside Services

As discussed above, Frontier proposes to offset two of the wage adjustments with credits to outside services expense (\$4,086) for the temporary employee and (\$25,110) for the human resources contractor for a total wage adjustment of (\$29,196).

Frontier also proposes to increase outside services expense by \$30,000 to reflect its amortizing of estimated rate case expense of \$90,000 over three years. In its response to a post hearing interrogatory, Frontier provided documentation to show that its actual rate case expense is \$113,462.

In reviewing the general ledger, the Commission determined that Frontier had incorrectly recorded as an operating expense legal fees of \$24,716 that were incurred for its PRP. The Commission finds that PRP legal fees should be removed from test-year outside services expense and amortized over three years.

Amortizing the PRP legal fees and the rate case expense over three years results in an increase to Frontier's pro forma outside services expense \$16,059.¹² The net adjustment to outside services expense is a decrease of \$8,117.¹³

Employee Health and Dental Insurance

In the test year, Frontier reported paying \$68,198 in employee health insurance premiums. Frontier paid 100 percent of the premium for employee health insurance coverage, while coverage for a spouse or child is paid for by the employee.¹⁴ Frontier proposed an adjustment of \$37,896. The adjustment is due to an increase in the number of employees taking health insurance; this totaled \$14,000. Additionally Frontier added Life-Disability-Dental coverage for \$16,000; however, this was offset by an adjustment of (\$13,725) to accidental death and disability insurance that was replaced. The new rates are projected to be \$110,839 per year.

The Commission is placing greater emphasis on evaluating employee total compensation packages, including both salary and benefits programs, for market and geographic competitiveness to ensure fair rate development and has determined that in most cases, 100 percent employer-funded health and dental care does not meet that criteria. Frontier should establish a policy of reasonably limiting its employer contributions to health and dental insurance costs by requiring that all employees pay a portion of those premiums. Accordingly, for ratemaking purposes, the Commission will

¹² $\$113,462$ (Actual Rate Case Expense) + $\$24,716$ (PRP Legal Fees) = $\$138,178 \div 3$ -Years = $\$46,059$ - $\$30,000$ (Frontier's Rate Case Amortization) = $\$16,059$.

¹³ $\$16,059$ (Amortization Increase) - $\$24,716$ (PRP Legal Fees) = $(\$8,117)$.

¹⁴ Frontier's response to Staff's Second Request, Item 9.

adjust test-year health and dental expenses for all employees based on the national average of employee contribution rates.

The Commission has reduced health insurance cost by \$18,104,¹⁵ based on a 21 percent employee contribution rate for single health insurance coverage.¹⁶ The Commission has also reduced dental insurance by \$1,365,¹⁷ based on a 60 percent employee contribution rate for single health insurance coverage.¹⁸

Depreciation

Frontier reported a test-year depreciation expense of \$357,013.¹⁹ Frontier proposed to adjust depreciation expense by a total of (\$115,979). Included in the adjustment was (\$81,489) for depreciation re-categorized as amortization, (\$8,333) for depreciation proposed as amortization for Public Gas, and (\$26,157) for depreciation adjustments. The Commission agrees with these adjustments and is decreasing test-year depreciation expense by (\$115,979).

Amortization

Frontier proposed to increase operating expense by \$166,062 to reflect reclassifying \$81,489 of amortization that was incorrectly recorded as depreciation; the amortization of the \$63,196 Auxier acquisition adjustment that was not included in its

¹⁵ $\$86,211 \text{ (Health Insurance)} \times 21\% \text{ (Emp. Contribution Rate)} = \$18,104$

¹⁶ Bureau of Labor Statistics, Healthcare Benefits, March 2017, Table 10, private industry workers. (<https://www.bls.gov/ncs/ebs/benefits/2017/ownership/private/table10a.pdf>)

¹⁷ $\$2,275 \text{ (Dental)} \times 60\% \text{ (Emp. Contribution Rate)} = \$1,365.$

¹⁸ The Willis Benchmarking Survey, 2015, at 62-63. (https://www.willis.com/Documents/publications/Services/Employee_Benefits/20151230_2015WillisBenefitsBenchmarkingSurveyReport.pdf)

¹⁹ Application at ARF Form 1 – Attachment SAO-G.

annual report; a \$12,500 proposed amortization of the Public Gas acquisition adjustment; and the amortization of loan fees of \$8,877. The Commission finds that Frontier's proposed adjustment to amortization expense is reasonable and is increasing amortization expense by \$166,062.

Summary Impact of Adjustments

After considering the test-year operating revenues and expenses, including appropriate adjustments found reasonable herein, the Commission has determined that the financial results of Frontier's pro forma test-year operations are as follows:

| | Test Year | Pro Forma Adjustments | Pro Forma Operations |
|----------------------|---------------------|--------------------------|-------------------------|
| Operating Revenues | \$ 3,828,976 | \$ (1,734,424) | \$ 2,094,552 |
| Operating Expenses | 3,984,205 | (2,024,865) | 1,959,340 |
| Net Operating Income | <u>\$ (155,229)</u> | <u>\$ 290,441</u> | <u>\$ 135,212</u> |

REVENUE REQUIREMENT DETERMINATION

The Commission has historically used an operating-ratio approach to determine revenue requirements for small, privately owned utilities.²⁰ This approach is used because either no basis for rate-of-return determination exists or the cost of the utility has been fully or largely recovered through the receipt of contributions. Given that

²⁰ An operating ratio measures the difference between operating revenues and operating expenses. It is defined by the following equation.

$$\text{Operating ratio} = \frac{\text{Operation \& Maintenance Exp. + Depreciation + Taxes}}{\text{Gross Revenues}}$$

The Commission has found that the operating ratio is a reasonable and necessary alternative to the rate of return method for calculating the allowable net operating income for small investor owned utilities. Specifically, it has found that the rate-of-return method cannot be used because there is "no basis" upon which to determine a rate of return for these utilities, Case No. 95-236, *Application of Thelma Waste Control, Inc. for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Apr. 15, 1996) at 6. Further, it has found that the operating-ratio method is appropriate when plant investment is low and operating expenses are high, Case No. 7982, *Notice of Application of Fern Lake Company* (Ky. PSC Aug. 27, 1981) at 3.

Frontier is a small gas distribution system, the Commission finds that this method should be used to determine Frontier's revenue requirement.

As shown in the table below, Frontier's pro forma operations combined with an 88 percent operating ratio results in a revenue requirement from base rates of \$2,271,232, which is an increase of 15.7 percent, or \$307,907, over normalized revenues from existing base rates of \$1,963,324.

| | |
|----------------------------------|--------------------|
| Pro Forma Operating Expenses | \$ 1,959,340 |
| Divide by: Operating Ratio | <u>88%</u> |
| Revenue to Cover Operating Ratio | 2,226,523 |
| Interest Expense | <u>175,936</u> |
| Total Revenue Requirement | 2,402,459 |
| Less: Other Operating Revenues | (131,227) |
| Revenue Requirement Base Rates | <u>2,271,232</u> |
| Less: Operating Revenues | <u>(1,963,324)</u> |
| Revenue Increase | <u>\$ 307,907</u> |
| % Increase | <u>15.7%</u> |

PIPELINE REPLACEMENT PROGRAM

Frontier proposed to increase its PRP surcharge from \$1.25 to \$2.00. The Commission is concerned with the progress Frontier is making toward replacing bare steel pipeline on its system. When Frontier's PRP was approved in Case No. 2011-00443,²¹ Frontier estimated that it had approximately 27 miles of bare steel pipeline on its system. Frontier replaced 8,700 feet in 2013, 12,255 feet in 2014, 8,966 feet in 2015, and 8,178 feet in 2016 for a total of approximately 7.2 miles since the program was

²¹ Case No. 2011-00443, *Application of Kentucky Frontier Gas, LLC for Approval of Consolidation of and Adjustment of Rates, Approval of AMR Equipment and a Certificate of Convenience and Necessity for Installation of AMR, Pipeline Replacement Program, Revision of Non-Recurring Fees and Revision of Tariffs* (Ky. PSC June 21, 2013).

approved.²² This level of replacement is well behind Frontier's intent to replace 2.5 miles of pipeline per year. The Commission notes that when Frontier's PRP was approved, it was estimated to last 10–12 years. Due to the slower than expected pace of replacements and the discovery of additional pipeline that qualified for replacement, Frontier estimates that it will take ten years to complete the program, extending the original timeframe for completion of the PRP by an additional two to four years.

The Commission has placed an emphasis on the replacement of unsafe and deteriorating bare steel pipeline, and the safety and integrity of Frontier's system is of great concern. Therefore, the Commission finds that granting an increase in the PRP surcharge from the current \$1.25 per customer per month to \$5.00 per customer per month is warranted and is reasonable,²³ and that the AG's concern regarding gradualism is better addressed through a lower increase granted to the fixed monthly customer charge. Frontier should use any methods at its disposal, including the hiring of outside contractors, to ensure that bare steel pipeline is removed from its system in the original timeframe as was approved in Case No. 2011-00443.

Furthermore, the Commission will require Frontier to establish an interest-bearing escrow account in which to deposit its PRP surcharge revenues. The revenues in this account should be used for the sole purpose of replacing bare steel pipeline on the Frontier system. The Commission agrees with the AG's conclusion in his brief regarding the need for higher scrutiny of the PRP, and finds that Frontier should be required to

²² Response to Commission Staff's third request for information, Item 1.c.

²³ Frontier stated in response to Staff's Fourth Request for Information, Item 2.b., that a surcharge of approximately \$5.00 would be necessary to finish the pipeline replacements in six more seasons to meet the original PRP target.

submit detailed reports for each upcoming year summarizing the projects it expects to replace in that year. At a minimum, the reports should show plant additions, retirements, and removals for each year, separately identified, and including their locations, length, and size of mains and service lines, and associated costs. Frontier should submit these reports for Commission review by December 31 each year. Likewise, Frontier should submit a similar report listing actual projects completed during the previous year. This report should be filed for Commission review at the same time Frontier files its Annual Report. Furthermore, Frontier should submit concurrently with its Gas Cost Adjustment filings a bank statement setting forth the deposits and withdrawals from the escrow account required to be established herein.

RATES AND RATE DESIGN

Frontier proposed to increase its monthly customer charges for its Residential and Commercial classes from \$10 to \$16, and to decrease those classes' volumetric charges from \$.42023 per ccf to \$.38430 per ccf for existing Frontier customers, and to increase the volumetric charges of customers on the former Public system from \$.30914 per ccf to \$.38430 per ccf. Frontier proposed no change in the monthly customer charge for its Large Commercial class, but did propose a decrease in the volumetric charge from \$.34454 per ccf to \$.33970 per ccf. Frontier also proposed to unify the rates of the former Public Residential and Commercial classes to match the proposed rates listed above.

Given the increase in the PRP surcharge, as well as the existing \$1.00 AMR surcharge, the Commission finds that for the Residential and Small Commercial classes, granting the requested increase in the customer charge would lead to those customers' paying \$22.00 in fixed costs regardless of gas use. In addition, the proposed 60 percent

increase in the monthly customer charge does not comport with the Commission's long-held principle of gradualism. The Commission finds that granting a \$3.00 increase in the monthly customer charge to \$13.00 is reasonable, and results in the same \$18.00 in residential and small commercial monthly fixed charges contained in Frontier's notice to its customers. The difference in revenue collection caused by not allowing the full increase proposed for the customer charge should be offset by increases to the volumetric charges. Therefore, the Commission finds that a volumetric charge of \$.422 per ccf for the Residential and Small Commercial classes is reasonable and should be approved.

For Frontier's Large Commercial class, the Commission finds that maintaining the monthly customer charge at \$50.00 is reasonable. However, given the magnitude of the increase being proposed for Frontier's Residential and Small Commercial classes, the Commission does not find it reasonable at this time to grant a reduction in Frontier's Large Commercial volumetric rate. Therefore, the rates for the Large Commercial class should remain unchanged.

NON-RECURRING CHARGES

The Commission finds that Frontier's proposal to unify its non-recurring charges so that former Public Gas customers' charges are the same charges as those already approved for Frontier is reasonable and should be approved. In Frontier's response to Staff's Second Request, Item 4, Frontier proposed to increase its reconnect fee to \$96.00. Frontier stated that it has had issues with customers disconnecting service during the summer with unpaid bills, and then reapplying for service in the winter.²⁴

²⁴ Frontier's response to the Commissions, July 28, 2017 Order, Item 6.c.

Furthermore, Frontier stated that it levied its current reconnect fee 397 times during the 2016 test year.²⁵ The Commission has reviewed the cost justification that was included in Frontier's previous ARF application,²⁶ which estimated the actual cost to perform a reconnection is \$99.23. Therefore, the Commission finds Frontier's proposal to increase its reconnect fee to \$96.00 is reasonable and should be approved.

Gas Cost Rate and Purchased Gas Adjustment

With respect to the commodity cost of gas, concurrent with the Commission's approval of unified, system-wide rates for the Frontier system including Public Gas, there will be one system-wide gas cost and one Purchased Gas Adjustment ("PGA") tariff for the combined system. The Appendix to this Order reflects one system-wide gas cost of \$5.4636 per Mcf for Frontier based on the most current Expected Gas Cost ("EGC") rates for the Frontier and Public Gas systems. The Commission finds that Frontier should file its first unified PGA application no later than January 11, 2018, for rates to be effective February 1, 2018,²⁷ pursuant to the PGA tariff approved herein. The January 2018 PGA filing will establish a current EGC for the combined system. The first Actual Adjustment to track under/over-recoveries for the combined system will be included in Frontier's PGA application for rates effective August 1, 2018, and will reconcile expected and actual gas cost for the four-month period January through April 2018.

As Frontier and Public currently have their own PGA mechanisms through which they track under/over-recoveries of gas cost, Frontier should continue to charge

²⁵ Frontier's response to Staff's Second Request, Item 4.

²⁶ Case No. 2011-00443, Application.

²⁷ Assuming that its PGA application for rates effective February 1, 2018, is received after January 2, 2018, Frontier should request a waiver of the 30-day notice requirement contained in its PGA tariff so that its change in rates may be effective with 20 days' notice.

customers in each of those systems separate trackers to reconcile any remaining under/over-recoveries of gas cost through December 31, 2017. Those individual tracking adjustments, which will be charged in the pre-existing Frontier and Public systems for one year, will be established in Frontier's PGA application for rates effective May 1, 2018, which should be filed no later than April 2, 2018.

VIOLATIONS OF STATUTE

Frontier included in its long-term debt obligations five auto loans totaling \$96,378 that it had secured in 2015 and 2016. Frontier confirmed in response to an AG interrogatory that it had not received Commission approval for the indebtedness.²⁸ Commission Staff also questioned Frontier's witness at the hearing about the loans. The witness stated that Frontier was aware of the requirement to receive Commission approval of financing, but did not think that it applied to auto loans.²⁹

Under KRS 278.300, a utility must receive Commission approval prior to issuing any evidence of indebtedness with a term longer than 24 months. Based on Frontier's having entered the aforementioned promissory notes, the Commission finds that it should open a proceeding to permit Frontier to show cause why it should not be penalized for violating KRS 278.300.

SUMMARY

The Commission, after consideration of the evidence of record and being sufficiently advised, finds that:

²⁸ Response to the AG's Supplemental Request for Information, Item 11.

²⁹ Hearing video at 11:11:30

1. The rates proposed by Frontier would produce revenues in excess of the amount found reasonable herein and should be denied.

2. The rates set forth in the Appendix to this Order are fair, just, and reasonable and should be approved.

3. A system-wide gas cost and single PGA mechanism should be approved for Frontier as discussed herein.

4. A proceeding should be initiated to permit Frontier to show cause why it should not be penalized for violating KRS 278.300.

5. A procedural schedule should be established to allow for further limited discovery on the affiliate transactions issue.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Frontier are denied

2. The rates and charges found reasonable herein and set forth in the Appendix to this Order are approved for service rendered by Frontier on and after January 1, 2018.

3. A system-wide gas cost and PGA mechanism is approved for Frontier as described in this Order.

4. Frontier shall establish a separate interest-bearing escrow account into which all PRP revenue shall be deposited.

5. Frontier shall file within 30 days of the date of this Order a copy of the escrow agreement establishing the escrow account for deposit of all PRP surcharge revenue.

6. Frontier shall file the reports concerning its PRP as discussed in the body of this Order.

7. An investigation shall be opened to provide Frontier an opportunity to present evidence to demonstrate that it should not be penalized for violating KRS 278.300.

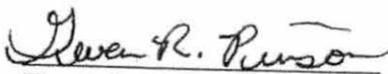
8. A procedural schedule will be issued in the near future to allow for further limited discovery on the affiliate transactions issue.

9. Within 20 days of the date of this Order, Frontier shall file with this Commission, using the Commission's electronic Tariff Filing System, revised tariff sheets setting out the rates approved herein and reflecting that they were approved pursuant to this Order.

By the Commission

ENTERED
DEC 22 2017
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

Case No. 2017-00263

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2017-00263 DATED **DEC 22 2017**

The following rates and charges are prescribed for the customers in the area served by Kentucky Frontier Gas, LLC. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

RESIDENTIAL

| | <u>Base Rate</u> | <u>Gas Cost Recovery Rate</u> | <u>Total</u> |
|-----------------|------------------|---------------------------------------|--------------|
| Customer Charge | \$13.00 | | |
| All ccf | \$.422 | \$.54636 | \$.96836 |

SMALL COMMERCIAL

| | <u>Base Rate</u> | <u>Gas Cost Recovery Rate*</u> | <u>Total</u> |
|-----------------|------------------|--|--------------|
| Customer Charge | \$13.00 | | |
| All ccf | \$.422 | \$.54636 | \$.96836 |

LARGE COMMERCIAL

| | <u>Base Rate</u> | <u>Gas Cost Recovery Rate*</u> | <u>Total</u> |
|-----------------|------------------|--|--------------|
| Customer Charge | \$50.00 | | |
| All ccf | \$.34454 | \$.54636 | \$.89090 |

PIPELINE REPLACEMENT PROGRAM

All Classes: \$5.00 per month

AMR

All Classes: \$1.00 per month

NON-RECURRING CHARGES:

| | |
|--------------------|------------------|
| Returned check fee | \$ 30.00 |
| Turn on fee | \$ 50.00 |
| Customer deposit | 2/12 annual bill |
| Special meter read | \$ 50.00 |
| Late payment | 10% |
| Relocate meter | \$150.00 |
| Transfer service | \$ 30.00 |
| Trip charge | \$ 50.00 |
| Meter test fee | \$225.00 |
| Reconnection fee | \$ 96.00 |

*Honorable John N Hughes
Attorney at Law
124 West Todd Street
Frankfort, KENTUCKY 40601

*Justin M. McNeil
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Kent Chandler
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Kentucky Frontier Gas, LLC
4891 Independence Street, Suite 200
Wheat Ridge, CO 80033

*Rebecca W Goodman
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|--|---|------------|
| ELECTRONIC APPLICATION OF KENTUCKY |) | |
| POWER COMPANY FOR (1) A GENERAL |) | |
| ADJUSTMENT OF ITS RATES FOR ELECTRIC |) | CASE NO. |
| SERVICE; (2) AN ORDER APPROVING ITS 2017 |) | 2017-00179 |
| ENVIRONMENTAL COMPLIANCE PLAN; (3) AN |) | |
| ORDER APPROVING ITS TARIFFS AND RIDERS; |) | |
| (4) AN ORDER APPROVING ACCOUNTING |) | |
| PRACTICES TO ESTABLISH REGULATORY |) | |
| ASSETS AND LIABILITIES; AND (5) AN ORDER |) | |
| GRANTING ALL OTHER REQUIRED APPROVALS |) | |
| AND RELIEF |) | |

ORDER

Kentucky Power Company ("Kentucky Power"), a wholly owned subsidiary of American Electric Power Company, Inc. ("AEP") is an electric utility that generates, transmits, distributes, and sells electricity to approximately 168,000 consumers in all or portions of 20 counties in eastern Kentucky.¹ Kentucky Power owns and operates a 285-megawatt ("MW") gas-fired steam-electric generating unit in Louisa, Kentucky, and owns and operates a 50 percent undivided interest in a coal-fired generating station in Moundsville, West Virginia; Kentucky Power's share consists of 780 MW. Kentucky Power obtains an additional 393 MW from Rockport (Indiana) Plant Generating Units No. 1 and No. 2 under a unit power agreement ("Rockport UPA"). Kentucky Power's transmission system is operated by PJM Interconnection, LLC ("PJM"), a regional

¹ Application at 2. Kentucky Power also furnishes electric service at wholesale to the Cities of Olive Hill and Vanceburg, Kentucky.

electric grid and market operator. Kentucky Power's most recent general rate increase was granted in June 2015 in Case No. 2014-00396.²

BACKGROUND

On April 26, 2017, Kentucky Power filed notice of its intent to file an Application ("Application") for approval of an increase in its electric rates based on a historical test year ending February 28, 2017. By Order entered May 24, 2017, the Commission granted Kentucky Power's motion to deviate from certain filing requirements, which Kentucky Power requested in order to obtain additional time to review its Application before its proposed filing date of June 28, 2017.

Kentucky Power tendered its Application on June 28, 2017, which included new rates to be effective on or after July 29, 2017, based on a request to increase its electric revenues by \$65,387,987, or 11.80 percent. On August 7, 2017, Kentucky Power supplemented its Application to reflect the impact of refinancing of certain debts in June 2017, which reduced Kentucky Power's requested annual increase in revenues to \$60,397,438. In its Application, Kentucky Power also requested approval of its environmental compliance plan, and proposed to revise, add, and delete various tariffs applicable to its electric service. After Kentucky Power cured filing deficiencies, its Application was deemed filed as of July 20, 2017. To determine the reasonableness of these requests, the Commission suspended the proposed rates for five months from their effective date, pursuant to KRS 278.190(2), up to and including January 18, 2018.

² Case No. 2014-00396, *Application of Kentucky Power Company for: (1) A General Adjustment of Its Rates for Electric Service; (2) An Order Approving Its 2014 Environmental Compliance Plan; (3) An Order Approving Its Tariffs and Riders; and (4) An Order Granting All Other Required Approvals and Relief* (Ky. PSC June 22, 2015) ("Case No. 2014-00396, Final Order").

The following parties requested and were granted full intervention: the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("Attorney General"); Kentucky Industrial Utility Customers, Inc. ("KIUC"); Kentucky School Boards Association ("KSBA"); Kentucky League of Cities ("KLC"); Kentucky Commercial Utility Customers, Inc. ("KCUC"); Kentucky Cable Telecommunications Association ("KCTA"); and Wal-Mart Stores East, LP and Sam's East, Inc. (jointly, "Walmart").

By order entered on July 17, 2017, the Commission established a procedural schedule that provided for discovery, intervenor testimony, rebuttal testimony from Kentucky Power,³ a formal evidentiary hearing, and an opportunity for the parties to file post hearing briefs.⁴ On October 26, 2017, and November 7, 2017, an informal conference ("IC") was held at the Commission's offices to discuss procedural matters and the possible resolution of pending issues. All parties participated in the IC held on October 26, 2017, with the exception of KCTA, who engaged in separate discussions with Kentucky Power regarding possible resolution of issues pertaining to the Cable Television Pole Attachment Tariff ("Tariff C.A.T.V.") The Attorney General did not attend the November 7, 2017 IC due to a scheduling conflict, but indicated that the IC should proceed as scheduled. At the November 7, 2017 IC, the parties in attendance,

³ On October 11, 2017, the Attorney General filed a motion to amend the procedural schedule to permit him to file rebuttal testimony. Kentucky Power and KLC each filed responses in opposition. By order issued October 24, 2017, the Commission found the Attorney General failed to establish good cause to amend the procedural schedule and denied the Attorney General's motion.

⁴ The Commission conducted public meetings in Kentucky Power's service territory on November 2, 2017, in Prestonsburg, Kentucky; on November 6, 2017, in Hazard, Kentucky; and on November 8, 2017, in Ashland, Kentucky.

with the exception of KCUC, arrived at an agreement in principle for the resolution of the issues raised in this case.

On November 22, 2017, Kentucky Power, KIUC, KLC, KSBA, KCTA, and Walmart ("Settling Intervenors") filed a Settlement Agreement ("Settlement") that addressed all of the issues raised in this proceeding. The Attorney General and KCUC are not signatories to the Settlement. The Settlement is attached as Appendix A to this Order.

Because the Settlement was not unanimous, the December 6, 2017, evidentiary hearing was held as scheduled for the purposes of hearing testimony in support of the Settlement and on contested issues. On January 5, 2018, Kentucky Power, the Attorney General, KIUC, and KCUC filed their respective post hearing briefs. The matter now stands submitted to the Commission for a decision.

SETTLEMENT AGREEMENT

The Settlement reflects the agreement of the parties, except for the Attorney General and KCUC, on all issues raised in this case. The major substantive areas addressed in the Settlement are as follow:

- Kentucky Power's electric retail revenues should be increased by \$31,780,734, effective January 19, 2018.⁵ This amount consists of a base rate revenue reduction of \$28,616,704 from the \$60,397,438 requested in Kentucky Power's August 7, 2017 supplemental filing.

⁵ Settlement, paragraphs 2(a) and 17.

- Establishment of deferral mechanisms for \$50 million in non-fuel, non-environmental Rockport UPA expenses.⁶

- Amendment of the Purchase Power Adjustment tariff (“Tariff P.P.A.”) to recover incremental PJM Open Access Transmission Tariff (“OATT”) Load Serving Entity (“LSE”) charges and credits above or below net PJM OATT LSE charges and credits in base rates.⁷

- Amendment of Tariff P.P.A. as described in the Direct Testimony of Alex E. Vaughan (“Vaughan Direct Testimony”) to collect from, or credit to, customers the amount of purchased power costs that are excluded from recovery through the Fuel Adjustment Clause (“FAC”), and gains and losses from incidental sales of natural gas purchased for use at Big Sandy Unit 1, but not used or stored.⁸

- Establishment of 20-year service life for Big Sandy Unit 1 for depreciation rates.⁹

- Establishment of a return on equity of 9.75 percent.¹⁰

- Agreement to lower the Kentucky Economic Development Surcharge rate (“Tariff K.E.D.S.”) for residential customers and increase the rate for non-residential customers, with matching contribution by Kentucky Power.¹¹

⁶ *Id.* at paragraph 3.

⁷ *Id.* at paragraph 4.

⁸ *Id.* at paragraph 6.

⁹ *Id.* at paragraph 7.

¹⁰ *Id.* at paragraph 8.

¹¹ *Id.* at paragraph 10.

- Agreement to continue Tariff K-12 School as a permanent customer class instead of a pilot rate.¹²
- Agreement that Kentucky Power will not request a general adjustment of base rates for rates that would be effective prior to the January 2021 billing cycle.¹³
- Increase Kentucky Power's customer charge for Residential Service customers to \$14.00 per month.¹⁴

CONTESTED REVENUE REQUIREMENT AND REVENUE ALLOCATION ISSUES

Kentucky Power proposed an annual increase in its electric revenues of \$60,397,438 in its August 7, 2017 supplemental filing. Through testimony, the Attorney General contended that Kentucky Power should be allowed to increase its electric revenues by \$39.9 million.¹⁵ Through testimony, KCUC contended that the revenue allocation contained in the Settlement does not provide fair or reasonable treatment for customers in the Large General Service class ("Tariff L.G.S."). Because the parties have not reached a unanimous settlement on the increase in revenues, the Commission must consider the evidentiary record on these issues as presented by Kentucky Power, the Attorney General, and KCUC, and render a decision based on a determination of Kentucky Power's capital, rate base, operating revenues, operating expenses, and revenue allocation, as would be done in a fully litigated rate case

¹² *Id.* at paragraphs 1213.

¹³ *Id.* at paragraph 5.

¹⁴ *Id.* at paragraph 16.

¹⁵ Direct Testimony of Ralph C. Smith ("Smith Testimony") at 12.

TEST PERIOD

Kentucky Power proposed the 12-month period ending February 28, 2017, as the test period for determining the reasonableness of its proposed rates. None of the intervenors contested the use of this period as the test period. The Commission finds it is reasonable to use the 12-month period ending February 28, 2017, as the test period in this case. Due to the timing of Kentucky Power's filing, the 12-month period ending February 28, 2017, is the most recent feasible period to use for setting rates and, except for the adjustments approved herein, the revenues and expenses incurred during that period are neither unusual nor extraordinary.¹⁶ In using this historic test period, the Commission has given full consideration to appropriate known and measurable changes.

RATE BASE

Jurisdictional Rate Base Ratio

Kentucky Power proposed a test-year-end Kentucky jurisdictional rate base of \$1,323,494,246.¹⁷ The Kentucky jurisdictional rate base is divided by Kentucky Power's test-year-end total company rate base to derive the Kentucky jurisdictional rate base ratio ("jurisdictional ratio"). This jurisdictional ratio is then applied to Kentucky Power's total company capitalization to derive the Kentucky jurisdictional capitalization. The jurisdictional ratio uses the test-year-end rate base before any ratemaking adjustments

¹⁶ On May 22, 2017, Kentucky Power filed a motion to deviate from filing requirement 807 KAR 5:001, Section 12(1)(a), which requires the submission of a detailed financial exhibit for the 12-month test period ending not more than 90 days prior to the date of its application. Kentucky Power requested to deviate by filing the required financial exhibit for 12-month period ending 120 days, rather than 90 days, prior to the date of its application. By Order, the Commission approved Kentucky Power's motion to deviate from 807 KAR 5:001, Section 12(1)(a) (Ky. PSC May 24, 2017).

¹⁷ Application, Section V, Exhibit 1, Schedule 4.

applicable to either Kentucky jurisdictional operations or other jurisdictional operations. Kentucky Power used a jurisdictional ratio of 98.3 percent.¹⁸ The Commission finds the calculation of Kentucky Power's test-year electric rate base reasonable for purposes of establishing the jurisdictional ratio.

Pro Forma Jurisdictional Rate Base

Kentucky Power calculated a pro forma jurisdictional rate base of \$1,194,888,447,¹⁹ which reflects the types of adjustments made by the Commission in prior rate cases to determine the pro forma rate base.

The Attorney General proposed one adjustment to Kentucky Power's proposed rate base for the Cash Working Capital ("CWC") allowance. The Attorney General proposed an allowance of \$18,953,980, which is \$740,459 lower than the \$19,694,529 proposed by Kentucky Power in its Application. While indicating a preference for using a lead-lag study, the Attorney General stated that if CWC is to be calculated using the Commission's long-standing 1/8th formula approach, then the proper level of CWC for ratemaking purposes should be based on the pro forma operations and maintenance expenses allowed by the Commission.²⁰ The Attorney General also stated that since Kentucky Power's revenue requirement is calculated based upon its jurisdictional capitalization rather than its adjusted jurisdictional rate base, any adjustment to CWC would have no impact on the revenue requirement.²¹

¹⁸ *Id.* The non-jurisdictional percentage of approximately 1.7 percent is due to the furnishing of electric service at wholesale to the City of Olive Hill and the City of Vanceburg.

¹⁹ *Id.*

²⁰ Smith Testimony at 22.

²¹ *Id.* at 23.

While the Commission agrees with the methodology the Attorney General utilized for calculating the CWC, the Commission does not agree with the Attorney General's proposed CWC. The CWC allowance included in the rate base, as shown below, is based on the adjusted operation and maintenance ("O&M") expenses discussed in this Order, as approved by the Commission. The Commission has determined Kentucky Power's pro forma jurisdictional rate base for ratemaking purposes for the test year to be as follows:

| | |
|--------------------------------------|------------------------|
| Total Utility Plant in Service | \$2,264,648,845 |
| Add: | |
| Materials & Supplies | 36,344,575 |
| Prepayments | 49,905,719 |
| Cash Working Capital Allowance | 18,905,292 |
| Subtotal | <u>\$105,155,586</u> |
| Deduct: | |
| Accumulated Depreciation | 764,544,392 |
| Customer Advances | 27,076,876 |
| Accumulated Deferred Income Taxes | 384,084,108 |
| Contributions in Aid of Construction | |
| Subtotal | <u>\$1,175,705,376</u> |
| Pro Forma Rate Base | <u>\$1,194,099,055</u> |

Reproduction Cost Rate Base

KRS 278.290 (1) states, in relevant part, that:

[T]he commission shall give due consideration to the history and development of the utility and its property, original cost, cost of reproduction as a going concern, capital structure, and other elements of value recognized by the law of the land for ratemaking purposes.

Neither Kentucky Power, the Attorney General, nor KCUC provided information regarding Kentucky Power's proposed Kentucky jurisdictional reproduction cost rate

base. Therefore, the Commission finds that using Kentucky Power's historic costs for deriving its rate base is appropriate and consistent with Commission precedent involving Kentucky Power, as well as other Kentucky jurisdictional utilities.

CAPITALIZATION

Kentucky Power proposed an adjusted Kentucky jurisdictional capitalization of \$1,191,785,493.²² This amount was derived through adjustments to exclude certain environmental compliance investments that remain part of the environmental rate base and are included in Kentucky Power's environmental surcharge mechanism.

Kentucky Power determined its electric capitalization by multiplying its total company capitalization by the rate base jurisdictional allocation ratio described earlier in this Order. This is consistent with the approach used in previous Kentucky Power rate cases.

The Attorney General did not recommend any adjustments to Kentucky Power's capitalization. The Attorney General proposed one adjustment to rate base for CWC, since it does not affect Kentucky Power's jurisdictional capitalization, but recommended no change to the amount proposed by Kentucky Power.

The Commission finds the proposed amount of Kentucky Power's jurisdictional capitalization is reasonable.

REVENUES AND EXPENSES

For the test year, Kentucky Power reported actual net operating income from its electric operations of \$85,033,742.²³ Kentucky Power proposed 55 adjustments to

²² Application, Section II, Exhibit L.

²³ Application, Section V, Exhibit 1, Supplemental Schedule 4 (filed Aug. 7, 2017).

revenues and expenses to reflect more current and anticipated operating conditions, resulting in an adjusted net operating income of \$43,690,670.²⁴ With this level of net operating income, Kentucky Power reported an adjusted test year revenue deficiency of \$60,397,438.²⁵

The Attorney General accepted 45 of Kentucky Power's proposed adjustments to its test-year revenues and expenses.

A list of the non-contested adjustments is contained in Appendix B to this Order. The Attorney General proposed 14 additional adjustments to Kentucky Power's operating income relating to: 1) theft recovery revenue; 2) payroll expense – employee merit increase; 3) overtime payroll expense related to employee merit increase; 4) payroll tax expense; 5) incentive compensation expense; 6) stock-based compensation; 7) savings plan expense; 8) supplemental executive retirement program expense; 9) affiliate charge for corporate aviation expense; 10) storm damage expense; 11) relocation expense; 12) gain on sale of utility property; 13) cash surrender value of life insurance policies; and 14) rate case expense.

The Attorney General's proposed adjustments pertain solely to Kentucky Power's base rate revenue requirements. The Commission makes the following determinations regarding the Attorney General's proposed base rate adjustments.

Theft Recovery Revenue

The Attorney General proposed an adjustment to increase Kentucky Power's theft recovery revenue by \$166,698 based upon Kentucky Power's estimate of

²⁴ *Id.*

²⁵ *Id.* at Schedule V, Supplemental Exhibit 2 (filed Aug. 7, 2017).

increased theft recovery revenue.²⁶ Kentucky Power expects to increase theft recovery revenue due to the addition of a new administrative assistant who would allow Kentucky Power's field investigators to spend more time on suspected energy theft.

The Commission finds that the Attorney General's proposed adjustment regarding theft recovery revenue is reasonable, and therefore the proposed adjustment for theft recovery revenue of \$166,698 should be allowed for ratemaking purposes.

Payroll Expenses: Employee Merit Increase, Overtime Payroll Expense, and Payroll Taxes

The Attorney General proposed adjustments to payroll expense for employee merit increases for non-exempt salaried employees, overtime payroll expense related to employee merit increases, and associated payroll taxes in the amount of \$57,205, \$4,148, and \$48,362, respectively. The Attorney General argued that Kentucky Power did not justify basing its proposed payroll expense adjustment on an annual merit increase of 3.5 percent. The Attorney General maintained that the payroll expense adjustment should be based upon a 3.0 percent merit increase.²⁷ Limiting the merit increase to 3.0 percent results in corresponding adjustments to overtime and payroll tax expenses. The payroll tax adjustment includes the impact of limiting the merit increase to 3.0 percent and other adjustments to incentive compensation and stock-based compensation proposed by the Attorney General.

Kentucky Power maintained that the test year wage increases are reasonable. A comparison of Kentucky Power's total target compensation with the 2016 EAPDIS

²⁶ Smith Testimony at 24; Kentucky Power's Response to the Attorney General's First Request for Information ("Attorney General's First Request"), Item 319.

²⁷ *Id.* at 26-30.

Energy, Technical, Craft & Clerical Survey (Southeast region data) reveals that, on average, Kentucky Power's compensation was 5.4 percent below the average for the region.²⁸ Kentucky Power claimed that, in light of the survey results, the test year wage increases were necessary to provide market competitive wages to target and retain employees.

The Commission finds that Kentucky Power's test year wages are reasonable and that the Attorney General's proposed adjustments to payroll expense for employee merit increases for non-exempt salaried employees, overtime payroll expense related to employee merit increase and payroll taxes should be denied.

Incentive Compensation and Stock Based Compensation

Kentucky Power included \$3,900,806 of incentive compensation plan ("ICP") costs²⁹ and \$1,758,874 in Long-Term Incentive Plan ("LTIP") costs in its Kentucky jurisdictional revenue requirement.³⁰ These amounts reflect the adjustments made by Kentucky Power.³¹ In the Settlement, Kentucky Power and the Settling Intervenors agreed to reduce incentive compensation expenses by \$3.15 million, which included incentive compensation and stock-based compensation.

²⁸ Application, Direct Testimony of Andrew J. Carlin ("Carlin Direct Testimony"), Exhibit ARC-4.

²⁹ Kentucky Power's Response to Commission Staff's Second Request for Information (Staff's Second Request"), Item 85; Kentucky Power's Response to KIUC's First Request for Information ("KIUC's First Request"), Item 31.

³⁰ Smith Testimony at 31. This consists of Kentucky Power direct-charged jurisdictional O&M expense of \$2,255,760, AEP allocated amount of \$3,118,781 and charges from other affiliates of \$51,300 less \$1,525,035 that was removed from the revenue requirement per the Application, Section V, Exhibit 2, Workpaper 32.

³¹ Application, Direct Testimony of Tyler H. Ross ("Ross Direct Testimony") at 14.

The Attorney General recommended reducing incentive compensation expense by a total of \$3,096,868. The Attorney General recommended an adjustment of ICP costs that decreased test year expense by \$1,350,120 on a Kentucky jurisdictional basis, which represented the removal of the 25 percent of ICP costs that represent performance measures tied to increasing shareholder value.³² The Attorney General maintained that ratepayers should not be responsible for those costs because Kentucky Power's shareholders are the main beneficiaries of the 25 percent performance measure for quantitative financial objectives, which include earnings per share.³³ Similarly, the Attorney General argued that \$1,746,748 in stock-based compensation costs should be removed because ratepayers should not be required to pay management compensation based on the performance of Kentucky Power's stock price, which primarily benefits Kentucky Power's parent company.³⁴ In support of his argument, the Attorney General pointed to previous cases in which the Commission held that ratepayers should not bear the cost of stock-based compensation programs unless there is clear and definitive quantitative evidence demonstrating a benefit to ratepayers.³⁵

In response, Kentucky Power argued that the Attorney General's adjustment to the proposed incentive compensation expense was not warranted because the

³² Smith Testimony at 35, Exhibit RCS-1, page 3 of 32; Smith Testimony at 30-31. The 2016 ICP was weighted 75 percent to AEP's earnings per share and 25 percent to other metrics

³³ *Id.* at 31.

³⁴ *Id.* at 39.

³⁵ Case No. 2014-00397, Final Order at 27-28; Case No. 2005-00042, *An Adjustment of the Gas Rates of the Union Light, Heat and Power Company* (Ky. PSC Feb. 2, 2006); Case No. 2010-00036, *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year* (Ky. PSC Dec. 14, 2010).

incentive compensation programs provide benefits to both Kentucky Power's customers and its shareholders.³⁶

The Commission finds that the Settlement provision that reduces incentive compensation by \$3.15 million, which is a greater reduction than the adjustment recommended by the Attorney General, is reasonable and should be approved.

Savings Plan Expense

Kentucky Power included \$1,662,975 in its jurisdictional revenue requirement for savings plan expense for employees who participate in a defined benefit plan and have matching 401(k) contributions from Kentucky Power.³⁷

The Attorney General proposed a Kentucky jurisdictional adjustment of \$1,102,496 for savings plan expense for employees who participate in a defined benefit plan and have matching 401(k) contributions from Kentucky Power.

In rebuttal, Kentucky Power explained that participation in the defined benefit plan ended in 2000 and benefits were frozen in 2010.³⁸ Therefore, Kentucky Power does not contribute to a defined benefit plan and 401(k) matching plan at the same time. The Commission has disallowed such matching contributions when both a defined benefit plan and 401(k) matching contribution exist concurrently. This is not the case with Kentucky Power.

The Commission finds that Kentucky Power's savings plan expense is reasonable and should be allowed for ratemaking purposes.

³⁶ Rebuttal Testimony of Andrew R. Carlin ("Carlin Rebuttal Testimony") at 7.

³⁷ Kentucky Power's Response to Staff's Second Request, Item 56.h. and i.

³⁸ Dec. 7, 2017 H.V.T. at 4:50:20.

Supplemental Executive Retirement Plan ("SERP")

The Attorney General proposed an adjustment of \$52,453 for the expense associated with Kentucky Power's Supplemental Executive Retirement Plan ("SERP"). The Attorney General argued that such plans provide benefits to executives that exceed amounts limited in qualified retirement plans by the Internal Revenue Service.³⁹ The Attorney General also maintained that the provision of additional retirement compensation to Kentucky Power's highest paid executives is not a reasonable expense that should be recovered in rates.

In rebuttal, Kentucky Power stated that the total benefit it provides under both its qualified and non-qualified plan is equal to the benefit that would be produced by the formulas utilized under the qualified plans if these plans were not subject to the benefit limitations imposed on qualified plans.⁴⁰

The Commission finds the SERP expenses reasonable and, therefore, should be allowed for ratemaking purposes.

Affiliate Charge for Corporate Aviation Expense

The Attorney General proposed an adjustment of \$382,769 to remove the cost of the AEP corporate aviation expense charged to Kentucky Power during the test year.⁴¹ The Attorney General argued that AEP corporate aviation is a perquisite for AEP executives and directors and, as such, shareholders should bear the cost, not ratepayers.

³⁹ Smith Testimony at 42.

⁴⁰ Carlin Rebuttal Testimony at R-32.

⁴¹ Smith Testimony at 43-44.

The Commission disagrees with the Attorney General's proposed adjustment for corporate aviation expense. While private jet travel may appear to be an extravagance, legitimate travel expenses would have been incurred through commercial airlines. The Commission finds that the aviation expense proposed by Kentucky Power is reasonable and should be approved.

Storm Damage Expense

Kentucky Power proposed an adjustment of \$595,932 for storm damage expense based upon a three-year average of major storm expense. The Attorney General proposed an adjustment to reduce storm damage expense by \$595,932, arguing that Kentucky Power had not demonstrated a compelling reason to increase test year storm damage expense.⁴²

Kentucky Power explained that it used a three-year average to normalize the level of costs to address the uncertainty regarding when, and how much, a major storm will affect Kentucky Power and because using only the test year amount in a base rate filing could lead to major swings in adjustments for storm damage expense.⁴³

The Commission finds that Kentucky Power's storm damage expense adjustment is reasonable and should be allowed for ratemaking purposes.

Test Year Relocation Expense

Kentucky Power included a \$318,073 adjustment for relocation expense in its test year revenue requirement.⁴⁴ The Attorney General proposed an adjustment to

⁴² *Id.* at 44.

⁴³ Rebuttal Testimony of Ranie K. Wohnhas ("Wohnhas Rebuttal Testimony") at R-18 – R-19.

⁴⁴ Kentucky Power's Response to the Attorney General's First Request, Item 251.

normalize relocation expenses that reduced the test year operating expenses by \$140,972 on a Kentucky jurisdictional basis.⁴⁵

In response to Commission Staff's Post-Hearing Data Request, Item 14, Kentucky Power stated that its relocation expense for the eight-month period March 1, 2017 to October 31, 2017 totaled \$125,736. Annualized over a twelve-month period ending February 28, 2018, relocation expenses are forecasted to total \$188,604. On a Kentucky jurisdictional basis, relocation expenses for the twelve months ending February 28, 2018 amount to \$185,964.

The Commission finds that the relocation expense should be adjusted based upon the Kentucky jurisdictional relocation expenses for the twelve months ending February 28, 2018. This results in a decrease to the Kentucky jurisdictional relocation expense of \$132,109.

Gain on Sale of Utility Property

The Attorney General proposed an adjustment to amortize a \$996,669 gain on the sale of utility property ("Carrs Site") over three years for \$327,240 per year on a Kentucky jurisdictional basis.⁴⁶ The Attorney General maintained that the Kentucky jurisdictional gain on the sale of utility property should flow back to customers.

In rebuttal, Kentucky Power argued that the gain on the sale of the property should not be adjusted to reduce its revenue requirement because the Carrs Site had not been included in rate base, and thus Kentucky Power had not received a return on

⁴⁵ Smith Testimony at 46.

⁴⁶ *Id.* at 47.

the Carrs Site for the last 33 years.⁴⁷ Kentucky Power also noted that it removed \$60,539 in property taxes from its cost of service in this case.⁴⁸

The Commission finds that, since Kentucky Power has not received a return on this investment and has excluded the property taxes from its cost of service, the proposed adjustment by the Attorney General is not reasonable and should be denied.

Cash Surrender Value of Life Insurance

Kentucky Power recorded expense in the test year associated with the cash surrender value of life insurance of former executives in a Kentucky jurisdictional amount of \$26,941.⁴⁹

The Attorney General asserted that Kentucky Power's ratepayers should not be responsible for paying the expenses for the cash surrender value of life insurance for former executives and recommended the \$26,941 of expense be denied for ratemaking purposes.⁵⁰

In rebuttal, Kentucky Power explained that the expense is part of the total compensation/benefit package given to executives (current or former) that should be recovered whether or not the executive is a current or a former employee.⁵¹

The Commission finds that the proposed expense is reasonable, and therefore the Attorney General's proposed adjustment should be denied.

⁴⁷ Wohnhas Rebuttal Testimony at R-20.

⁴⁸ *Id.*

⁴⁹ Smith Testimony at 48.

⁵⁰ *Id.*

Rate Case Expense

The Attorney General proposed an adjustment to remove \$458,333 in rate case expenses.⁵² The Attorney General proposed to remove certain rate case expenses billed by a consultant who conducted witness preparation but did not sponsor testimony on Kentucky Power's behalf. The Attorney General also proposed to remove remaining rate case expenses as a penalty for Kentucky Power not seeking a reduction in the Rockport UPA ROE, which was established by the Federal Energy Regulatory Commission ("FERC").

In rebuttal, Kentucky Power argued that witness preparation is a necessary part of litigating a base rate case and that, regardless of who performs the function, the cost should be recovered.⁵³ Kentucky Power further argued that FERC's determination of the Rockport UPA ROE was fair, just, and reasonable, and that the decision was within FERC's exclusive jurisdiction. Kentucky Power asserted that the Attorney General's proposal to deny rate case expense as a penalty for the Rockport UPA ROE was an unlawful and unconstitutional attempt to overturn a FERC decision.

The Commission finds that the Attorney General's adjustment to remove rate case expenses for witness preparation and as a penalty for the Rockport UPA ROE is unreasonable, and should be denied. Given the type of service provided, the Attorney General's argument to remove the witness preparation consultant's fees is not

⁵¹ Wohnhas Rebuttal Testimony at 17.

⁵² Smith Testimony at 52.

⁵³ Wohnhas Rebuttal Testimony at R-20.

persuasive.⁵⁴ In regard to adjusting the rate case expenses as a penalty not related to ratemaking, as set forth in *South Central Bell v. Utility Reg. Comm'n*, 637 S.W.2d 649, 653 (Ky. 1982), the imposition of penalty that is not germane to the factors that go into the ratemaking process is arbitrary and subjective. If the Attorney General objects to the ROE awarded by FERC, the appropriate forum to address that issue is at FERC, and not the Commission.

COMMISSION ADJUSTMENTS TO REVENUES AND EXPENSES

Off System Sales ("OSS") Margins, System Sales Clause Tariff ("Tariff S.S.C.")

During the test year, Kentucky Power included OSS margins in the amount of \$7,163,948. Kentucky Power operated the converted Big Sandy Unit 1 for only nine months of the test period. While Kentucky Power annualized the plant maintenance expense for Big Sandy Unit 1,⁵⁵ there was no adjustment or annualization to OSS margins.

The Commission finds that OSS margins should be adjusted to reflect an annualized amount. For the 12-month period ending September 30, 2017, Kentucky Power had OSS margins of \$7,650,360.⁵⁶ Therefore, the Commission will utilize the OSS margins of \$7,650,360 for the 12-month period ending September 30, 2017, rather than the test year amount, resulting in an increase in operating revenue of \$486,412. Additionally, the amount of OSS margins to be collected in base rates is \$7,650,360, rather than the \$7,163,948 proposed in the application.

⁵⁴ See Kentucky Power Fifth Supplemental Response to Staff's First Request (filed Jan. 2, 2018), Item 56. The witness preparation fees were \$42,623; Kentucky Power's other legal fees were \$677,547.

⁵⁵ Application, Section V, Exhibit 2, Workpaper 41.

⁵⁶ Response to Commission Staff's Fourth Request for Information, Item 2.

Weather Normalized Commercial Sales

Kentucky Power proposed an adjustment to increase revenues to reflect normal temperatures, but its adjustment applied only to residential customer sales. In discovery, Kentucky Power stated that commercial revenues would have been \$914,000 greater based on weather normalized temperatures.⁵⁷ After the related variable expenses are removed from revenues, the rate increase is reduced by \$400,000.

The Commission finds this adjustment reasonable as temperatures affect the revenues in both the residential and commercial classes. Therefore, the Commission will reduce the rate increase by \$400,000 to reflect this adjustment.

Purchased Power Limitation and Forced Outage Purchase Power Limitation Expense

Kentucky Power proposed adjustments to include the purchased power limitation and forced outage purchase power limitation expense in base rates in its application in the amount of \$3,150,582 and \$882,204, respectively.

As discussed under the FAC Purchase Power Limitation section below, the Commission is denying Kentucky Power's proposal to recover such costs under Tariff P.P.A. Accordingly, the Commission finds these adjustments unreasonable and should be denied.

Net Operating Income Summary

After considering all pro forma adjustments and applicable income taxes, Kentucky Power's adjusted net operating income is as follows:

⁵⁷ Direct Testimony of Lane Kollen at 16-17.

| | |
|-------------------------------|----------------------|
| Operating Revenues | \$568,163,551 |
| Operating Expenses | <u>519,965,870</u> |
| Adjusted Net Operating Income | <u>\$ 48,197,681</u> |

RATE OF RETURN

Capital Structure and Cost of Debt

Kentucky Power proposed an adjusted test-year-end capital structure consisting of 54.45 percent long-term debt at 5.32 percent; zero percent short-term debt at 0.80 percent; 3.87 percent accounts receivable financing at 1.95 percent; and 41.68 percent common equity at a return of 10.31 percent.⁵⁸ On August 7, 2017, Kentucky Power filed a supplement to its Application reflecting the results of Kentucky Power's June 2017 refinancing of \$325 million 6.00 percent Senior Unsecured Notes, and \$65 million WVEDA Mitchell Project, Series 2014A Variable Rate Demand Notes as authorized in Case No. 2016-00345.⁵⁹ This refinancing reduced the annual cost of long-term debt to 4.36 percent.⁶⁰ The capital structure proposed by the Settlement downwardly adjusts the long-term debt by one percent and places this percent onto the short-term debt at an interest rate of 1.25 percent.⁶¹

⁵⁸ Application, Direct Testimony of Zachary C. Miller ("Miller Direct Testimony") at 3.

⁵⁹ Case No. 2016-00345 *Electronic Application of Kentucky Power Company for Authority Pursuant to KRS 278.300 to Issue and Sell Promissory Notes of One or More Series and for Other Authorizations* (Ky. PSC Dec. 21, 2016).

⁶⁰ Supplemental Direct Testimony of Zachary C. Miller at 5.

⁶¹ Settlement Testimony of Matthew J. Satterwhite ("Satterwhite Settlement Testimony") at Exhibit 6a.

The Attorney General employed Kentucky Power's proposed capital structure and senior capital cost rates.⁶² KCUC was silent on this topic.

Kentucky Power stated that it sells its receivables to AEP for cost savings due to default risks and to improve cash flow.⁶³ However, Kentucky Power's uncollectible accounts remain with Kentucky Power and are not sold with the accounts receivable.⁶⁴ The Commission notes that the cost of accounts receivable financing is higher than traditional short-term financing. The Commission believes that selling the receivables but maintaining the bad debt places an undue burden onto Kentucky Power's customers. Therefore, the Commission will blend the funds between short-term debt and accounts receivable financing so that the weighted average cost percentage of accounts receivable financing is decreased three basis points and placed on the short-term debt weighted average cost percentage. This reduces the percent of accounts receivable financing to 1.67 percent of the total capital structure and increases the percent of short-term debt to 3.20 percent of the total capital structure. The Commission finds that the cost of long-term debt and short-term debt of 4.36 percent and 1.25 percent, respectively, to be reasonable.

Return on Equity

In its Application, Kentucky Power developed its return on equity ("ROE") using the discounted cash flow method ("DCF"), the capital asset pricing model ("CAPM"), the empirical capital asset pricing model ("ECAPM"), and the utility risk premium ("RP"). In

⁶² Direct Testimony of J. Randall Woolridge, Ph.D. ("Woolridge Testimony") at 3.

⁶³ Dec. 8, 2017 H.V.T. at 12:15:22.

⁶⁴ Dec. 6, 2017 H.V.T. at 5:43:36.

addition, Kentucky Power referenced the expected earnings approach.⁶⁵ Based on the results of the methods employed in its analysis, Kentucky Power recommended an ROE range of 9.71 percent to 10.91 percent, including flotation cost.⁶⁶ Kentucky Power recommended awarding the midpoint of this range, 10.31 percent, to maintain financial integrity and to support additional capital investment.⁶⁷ Kentucky Power further stressed that consideration of all models, not just the DCF model, is important as the DCF model results may reflect the impact from the recent recession and such financial inputs are not representative of what may prevail in the near future.⁶⁸

Direct testimony and analysis regarding ROE was provided by the Attorney General. The Attorney General employed the DCF and CAPM models for his analysis and both models were evaluated using Kentucky Power's proxy group and the Attorney General's own proxy group. This was mostly for comparison purposes, as the Attorney General stated that, on balance, the two proxy groups were similar in risk.⁶⁹ The Attorney General's DCF model results indicated equity cost rates of 8.25 percent and 8.7 percent for the Attorney General and Kentucky Power proxy groups, respectively. The Attorney General disagreed with Kentucky Power's DCF analysis, specifically noting Kentucky Power's elimination of low-end DCF results and the use of growth forecasts that the Attorney General believes are overly optimistic and upwardly biased.⁷⁰

⁶⁵ Application, Direct Testimony of Adrian M. McKenzie, CFA ("McKenzie Direct Testimony") at 6.

⁶⁶ *Id.* at Exhibit AMM-2 at 1.

⁶⁷ *Id.* at 6.

⁶⁸ *Id.* at 7.

⁶⁹ *Id.* at 25.

⁷⁰ *Id.* at 65.

The Attorney General's CAPM results were 7.6 percent for both proxy groups. The Attorney General stated that Kentucky Power's CAPM analysis is flawed as the ECAPM version of the CAPM was used, which the Attorney General claims makes an inappropriate adjustment to the risk-free rate and the market risk premium.⁷¹ Additionally, the Attorney General stated that Kentucky Power's CAPM analysis employed an inflated projected interest rate, an unwarranted size adjustment, and an excessive market or equity risk premium.⁷²

The Attorney General recommended relying primarily on the DCF model, determined the ROE range of the two proxy groups, 8.25 percent and 8.7 percent, to be reasonable, and recommended an ROE of 8.6 percent.⁷³ In support of his recommendation, the Attorney General noted that: as investment risk, Kentucky Power's credit ratings are on par with the proxy groups; capital costs for utilities remain at historical low levels and are likely to remain at low levels; the risk associated with the electric utility industry is among the lowest and, as such, the cost of equity capital is amongst the lowest; and authorized ROEs have been gradually decreasing in recent years.⁷⁴

The Attorney General also disagreed with Kentucky Power's upward adjustment of 0.11 percent to the equity cost rate recommendation to account for flotation costs. The Attorney General argued that Kentucky Power did not identify any flotation costs

⁷¹ *Id.* at 68.

⁷² *Id.*

⁷³ Woolridge Testimony at 58.

⁷⁴ *Id.* at 59.

that are specifically associated with Kentucky Power.⁷⁵ The Attorney General stated that it is commonly argued that a flotation cost adjustment is necessary to recover issuance costs, but should not be recovered through the regulatory process, as these costs are already known to the investor upon buying the stock.⁷⁶

The parties to the Settlement agreed that the revenue requirement increases for Kentucky Power will reflect a 9.75 percent ROE as applied to Kentucky Power's capitalization and capital structure of the proposed revenue requirement increases as modified through discovery. As a result, use of a 9.75 percent ROE reduced Kentucky Power's proposed electric revenue requirement by \$4.7 million.⁷⁷ In his post hearing brief, the Attorney General recognized the significant reduction from the original ROE, but still believes it is in excess of the return shareholders require.⁷⁸ The Attorney General further argued that utilities seem to overstate necessary ROE, and does not support the 9.75 percent.⁷⁹ For the reasons discussed below, the Commission finds a ROE of 9.75 percent to be unreasonable, and for the purpose of base rate revenues and certain tariffs, an ROE of 9.70 percent should be applied.

In his testimony, the Attorney General noted that differing opinions between Kentucky Power and the Attorney General regarding capital market conditions result in differing ROE recommendations.⁸⁰ Kentucky Power's analysis assumes higher interest

⁷⁵ *Id.* at 80.

⁷⁶ *Id.* at 81.

⁷⁷ Settlement at 4.

⁷⁸ Attorney General's Post Hearing Brief ("Attorney General's Brief") (filed Jan. 5, 2018) at 18.

⁷⁹ *Id.* at 19 and 20.

⁸⁰ Woolridge Testimony at 5.

rates and capital costs whereas the Attorney General concludes that interest rates and capital costs are at low levels and likely to remain low for some time.⁸¹ The Commission agrees with the Attorney General that, although interest rates are increasing, they are doing so slowly and are still historically low. In fact, the Federal Reserve noted the following:

The Committee expects that economic conditions will evolve in a manner that will warrant gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run. However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data.⁸²

The Commission further agrees that models supporting the low interest rate environment should be given more weight than those supporting high interest rate expectations.

The Commission also agrees with the Attorney General that flotation costs should be excluded from the analysis. The Commission believes that flotation costs are accounted for in the current stock prices, as the price includes the underwriting spread and adding the adjustment amounts to double counting. Removal of the flotation costs from Kentucky Power's initial cost of equity range lowers the range to 9.6 percent from 10.8 percent.⁸³

The 2017 economic environment has shown signs of relative improvement. In response to low inflation and low unemployment, the Federal Reserve increased interest rates a quarter of a percent three times in 2017. Current outlooks for 2018 are

⁸¹ *Id.*

⁸² Testimony of Richard A. Baudino at 8.

⁸³ McKenzie Direct Testimony, Exhibit AMM-2 at 1.

healthy, with gross domestic product growth rates expected to remain between two and three percent, unemployment forecasted to continue at the natural rate, and inflation expected to hover at around two percent.⁸⁴ However, notwithstanding these improvements, the economy of Eastern Kentucky has lagged behind national and state trends. Employment trends have not recovered to pre-recession levels, earnings trends remain stagnant and lag behind the state trends, and poverty rates in the majority of Kentucky Power's service territory are 24.4 percent or higher.⁸⁵

The Commission is cognizant of the risk inherent to Kentucky Power's service territory and load profile. The Commission notes the Attorney General's position that Eastern Kentucky has been economically depressed for the past decade and that the Commission should consider the economic conditions of the region in evaluating the overall rates and rate design.⁸⁶ Therefore, given the adverse economic situation of the service territory of high unemployment, low earnings, and high poverty rates, the Commission finds a lower ROE will allow Kentucky Power to earn a fair return while reflecting the economic situation of its customers.

For 2016, the median ROE of the utilities in the Attorney General's proxy group was 9.3 percent; for Kentucky Power's proxy group, the median ROE was 9.4 percent.⁸⁷ In addition, the average authorized ROE reported by SNL Financial for 2017 is

⁸⁴ <https://www.thebalance.com/us-economic-outlook-3305669>.

⁸⁵ Attorney General's Brief at 12; Dismukes Testimony at 5-6; Dec. 6, 2017 H.V.T., PSC Exhibit 1.

⁸⁶ Dismukes Testimony at 6.

⁸⁷ Woolridge Testimony, Exhibit JRW-4 at 1.

approximately 9.7 percent.⁸⁸ The Commission agrees with Kentucky Power that this is a benchmark worthy of consideration, but disagrees that a downward adjustment will be injurious to customers and the Kentucky economy.⁸⁹ Based on the entire record developed in this proceeding, we find that an ROE of 9.7 falls within the range of the Attorney General's proposed 8.6 percent to the initial proposed ROE of 10.31 percent, and within Kentucky Power's original range of 9.6-10.8 percent, adjusted for flotation costs. Additionally, an ROE of 9.7 is within the range of the benchmarks provided by SNL, the proxy groups, and recent Commission Orders⁹⁰.

Rate-of-Return Summary

Applying the rates of 4.36 percent for long-term debt, 1.25 percent for short-term debt, 1.95 percent for accounts receivable financing, and 9.70 percent for common equity to the Commission adjusted capital structure produces an overall cost of capital of 6.44 percent.⁹¹ The cost of capital produces a return on Kentucky Power's rate base of 6.42 percent.

BASE RATE REVENUE REQUIREMENTS

In the Settlement, Kentucky Power and the Settling Intervenors agreed to a base rate increase of \$31.8 million. The Attorney General's expert witness proposed a base

⁸⁸ Direct Testimony and Exhibits of Gregory W. Tillman on behalf of Wal-Mart Stores East, LP and Sam's East, Inc. at 11.

⁸⁹ Rebuttal Testimony of Adrien M. McKenzie, CFA at 73.

⁹⁰ Case No. 2016-00370 Electronic Application of Kentucky Utilities Company For An Adjustment Of Its Electric Rates and For Certificates of Public Convenience and Necessity (Ky. PSC Jun. 22, 2017) and Case No. 2016-00371 Electronic Application of Louisville Gas and Electric Company For An Adjustment Of Its Electric and Gas Rates and For Certificates Of Public Convenience and Necessity (Ky. PSC Jun. 22, 2017).

rate increase of \$39.8 million. The Commission finds that, subject to the adjustments discussed in this Order, a base rate increase of \$12.35 million is reasonable, as is discussed in the Total Jurisdictional Revenue Requirement section below.

REVENUE REQUIREMENT-RELATED RIDERS AND DEFERRALS

Big Sandy Retirement Rider

In its Application, Kentucky Power proposed to rename the Big Sandy Retirement Rider to the Decommissioning Rider to alleviate customer confusion regarding the purpose of the rider. Pursuant to the settlement agreement approved in Case No. 2014-00396, Kentucky Power recovers the coal-related retirement costs of Big Sandy Unit 1, the retirement costs of Big Sandy Unit 2, and other site-related retirement costs through this rider. Only the rider name will change; the rider will continue to operate in the manner approved by the Commission in Case No. 2014-00396.

The Commission finds the name change reasonable and that it should be approved. The Commission further finds that the carrying charges associated with this rider should be based on the weighted average cost of capital ("WACC"), after reflecting the impacts of the reduction in the federal corporate income tax rates approved in this Order, should become effective as of the date of this Order. However, the monthly amounts collected will not change until Kentucky Power makes its annual filing on or before August 15, 2018, to adjust the amounts collected under this rider.

Big Sandy Unit 1 Operation Rider

In its Application, Kentucky Power proposed to eliminate the Big Sandy Unit 1 Operation Rider ("Tariff B.S.1.O.R.") and to recover through base rates the costs

⁹¹ The Commission adjusted capital structure consists of 54.45 percent long-term debt, 3.2

currently recovered through Tariff B.S.1.O.R. Once new rates become effective in this case, Tariff B.S.1.O.R. will have an under- or over-recovery balance. Therefore, Kentucky Power also requested authority to establish a regulatory asset or liability that will allow Kentucky Power to track and defer any under- or over-recovery balance until its next rate case.

In Case No. 2014-00396, the Commission approved Tariff B.S.1.O.R. to permit Kentucky Power to recover the non-fuel costs of operating Big Sandy Unit 1 as a coal burning unit until its conversion to natural gas, the non-fuel costs of its operation as a natural gas unit and capital investment required for its conversion to natural gas once it is placed in service. Tariff B.S.1.O.R. was designed to be in effect until the rates established in Kentucky Power's next base rate case were implemented.

The Commission has previously approved regulatory assets for other jurisdictional utilities. Such approval has been granted when a utility has incurred: (1) an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning; (2) an expense resulting from a statutory or administrative directive; (3) an expense in relation to an industry-sponsored initiative; or (4) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.⁹² Since Tariff B.S.1.O.R. was approved by the Commission in Case No. 2014-00396, the establishment of a regulatory asset to address the under-

percent of short term debt, 1.67 percent of accounts receivable financing, and 41.68 percent of common equity.

⁹² Case No. 2008-00436, *The Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages* (Ky. PSC Dec. 23, 2008), at 4. See also Case No. 2010-00449, *Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of a Regulatory Asset for the Amount Expended on Its Smith 1 Generating Unit* (Ky. PSC Feb, 28, 2011), at 7.

recovery of Tariff B.S.1.O.R. is consistent with the second example listed above. Regarding a possible regulatory liability, the Commission notes that it is appropriate that Kentucky Power customers be the beneficiaries of any over-recovery of Tariff B.S.1.O.R.

The Commission finds the establishment of a regulatory asset or liability due to the elimination of Tariff B.S.1.O.R. to be reasonable and that it should be approved. This approval is for accounting purposes only, and the appropriate ratemaking treatment for the regulatory asset or liability account will be addressed in Kentucky Power's next general rate case.

Tariff A.T.R.

In its Application, Kentucky Power proposed to eliminate Tariff Asset Transfer Rider ("Tariff A.T.R."). Given that Kentucky Power has recovered the full amount that Tariff A.T.R. was designed to recover, the Commission finds the elimination of Tariff A.T.R. to be reasonable and that it should be approved.

Tariff K.E.D.S.

In its Application, Kentucky Power proposed to increase Tariff K.E.D.S. from \$0.15 per meter per month to \$0.25 per meter per month. In the Settlement, Kentucky Power and the Settling Intervenors agreed to a surcharge of \$0.10 per meter for residential customers and \$1.00 per meter for non-residential customers. KCUC did not provide testimony regarding Tariff K.E.D.S.

Tariff K.E.D.S. imposes an economic development surcharge, which was approved in Kentucky Power's last rate case,⁹³ to fund economic development initiatives

⁹³ Case No. 2014-00396, Final Order at 49-51.

in Kentucky Power's service territory, with funds collected through the surcharge matched equally by Kentucky Power from AEP shareholder funds. As a basis for the increase, Kentucky Power argued that additional economic development funds were needed to grow its load and customer base. One of the reasons for Kentucky Power's proposed rate increase is a significant decline in load and customers since the economic downturn in 2008.⁹⁴ A decrease in customers and load concentrates costs among a smaller customer base, which results in fewer customers paying a larger share of the cost. Correspondingly, a growth in load and customer base spreads costs among a greater number of customers.

The Attorney General recommended that the economic development surcharge be eliminated.⁹⁵ The Attorney General asserted that Kentucky Power failed to provide evidence of a direct tie between Kentucky Power's economic development efforts and increased jobs and electricity sales.⁹⁶ The Attorney General further asserted that the economic development surcharge simply redistributes ratepayer dollars without evidence of an identifiable benefit for ratepayers.

In rebuttal, Kentucky Power countered that it maintains economic development metrics, including job counts, investments, and grants, which it uses to evaluate the

⁹⁴ Application, Direct Testimony of Brad N. Hall ("Hall Direct Testimony") at 5. Between 2008 and 2016, Kentucky Power lost 6,931 customers, and its total annual sales declined from 7.24 GWh to 5.80 GWh.

⁹⁵ Direct Testimony of David E. Dismukes ("Dismukes Testimony") at 4; Direct Testimony of Roger McCann ("McCann Testimony") at 6, 17.

⁹⁶ Dismukes Testimony at 4, 41.

success of its economic development program.⁹⁷ In a subsequent discovery response, Kentucky Power provided its written economic development action plan with strategic goals and metrics set forth in specific detail.⁹⁸ Kentucky Power contended that its economic development program achieves identifiable goals, and that Kentucky Power's customers receive benefits from the economic development surcharge. As an example, Kentucky Power asserted that its economic development efforts are projected to create 1,705 new full-time positions, with an additional 1,000 construction jobs.⁹⁹

The Commission recognizes the importance of economic development efforts, especially given the economic needs of Kentucky Power's service area. However, the Commission also recognizes that 26 percent, or 35,756, of Kentucky Power's residential customers are at or below the poverty level.¹⁰⁰ In 2016, Kentucky Power disconnected more than 11,000 residential customers who could not pay their electric bill.¹⁰¹ In the course of this proceeding, the Commission received a large number of public comments from residential customers who questioned why they are charged for Kentucky Power's economic development efforts, particularly given the difficulty that residential customers have in paying their electric bills. Residential customers, especially those on fixed incomes, cannot pass along their costs; to a certain extent, non-residential customers

⁹⁷ Dec. 8, 2017 H.V.T. at 10:44:56.

⁹⁸ Kentucky Power Response to KCUC's Post Hearing Data Request ("Response to KCUC Post Hearing Request"), Item No. 1, Attachment 1.

⁹⁹ Hall Direct Testimony at 12; Dec. 8, 2017 H.V.T. at 10:31:23. On December 7, 2017, there was an announcement that 875 jobs would result from a business locating in Pikeville, Kentucky. Prior to that announcement, there were 830 projected new jobs created from Kentucky Power economic development efforts.

¹⁰⁰ Dec. 8, 2017 H.V.T. at 11:58:01 and 5:33:49.

¹⁰¹ *Id.* at 11:58:19.

can pass along their costs to their customers. The Commission finds that the residential customer economic development surcharge of \$0.10 per meter per month, as set forth in the Settlement, is unreasonable and therefore should be denied. The Commission further finds that the residential customer economic development surcharge should be eliminated. However, the Commission finds that the economic development surcharge on non-residential customers of \$1.00 per meter per month, as set forth in the Settlement, is reasonable. Therefore, the Commission approves the portion of the Settlement applicable to the economic development surcharge for non-residential customers only.

Home Energy Assistance Program Surcharge

In its Application, Kentucky Power proposed to increase the HEAP surcharge from \$0.15 per residential meter per month to \$0.20 per residential meter per month. Similar to the economic development surcharge, funds collected through the HEAP surcharge are matched equally by Kentucky Power from AEP shareholder funds.

HEAP funds provide subsidies to assist eligible low-income customers in Kentucky Power's service territory to pay electric bills during seven peak heating and cooling months.¹⁰² There is a waiting list of eligible customers because there are not sufficient HEAP funds available to assist all eligible customers.¹⁰³

The Attorney General supported the five-cent increase to \$0.20 per residential meter per month, but argued that the increase was inadequate to keep pace with

¹⁰² McCann Testimony at 5-6, 14. Subsidies are available in January, February, March, July, August, September, and December.

¹⁰³ *Id.* at 15. As of Sept. 20, 2017, there were 1,475 eligible customers on a wait-list for HEAP subsidies.

Kentucky Power's rate increases. The Attorney General proposed that the Commission approve the HEAP surcharge increase and, if the Commission discontinued the economic development surcharge, that the HEAP surcharge be increased in the same amount by which the economic development is reduced.¹⁰⁴

Kentucky Power's President, Matthew J. Satterwhite, testified that, if the Commission modified the Settlement to eliminate the \$0.10 per meter per month economic development surcharge for residential customers, Kentucky Power could agree to a commensurate increase in the HEAP surcharge by \$0.10 per residential meter per month, with matching shareholder funds.¹⁰⁵

The Settlement is silent as to the HEAP surcharge.

The Commission finds that the proposed increase in the HEAP surcharge is insufficient to address the demonstrable need to assist eligible low-income customers with their electric bills. The Commission further finds that the HEAP surcharge should be increased by the corresponding amount that the economic development surcharge for residential customers is reduced. Therefore, the Commission rejects Kentucky Power's proposed increase in the HEAP surcharge to \$0.20 per residential meter per month. The Commission finds an increase of the HEAP surcharge to \$0.30 per residential meter per month is reasonable and should be approved.

Rockport Deferral Mechanism

In the Settlement, Kentucky Power and the Settling Intervenors agreed to defer \$50 million of non-fuel and non-environmental lease expenses from Rockport Unit 2

¹⁰⁴ McCann Testimony at 6, 17; Dismukes Testimony at 4.

over five years, with the establishment of a regulatory asset for later recovery (“Rockport Deferral Regulatory Asset”) of these expenses. This Rockport Deferral Regulatory Asset, plus a carrying charge based on a WACC of 9.11 percent, will be recovered through Kentucky Power’s Tariff P.P.A. over five-years starting in December of 2022. The dates of the end of the deferral period and the start of the five-year amortization period coincide with the anticipated end of the Rockport UPA lease agreement.¹⁰⁶

The Settlement proposed a deferral of \$15 million in 2018 and 2019, \$10 million in 2020, and \$5 million in 2021 and 2022. The Settlement’s annual revenue requirement reflects a decrease to base rates of the 2018 \$15 million adjustment. In 2020, 2021 and 2022 the decrease in the deferral will be offset with an increase in the amount recovered through Tariff P.P.A. Additionally, in 2022, the increase in the amount recovered through Tariff P.P.A. will be prorated through December 8, 2022, as the Rockport UPA will terminate on that date. By utilizing Tariff P.P.A., Kentucky Power is able to reduce the annual deferral amount and concurrently keep base rates unchanged. Beginning in December 2022, the five-year deferral period will end and the recovery of the Rockport Deferral Regulatory Asset will begin. The Rockport Deferral Regulatory Asset will be amortized through 2027 and be subject to carrying charges until it is fully recovered. Kentucky Power estimates that the Rockport Deferral

¹⁰⁵ Dec. 7, 2017 H.V.T. at 10:53:09.

¹⁰⁶ Satterwhite Settlement Testimony at S-10.

Regulatory Asset will total approximately \$59 million in December 2022. That amount will decrease incrementally until fully collected over the five-year amortization period.¹⁰⁷

Neither the Attorney General nor KCUC offered testimony concerning the Rockport Deferral. However, during the hearing and in his post-hearing brief, the Attorney General expressed his concerns about the “very large financing costs” associated with the deferrals, stating that the “\$50M over the entire deferral period is going to have financing costs piled on top of it... [t]hese financing costs are at the weighted average cost of capital including the 9.75 percent return of equity which then gets a tax gross up on top of it.”¹⁰⁸ The Attorney General further stated that a concern that the costs of the deferral will eventually require rate recovery in future rate proceedings.¹⁰⁹ The Attorney General recommended that the carrying charge be reduced to 4.36 percent for Kentucky Power’s current long term debt.¹¹⁰

In response, Kentucky Power argued that the 9.11 percent WACC made Kentucky Power financially whole because of its need to finance the deferral through a combination of debt and equity, and therefore was appropriate.¹¹¹

The recovery period of the proposed Rockport Deferral Mechanism is contingent upon Kentucky Power not renewing the Rockport UPA.¹¹² If the lease is not renewed,

¹⁰⁷ See Appendix A, paragraph 3 for details of the Rockport UPA Expense Deferral.

¹⁰⁸ Dec. 6, 2017 H.V.T. at 04:01:19; See also Attorney General’s Brief at 31.

¹⁰⁹ Dec. 6, 2017 H.V.T. at 04:01:19

¹¹⁰ Attorney General’s Brief at 31.

¹¹¹ Kentucky Power’s Post Hearing Brief (“Kentucky Power’s Brief”) (filed Jan. 5, 2018) at 48.

¹¹² Kentucky Power stated that it is unlikely that the Rockport lease will be renewed. Dec. 6, 2017 H.V.T. at 5:47:44; Kentucky Power Response to Staff’s Second Request, Item 72.

the expenses associated with the Rockport UPA will be removed from rate base, which allows the regulatory asset to be funded without a change in rate base. However, if the lease is renewed, the deferred expenses will have to be recovered from future ratepayers, and possibly through an increase in rate base.¹¹³ The Commission recognizes that there are inherent risks associated with any deferral mechanism, especially since the deferral recovery is contingent upon not renewing the Rockport UPA. Given Kentucky Power's excess capacity and slow load growth, the Commission believes the benefits of the deferral outweigh the associated risks, and approves the Rockport Deferral Mechanism and the associated \$15 million decrease to rate base. The carrying charges associated with this rider shall be based on the WACC approved in this Order and are effective as of the date of this Order. This approval is for accounting purposes only, and the appropriate ratemaking treatment for this regulatory asset account will be addressed in Kentucky Power's next general rate case.

Environmental Surcharge Tariff E.S.

Kentucky Power proposed an addition to its Environmental Compliance Plan to recover the cost of installing Selective Catalytic Reduction ("SCR") technology at Rockport Unit 1, affecting the amounts collected under Tariff E.S. The project is discussed later in the Environmental Compliance Plan section of this Order. Kentucky Power estimated the revenue requirement for the SCR project to be \$3,903,065.¹¹⁴ The Commission finds the Rockport Unit 1 revenue requirement to be reasonable.

¹¹³ Satterwhite Settlement Testimony at S-13.

¹¹⁴ Elliott Testimony, Exhibit AJE-5.

TOTAL JURISDICTIONAL REVENUE REQUIREMENTS

The Commission has found that Kentucky Power's required ROE falls within a range of 8.60 percent to 10.31 percent, and approves an ROE of 9.70 percent. The Settlement proposed a base rate increase of \$31.8 million and environmental surcharge revenues of \$3.9 million, for a total of \$35.7 million. The environmental surcharge is discussed farther below. Because Kentucky Power recovers the costs associated with the decommissioning of coal-related assets at Big Sandy through the Decommissioning Rider, those costs are not included for recovery in the base rates. However, for the twelve months ending September 30, 2018, Kentucky Power will recover approximately \$20.2 million through the Decommissioning Rider,

Due to the modifications the Commission makes to the Settlement and the provision for the reduction in the federal corporate income tax rate from 35 percent to 21 percent in the Tax Cuts and Jobs Act, the Commission finds that an increase in base rate revenues of \$12.35 million, as shown in Appendix F to this Order, exclusive of the environmental surcharge, will result in fair, just, and reasonable electric rates for Kentucky Power and its ratepayers. The Commission utilized Kentucky Power's equity gross up revenue conversion factor ("GRCF"), as provided in Kentucky Power's revised Environmental Surcharge forms filed on January 3, 2018, to reflect the reduction in the federal corporation income tax rate effective with the date of this Order. Additionally, the adjustments the Commission makes to the test year operating income and expense items reflect the income tax rate reduction and change in the GRCF. The excess accumulated deferred income tax ("ADIT") impacts resulting from the reduction federal corporate income tax rate will be addressed in Case No. 2017-00477. The Commission

also finds that Kentucky Power should establish a mechanism to track the over/under-collection of federal income taxes, and that a true-up of any over/under-collections be addressed in Case No. 2017-00477.

Due to the economic conditions in Kentucky Power's service territory, the Commission believes that the impact of the federal corporate income tax reduction on rates should be put into place effective with the date of this Order. In addition, the lower rates should serve as an impetus for economic development through recruiting new businesses as well as maintaining existing business customers.

NONREVENUE REQUIREMENT RIDERS AND TARIFFS

The following sections address riders and a tariff that have no direct impact on Kentucky Power's revenue requirement. The discussion covers both those that have been contested, and those that are included in the Settlement.

Non-Utility Generator Tariff

In its Application, Kentucky Power proposed to revise the Non-Utility Generator Tariff ("Tariff N.U.G.") to eliminate a provision that requires a 30-day written notice to customers taking service under Tariff N.U.G. if a transmission provider implements charges for transmission congestion. Kentucky Power asserted that this clause is no longer necessary because PJM has already created transmission congestion charges.¹¹⁵ Kentucky Power also proposed to revise language in the special terms and conditions section of Tariff N.U.G. to clarify the requirement to take service for remote

¹¹⁵ Application, Vaughan Direct Testimony at 25.

self-supply.¹¹⁶ The Settlement is silent as to Tariff N.U.G. Neither KCUC nor the Attorney General contested the proposed revisions to Tariff N.U.G.

The Commission finds the revisions to Tariff N.U.G. to be reasonable and that they should be approved.

Systems Sales Clause

In its Application, Kentucky Power proposed to reduce monthly bill volatility by revising its Tariff S.S.C. to change from a monthly system sales adjustment factor to an annual sales adjustment factor. Kentucky Power further proposed to set the Tariff S.S.C. rate to \$0, with the difference between actual off-system sales margins and a base amount of \$7,163,948 deferred based on the current 75/25 customer sharing mechanism approved in Case No. 2014-00396.¹¹⁷ The net deferred credit or charge to customers would then be the base for the annual Tariff S.S.C. rate update.¹¹⁸ Kentucky Power proposed to file the required true-up information no later than August 15 of each year, with rates to be effective with Cycle 1 of October. The first filing would be made by August 15, 2018. The Settlement is silent as to Tariff S.S.C. Neither the Attorney General nor KCUC contested the proposed revisions to Tariff S.S.C.

The Commission finds the revisions to Tariff S.S.C., as adjusted to include \$7,650,350 in base rates, to be reasonable and should be approved.

¹¹⁶ Sharp Direct Testimony at 28.

¹¹⁷ Kentucky Power credits 75 percent of the difference between base and actual off system sales margins amounts to customers and retains 25 percent.

¹¹⁸ Vaughan Direct Testimony at 36-37.

PJM Billing Line Items

In the Application, Kentucky Power proposed to include additional PJM Billing Line Items (“BLIs”) for recovery through its FAC. Kentucky Power stated that these BLIs represent items that either require generation resources to be running and online, or are associated with other BLIs that require generation resources to be running and online. Kentucky Power stated that all of the service functions represented by the BLIs are related to fuel-related services previously received by Kentucky Power when it was a member of the AEP East Pool, and that those amounts were previously included in Kentucky Power’s base fuel cost. The Settlement is silent as to the BLIs. Neither the Attorney General nor KCUC contested this proposal.

The Commission has reviewed the additional BLIs and finds that they are appropriate for inclusion in the FAC, as these BLIs represent charges and credits that relate to fuel consumed by resources that are running and online. Furthermore, the Commission finds that when Kentucky Power files its compliance tariff, it should amend its Tariff F.A.C to include PJM BLIs 2211, 2215, and 2415, as those BLIs have replaced BLI 2210.

MODIFICATIONS TO TERMS AND CONDITIONS OF SERVICE TARIFFS

In its Application, Kentucky Power proposed certain revisions to its terms and conditions for service. The revisions include: verification of a customer’s identity and proof of ownership or lease of property where service is requested at the time an application for service is filed; information to be considered when evaluating whether to waive a deposit; payment arrangements; mobile alerts; elimination of the employee discount; modifying the equal payment plan; and denial or discontinuance of service.

Kentucky Power also requested a deviation from 807 KAR 5:006, Section 14(2)(a) to amend when a customer can sign up for the Equal Payment Plan, and the annual settle-up month for certain customers.

Neither the Attorney General nor KCUC contested the revisions.

The Commission finds that the proposed revisions to the terms and conditions of service as contained in the Application are reasonable, with the exception of the denial or discontinuance of service, and should be approved. The Commission further finds that Kentucky Power established good cause to deviate from 807 KAR 5:006, Section 14(2)(a), and that its request for a deviation should be granted.

As to the denial or discontinuance of service, the Commission finds that the proposed revisions as contained in the Application are overbroad and do not comply with Commission precedent.¹¹⁹ In response to Commission Staff's Post Hearing Data Request, Kentucky Power revised the terms for denial or discontinuance of service as follows:

The Company reserves the right to refuse or discontinue service to any customer if the customer is indebted to the Company for any service theretofore rendered at any location. Service will not be supplied or continued to any premises if at the time of application for service the Applicant is merely acting as an agent of a person or former customer who is indebted to the Company for service previously supplied at the same, or other premises, until payment of such indebtedness shall have been made;

The Commission finds that the revised language regarding denial or discontinuance of service as filed on in the Supplemental Response on December 21, 2017, is reasonable and should be approved.

¹¹⁹ See H.V.T., PSC Exhibits 2, 3, 4, and 6.

RATE DESIGN, TARIFFS AND OTHER ISSUES

Rate Design

Kentucky Power filed a fully allocated jurisdictional cost-of-service study ("COSS") to determine the cost to service each customer class as well as the rate of return on rate base for each class during the test year. The results of the COSS illustrate the amount of cross-subsidization between the rate classes and show that all non-residential rate classes subsidize the residential class. In its Application, Kentucky Power proposed to reduce these subsidies by five percent in its proposed rates. The Settlement modifies this proposed revenue allocation and proposes to use the first \$5.8 million of any Commission-authorized revenue increase to the Industrial General Service ("IGS") rate class to fully eliminate the subsidy Rate IGS would have paid under the rate increase as originally proposed by Kentucky Power.¹²⁰ The remaining revenue increase is spread uniformly among the rate classes, further reducing interclass subsidies.¹²¹

The Attorney General did not offer any testimony concerning the allocation of any proposed revenue increase, aside from recommending limiting any revenue increase, and stating that Kentucky Power's customers are unable to afford a rate increase and that a large increase would set the entire economy of Eastern Kentucky back, counteracting any economic expansion.¹²²

¹²⁰ Satterwhite Settlement Testimony at S-9; Dec. 8, 2017 H.V.T. at 2:59:20; Direct Testimony of Stephen J. Baron ("Baron Testimony") at 15 and Table 2.

¹²¹ Satterwhite Settlement Testimony at S-9.

¹²² Dismukes Testimony at 3.

The KCUC does not support the revenue allocation as set forth in the Settlement, contending that the Settlement does not provide fair or reasonable treatment of the Tariff L.G.S. customer class. KCUC stated that in addition to bearing a subsidy burden associated with the overall rate structure, the L.G.S. class must also absorb an additional \$500,000 subsidy resulting from the Public and Private School service ("PS") tariff.¹²³ To remedy this, the KCUC proposes that the first \$500,000 of any additional Commission-directed decrease in the revenue requirement be applied to the Tariff L.G.S. customer class and any revenue reduction beyond \$500,000 be uniformly spread among all the rate classes in proportion to each class's revenue requirement.¹²⁴

Residential Customer Charge

In its Application, Kentucky Power proposed an increase in the residential customer charge from \$11.00 to \$17.50, an increase of 59 percent. The cost-of-service study filed by Kentucky Power in this proceeding supports a customer charge of \$37.88.¹²⁵ The Settlement allows for an increase in the residential customer charge to \$14.00, an increase of 27 percent.

The Attorney General objected to any increase on the residential customer charge.¹²⁶ The Attorney General contended that shifts towards fixed cost recovery disproportionately hurt low-income customers and Kentucky Power did not provide

¹²³ Settlement Testimony of Kevin Higgins ("Higgins Settlement Testimony") at 2.

¹²⁴ *Id.* at 4.

¹²⁵ Vaughan Direct Testimony, Exhibit AEV-2 at 1.

¹²⁶ Dismukes Testimony at 6.

sufficient evidence to justify an increase.¹²⁷ The Attorney General argued that Kentucky Power's fixed cost calculation of almost \$38.00 is flawed because a portion of demand-related costs are assigned as fixed costs, which the Attorney General argued is fundamentally incorrect.¹²⁸ The Attorney General noted that none of the parties to the proposed Settlement represent the interests of residential ratepayers, and the proposed \$14 would recover too much of any potential revenue increase through the customer charge and undermine future incentives for efficiency, resulting in an erosion of LIHEAP funds.¹²⁹

The Commission believes an increase to the Residential Basic Service Charge is warranted, and finds that the Settlement's increase to \$14.00 is reasonable. The proposed 27 percent increase is consistent with the principle of gradualism that the Commission has long employed. Consistent with this change, the Commission also approves the customer charges of \$14.00 as set forth in the Settlement for the three optional residential tariffs: 1) Residential Service Load Management Time-of-Day; 2) Residential Service Time-of-Day; 3) and Experimental Residential Service Time-of-Day 2. The Commission also approves a customer charge of \$14.50 for the new optional Residential Demand Metered Electric Service ("Tariff R.S.D.").¹³⁰

¹²⁷ *Id.*

¹²⁸ *Id.* at 20.

¹²⁹ Attorney General's Brief at 32-33.

¹³⁰ The Settlement and supporting testimony state that Kentucky Power and the Settling Intervenors agreed to a residential customer charge of \$14.00. Settlement at paragraph 16(a); Satterwhite Settlement Testimony at S-22. The proposed Settlement Tariff R.S.D. filed on Dec. 1, 2017, inadvertently contains a monthly customer charge of \$17.50.

General Service Rate Class

Kentucky Power proposed to combine the Small General Service ("S.G.S.") and Medium General Service ("M.G.S.") rate classes into a single General Service ("G.S.") rate class under which all general service customers with average demands up to 100 kilowatts ("kW") will take service. Kentucky Power stated that both the S.G.S. and M.G.S. rate classes currently incur a monthly service charge and a blocked energy charge. Additionally, the M.G.S. rate class incurs a demand charge. Due to this current tariff structure, there is movement between the S.G.S. and M.G.S. rate classes as load characteristics vary month to month for many commercial customers. Kentucky Power stated that combining the S.G.S. and M.G.S. into a single tariff allows for administration efficiencies by eliminating this movement between the two rate classes.¹³¹ The new G.S. tariff combines rate design features from the S.G.S. and M.G.S. tariffs, and will include a monthly service charge, two blocked energy charges, and a demand charge for monthly billing demand greater than 10 kW. The blocked energy charge transition point is 4,450 kilowatt hours ("kWh"). Kentucky Power stated that setting the kWh block at 4,450 kWh ensures that almost all usage that was billed under the current S.G.S. tariff will continue to be billed on an energy charge only and such a rate design will minimize bill impact on current S.G.S. and M.G.S. customers.¹³²

Although the proposed rate design minimizes the impact on an average commercial customer, due to the proposed increase in the demand charge from \$1.91

¹³¹ Vaughan Direct Testimony at 21.

¹³² *Id.* at 21.

for all kW to \$7.95 for all kW greater than 10 kW, it negatively affects customers whose load characteristics include low usage coupled with high demand.¹³³ The Commission believes that Kentucky Power's proposed increase in the demand charge of over 300 percent is excessive. For this reason, the Commission will minimize the impact on high demand commercial customers, apply a 2-step phase-in increase of demand rates, and limit the increase in year 2 to \$6.00 per kW. In addition, Kentucky Power must identify and contact G.S. class customers whose average monthly demand is 25 kW or greater to meet to discuss the impacts of the rate increase on those customers' bills and analyze other tariff options, such as time-of-day rates, that may offer relief to these customers. Last, Kentucky Power should file with the Commission, within twelve months of this Order, a report listing the commercial customers who meet this load profile and the results of each meeting.

Rate Adjustment

In setting the rates shown in Appendix C, the Commission maintained the basic service charge for each class that was included in the Settlement. The reduction of Kentucky Power's revenue increase was allocated to the energy charges of those customer classes for which revenue increases were proposed. The reduction to each class's proposed revenue increase was approximately in proportion to the increase set forth in the Settlement.

¹³³ Dec. 8, 2017 H.V.T. at 4:53:40.

Tariff Purchased Power Adjustment

In its Application, Kentucky Power proposed to include the following additional cost of service items to be tracked and recovered through Tariff P.P.A.: (1) PJM OATT charges and credits that it incurs or receives from its participation as a LSE in the organized wholesale power markets of PJM; (2) purchased power costs excluded from recovery through the FAC as a result of the purchased power limitation; and (3) gains and losses from incidental gas sales. In addition, Kentucky Power proposed to change Tariff P.P.A. from a monthly adjusting surcharge to an annually updated surcharge.

The Attorney General filed testimony stating that these cost-of-service items should continue to be collected through base rates as Kentucky Power has not demonstrated a compelling reason to have these items tracked and recovered through Tariff P.P.A.¹³⁴

1. PJM LSE OATT Charges and Credits

Kentucky Power proposed to include the following PJM LSE transmission charges and credits to costs recoverable through Tariff P.P.A.: network integration transmission service ("NITS"); transmission owner scheduling system control and dispatch service ("TO"); regional transmission expansion plan ("RTEP"); point-to-point transmission service; and RTO start-up cost recovery. An adjusted level of the net OATT charges and credits in the amount of \$74,377,364 will be included in base rates.¹³⁵ The amount above or below the base rate level would be tracked monthly and the annual net over- or under-collection would then be collected from or credited to customers through the operation of Tariff P.P.A.

¹³⁴ Smith Testimony at 70.

Kentucky Power stated that the proposed tracking mechanism for PJM OATT LSE Charges is necessary due to the volatility of these PJM charges and credits, which Kentucky Power claimed are largely out of its control. Kentucky Power estimated that its PJM OATT LSE expenses will increase in 2018 by approximately \$14 million, or 19 percent over the test year amount.¹³⁶ Kentucky Power expects increasing investment in the transmission grid by PJM member transmission owners, which will increase transmission charges allocated to LSEs in PJM. Kentucky Power stated that tracking the PJM LSE charges and credits via Tariff P.P.A. could preclude it from seeking more frequent rate cases.¹³⁷

Finally, two proceedings currently before the FERC may affect the level of PJM LSE OATT charges incurred by Kentucky Power. One proceeding is a challenge to the ROE included in the AEP Zone formula, which determines the PJM transmission costs of service for the AEP Transmission Zone. Kentucky Power stated that at this time, any change resulting from this proceeding is not known and measurable. Therefore, an adjustment in this case is not possible. The second proceeding is a pending non-unanimous settlement regarding the cost allocation methodology historically used by PJM to allocate costs of transmission enhancement projects to the LSEs in its footprint. If approved, the proposed stipulation is expected to result in lower PJM LSE OATT

¹³⁵ Vaughan Direct Testimony at 29.

¹³⁶ Satterwhite Settlement Testimony at S-14–S-15.

¹³⁷ Vaughan Direct Testimony at 27-28.

charges. However, the timing or magnitude of the possible cost allocation changes are not currently known.¹³⁸

The Settlement revised the proposal regarding the PJM OATT LSE charges and credits as follows:

- Kentucky Power will recover and collect 80 percent of the annual over- or under-collection of PJM OATT LSE charges, as compared to the annual amount included in base rates, (“Annual PJM OATT LSE Recovery”) through Tariff P.P.A.
- Kentucky Power will credit against the Annual PJM OATT LSE Recovery 100 percent of the difference between the return on its incremental transmission investments calculated using the FERC approved PJM OATT return on equity, and the return on its incremental transmission investments calculated using the 9.75 percent return on equity provided for in the settlement.
- The changes to Tariff P.P.A. to allow for the Annual PJM OATT LSE Recovery will terminate on the effective date when base rates are reset in the next base rate proceeding unless otherwise extended by the Commission.

Due to the volatility of the OATT charges and credits, the Commission finds the proposal to include the PJM LSE transmission charges and credits to the costs recoverable through Tariff P.P.A., as modified in the Settlement, reasonable with one modification. When calculating the credit against the Annual PJM OATT LSE Recovery, the return on equity amounts used to calculate the incremental transmission investments shall be 9.7 percent, the Commission-approved ROE amount.

¹³⁸ *Id.* at 28-29.

In conjunction with approving the PJM OATT LSE tracker, the Commission finds that the three-year stay-out provision in the Settlement is reasonable and should be accepted. In approving the tracker, the Commission addresses Kentucky Power's primary concern, raised in the last rate case and in this case, that an increase in major expenses not directly under Kentucky Power's control would result in more frequent rate cases.

Regarding proposed transmission projects at PJM, the Commission expects Kentucky Power to work through the PJM stakeholder process to protect its customer interests.

2. FAC Purchased Power Limitations.

Kentucky Power proposed to track, on a monthly basis, the amount of purchased power costs excluded for recovery through the FAC over or above the base rate level using deferral accounting. The annual net over- or under-collection of these purchase power costs would be collected from or credited to customers through Tariff P.P.A.¹³⁹

The FAC Purchase Power Limitation is a calculation that caps the amount of purchase power expense to be recovered through the monthly FAC surcharge. The calculation compares the cost of actual purchased power on an hourly basis to the cost of Kentucky Power's highest cost unit or the theoretical peaking unit equivalent, and caps the FAC-recoverable purchase power expense at the cost (\$/MWh) of the highest generating unit (Kentucky Power owned or peaking unit equivalent). Kentucky Power claims that, because it relies on factors outside of its control, the FAC Purchase Power Limitation and the peaking unit equivalent calculation promote variability and volatility.

¹³⁹ *Id.* at 29.

The Commission is not convinced that this issue requires special ratemaking treatment. The Commission has long held that any purchased power costs not recoverable through the FAC are eligible for recovery through base rates. The Commission finds Kentucky Power's proposal to include an estimated amount of FAC Purchased Power Limitation Expense in base rates, and to subsequently true up that amount through Tariff P.P.A., is unreasonable, and therefore should be denied. The Commission notes that Kentucky Power filed this case using a historic test period. The Commission will allow recovery of the test year amount of purchased power reasonably incurred, but excluded from the FAC. To the extent that Kentucky Power incurs any expense due to purchased power that is appropriately incurred after the test year, but excluded from the FAC, it can file a base rate case seeking recovery of those expenses. For the foregoing reasons, adjustments W26 and W27, which total \$4,032,786, are unreasonable and should be removed from the revenue requirement.

3. Peaking Unit Equivalent Calculation

Kentucky Power proposed to change the methodology for calculating the peaking unit equivalent ("PUE") used in determining the FAC Purchased Power Limitation. In its Application, Kentucky Power proposes to include the cost of firm gas service as an expense in the calculation of its PUE. Kentucky Power stated that since the hypothetical combustion turbine ("CT") could be dispatched any day of the year, it requires firm gas service. The Commission disagrees. While firm gas service would certainly allow the CT to be dispatched any day of the year, the Commission is unaware of any jurisdictional utility utilizing firm gas service for a CT. Because CTs typically operate at low capacity factors and are primarily utilized during the summer peaking

months, when pipeline capacity would typically not be constrained, the Commission finds the inclusion of firm gas service in the calculation of the PUE to be unreasonable, and therefore, this change in the PUE calculation should be denied. Kentucky Power's proposal to include startup costs and variable O&M expense is reasonable and should be approved.

4. Gains and Losses from Incidental Gas Sales.

Kentucky Power proposed to recover gains and losses from incidental sales of natural gas through Tariff P.P.A. Kentucky Power nominates Big Sandy Unit 1 in the PJM day-ahead electric power market based in part on the price of natural gas purchased for delivery the next day. If the Big Sandy Unit 1 Day Ahead nomination price is higher than the PJM electric power market clearing price, Big Sandy Unit 1 is not selected to run in the Real Time Market. In such a case, the natural gas purchased must either be stored by Columbia Gas or be sold. Kentucky Power stated that in August, September, and November of 2016, there were days that it was required to sell natural gas that had been purchased for delivery because Big Sandy Unit 1 was not selected by PJM to run.¹⁴⁰

In Case No. 2014-00078, Duke Energy Kentucky ("Duke Energy") proposed similar treatment of gains and losses it experienced in January and February of 2014 from incidental sales of natural gas.¹⁴¹ Duke Energy amended its request to apply to similar losses or gains occurring in the future. The Commission approved the treatment of the January and February 2014 gains and losses. However, the Commission found

¹⁴⁰ Application, Direct Testimony of John A. Rogness at 26-27

¹⁴¹ Case No. 2014-00078, *An Investigation of Duke Energy Kentucky, Inc.'s Accounting Sale of Natural Gas Not Used in Its Combustion Turbines* (Ky. PSC Nov. 25, 2014).

Duke Energy's proposal to apply such treatment to similar losses or gains in the future to be overly broad and did not approve such treatment, finding that such gains and losses should be investigated on a case-by-case basis.

In this case, the Commission finds, as it did in Case No. 2014-00078, that gains and losses from the incidental sale of natural gas should be investigated on a case-by-case basis. If such gains or losses occur in the future, Kentucky Power should notify the Commission so those matters may be addressed in a formal proceeding. For purposes of this case, the Commission finds that the gain on the incidental sale of natural gas of \$13,982 should be utilized to reduce Kentucky Power's revenue requirement.

Tariff K-12 School

In its Application, Kentucky Power proposed to discontinue the pilot Tariff K-12 School under which public schools in Kentucky Power's service territory took service under discounted rates. Kentucky Power stated that its load research and class cost of service study demonstrated that Tariff K-12 School customers would be better off in the Tariff L.G.S. customer class than they were previously a part of prior to the pilot Tariff K-12.

Tariff Pilot K-12 School was approved as part of the settlement agreement in Case No. 2014-00396. In Case No. 2014-00396, KSBA argued, as it does in this proceeding, that public school load characteristics were sufficiently unique to justify a distinct rate class for K-12 schools. Because school load data did not exist, Kentucky Power agreed to establish a pilot tariff with load research meters at 30 K-12 schools.

Kentucky Power further agreed to evaluate whether to continue Tariff K-12 School in its next base rate case using the load research data.

Tariff K-12 School rates were designed to produce an annual revenue requirement that was \$500,000 less than would be produced under the L.G.S. rates from customers eligible to take service under Tariff K-12 School.¹⁴² Tariff L.G.S. and Tariff M.G.S. customers rates were designed to include the \$500,000 subsidy to Tariff K-12 Schools.¹⁴³

Under the Settlement, Tariff K-12 School would cease to be a pilot, and would continue as a separate rate class. The tariff would be available to all K-12 schools, public and private, in Kentucky Power's service territory with normal maximum demands greater than 100 kW. Tariff K-12 School rates continue to be designed with a \$500,000 subsidy absorbed by Tariff L.G.S. customers.

In its Settlement Testimony, KCUC asserted that the Settlement is unfair and unreasonable because L.G.S. customers had to absorb the subsidy to provide a \$500,000 benefit for Tariff K-12 School customers, in addition to a significant inter-class subsidy burden as part of the overall rate structure.¹⁴⁴ KCUC stated that it did not object to the \$500,000 discount to Tariff K-12 School customers, but instead objected that the discount is funded by L.G.S. customers, and not spread out among all customer classes. As a remedy, KCUC proposed that, if the Commission reduced the revenue requirement, that the first \$500,000 of any reduction be applied first to reduce the revenue requirement of the L.G.S. class.

¹⁴² Case No. 2014-00396, Final Order, at 19.

¹⁴³ *Id.*

The Commission finds that load research data collected and analyzed by Kentucky Power demonstrates that a separate, discounted K-12 schools tariff is not justified and that public school usage characteristics do not support the discounted rates paid by Tariff K-12 School customers relative to the L.G.S. class. The Commission finds that it is unreasonable to continue Tariff K-12 School, and therefore rejects this portion of the Settlement.

Green Pricing Option Rider/Renewable Power Option Rider

Kentucky Power proposed to revise its Green Pricing Option Rider to expand the categories of renewable energy credits available, to allow participating customers to purchase their full requirements from renewable energy generators, and to change the name of the rider to the Renewable Power Option Rider ("Rider R.P.O"). The Commission finds that the Rider R.P.O. provision in the Settlement is reasonable and should be approved.

Tariff C.A.T.V.

In its Application, Kentucky Power proposed to increase Tariff C.A.T.V. rates for pole attachments on a two-user pole from \$7.21 per year to \$11.97 per year, and for pole attachments on a three-user pole from \$4.47 per year to \$7.52 per year. In the Settlement, Kentucky Power and the Settling Intervenors agreed to a rate of \$10.82 per year for attachments on a two-user pole, and \$6.71 per year for attachments on a three-user pole.

The Commission finds that the rates for Tariff C.A.T.V. as set forth in the Settlement are reasonable and should be approved.

¹⁴⁴ Higgins Settlement Testimony at 2.

Temporary Service Tariff

In its Application, Kentucky Power proposed to revise its Temporary Service Tariff ("Tariff T.S.") to limit service provided under Tariff T.S. to ensure that customers do not continue to take service under Tariff T.S. even after construction is complete and the facility is occupied. The Commission finds these changes to be reasonable and that they should be approved.

Optional Residential Demand Charge Tariff

Kentucky Power proposed a new optional residential rate schedule ("Tariff R.S.D.") that will be available to up to 1,000 residential customers. The rate structure will consist of a monthly service charge, on-peak and off-peak kWh energy charges, and an on-peak kW demand charge. Kentucky Power stated that the goal of Tariff R.S.D. is to send targeted price signals that will reward customers for shifting usage away from the peak time periods that cause Kentucky Power to incur higher costs. Kentucky Power also stated that certain electric heating customers may benefit from Tariff R.S.D. due to their potentially higher load factor usage characteristics, and that the rate design is revenue neutral to the standard residential tariff.¹⁴⁵

The Commission finds the proposed Tariff R.S.D. to be reasonable, that it should be approved, and that the rates included in Appendix C of this Order should be approved.

Tariff C.S.-Coal, Tariff C.S.-I.R.P. and Tariff E.D.R.

The Settlement extends through December 31, 2018, Tariff C.S.-Coal and the amendments to Tariff C.S.-I.R.P. and Tariff E.D.R., which were due to expire December

¹⁴⁵ Vaughan Direct Testimony at 19

31, 2017. The Commission finds the extension of the tariffs reasonable and that they should be approved. Any financial loss incurred in connection with these tariffs will be deferred for review and recovery in Kentucky Power's next base rate proceeding.

ENVIRONMENTAL COMPLIANCE PLAN

In its Application, Kentucky Power requested Commission approval of an amended environmental Compliance Plan ("2017 Plan") and an amended Environmental Surcharge tariff ("Tariff E.S.").

The 2017 Environmental Compliance Plan

The 2017 Plan includes previously approved projects and two new projects, Project 19 and Project 20. The 20 projects included in the 2017 Plan are listed in Appendix D to this Order.

Project 19 will install SCR technology at Rockport Unit 1 ("Rockport Unit 1 SCR Project"). The Rockport Unit 1 SCR project will reduce the plant's nitrogen oxide emissions, and is required under terms of a 2007 Consent Decree ("Consent Decree") among several AEP entities including Kentucky Power and I&M, and the Environmental Protection Agency and several environmental plaintiffs.

Project 20 seeks to include a return on inventories for consumables used in conjunction with approved projects through Tariff E.S. Kentucky Power currently recovers the cost of the consumption of consumables through Tariff E.S. The return on consumable inventories is currently part of the general rate base. Kentucky Power proposed that the return on consumable inventories be recovered through Tariff E.S. to align that cost with the cost recovery of items consumed.

Kentucky Power stated that the pollution control projects included in the 2017 Plan amendment are necessary to comply with the Federal Clean Air Act (“CAA”) and other federal, state, and local regulations that apply to coal combustion wastes and by-products from facilities utilized for the production of energy from coal. Kentucky Power asserted that the costs associated with its 2017 Plan are reasonable, and that the projects are a reasonable and cost-effective means to comply with environmental requirements.

The Attorney General argued that Kentucky Power should not be permitted to recover the cost of the Rockport Unit 1 SCR Project.¹⁴⁶ The Attorney General asserted that Kentucky Power’s customers have been paying increasing amounts for environmental costs resulting from the Consent Decree because AEP voluntarily made environmental upgrades at generating stations, including the Rockport generating units, that were not identified in the original EPA litigation that led to the Consent Decree. Because Rockport was not part of the original litigation, the Attorney General asserts Kentucky Power should not recover the costs for the Rockport Unit 1 SCR project from its ratepayers.

In rebuttal, Kentucky Power stated that the decision to include Rockport in the Consent Decree settlement was a way to remove the significant risk of additional litigation at those units not named in any pending complaints, as well as to provide a more favorable outcome than would be expected on an individual basis.¹⁴⁷ Kentucky Power further stated that the Consent Decree provided certainty regarding the timing of

¹⁴⁶ Smith Testimony at 59.

¹⁴⁷ Rebuttal Testimony of John McManus at 3.

additional control installations across the AEP fleet. At the time of the settlement, Kentucky Power was still participating in the AEP Pool, which meant that the outcome of litigation involving all units across the AEP fleet contributing to the pool was in the best interest of Kentucky Power and its customers.

The Settlement was silent on the 2017 Environmental Compliance Plan.

The Commission finds that the 2017 Plan is reasonable as set forth in the Application and should be approved.

ENVIRONMENTAL SURCHARGE TARIFF MODIFICATIONS

Kentucky Power updated its Tariff E.S. to reflect the changes proposed in its Application and the Settlement. Kentucky Power updated the list of projects in the tariff to match the projects included in the 2017 Plan as noted previously in this Order. Kentucky Power updated Tariff ES to reflect the rate of return included in the Settlement to this case. Kentucky Power also updated the tariff to reflect the new monthly base environmental costs based on that rate of return. Kentucky Power determined the annual base revenue requirement level for environmental cost recovery to be \$47,513,461.¹⁴⁸ The Commission has determined that the correct annual base revenue requirement is \$44,379,316, which reflects the Commission authorized return on equity, capital structure changes, reduction of the federal corporate income tax rate from 35 percent to 21 percent and the depreciation rates set forth in Exhibit 5 of the

¹⁴⁸ In the Tariff E.S. filed December 1, 2017, Kentucky Power reflected an annual base revenue requirement of \$47,811,215. Kentucky Power updated this amount to \$47,513,461 to reflect the depreciation rates included in Exhibit 5 to the Settlement Agreement. See Response to Commission Staff's Post-Hearing Request for Information ("Staff's Post-Hearing Request"), Item 20 attachment KPCO_R_KPSC_PH_20_Attachment1.xls.

Settlement.¹⁴⁹ Kentucky Power shall file a revised Tariff ES to reflect the Commission authorized return on equity and capitalization discussed in this Order, and the annual base revenue requirement as shown on Appendix E attached to this order. Per the settlement agreement in Case No. 2012-00578,¹⁵⁰ all costs associated with the Mitchell FGD equipment are excluded from base rates and therefore are not included in the base revenue requirement noted above, but will be included as part of the current period environmental revenue requirement. The Commission finds that Tariff E.S. as discussed and modified in this Order should become effective for service rendered on and after the date of this Order.

Costs Associated with the 2015 Plan

Tariff E.S. revenue requirement is determined by comparing the base period revenue requirement with the current period revenue requirement. Kentucky Power proposed to incorporate the costs associated with the 2017 Plan into the existing surcharge mechanism used for previous compliance plans. Kentucky Power identified the environmental compliance costs for the 2017 Plan projects, which Kentucky Power proposed to recover through its environmental surcharge. Kentucky Power proposed to apply a gross-up factor to environmental expenses to account for uncollectible accounts and the Commission assessment fee. The factor will be applied to the incremental change in operating, maintenance, and other expenses from the base period. The

¹⁴⁹ Response to Staff's Post-Hearing Request, Item 20.

¹⁵⁰ Case No. 2012-00578, *Application of Kentucky Power Company for (1) a Certificate of Public Convenience and Necessity Authorizing the Transfer to the Company of an Undivided Fifty Percent Interest in the Mitchell Generating Station and Associated Assets; (2) Approval of the Assumption by Kentucky Power Company of Certain Liabilities in Connection with the Transfer of the Mitchell Generating Station; (3) Declaratory Rulings; (4) Deferral of Costs Incurred in Connection with the Company's Efforts to Meet Federal Clean Air Act and Related Requirements; and (5) All Other Required Approvals and Relief* (Ky. PSC Oct. 7, 2013).

costs identified by Kentucky Power are eligible for surcharge recovery if they are shown to be reasonable and cost-effective for complying with the environmental requirements specified in KRS 278.183. The Commission finds that the costs identified for the 2017 Plan projects have been shown to be reasonable and cost-effective for environmental compliance. Thus, they are reasonable, and should be approved for recovery through Kentucky Power's environmental surcharge.

Qualifying Costs

As stated previously, the qualifying costs included in Kentucky Power's annual baseline level for environmental cost recovery under the tariff shall be \$44,379,316. The qualifying costs included in the current period revenue requirement will reflect the Commission-approved environmental projects from Kentucky Power's 1997, 2005, 2007, 2015 and 2017 Plans. Per the settlement agreement in Case No 2012-00578, all costs associated with Mitchell Units 1 and 2 FGD equipment have been excluded from base rates and the environmental baseline level and shall be recovered exclusively through Tariff E.S. Should Kentucky Power desire to include other environmental projects in the future, it will have to apply for an amendment to its approved compliance plans.

Rate of Return

Paragraph 8(a) of the Settlement authorizes Kentucky Power to use a 9.75 percent ROE to be utilized in Tariff E.S. to determine the WACC for non-Rockport environmental projects. However as previously noted, the Commission has authorized a 9.70 percent ROE that should be used for all non-Rockport environmental projects.

Kentucky Power's ROE for environmental projects at the Rockport Plant is 12.16 percent as established by the FERC-approved Rockport Unit Power Agreement.

Capitalization and Gross Revenue Conversion Factor

Paragraph 3(c) and Exhibit 6 of the Settlement provide that Kentucky Power shall utilize a WACC of 6.48 percent and a gross revenue conversion factor ("GRCF") of 1.6433 to determine a rate of return of 9.11 percent to be used in the monthly environmental surcharge filings. As a result of the reduction of the federal corporate tax rate from 35 percent to 21 percent, the Commission has determined that Kentucky Power should use a GRCF of 1.352116. Because of the change in the authorized ROE, capitalization, and the GRCF, the WACC to be used for non-Rockport environmental projects is 6.44 percent. Utilizing a WACC of 6.44 percent and a GRCF produces a rate of return of 7.88 percent to be used in the monthly environmental surcharge filings. The WACC and GRCF shall remain constant until the Commission sets base rates in Kentucky Power's next base rate case proceeding.

Surcharge Formulas

The inclusion of the 2017 Plan into Kentucky Power's existing surcharge mechanism will not result in changes to the surcharge formulas. The costs associated with the Mitchell FGD will be excluded from base rates and the base rate revenue requirement of the environmental surcharge at least until June 30, 2020, but will be included in the current period revenue requirement for the environmental surcharge. The Commission finds that the formulas used to determine the environmental surcharge revenue requirement as proposed by Kentucky Power should be approved.

Surcharge Allocation

The retail share of the revenue requirement will be allocated between residential and non-residential customers based upon their respective total revenue during the previous calendar year. The environmental surcharge will be implemented as a percentage of total revenues for the residential class and as a percentage of non-fuel revenues for all other customers.

Monthly Reporting Forms

The inclusion of the 2017 Plan into the existing surcharge mechanism will require modifications to the monthly environmental surcharge reporting forms. Kentucky Power provided its proposed revised forms to be used in the monthly environmental reports. The revised forms include the changes necessary to reflect the proposed 2017 Plan, as well as changes necessitated by the application of a gross-up factor to the incremental operating, maintenance and other expenses. The Commission finds that Kentucky Power's proposed monthly environmental surcharge reporting forms as revised should be approved.

FINDINGS ON SETTLEMENT AGREEMENT

Based upon a review of all the provisions in the Settlement, an examination of the entire record, and being otherwise sufficiently advised, the Commission finds that the provisions of the Settlement are in the public interest and should be approved, subject to the modifications as discussed in this Order. Our approval of the Settlement as modified is based solely on its reasonableness and does not constitute precedent on any issue except as specifically provided for in this Order.

OTHER ISSUES

Vegetation Management

Kentucky Power's current Vegetation Management Plan ("2015 Vegetation Management Plan") was modified from its 2010 Vegetation Management Plan in Kentucky Power's last rate case, Case No. 2014-00396. In Case No. 2014-00396, it was determined that funding for the 2010 Vegetation Management Plan, which was scheduled to move to a four-year cycle within seven years of initial circuit clearing, needed modification. However, the work required to transition to a four-year cycle was significantly greater than initially estimated, and Kentucky Power could not wait until all circuits had an initial clearing ("Task 1") to begin re-clearing the circuits. Thus, the modification was approved allowing the continuation of Task 1 and a simultaneous undertaking of interim re-clearing ("Task 2"). Under this schedule, Task 1 would be completed by December 31, 2018, Task 2 would be completed by June 30, 2019, and on July 1, 2019, Kentucky Power's entire distribution system would commence to be re-cleared on a five-year cycle ("Task 3"), rather than a four-year cycle. Funding was approved for the 2015 Vegetation Management Plan, as well as a provision requiring Kentucky Power to obtain Commission approval prior to modifying its annual projected vegetation management spending on both an aggregate and a district basis if the change is more than 10 percent of the budget.

Kentucky Power is on pace to exceed the December 31, 2018 target for Task 1, and expects to complete Task 1 circuit clearing in the first quarter of 2018. In addition, Task 2 circuit re-clearing is expected to be completed by December 31, 2018, six months sooner than projected. To date, Kentucky Power has exceeded targets on budget as total expenditures are 101 percent of target level.¹⁵¹ Reliability has increased

¹⁵¹ Application, Direct Testimony of Everett G. Phillips ("Phillips Testimony") at 35.

and Kentucky Power customers have seen a 60 percent decrease in interruptions related to rights-of-way trees and vegetation.¹⁵² Task 3 is estimated to begin in January 2019.

Embedded in Kentucky Power's current base rates are annual vegetation management O&M expenses of \$27.661 million. Due to early completion of Tasks 1 and 2, Kentucky Power estimates a reduction of O&M expenses related to Tasks 1 and 2 from \$27.661 million in 2017 to \$21.639 million 2018. According to the 2015 Vegetation Management Plan, at the start of Task 3, O&M expenses are projected to decrease, resulting in a decrease of O&M expenses of \$11.780 million. However, Kentucky Power has determined that the estimates of the annual O&M expenditures for Task 3 as estimated in the 2015 Vegetation Management Plan are undervalued and need to be increased.¹⁵³ Due to the re-clearing in Task 2, Kentucky Power now has a better grasp on regrowth, the effect of higher-than-average rainfall, and growing customer demand to remove tree debris, and proposes to increase the annual O&M expenses for Task 3. This re-estimation calculates costs for Task 3 to increase from the original \$15.880 million to \$21.284 million in 2019, and \$21.473 in 2020.¹⁵⁴ Kentucky Power proposes the amount of vegetation management O&M expenses to be recovered through base rates for the instant case to be equal to the average of the revised estimated annual vegetation management plan O&M spending over 2018-2020, or \$21.465 million.¹⁵⁵

¹⁵² *Id* at 40.

¹⁵³ *Id.*

¹⁵⁴ *Id.* at 46

Kentucky Power also proposes two changes to its current vegetation management reporting requirements. First, Kentucky Power proposes to modify the pre-approval requirement for deviation of 10 or more percent from projected annual vegetation management O&M expenditures to eliminate the district-specific threshold and retain only the requirement for pre-approval if overall Kentucky Power vegetation management expenditures deviate more than 10 percent. Second, Kentucky Power proposes to manage its vegetation work and expenditures on a calendar year basis, as opposed to managing its vegetation work on a fiscal year and expenditures on a calendar year. Kentucky Power stresses that neither modification will change their overall vegetation management obligation, but provides for more flexibility to manage its obligations.¹⁵⁶

The 2015 Vegetation Management Plan included a one-way balancing account. In this balancing account, any annual shortfall or excess in vegetation management O&M expenditures that is over the amount in base rates is added to or subtracted from future expenditures over four years. At the end of the four-year period, Kentucky Power will record a cumulative shortfall as a regulatory liability that will either be refunded to the customers or used to reduce the revenue requirement in its next filed base-rate case. If Kentucky Power has overspent on a cumulative basis during the four-year period, it will not seek recovery of such costs in a future base-rate proceeding. As of the end of November 2017, Kentucky Power testified that cumulative expenditures were slightly over the budgeted amount.¹⁵⁷

¹⁵⁵ Application, Section V, Exhibit 2, page 59.

¹⁵⁶ *Id.* at 43.

The Commission finds that the one-way balancing adjustment should be continued; however due to the change in the annual revenue requirement as noted in the Application, it should be adjusted accordingly. All expenses will be recorded against the annual budget. The annual shortfall or excess will be applied to the balance account. Through 2023, or until Kentucky Power's next base rate application, whichever occurs first, the expenditures will be balanced against the annual projected expenditures as found in the Application.¹⁵⁸

The Commission approves the proposed modifications allowing Kentucky Power to request Commission approval for any spending deviation greater than 10 percent on an aggregate level as opposed to a district level. The Commission also approves Kentucky Power's request to manage its vegetation management program on a calendar year basis to coincide with the budgetary year. The Commission notes that Kentucky Power has exceeded the goals of the 2015 Vegetation Management Plan resulting in a reduction of O&M expenses 24 months earlier than estimated. The Commission approves Kentucky Power's proposed revenue requirement of \$21.465 million. All other provisions of the 2015 Vegetative Management Plan are to remain unchanged.

The Commission will continue to review closely the vegetation management annual work plans and expenditures filed by Kentucky Power. In addition, the Commission will monitor the progress of the five-year maintenance cycle.

Bill Redesign

¹⁵⁷ Dec. 8, 2017 H.V.T. at 2:09:38.

¹⁵⁸ Phillips Testimony, Table 9 at 46.

On June 12, 2017, Kentucky Power filed an Application requesting approval to implement new bill formats that change the bill layout and composition, which is being implemented concurrently for all AEP operating companies, and to combine certain billing line items. That Application was docketed as Case No. 2017-00231.¹⁵⁹ By Order dated July 17, 2017, that case was consolidated into this proceeding. By further Order dated September 12, 2017, the Commission approved Kentucky Power's request to redesign the appearance of its bills, but stated that a decision on the proposed substantive changes to consolidate billing line items would be determined in the final Order in this proceeding.

Kentucky Power proposed to consolidate eight residential billing line items,¹⁶⁰ and seven commercial and industrial billing line items¹⁶¹ into a single "Rate Billing" line item. Kentucky Power explained that customer satisfaction regarding billing correspondence was below the industry average according to a survey commissioned by Kentucky Power.¹⁶² Kentucky Power asserted that its customers found the number of billing line

¹⁵⁹ Case No. 2017-00231, *Electronic Application of Kentucky Power Company for (1) Approval of Its Revised Terms and conditions of Service Implementing New Bill Formats; (2) An Order Granting All other Required Approvals and Relief* (filed June 12, 2017).

¹⁶⁰ The residential billing line items Kentucky Power proposes to consolidate into a single line items are Rate Billing, Residential Home Energy Assistance Program Charge, Kentucky Economic Development Surcharge, Capacity charge, Big Sandy 1 Operation Rider, Big Sandy Retirement Rider, Purchased Power Adjustment, and Green Pricing Option. The residential charges that Kentucky Power proposes to continue to display as individual billing line items are the Fuel Adjustment Charge, Demand-Side Management Factor, Environmental Surcharge, School Tax, Franchise Fee, State Sales tax, and HomeServe Warranty.

¹⁶¹ The commercial and industrial billing line items Kentucky Power proposes to consolidate into a single line items are Rate Billing, Kentucky Economic Development Surcharge, Capacity charge, Big Sandy 1 Operation Rider, Big Sandy Retirement Rider, Purchased Power Adjustment, and Green Pricing Option. The commercial and industrial charges that Kentucky Power proposes to continue to display as individual billing line items are the Fuel Adjustment Charge, Demand-Side Management Factor, Environmental Surcharge, School Tax, Franchise Fee, and State Sales tax.

¹⁶² Case No. 2017-00231; Direct Testimony of Stephen L. Sharp, Jr. (filed June 12, 2017) at 2.

items were “unhelpful,” made the bills “difficult to understand,” and obscured the information customers most wanted to know, which was the total amount owed and payment due date.¹⁶³ Kentucky Power further asserted that customers requested that line items be consolidated in order to simplify the bills. Customers who want detailed billing information could contact a Kentucky Power customer service center.

In the Settlement, the Settling Intervenors agreed to Kentucky Power’s proposed consolidation of billing line items.

Neither KCUC nor the Attorney General filed testimony in this proceeding regarding the consolidation of billing line items. However, in a motion filed in Case No. 2017-00231 before it was incorporated into this proceeding, the Attorney General argued that consolidating the billing line items would result in a lack of transparency that impeded customers’ understanding of how rates and their bills are calculated.¹⁶⁴

The Commission finds that Kentucky Power’s proposed consolidation of billing line items is unreasonable and should be denied. The Commission concurs with the Attorney General that displaying discrete billing line items on customer bills promotes transparency and customer understanding of their billing amounts. Further, it is not reasonable to require customers to take additional steps in order to obtain a detailed accounting for their bills. This is especially so given that the billing line items that Kentucky Power wishes to consolidate represent charges in addition to the base rate charge for utility service.

Analysis of Kentucky Power’s Participation in PJM

¹⁶³ *Id.* at 3; *Id.* at Application, paragraph 11.

Kentucky Power currently elects to self-supply its PJM capacity requirements under the Fixed Resource Requirement (“FRR”) alternative. As discussed in testimony at the hearing, AEP conducts regular evaluations to determine whether its operating companies in PJM should elect to participate in the Reliability Pricing Model (“RPM”) capacity market, or to self-supply under FRR.¹⁶⁵

The Commission finds that Kentucky Power should file an annual update of the FRR/RPM election analysis. The Commission recognizes that this information is deemed confidential during the AEP internal decision-making process. However, once PJM is notified of the election, the information becomes public and ceases to be confidential. Kentucky Power should file the annual update after the information becomes public.

Further, the Commission recognizes that Kentucky Power’s interests may not be aligned with the interests of other AEP operating companies. The Commission is aware that PJM bills AEP based on a one-coincident peak methodology, and that AEP subsequently allocates those costs to its operating companies using a twelve-coincident peak methodology. The Commission finds that Kentucky Power should file an annual report with the supporting calculations used by AEP to allocate these costs.

Last, the Commission strongly encourages Kentucky Power to recognize that it must make a determination regarding its participation in PJM that aligns with the interests of Kentucky Power and its ratepayers.

Reduction in Corporate Tax Rates

¹⁶⁴ Case No. 2017-00231, Attorney General’s Motion to Consolidate Cases (filed July 13, 2017) paragraphs 4-5.

¹⁶⁵ Dec. 7, 2017 H.V.T. at 10:43:18, and Kentucky Power Exhibit 9.

Effective January 1, 2018, the federal corporate income tax rate was reduced from 35 percent to 21 percent. Consistent with Kentucky Power's revised gross-up factor calculation in certain riders, the Commission finds that it is reasonable to utilize the 21 percent corporate income tax rate in the gross-up factor calculation. The Commission will address the impact of the recently enacted tax cuts on the excess ADIT and the rates of all investor-owned utilities, including Kentucky Power, on a prospective basis in pending cases that were opened on December 27, 2017.¹⁶⁶

Based on the evidence of record and the findings contained herein, HEREBY ORDERS that:

1. The rates and charges proposed by Kentucky Power are denied.
2. The provisions in the Settlement, as set forth in Appendix A to this Order, are approved, subject to the modifications and deletions set forth in this Order.
3. The rates and charges for Kentucky Power, as set forth in Appendix C to this Order, are the fair, just, and reasonable rates for Kentucky Power, and these rates are approved for service rendered on and after January 19, 2018.
4. Kentucky Power's request to deviate from 807 KAR 5:006, Section 14(2)(a) by limiting enrollment in its Equal Payment Plan to the months of April through December is granted.
5. Kentucky Power's proposed depreciation rates, with the exception of the changes proposed in the Settlement are approved.

¹⁶⁶ Case No. 2017-00477, *Kentucky Industrial Utility Customers, Inc. v. Kentucky Utilities Company, Louisville Gas and Electric Company, Kentucky Power Company, and Duke Energy Kentucky, Inc.* (Ky PSC Dec. 27, 2017); Case No. 2017-00481, *An Investigation of the Impact of the Tax Cuts and Job Act on the Rates of Atmos Energy Corporation, Delta Natural Gas Company, Inc., Columbia Gas of Kentucky, Inc., Kentucky-American Water Company, and Water Service Corporation of Kentucky* (Ky. PSC Dec. 27, 2017).

6. The regulatory asset or liability account established by under- or over-recovery from the elimination of Tariff B.S.1.O.R. is approved for accounting purposes only.

7. The regulatory asset account established by the deferral of Rockport UPA expenses is approved for accounting purposes only.

8. Kentucky Power's 2017 Environmental Compliance Plan is approved.

9. Kentucky Power's environmental surcharge tariff is approved for service rendered on and after the date of this Order.

10. The base period and current period revenue requirements for the environmental surcharge shall be calculated as described in this Order.

11. The environmental reporting formats described in this Order shall be used for the monthly environmental surcharge filings. Previous reporting formats shall no longer be submitted.

12. The Commission approves the sample forms that were filed by Kentucky Power on January 3, 2018.

13. Within three months of the date of this Order, Kentucky Power shall identify and contact GS class customers whose average monthly demand is 25 kW or greater for the purpose of meeting to discuss the impact of the rate increase on their bills and analyze other available tariff options, such as time-of-day rates.

14. Within twelve months of the date of this Order, Kentucky Power shall file a report listing the names of each GS class customers whose average monthly demand is 25 kW or greater, and stating the date and method of contact with the customer, whether Kentucky Power has met with the customer, and the results of each meeting.

15. Kentucky Power's request to revise its billing format to consolidate billing line items, as set forth in the application, is denied.

16. Kentucky Power's Vegetation Management Plan, as set forth in the Application, is approved.

17. Kentucky Power's request to obtain Commission approval for any spending deviation from its Vegetation Management Plan greater than 10 percent on an aggregate level as opposed to a district level is approved.

18. Kentucky Power's request to manage its Vegetation Management Plan on a calendar year basis is approved.

19. Kentucky Power shall file an annual update of the FRR/RPM election analysis conducted by AEP and its operating companies within 30 days of notifying PJM of the election.

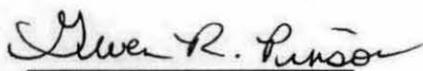
20. Kentucky Power shall file annually the supporting calculations for allocating PJM bills, which are based on a one-coincident peak methodology, AEP's operating companies using a twelve-coincident-peak methodology.

21. Within 20 days of the date of this Order, Kentucky Power shall, using the Commission's electronic Tariff Filing System, file its revised tariffs setting out the rates authorized herein and reflecting that they were approved pursuant to this Order.

By the Commission

ENTERED
JAN 18 2018
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

Case No. 2017-00179

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2017-00179 DATED **JAN 18 2018**

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

In the Matter of:

| | | |
|--|---|---------------------|
| Electronic Application Of Kentucky Power |) | |
| Company For (1) A General Adjustment Of Its |) | |
| Rates For Electric Service; (2) An Order |) | |
| Approving Its 2017 Environmental Compliance |) | |
| Plan; (3) An Order Approving Its Tariffs And |) | Case No. 2017-00179 |
| Riders; (4) An Order Approving Accounting |) | |
| Practices To Establish Regulatory Assets Or |) | |
| Liabilities; And (5) An Order Granting All Other |) | |
| Required Approvals And Relief |) | |

SETTLEMENT AGREEMENT

This Settlement Agreement, made and entered into this 22nd day of November, 2017, by and among Kentucky Power Company (“Kentucky Power” or “Company”); Kentucky Industrial Utility Customers, Inc. (“KIUC”); Kentucky School Boards Association (“KSBA”); Kentucky League of Cities (“KLC”); Wal-Mart Stores East, LP and Sam’s East, Inc. (“Wal-Mart”); and Kentucky Cable Telecommunications Association (“KCTA”); (collectively Kentucky Power, KIUC, KSBA, KLC, Wal-Mart, and KCTA, are “Signatory Parties”).

RECITALS

1. On June 28, 2017 Kentucky Power filed an application pursuant to KRS 278.190, KRS 278.183, and the rules and regulations of the Public Service Commission of Kentucky (“Commission”), seeking an annual increase in retail electric rates and charges totaling \$69,575,934, seeking approval of its 2017 Environmental Compliance Plan, an order approving accounting practices to establish regulatory assets or liabilities, and further seeking authority to implement or amend certain tariffs (“June 2017 Application”).

2. On August 8, 2017, Kentucky Power supplemented its filing to reflect the impact of subsequent refinancing activities on the Company's Application ("August 2017 Refinancing Update"). The refinancing activities reduced the Company's requested annual increase in retail electric rates and charges from \$69,575,934 to \$60,397,438.

3. KIUC, KSBA, KLC, Wal-Mart, and KCTA filed motions for full intervention in Case No. 2017-00179. The Commission granted the intervention motions. Collectively KIUC, KSBA, KLC, Wal-Mart, and KCTA are referred to in this Settlement Agreement as the "Settling Intervenors."

4. The Attorney General of the Commonwealth of Kentucky ("Attorney General") and Kentucky Commercial Utility Customers, Inc. ("KCUC") also filed motions to intervene. The Attorney General and KCUC, who are not parties to this agreement, were granted leave to intervene.

5. Certain of the Settling Intervenors, KCUC, and the Attorney General filed written testimony in Case No. 2017-00179 raising issues regarding Kentucky Power's Rate Application.

6. Kentucky Power, KCUC, the Attorney General, and the Settling Intervenors have had a full opportunity for discovery, including the filing of written data requests and responses.

7. Kentucky Power offered the Settling Intervenors, KCUC, and the Attorney General, along with Commission Staff, the opportunity to meet and review the issues presented by Kentucky Power's application in this proceeding and for purposes of settlement.

8. The Signatory Parties execute this Settlement Agreement for purposes of submitting it to the Kentucky Public Service Commission for approval pursuant to KRS 278.190 and KRS 278.183 and for further approval by the Commission of the rate increase, rate structure, and tariffs as described herein.

9. The Signatory Parties believe that this Settlement Agreement provides for fair, just, and reasonable rates.

NOW, THEREFORE, for and in consideration of the mutual promises set forth above, and the agreements and covenants set forth herein, Kentucky Power and the Settling Intervenor hereby agree as follows:

AGREEMENT

1. **Kentucky Power's Application**

(a) Except as modified in this Settlement Agreement, Kentucky Power's June 2017 Application as updated by the August 2017 Refinancing Update is approved.

2. **Revenue Requirement**

(a) Effective for service rendered on or after January 19, 2018, Kentucky Power shall implement a base rate adjustment sufficient to generate additional annual retail revenues of \$31,780,734. This annual retail revenue amount represents a \$28,616,704 million reduction from the \$60,397,438 sought in the Company's August 2017 Refinancing Update.

(b) The \$28,616,704 million reduction was the result of the following adjustments to the Company's request in the June 2017 Rate Application as modified in the August 2017 Refinancing Update:

| Adjustment | Reduction in Revenue Requirement (\$Millions) |
|--|---|
| Defer a portion of Rockport UPA non-fuel, non-environmental expenses | 15.0 |
| Increase revenues to Apply Weather Normalization to Commercial Sales Net of Variable O&M | 0.40 |
| Reduce Incentive Compensation | 3.15 |
| Reduce Amortization Expense to Recalibrate Storm Damage Amortization | 1.22 |

| | |
|---|-------------|
| Reduce Depreciation Expense by Extending Service Life of BS1 to 20 years | 2.84 |
| Reduce Depreciation Expense by Removing Terminal Net Salvage for BSU1 | 0.37 |
| Reduce Depreciation Expense by Removing Terminal Net Salvage for Mitchell | 0.57 |
| Increase Short Term Debt to 1% and Set Debt Rate at 1.25% | 0.36 |
| Change in Return on Equity from 10.31% to 9.75% | 4.70 |
| Total Adjustments | 28.6 |

(c) Kentucky Power agrees to allocate the \$31,780,734 in additional annual revenue as illustrated on **EXHIBIT 1**. The Company will design rates and tariffs consistent with this allocation of additional revenue.

(i) As part of the Commission's consideration of the reasonableness of this Settlement Agreement, the tariffs designed in accordance with this subparagraph shall be filed with the Commission and served on counsel for all parties to this case no later than December 1, 2017.

(ii) Within ten days of the entry of the Commission's Order approving without modification this Settlement Agreement and the rates thereunder, Kentucky Power shall file with the Commission signed copies of the tariffs in conformity with 807 KAR 5:011.

3. Rockport UPA Expense Deferral

(a) Kentucky Power is a party to a FERC-approved Unit Power Agreement with AEP Generating Company for capacity and energy produced at the Rockport Plant ("Rockport UPA"). The Rockport UPA expires on December 8, 2022.

(b) Kentucky Power will defer a total of \$50 million in non-fuel, non-environmental Rockport UPA Expense for later recovery as follows:

(i) Kentucky Power will defer \$15M annually of Rockport UPA Expense in 2018 and 2019 for later recovery.

(ii) Kentucky Power will defer \$10M of Rockport UPA Expense in 2020 for later recovery.

(iii) Kentucky Power will defer \$5M annually of Rockport UPA Expense in years 2021 and 2022 for later recovery.

(c) The Rockport UPA Expense of \$50 million described in Paragraph 3(b) above will be deferred into a regulatory asset (“the Rockport Deferral Regulatory Asset”) and will be subject to carrying charges based on a weighted average cost of capital (“WACC”) of 9.11%¹ until the Regulatory Asset is fully recovered. From January 1, 2018 through December 8, 2022, the WACC will be applied to the monthly Rockport Deferral Regulatory Asset principal balance net of accumulated deferred income taxes (“ADIT”). From December 9, 2022 until the Rockport Deferral Regulatory Asset is fully recovered, the WACC will be applied to the monthly Rockport Deferral Regulatory Asset balance including deferred carrying charges net of ADIT. The Rockport Deferral Regulatory Asset shall be recovered on a levelized basis through the demand component of Tariff P.P.A. and amortized over five years beginning on December 9, 2022. Kentucky Power estimates that the regulatory asset balance will total approximately \$59 million on December 8, 2022.

(d) Additional expenses reflecting the declining deferral amount in years 2020 through 2022 will be recovered through the demand component of Tariff P.P.A. as follows:

- (i) Kentucky Power will recover \$5 million through Tariff P.P.A. in 2020
- (ii) Kentucky Power will recover \$10 million through Tariff P.P.A. in 2021

¹ 6.48% grossed up for applicable State and Federal taxes, uncollectible accounts expense, and the KPSC maintenance fee

(iii) Kentucky Power will recover \$10 million through Tariff P.P.A. in 2022, prorated through December 8, 2022.

(e) The Signatory Parties acknowledge that the Company's decision whether to seek Commission approval to extend the Rockport UPA will be made at a later date. Whether or not the Company seeks to extend the Rockport UPA, beginning December 9, 2022, the Capacity Charge recovered through Tariff C.C., approved in Case No. 2004-00420, will end. Any final over- or under-recovery balance will be included in the subsequent calculation of the purchase power adjustment under Tariff P.P.A. In the event that Kentucky Power elects not to extend the Rockport UPA, it will experience a reduction in Rockport UPA fixed costs ("Rockport Fixed Costs Savings").

(f) If Kentucky Power elects not to extend the Rockport UPA, it will, beginning December 9, 2022, credit the Rockport Fixed Cost Savings through the demand component of Tariff P.P.A. until new base rates are set. However, for 2023 only, the Rockport Fixed Cost Savings credit will be offset by the amount, if any, necessary for the Company to earn its Kentucky Commission-authorized return on equity (ROE) for 2023 ("Rockport Offset"). An example of the calculation of the Rockport Offset is included as EXHIBIT 2.

(g) For the purposes of implementing the Rockport Fixed Costs Savings credit described in Paragraph 3(f) above, the following definitions apply:

(i) "Rockport Fixed Costs Savings" shall mean the annual amount of non-fuel, non-environmental Rockport UPA expense included in base rates for rates effective in November 2022.

(ii) "Estimated Rockport Offset" shall mean the amount of additional annual revenue the Company estimates would be necessary for it to earn the Commission-authorized

return on equity for 2023 considering the termination of the Rockport UPA and the Rockport Fixed Cost Savings.

(iii) "Actual Rockport Offset" shall mean the amount of additional annual revenue that would have been necessary for the Company to earn the Commission-authorized return on equity for 2023 considering the termination of the Rockport UPA and the Rockport Fixed Cost Savings. The Company shall calculate the Actual Rockport Offset using a comparison of the per books return on equity for 2023 to the Commission-approved return on equity. The Actual Rockport Offset cannot exceed the Rockport Fixed Costs Savings.

(iv) "Rockport Offset True-Up" shall mean the difference between the Estimated Rockport Offset and the Actual Rockport Offset.

(h) The Company shall implement the Rockport Fixed Costs Savings credit described in Paragraph 3(f) above as follows:

(i) By November 15, 2022, the Company shall file an updated purchase power adjustment factor under Tariff P.P.A. for rates effective December 9, 2022. This filing shall reflect the impact of the Rockport Fixed Cost Savings and the Estimated Rockport Offset on the purchase power adjustment factor. This filing shall also reflect the commencement of recovery of the Rockport Deferral Regulatory Asset.

(ii) The Company shall make its normal August 15, 2023 Tariff P.P.A. filing for rates effective in October 2023. The Rockport Fixed Cost Savings and the Estimated Rockport Offset will continue to be factored into the calculation of the purchase power adjustment factor through the end of 2023. Beginning in January 2024, the Estimated Rockport Offset will not be factored into the calculation of the purchase power adjustment factor.

(iii) By February 1, 2024, the Company shall file an updated purchase power adjustment factor under Tariff P.P.A. for rates effective March 1, 2024. This filing shall only reflect the impact of the Rockport Offset True-Up on the purchase power adjustment factor. The purchase power adjustment factor shall be established to recover or credit the Rockport Offset True-Up amount in three months.

(iv) Beginning with the August 15, 2024 Tariff P.P.A. filing, the Company will incorporate the Rockport Fixed Cost Savings in its annual calculation of the purchase power adjustment factor.

4. PJM OATT LSE Expense Recovery

(a) As described in the testimony of Company Witness Vaughan, Kentucky Power has included an adjusted test year amount of net PJM OATT LSE charges and credits in base rates. Kentucky Power will track, on a monthly basis, the amount of OATT LSE charges and credits above or below the base rate level using deferral accounting. Kentucky Power will recover and collect 80% of the annual over or under collection of PJM OATT LSE charges, as compared to the annual amount included in base rates, (“Annual PJM OATT LSE Recovery”) through the operation of Tariff P.P.A.

(b) Kentucky Power will credit against the Annual PJM OATT LSE Recovery 100% of the difference between the return on its incremental transmission investments calculated using the FERC-approved PJM OATT return on equity and the return on its incremental transmission investments calculated using the 9.75% return on equity provided for in this settlement (the “Transmission Return Difference”). Kentucky Power shall calculate the Transmission Return Difference as shown in **EXHIBIT 3**.

(c) These changes to Tariff P.P.A. to allow for the Annual PJM OATT LSE Recovery will terminate on the effective date when base rates are reset in the next base rate proceeding unless otherwise specifically extended by the Commission. Nothing in this Paragraph 4(c) prohibits Kentucky Power or any other Signatory Party from taking any position regarding the extension of the Annual PJM OATT LSE Recovery mechanism or any other treatment of the Company's PJM OATT LSE expenses.

5. Rate Case Stay Out

(a) Kentucky Power will not file an application for a general adjustment of base rates for rates that would be effective prior to the first day of the January 2021 billing cycle. This rate case "stay out" is expressly conditioned on Commission approval of this Settlement Agreement without modification including the recovery of the Rockport Deferral Regulatory Asset as described in Section 3 above and the incremental PJM OATT LSE expense through Tariff P.P.A. as described in Section 4 above.

(b) This stay out will not apply if a change in law occurs that will result in a material adverse effect on the Company's financial condition.

(c) Nothing in this stay out provision should be interpreted as prohibiting the Commission from altering the Company's rates upon its own investigation, or upon complaint, including to reflect changes in the tax code, including the federal corporate income tax rate, depreciation provisions, or upon a request by the Company to seek leave to address an emergency that could adversely impact Kentucky Power or its customers. In the event the Commission initiates an investigation or a complaint is filed with the Commission regarding the Company's rates, the Company retains the right to defend the reasonableness of its rates in such proceedings.

6. Tariff P.P.A.

(a) Kentucky Power's proposed changes to Tariff P.P.A., as set forth in the testimony of Company Witness Vaughan and modified by Sections 2 and 3 above, are approved.

(b) A revised version of Tariff P.P.A. incorporating the modifications described in Sections 2 and 3 above is included as **EXHIBIT 4**.

7. Depreciation Rates

(a) Kentucky Power and the Settling Intervenors agree that Big Sandy Unit 1 has an expected life of 20 years following its conversion from a coal-fired to a natural gas-fired generating unit. The depreciation rates for Big Sandy Unit 1 have been adjusted to reflect the 20 year expected life. Kentucky Power and the Signatory Parties retain the right to propose updated depreciation rates for Big Sandy Unit 1 in future proceedings to reflect updates to the expected life.

(b) Kentucky Power has adjusted depreciation rates for Big Sandy Unit 1 and for the Mitchell Plant to remove terminal net salvage costs. Kentucky Power retains the right to propose updated depreciation rates for Big Sandy Unit 1 and for the Mitchell Plant in future proceedings to include terminal net salvage costs, and the Settling Intervenors retain the right to challenge the inclusion of such costs in future proceedings.

(c) Kentucky Power's updated depreciation rates are included as **EXHIBIT 5**.

8. Return on Equity, Capitalization, WACC, and GRCF

(a) Kentucky Power shall be authorized a 9.75% return on equity. The authorized return on equity of 9.75% will be used in the calculation of the Company's Environmental Surcharge factor (for non-Rockport environmental projects) and the carrying charges for the Rockport Deferral and Decommissioning Rider regulatory assets.

(b) Kentucky Power will update its capitalization to reflect short term debt as 1% of the Company's total capital structure. The annual interest rate for the short term debt will be set at 1.25%.

(c) Kentucky Power shall utilize a weighted average cost of capital ("WACC") of 9.11% including a gross revenue conversion factor ("GRCF") of 1.6433%. The GRCF does not include a Section 199 deduction. This WACC and GRCF shall remain constant (including for the riders and surcharges described in Paragraph 8(a) above) until such time as the Commission sets base rates in the Company's next base rate case proceeding. The calculations of the WACC and GRCF are shown on **EXHIBIT 6**.

9. Storm Damage Expense Amortization

(a) Kentucky Power will recover and amortize the remaining unamortized balance of its deferred storm expense regulatory asset authorized in Case No. 2012-00445 over a period of five years beginning January 1, 2018, consistent with the recommendation of KIUC. The unamortized balance of the regulatory asset authorized in Case No. 2012-00445 will total \$6,087,000 on December 31, 2017 and will be amortized over five years at an annual amount of \$1,217,400.

(b) Kentucky Power will recover and amortize the deferred storm expense regulatory asset authorized in Case No. 2016-00180 over a period of 5 years beginning January 1, 2018 consistent with the testimony of Company Witness Wohnhas. The balance of the regulatory asset authorized in Case No. 2016-00180 totals \$4,377,336 and will be amortized over five years at an annual amount of \$875,467.

(c) The combined balance of the Kentucky Power's deferred storm expense regulatory assets (the remaining unamortized balance authorized in Case No. 2012-00445 and the amount

authorized in Case No. 2016-00180) will total \$10,464,336 on December 31, 2017 and will be amortized over five years at an annual amount of \$2,092,867.

10. Kentucky Economic Development Surcharge

(a) Kentucky Power's new Kentucky Economic Development Surcharge Tariff ("Tariff K.E.D.S.") shall be approved with rates amended as follows:

(i) The KEDS rate for residential customers will be set at \$0.10 per meter instead of \$0.25 as proposed by the Company.

(ii) The KEDS rate for non-residential customers for which the KEDS applies will be set at \$1.00 per meter instead of \$0.25 as proposed by the Company.

(b) All KEDS funds collected by Kentucky Power shall be matched dollar-for-dollar by Kentucky Power from shareholder funds. The proceeds of KEDS and Kentucky Power's shareholder contribution shall be used by Kentucky Power for economic development projects, including the training of local economic development officials, in the Company's service territory. The KEDS, and the matching shareholder contribution, shall remain in effect until changed by order of the Commission.

(c) Kentucky Power will continue to file on or before March 31st of each year a report with the Commission describing: (i) the amount collected through the Economic Development Surcharge; and (ii) the matching amount contributed by Kentucky Power from shareholder funds. The annual report to be filed by the Company shall also describe the amount, recipients, and purposes of its expenditure of the funds collected through the Economic Development Surcharge and shareholder contribution.

(d) Kentucky Power shall serve a copy of the annual report to be filed with the Commission in accordance with subparagraph (c) on counsel for all parties to this proceeding.

11. Backup and Maintenance Service

(a) In order for Marathon Petroleum L.P. ("Marathon") to evaluate the economics of self or co-generation, Kentucky Power and Marathon will begin negotiations regarding the terms, conditions and pricing for backup and maintenance service within 30 days of a Commission Order approving this provision and will complete negotiations within the next 120 days. Prior to the start of the 120 day negotiation period, Marathon will provide Kentucky Power with specific information regarding the MW size of a potential self or co-generation facility and the type of generation technology being considered.

(b) If Kentucky Power and Marathon cannot reach an agreement on backup and maintenance service within 120 days, Kentucky Power and Marathon agree to submit the issue to the Commission for resolution.

12. School Energy Manager Program

(a) Kentucky Power shall seek leave from the Commission to include up to \$200,000 for the School Energy Manager Program in its each of its 2018 and 2019 DSM Program offerings.

(b) Kentucky Power and KSBA both expressly acknowledge that there is in Case No. 2017-00097 a currently-pending Commission investigation of the Company's DSM programs and funding and that the outcome of that investigation could impact the School Energy Manager Program.

13. Tariff K-12 School

(a) Kentucky Power shall continue its current Pilot Tariff K-12 School but shall remove the Pilot designation as set forth in EXHIBIT 7. Tariff K-12 School shall be available for general service to all K-12 schools in the Company's service territory, public and private, with normal maximum demands greater than 100 kW. Tariff K-12 School shall reflect rates for

customers taking service under the tariff designed to produce annually in the aggregate \$500,000 less from Tariff K-12 School customers than would be produced under the new L.G.S. rates to be established under this Settlement Agreement from customers eligible to take service under Tariff K-12 School. The aggregate total revenues to be produced by Tariff K-12 School and Tariff L.G.S. shall be equal to the revenues that would be produced in the aggregate by the new rates in the absence of Tariff K-12 School. Service under Tariff K-12 School shall be optional.

14. Bill Format Changes

(a) The bill formatting changes proposed by the Company in Case No. 2017-00231 and consolidated into this case by Commission Order dated July 17, 2017, to the extent not already approved, are approved.

(b) Within 180 days of a Commission Order approving this Settlement, Kentucky Power will conduct a training session with representatives from its municipal clients and KLC to explain the new bill format and tools available to clients to evaluate their electric usage.

15. Renewable Power Option Rider

(a) The proposed changes to the Company's Green Pricing Option Rider, including renaming the rider to the Renewable Power Option Rider ("Rider R.P.O."), are approved except that the availability of service provision for Option B will state the following:

"Customers who wish to directly purchase the electrical output and all associated environmental attributes from a renewable energy generator may contract bilaterally with the Company under Option B. Option B is available to customers taking metered service under the Company's I.G.S., and C.S.-I.R.P. tariffs, or multiple L.G.S. tariff accounts with common ownership under a single parent company that can aggregate multiple accounts to exceed 1000 kW of peak demand."

A revised version of Rider R.P.O. incorporating the modifications described above is included as **EXHIBIT 8**. Bills for customers receiving service under Rider R.P.O. will include a separate line item for Rider R.P.O. charges.

(b) Beginning no later than March 31, 2018, and no later than each March 31 thereafter, Kentucky Power will file a report with the Commission describing the previous year's activity under Rider R.P.O. This annual report will replace the semi-annual reports filed in Case No. 2008-00151.

16. Modifications To Kentucky Power's Rate Tariffs

In addition to the rate and tariff changes described and agreed to above, Kentucky Power and the Settling Intervenors agree that the following tariffs shall be modified or implemented as described below:

(a) The Customer charge for the Residential Class ("Tariff R.S.") shall be increased to \$14.00 per month instead of the \$17.50 per month proposed by the Company in its filing in this case.

(b) The Company is extending the termination date for Tariff C.S. – Coal and the amendments to Tariff C.S. – I.R.P. and Tariff E.D.R. approved in Case No. 2017-00099 from December 31, 2017 to December 31, 2018.

(c) The pole attachment rate under Tariff C.A.T.V. shall be \$10.82 for attachments on two-user poles and \$6.71 for attachments on three-user poles for all attachments instead of the \$11.97 for attachments on two-user poles and \$7.42 for attachments on three-user poles proposed by the Company in its filing in this case.

17. Filing Of Settlement Agreement With The Commission And Request For Approval

Following the execution of this Settlement Agreement, Kentucky Power and the Settling Intervenors shall file this Settlement Agreement with the Commission along with a joint request to the Commission for consideration and approval of this Settlement Agreement so that Kentucky

Power may begin billing under the approved adjusted rates for service rendered on or before January 19, 2018.

18. Good Faith And Best Efforts To Seek Approval

(a) This Settlement Agreement is subject to approval by the Public Service Commission.

(b) Kentucky Power and the Settling Intervenors shall act in good faith and use their best efforts to recommend to the Commission that this Settlement Agreement be approved in its entirety and without modification and that the rates and charges set forth herein be implemented.

(c) Kentucky Power and the Settling Intervenors filed testimony in this case. Kentucky Power also filed testimony in support of the Settlement Agreement. For purposes of any hearing, the Settling Intervenors and Kentucky Power waive all cross-examination of the other Signatory Parties' witnesses except for purposes of supporting this Settlement Agreement unless the Commission disapproves this Settlement Agreement. Each further stipulates and recommends that the Notice of Intent, Application, testimony, pleadings, and responses to data requests filed in this proceeding be admitted into the record.

(d) The Signatory Parties further agree to support the reasonableness of this Settlement Agreement before the Commission, and to cause their counsel to do the same, including in connection with any appeal from the Commission's adoption or enforcement of this Settlement Agreement.

(e) No party to this Settlement Agreement shall challenge any Order of the Commission approving the Settlement Agreement in its entirety and without modification.

19. Failure Of Commission To Approve Settlement Agreement

If the Commission does not accept and approve this Stipulation in its entirety, then any adversely affected Party may withdraw from the Stipulation within the statutory periods provided for rehearing and appeal of the Commission's order by (1) giving notice of withdrawal to all other Parties and (2) timely filing for rehearing or appeal. Upon the latter of (1) the expiration of the statutory periods provided for rehearing and appeal of the Commission's order and (2) the conclusion of all rehearing's and appeals, all Parties that have not withdrawn will continue to be bound by the terms of the Stipulation as modified by the Commission's order.

20. Continuing Commission Jurisdiction

This Settlement Agreement shall in no way be deemed to divest the Commission of jurisdiction under Chapter 278 of the Kentucky Revised Statutes.

21. Effect of Settlement Agreement

This Settlement Agreement shall inure to the benefit of, and be binding upon, the parties to this Settlement Agreement, their successors, and assigns.

22. Complete Agreement

This Settlement Agreement constitutes the complete agreement and understanding among the parties to this Settlement Agreement, and any and all oral statements, representations, or agreements. Any and all such oral statements, representations, or agreements made prior hereto or contained contemporaneously herewith shall be null and void and shall be deemed to have been merged into this Settlement Agreement.

23. Independent Analysis

The terms of this Settlement Agreement are based upon the independent analysis of the parties to this Settlement Agreement, are the product of compromise and negotiation, and reflect

a fair, just, and reasonable resolution of the issues herein. Notwithstanding anything contained in this Settlement Agreement, Kentucky Power and the Settling Intervenors recognize and agree that the effects, if any, of any future events upon the income of Kentucky Power are unknown and this Settlement Agreement shall be implemented as written.

24. Settlement Agreement And Negotiations Are Not An Admission

(a) This Settlement Agreement shall not be deemed to constitute an admission by any party to this Settlement Agreement that any computation, formula, allegation, assertion, or contention made by any other party in these proceedings is true or valid. Nothing in this Settlement Agreement shall be used or construed for any purpose to imply, suggest or otherwise indicate that the results produced through the compromise reflected herein represent fully the objectives of the Signatory Parties.

(b) Neither the terms of this Settlement Agreement nor any statements made or matters raised during the settlement negotiations shall be admissible in any proceeding, or binding on any of the parties to this Settlement Agreement, or be construed against any of the parties to this Settlement Agreement, except that in the event of litigation or proceedings involving the approval, implementation or enforcement of this Agreement, the terms of this Settlement Agreement shall be admissible. This Settlement Agreement shall not have any precedential value in this or any other jurisdiction.

25. Consultation With Counsel

The parties to this Settlement Agreement warrant that they have informed, advised, and consulted with their respective counsel with regard to the contents and significance of this Settlement Agreement and are relying upon such advice in entering into this agreement.

26. Authority To Bind

Each of the signatories to this Settlement Agreement hereby warrant they are authorized to sign this agreement upon behalf of, and bind, their respective parties.

27. Construction Of Agreement

This Settlement Agreement is a product of negotiation among all parties to this Settlement Agreement, and no provision of this Settlement Agreement shall be construed in favor of or against any party hereto. This Settlement Agreement is submitted for purposes of this case only and is not to be deemed binding upon the parties hereto in any other proceeding, nor is it to be offered or relied upon in any other proceeding involving Kentucky Power or any other utility.

28. Counterparts

This Settlement Agreement may be executed in multiple counterparts.

29. Future Rate Proceedings

Nothing in this Settlement Agreement shall preclude, prevent, or prejudice any party to this Settlement Agreement from raising any argument or issue, or challenging any adjustment, in any future rate proceeding of Kentucky Power.

IN WITNESS WHEREOF, this Settlement Agreement has been agreed to as of this 22nd day of November 2017.

KENTUCKY POWER COMPANY

By: 

Its: Counsel

KENTUCKY INDUSTRIAL UTILITY
CUSTOMERS, INC.

By: Mill L. Kurt

Its: Counsel

KENTUCKY SCHOOL BOARDS
ASSOCIATION, INC.

By: Walter Malone

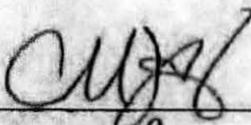
Its: Legal Counsel

KENTUCKY CABLE
TELECOMMUNICATION
ASSOCIATION, INC.

By: Jason K. [Signature]

Its: KCTA Board Chairman

WAL-MART STORES EAST, LP AND
SAM'S EAST, INC.

By: 
Its: Counsel

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2017-00179 DATED JAN 18 2018

| Adjustments | Amounts |
|---|----------------|
| Capacity Charge Revenues Removal | (\$6,396,832) |
| Removal of Effects of Decommissioning Rider Revenue and Expenses | (\$18,512,331) |
| Eliminate Mitchell FGD Operating Expenses | (\$13,308,197) |
| Remove Mitchell plant FGD and Consumable inventory from Rate Base | (\$1,610,192) |
| Removal of Mitchell FGD Environmental Surcharge Rider Revenues | (\$538,417) |
| Remove Big Sandy Unit 1 Operation Rider Deferrals | (\$4,333,902) |
| Fuel Under (Over) Revenues | \$4,574,472 |
| Reset OSS Margin Baseline to 2016 Test Year OSS Margins | (\$8,800,856) |
| PPA Rider Synchronization Adjustment | \$372,542 |
| Remove DSM Revenue Expense | (\$5,503,380) |
| Remove HEAP Revenue and Expense | (\$246,772) |
| Remove Economic Development Surcharge Revenue and Expense | (\$303,011) |
| Tariff Migration Adjustment | \$1,026,263 |
| Customer Annualization Revenue Adjustment | (\$1,342,364) |
| Weather Normal Load Revenue Adjustment | \$4,080,748 |
| O&M Expense Interest on Customer Deposit | \$67,254 |
| Amortization of Major Storm Cost Deferral | \$874,592 |
| Postage Rate Decrease Adjustment | (\$6,656) |
| Eliminate Advertising Expense | \$100,444 |
| Adjust Pension and OPEB Expense | \$148,679 |
| Employee Related Group Benefit Expense | \$429,241 |
| Remove PJM BLIs From Base for FAC Inclusions | (\$516,659) |
| Adjustment to Include Purchase Power Limitation Expense in Rate Base | \$3,150,582 |
| Adjustment to Include Forced Outage Purchase Power Limitation in Base Rates | \$882,204 |
| Annualize NITS/PJM LSE OATT Expense | \$3,825,858 |
| Annualize PJM Admin Charges | \$118,606 |
| Amortization of NERC Cost Deferral | \$14,275 |
| Severance Expense Adjustment | \$2,363 |
| Annualization of Payroll Expense Adjustment | \$244,837 |
| Social Security Tax Base Adjustment | \$26,009 |
| Eliminate Non-Recoverable Business Expenses | \$14,914 |
| Plant Maintenance Normalization | (\$274,334) |
| Depreciation Annualization Adjustment Electric Plant in Service | \$2,037,359 |
| Decrease ARO Depreciation Expense to an Annualized Level | (\$3,818) |
| Decrease ARO Accretion Expense to an Annualized Level | (\$109,495) |
| Annualization of Cable Pole Attachment Revenue | \$532,369 |
| KPSC Maintenance Assessment | (\$1,801) |
| State Gross Receipts Tax Adjustment | \$78,776 |

| | |
|---|---------------|
| Interest Synchronization Adjustment (Per 8/7/2017 Amendment) | \$6,449,828 |
| AFUDC Offset Adjustment (Per 8/17/2017 Amendment) | \$28,197 |
| Adjustment to Recognize Accrued Surcharge Revenue Differences | (\$62,588) |
| Mitchell Plant ADSIT Amortization | \$1,292,491 |
| Decrease O&M for Vegetation Management Tree Trimming | (\$6,794,282) |
| Annualization of Property Taxes | \$595,507 |

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2017-00179 DATED **JAN 18 2018**

The following rates and charges are prescribed for the customers in the area served by Kentucky Power Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

TARIFF R.S.
RESIDENTIAL SERVICE

| | |
|--|-----------|
| Service Charge per month | \$ 14.00 |
| Energy Charge per kWh | \$.09660 |
| Storage Water Heating Provision - Per kWh | \$.06072 |
| Load Management Water Heating Provision - Per kWh | \$.06072 |
| Home Energy Assistance Program Charge Per meter per month | \$.30 |

TARIFF R.S.-L.M.-T.O.D.
RESIDENTIAL SERVICE LOAD MANAGEMENT TIME-OF-DAY

| | |
|--|-----------|
| Service Charge per month | \$ 16.00 |
| Energy Charge per kWh: | |
| All kWh used during on-peak billing period | \$.14346 |
| All kWh used during off-peak billing period | \$.06072 |
| Separate Metering Provision Per Month | \$ 3.75 |
| Home Energy Assistance Program Charge Per meter per month | \$.30 |

TARIFF R.S.-T.O.D.
RESIDENTIAL SERVICE TIME-OF-DAY

| | |
|--|-----------|
| Service Charge per month | \$ 16.00 |
| Energy Charge per kWh: | |
| All kWh used during on-peak billing period | \$.14386 |
| All kWh used during off-peak billing period | \$.06072 |
| Home Energy Assistance Program Charge Per meter per month | \$.30 |

TARIFF R.S.-T.O.D. 2
EXPERIMENTAL RESIDENTIAL SERVICE TIME-OF-DAY 2

| | |
|---|-----------|
| Service Charge per month | \$ 16.00 |
| Energy Charge per kWh: | |
| All kWh used during summer on-peak billing period | \$.17832 |
| All kWh used during winter on-peak billing period | \$.15342 |
| All kWh used during off-peak billing period | \$.08094 |
| Home Energy Assistance Program Charge | |
| Per meter per month | \$.30 |

TARIFF R.S.D.
RESIDENTIAL DEMAND-METERED ELECTRIC SERVICE

| | |
|---|-----------|
| Service Charge per month | \$ 17.50 |
| Energy Charge per kWh: | |
| All kWh used during on-peak billing period | \$.09738 |
| All kWh used during off-peak billing period | \$.07029 |
| Demand Charge per kW | \$ 4.02 |
| Home Energy Assistance Program Charge | |
| Per meter per month | \$.30 |

TARIFF G.S.
GENERAL SERVICE

Secondary Service:

| | |
|---|-----------|
| Service Charge per month | \$ 22.50 |
| Energy Charge per kWh: | |
| Phase 1 | |
| First 4,450 kWh per month | \$.10198 |
| Over 4,450 kWh per month | \$.10188 |
| Phase 2 | |
| First 4,450 kWh per month | \$.09807 |
| Over 4,450 kWh per month | \$.09798 |
| Demand Charge per kW greater than 10 kW | |
| Phase 1 | \$ 4.00 |
| Phase 2 | \$ 6.00 |

Primary Service:

| | |
|---|-----------|
| Service Charge per month | \$ 75.00 |
| Energy Charge per kWh: | |
| First 4,450 kWh per month | \$.08629 |
| Over 4,450 kWh per month | \$.08659 |
| Demand Charge per kW greater than 10 kW | \$ 7.18 |

| | |
|---|-----------|
| <u>Subtransmission Service:</u> | |
| Service Charge per month | \$ 364.00 |
| Energy Charge per kWh: | |
| First 4,450 kWh per month | \$.07822 |
| Over 4,450 kWh per month | \$.07855 |
| Demand Charge per kW greater than 10 kW | \$ 5.74 |

TARIFF G.S.
GENERAL SERVICE
RECREATIONAL LIGHTING SERVICE PROVISION

| | |
|--------------------------|-----------|
| Service Charge per month | \$ 22.50 |
| Energy Charge per kWh | \$.09968 |

TARIFF G.S.
GENERAL SERVICE
LOAD MANAGEMENT TIME-OF-DAY PROVISION

| | |
|---|-----------|
| Service Charge per month | \$ 22.50 |
| Energy Charge per kWh: | |
| All kWh used during on-peak billing period | \$.14423 |
| All kWh used during off-peak billing period | \$.06072 |

TARIFF G.S.
GENERAL SERVICE
OPTIONAL UNMETERED SERVICE PROVISION

| | |
|---------------------------|-----------|
| Service Charge per month | \$ 14.00 |
| Energy Charge per kWh: | |
| Phase 1 | |
| First 4,450 kWh per month | \$.10198 |
| Over 4,450 kWh per month | \$.10188 |
| Phase 2 | |
| First 4,450 kWh per month | \$.09807 |
| Over 4,450 kWh per month | \$.09798 |

TARIFF S.G.S.-T.O.D.
SMALL GENERAL SERVICE TIME-OF-DAY

| | |
|---|-----------|
| Service Charge per month | \$ 22.50 |
| Energy Charge per kWh: | |
| All kWh used during summer on-peak billing period | \$.17034 |
| All kWh used during winter on-peak billing period | \$.14372 |
| All kWh used during off-peak billing period | \$.07511 |

TARIFF M.G.S.-T.O.D.
MEDIUM GENERAL SERVICE TIME-OF-DAY

| | |
|---|-----------|
| Service Charge per month | \$ 22.50 |
| Energy Charge per kWh: | |
| All kWh used during on-peak billing period | \$.16747 |
| All kWh used during off-peak billing period | \$.06072 |

TARIFF L.G.S.
LARGE GENERAL SERVICE

| | |
|-----------------------------------|-----------|
| <u>Secondary Service Voltage:</u> | |
| Service Charge per month | \$ 85.00 |
| Energy Charge per kWh | \$.07712 |
| Demand Charge per kW | \$ 7.97 |

| | |
|---------------------------------|-----------|
| <u>Primary Service Voltage:</u> | |
| Service Charge per month | \$ 127.50 |
| Energy Charge per kWh | \$.06711 |
| Demand Charge per kW | \$ 7.18 |

| | |
|--|-----------|
| <u>Sub-transmission Service Voltage:</u> | |
| Service Charge per month | \$ 660.00 |
| Energy Charge per kWh | \$.05112 |
| Demand Charge per kW | \$ 5.74 |

| | |
|--------------------------------------|-----------|
| <u>Transmission Service Voltage:</u> | |
| Service Charge per month | \$ 660.00 |
| Energy Charge per kWh | \$.04997 |
| Demand Charge per kW | \$ 5.60 |

| | |
|--------------------------------|---------|
| <u>All Service Voltages:</u> | |
| Excess Reactive Charge per KVA | \$ 3.46 |

TARIFF L.G.S.
LARGE GENERAL SERVICE
LOAD MANAGEMENT TIME-OF-DAY PROVISION

| | |
|---|-----------|
| Service Charge per month | \$ 85.00 |
| Energy Charge per kWh: | |
| All kWh used during on-peak billing period | \$.14063 |
| All kWh used during off-peak billing period | \$.06088 |

TARIFF L.G.S. – T.O.D.
LARGE GENERAL SERVICE TIME-OF-DAY

Secondary Service Voltage:

| | |
|--------------------------------|-----------|
| Service Charge per month | \$ 85.00 |
| Energy Charge: | |
| On-Peak Energy Charge per kWh | \$.09670 |
| Off-Peak Energy Charge per kWh | \$.04132 |
| Demand Charge per kW | \$ 10.87 |

Primary Service Voltage:

| | |
|--------------------------------|-----------|
| Service Charge per month | \$ 127.50 |
| Energy Charge: | |
| On-Peak Energy Charge per kWh | \$.09300 |
| Off-Peak Energy Charge per kWh | \$.04010 |
| Demand Charge per kW | \$ 7.84 |

Sub-transmission Service Voltage:

| | |
|--------------------------------|-----------|
| Service Charge per month | \$ 660.00 |
| Energy Charge: | |
| On-Peak Energy Charge per kWh | \$.09176 |
| Off-Peak Energy Charge per kWh | \$.03970 |
| Demand Charge per kW | \$ 1.52 |

Transmission Service Voltage:

| | |
|--------------------------------|-----------|
| Service Charge per month | \$ 660.00 |
| Energy Charge: | |
| On-Peak Energy Charge per kWh | \$.09049 |
| Off-Peak Energy Charge per kWh | \$.03928 |
| Demand Charge per kW | \$ 1.49 |

All Service Voltages:

| | |
|--------------------------------|---------|
| Excess Reactive Charge per KVA | \$ 3.46 |
|--------------------------------|---------|

TARIFF I.G.S.
INDUSTRIAL GENERAL SERVICE

Secondary Service Voltage:

| | |
|------------------------------------|-----------|
| Service Charge per month | \$ 276.00 |
| Energy Charge per kWh | \$.02663 |
| Demand Charge per kW | |
| Of Monthly On-Peak Billing Demand | \$ 24.13 |
| Of Monthly Off-Peak Billing Demand | \$ 1.60 |

| | |
|-----------------------------------|-----------|
| <u>Primary Service Voltage:</u> | |
| Service Charge per month | \$ 276.00 |
| Energy Charge per kWh | \$.02553 |
| Demand Charge per kW | |
| Of Monthly On-Peak Billing Demand | \$ 20.57 |

| | |
|--|-----------|
| <u>Sub-transmission Service Voltage:</u> | |
| Service Charge per month | \$ 794.00 |
| Energy Charge per kWh | \$.02793 |
| Demand Charge per kW | |
| Of Monthly On-Peak Billing Demand | \$ 13.69 |
| Of Monthly Off-Peak Billing Demand | \$ 1.51 |

| | |
|--------------------------------------|------------|
| <u>Transmission Service Voltage:</u> | |
| Service Charge per month | \$1,353.00 |
| Energy Charge per kWh | \$.02792 |
| Demand Charge per kW | |
| Of Monthly On-Peak Billing Demand | \$ 13.26 |
| Of Monthly Off-Peak Billing Demand | \$ 1.49 |

All Service Voltages:
 Reactive demand charge for each kilovar of maximum leading or lagging reactive demand in excess of 50 percent of the kW of monthly metered demand is \$.69 per KVAR.

Minimum Demand Charge
 The minimum demand charge shall be equal to the minimum billing demand times the following minimum demand rates per kW:

| | |
|-----------------|----------|
| Secondary | \$ 25.83 |
| Primary | \$ 22.21 |
| Subtransmission | \$ 15.30 |
| Transmission | \$ 14.86 |

TARIFF M.W.
MUNICIPAL WATERWORKS

| | |
|---------------------------------|-----------|
| Service Charge per month | \$ 22.90 |
| Energy Charge - All kWh per kWh | \$.09135 |

Subject to a minimum monthly charge equal to the sum of the service charge plus \$8.89 per kW as determined from customer's total connected load.

TARIFF O.L.
OUTDOOR LIGHTING

OVERHEAD LIGHTING SERVICE

| | | |
|--------------------------------|----|-------|
| High Pressure Sodium per Lamp: | | |
| 100 Watts (9,500 Lumens) | \$ | 8.50 |
| 150 Watts (16,000 Lumens) | \$ | 9.30 |
| 200 Watts (22,000 Lumens) | \$ | 10.90 |
| 250 Watts (28,000 Lumens) | \$ | 15.04 |
| 400 Watts (50,000 Lumens) | \$ | 16.01 |
| Mercury Vapor per Lamp: | | |
| 175 Watts (7,000 Lumens) | \$ | 9.04 |
| 400 Watts (20,000 Lumens) | \$ | 14.64 |

POST-TOP LIGHTING SERVICE

| | | |
|------------------------------------|----|-------|
| High Pressure Sodium per Lamp: | | |
| 100 Watts (9,500 Lumens) | \$ | 14.05 |
| 150 Watts (16,000 Lumens) | \$ | 23.30 |
| 100 Watts Shoe Box (9,500 Lumens) | \$ | 29.50 |
| 250 Watts Shoe Box (28,000 Lumens) | \$ | 24.99 |
| 400 Watts Shoe Box (50,000 Lumens) | \$ | 36.16 |
| Mercury Vapor per Lamp: | | |
| 175 Watts (7,000 Lumens) | \$ | 10.59 |

FLOOD LIGHTING SERVICE

| | | |
|---|----|-------|
| High Pressure Sodium per Lamp: | | |
| 200 Watts (22,000 Lumens) | \$ | 13.10 |
| 400 Watts (50,000 Lumens) | \$ | 17.06 |
| Metal Halide | | |
| 250 Watts (20,500 Lumens) | \$ | 15.27 |
| 400 Watts (36,000 Lumens) | \$ | 18.39 |
| 1,000 Watts (110,000 Lumens) | \$ | 30.94 |
| 250 Watts Mongoose (19,000 Lumens) | \$ | 20.57 |
| 400 Watts Mongoose (40,000 Lumens) | \$ | 23.59 |
| Per Month: | | |
| Wood Pole | \$ | 3.40 |
| Overhead Wire Span not over 150 Feet | \$ | 2.00 |
| Underground Wire Lateral not over 50 Feet | \$ | 7.40 |

Per Lamp plus \$0.02725 x kWh in Sheet No. 14-3 in Company's tariff

TARIFF S.L.
STREET LIGHTING

Rate per Lamp:

Overhead Service on Existing Distribution Poles

| | |
|---------------------------|----------|
| High Pressure Sodium | |
| 100 Watts (9,500 Lumens) | \$ 7.02 |
| 150 Watts (16,000 Lumens) | \$ 7.55 |
| 200 Watts (22,000 Lumens) | \$ 8.95 |
| 400 Watts (50,000 Lumens) | \$ 11.71 |

Service on New Wood Distribution Poles

| | |
|---------------------------|----------|
| High Pressure Sodium | |
| 100 Watts (9,500 Lumens) | \$ 10.80 |
| 150 Watts (16,000 Lumens) | \$ 11.55 |
| 200 Watts (22,000 Lumens) | \$ 12.95 |
| 400 Watts (50,000 Lumens) | \$ 16.61 |

Service on New Metal or Concrete Poles

| | |
|---------------------------|----------|
| High Pressure Sodium | |
| 100 Watts (9,500 Lumens) | \$ 27.45 |
| 150 Watts (16,000 Lumens) | \$ 28.15 |
| 200 Watts (22,000 Lumens) | \$ 26.70 |
| 400 Watts (50,000 Lumens) | \$ 27.11 |

Per Lamp plus \$0.02725 x kWh in Sheet No. 15-2 in Company's tariff

TARIFF C.A.T.V.
CABLE TELEVISION POLE ATTACHMENT

Charge for attachments

| | |
|----------------------|----------|
| On a two-user pole | \$ 10.82 |
| On a three-user pole | \$ 6.71 |

TARIFF COGEN/SPP I
COGENERATION AND/OR SMALL POWER PRODUCTION
100 KW OR LESS

Monthly Metering Charges:

| | |
|-------------------------|---------|
| Single Phase: | |
| Standard Measurement | \$ 9.25 |
| Time-of-Day Measurement | \$ 9.85 |

| | | | |
|------------------------|--------------------------|----|--------|
| Polyphase: | | | |
| | Standard Measurement | \$ | 12.10 |
| | Time-of-Day Measurement | \$ | 12.40 |
| Energy Credit per kWh: | | | |
| | Standard Meter – All kWh | \$ | .03240 |
| | Time-of-Day Meter: | | |
| | On-Peak kWh | \$ | .03860 |
| | Off-Peak kWh | \$ | .02790 |
| Capacity Credit: | | | |
| | Standard Meter per kW | \$ | 3.11 |
| | Time-of-Day Meter per kW | \$ | 7.47 |

TARIFF COGEN/SPP II
COGENERATION AND/OR SMALL POWER PRODUCTION
OVER 100 KW

| | | | |
|------------------------|--------------------------|----|--------|
| Metering Charges: | | | |
| Single Phase: | | | |
| | Standard Measurement | \$ | 9.25 |
| | Time-of-Day Measurement | \$ | 9.85 |
| Polyphase: | | | |
| | Standard Measurement | \$ | 12.10 |
| | Time-of-Day Measurement | \$ | 12.40 |
| Energy Credit per kWh: | | | |
| | Standard Meter – All kWh | \$ | .03240 |
| | Time-of-Day Meter: | | |
| | On-Peak kWh | \$ | .03860 |
| | Off-Peak kWh | \$ | .02790 |
| Capacity Credit: | | | |
| | Standard Meter per kW | \$ | 3.11 |
| | Time-of-Day Meter per kW | \$ | 7.47 |

TARIFF K.E.D.S.
KENTUCKY ECONOMIC DEVELOPMENT SURCHARGE

| | | | |
|------------------------|-------------|----|------|
| Per month per account: | | | |
| | Residential | \$ | .00 |
| | All Other | \$ | 1.00 |

TARIFF C.C.
CAPACITY CHARGE

Energy Charge per kWh:

| | | |
|----------------|----|---------|
| Service Tariff | | |
| I.G.S. | \$ | .000749 |
| All Other | \$ | .001435 |

RIDER R.P.O.
RENEWABLE POWER OPTION RIDER
OPTION A

| | | |
|--------------------------------------|----|--------|
| Solar RECs: | | |
| Block Purchase per 100 kWh per month | \$ | 1.00 |
| All Usage Purchase per kWh consumed | \$ | .01000 |

| | | |
|--------------------------------------|----|--------|
| Wind RECs: | | |
| Block Purchase per 100 kWh per month | \$ | 1.00 |
| All Usage per kWh consumed | \$ | .01000 |

| | | |
|--------------------------------------|----|--------|
| Hydro & Other RECs: | | |
| Block Purchase per 100 kWh per month | \$ | .30 |
| All Usage per kWh consumed | \$ | .00300 |

RIDER A.F.S.
ALTERNATE FEED SERVICE RIDER

| | | |
|--|----|-------|
| Monthly Rate for Annual Test of Transfer Switch/Control Module | \$ | 14.67 |
| Monthly Capacity Reservation Demand Charge per kW | \$ | 6.29 |

APPENDIX D

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2017-00179 DATED **JAN 18 2018**

ENVIRONMENTAL COMPLIANCE PLAN

| Project | Plant | Pollutant | Description | In-Service Year |
|--|--------------------------------|---|--|---------------------|
| <u>Previously Approved Environmental Compliance Projects</u> | | | | |
| 1 | Mitchell | NOx, SO2, and SO3 | Mitchell Units 1 & 2, Water Injection, Low NOx Burners, Low NOx Burner Modification, SCR, FGD, Landfill, Coal Blending Facilities & SO3 Mitigation | 1993-1994-2002-2007 |
| 2 | Mitchell | SO2, NOx and Gypsum | Mitchell Plant Common CEMS, Replace Burner Barrier Valves & Gypsum Material Handling Facilities | 1993-1994-2007 |
| 3 | Rockport | SO2 / NOx | Continuous Emission Monitors ("CEMS") | 1994 |
| 4 | Rockport | NOx, Fly Ash, & Bottom Ash | Rockport Units 1 & 2 Low NOx Burners, Over Fire Air & Landfill | 2003-2008 |
| 5 | Mitchell & Rockport | SO2, NOx, Particulates & VOC and etc. | Title V Air Emissions Fees at Mitchell and Rockport Plants | Annual |
| 6 | Big Sandy, Mitchell & Rockport | NOx | Costs Associated with NOx Allowances | As Needed |
| 7 | Big Sandy, Mitchell & Rockport | SO2 | Costs Associated with SO2 Allowances | As Needed |
| 8 | Big Sandy, Mitchell & Rockport | SO2 / NOx | Costs Associated with the CSAPR Allowances | As Needed |
| 9 | Mitchell | Particulates | Mitchell Units 1 & 2 - Precipitator Modifications | 2007-2013 |
| 10 | Mitchell | Particulates | Mitchell Units 1 & 2 - Bottom Ash & Fly Ash Handling | 2008-2010 |
| 11 | Mitchell | Mercury | Mitchell Units 1 & 2 - Mercury Monitoring ("MATS") | 2014 |
| 12 | Mitchell | Selenium | Mitchell Units 1 & 2 - Dry Fly Ash Handling Conversion | 2014 |
| 13 | Mitchell | Fly Ash, Bottom Ash, Gypsum & WWTP Solids | Mitchell Units 1 & 2 - Coal Combustion Waste Landfill | 2014 |
| 14 | Mitchell | Particulates | Mitchell Unit 2 - Electrostatic Precipitator Upgrade | 2015 |
| 15 | Rockport | Particulates | Rockport Units 1 & 2 - Precipitator Modifications | 2004-2009 |
| 16 | Rockport | Mercury | Rockport Units 1 & 2 - Activated Carbon Injection ("ACI") & Mercury Monitoring | 2009-2010 |

| | | | | |
|----|----------|-----------------------------------|---|-------------|
| 17 | Rockport | Hazardous Air Pollutants ("HAPS") | Rockport Units 1 & 2 - Dry Sorbent Injection | 2015 |
| 18 | Rockport | Fly Ash & Bottom Ash | Rockport Plant Common - Coal Combustion Waste Landfill Upgrade to Accept Type 1 Ash | 2013 & 2015 |

Proposed Environmental Compliance Projects

| | | | | |
|----|----------------------|---|---|-----------|
| 19 | Rockport | NOx | Rockport Unit 1 - Selective Catalytic Reduction equipment | 2017 |
| 20 | Mitchell Rockport | SO2 / NOx, Mercury, Particulates, Hazardous Air Pollutants ("HAPS") | Cost of consumables used in conjunction with approved ECP projects including the cost of the consumables used and a return on consumable inventories. Consumables include, but are not limited to sodium bicarbonate, activated carbon, anhydrous ammonia, trona, lime hydrate, limestone, polymer, and urea. | As Needed |

APPENDIX E

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2017-00179 DATED **JAN 18 2018**

MONTHLY BASE PERIOD REVENUE REQUIREMENT

| <u>Billing Month</u> | <u>Base Period Cost</u> |
|----------------------|-------------------------|
| January | \$ 3,664,681 |
| February | 3,581,017 |
| March | 3,353,024 |
| April | 3,661,574 |
| May | 3,595,145 |
| June | 3,827,332 |
| July | 3,747,320 |
| August | 3,888,262 |
| September | 3,636,247 |
| October | 3,824,697 |
| November | 3,717,340 |
| December | <u>3,882,677</u> |
| | \$ 44,379,316 |

APPENDIX F

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
 COMMISSION IN CASE NO. 2017-00179 DATED **JAN 18 2018**

Commission Staff Adjustments to the Revenue Requirement in the Settlement Agreement
 Case No. 2017-00179
 Kentucky Power Company (Kentucky Jurisdiction)

| | | | | <u>Staff RR Amount</u> |
|--|--|-----------------------|-------------|----------------------------|
| Increase Per Settlement | | | | 31,780,734 |
| | <u>Pre-Tax Operating Income Amount</u> | <u>NOI Amount</u> | <u>GRCF</u> | |
| Operating Income Issues | | | | |
| OSS Rider Adjustment | (486,412) | (361,693) | 1.352116 | \$ (489,051) |
| Theft Recovery Revenue | (166,198) | (123,584) | 1.352116 | \$ (167,100) |
| Purchased Power Adj (WP 26&27) | (4,032,786) | (2,998,755) | 1.352116 | \$ (4,054,664) |
| Relocation Expense | (132,109) | (98,235) | 1.352116 | \$ (132,826) |
| Cost of Capital Issues | | | | |
| Total Change in ROE and capitalization | | (476,714) | 1.352116 | \$ (644,573) |
| Change in GCRF | | | | (13,943,890) |
| Total Adjustments to the Settlement Agreement | | | | <u>\$ (19,432,104)</u> |
| Recommended Change in Base Rates | | | | <u>\$ 12,348,630</u> |

*William H May, III
Hurt, Deckard & May
The Equus Building
127 West Main Street
Lexington, KENTUCKY 40507

*James W Gardner
Sturgill, Turner, Barker & Moloney, PLLC
333 West Vine Street
Suite 1400
Lexington, KENTUCKY 40507

*Kentucky Power Company
Kentucky Power Company
855 Central Avenue, Suite 200
Ashland, KY 41101

*Barry Alan Naum
Spilman Thomas & Battle, PLLC
1100 Brent Creek Blvd., Suite 101
Mechanicsburg, PENNSYLVANIA 17050

*Jody M Kyler Cohn
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OHIO 45202

*Kenneth J Gish, Jr.
Stites & Harbison
250 West Main Street, Suite 2300
Lexington, KENTUCKY 40507

*Carrie M Harris
Spilman Thomas & Battle, PLLC
1100 Brent Creek Blvd., Suite 101
Mechanicsburg, PENNSYLVANIA 17050

*Janice Theriot
Zielke Law Firm PLLC
1250 Meidinger Tower
462 South Fourth Avenue
Louisville, KENTUCKY 40202

*Katie M Glass
Stites & Harbison
421 West Main Street
P. O. Box 634
Frankfort, KENTUCKY 40602-0634

*Don C Parker
Spilman Thomas & Battle, PLLC
300 Kanawha Blvd, East
Charleston, WEST VIRGINIA 25301

*Justin M. McNeil
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Larry Cook
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Elizabeth Sekula
American Electric Power Service Corporation
1 Riverside Plaza, 29th Floor
Post Office Box 16631
Columbus, OHIO 43216

*Honorable Kurt J Boehm
Attorney at Law
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OHIO 45202

*Laurence J Zielke
Zielke Law Firm PLLC
1250 Meidinger Tower
462 South Fourth Avenue
Louisville, KENTUCKY 40202

*Gregory T Dutton
Goldberg Simpson LLC
9301 Dayflower Street
Louisville, KENTUCKY 40059

*Kent Chandler
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Mark E Heath
Spilman Thomas & Battle, PLLC
300 Kanawha Blvd, East
Charleston, WEST VIRGINIA 25301

*Hector Garcia
American Electric Power Service Corporation
1 Riverside Plaza, 29th Floor
Post Office Box 16631
Columbus, OHIO 43216

*Kentucky Power Company
855 Central Avenue, Suite 200
Ashland, KY 41101

*Honorable Michael L Kurtz
Attorney at Law
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OHIO 45202

*Honorable Matthew R Malone
Attorney at Law
Hurt, Deckard & May
The Equus Building
127 West Main Street
Lexington, KENTUCKY 40507

*Honorable Mark R Overstreet
Attorney at Law
Stites & Harbison
421 West Main Street
P. O. Box 634
Frankfort, KENTUCKY 40602-0634

*Morgain Sprague
Kentucky League of Cities
101 East Vine Street
Suite 800
Lexington, KENTUCKY 40507

*Rebecca W Goodman
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Ranie Wohnhas
Managing Director
Kentucky Power Company
855 Central Avenue Suite 200
Ashland, KENTUCKY 41101

*M. Todd Osterloh
Sturgill, Turner, Barker & Moloney, PLLC
333 West Vine Street
Suite 1400
Lexington, KENTUCKY 40507

1

2

1. Use of a “forecasted” A-rated bond yield.

3

2. Inclusion of flotation costs.

4

3. Use of quarterly compounding in his DCF calculation.

5

6

I have already discussed items 2 and 3 previously in my testimony and this discussion also applies to the way Dr. Vander Weide calculated the DCF return for his portfolio of proxy companies using the ex-ante risk premium method. Dr. Vander Weide’s inclusion of flotation costs and quarterly compounding inflates his proxy group DCF results, thereby overstating the risk premium he used in his analysis.

7

8

9

10

11

Q. How does the use of a forecasted A-rated bond yield overstate the risk premium return on equity?

12

13

A. Dr. Vander Weide's use of a forecasted A-rated utility bond yield should be rejected.

14

15

Current, observable bond yields should be used for any risk premium analysis.

16

Current bond yields reflect all relevant current market information, including

17

expectations about future interest rates. If investors really expected A-rated utility

18

bonds to be significantly higher than they are now, they likely would have already

19

adjusted the current bond yield to avoid or minimize capital losses in the future.

20

Q. How does the forecasted A-rated utility bond yield used by Dr. Vander Weide compare to current A-rated utility bond yields?

21

22

A. The December 29, 2017 yield on Moody’s average public utility bond was 3.81%.

23

Dr. Vander Weide's forecasted A-rated utility bond yield is 5.80%, *which is about*

24

200 basis points higher than the current yield on the average public utility bond. On

H.R. 1

One Hundred Fifteenth Congress of the United States of America

AT THE FIRST SESSION

*Begun and held at the City of Washington on Tuesday,
the third day of January, two thousand and seventeen*

An Act

To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I

SECTION 11000. SHORT TITLE, ETC.

(a) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this title an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

Subtitle A—Individual Tax Reform

PART I—TAX RATE REFORM

SEC. 11001. MODIFICATION OF RATES.

(a) IN GENERAL.—Section 1 is amended by adding at the end the following new subsection:

“(j) MODIFICATIONS FOR TAXABLE YEARS 2018 THROUGH 2025.—

“(1) IN GENERAL.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026—

“(A) subsection (i) shall not apply, and

“(B) this section (other than subsection (i)) shall be applied as provided in paragraphs (2) through (6).

“(2) RATE TABLES.—

“(A) MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES.—The following table shall be applied in lieu of the table contained in subsection (a):

| “If taxable income is: | The tax is: |
|---|--|
| Not over \$19,050 | 10% of taxable income. |
| Over \$19,050 but not over \$77,400 | \$1,905, plus 12% of the excess over \$19,050. |
| Over \$77,400 but not over \$165,000 | \$8,907, plus 22% of the excess over \$77,400. |
| Over \$165,000 but not over \$315,000 | \$28,179, plus 24% of the excess over \$165,000. |
| Over \$315,000 but not over \$400,000 | \$64,179, plus 32% of the excess over \$315,000. |

H. R. 1—2

| “If taxable income is: | The tax is: |
|---|---|
| Over \$400,000 but not over \$600,000 | \$91,379, plus 35% of the excess over \$400,000. |
| Over \$600,000 | \$161,379, plus 37% of the excess over \$600,000. |

“(B) HEADS OF HOUSEHOLDS.—The following table shall be applied in lieu of the table contained in subsection (b):

| “If taxable income is: | The tax is: |
|---|---|
| Not over \$13,600 | 10% of taxable income. |
| Over \$13,600 but not over \$51,800 | \$1,360, plus 12% of the excess over \$13,600. |
| Over \$51,800 but not over \$82,500 | \$5,944, plus 22% of the excess over \$51,800. |
| Over \$82,500 but not over \$157,500 | \$12,698, plus 24% of the excess over \$82,500. |
| Over \$157,500 but not over \$200,000 | \$30,698, plus 32% of the excess over \$157,500. |
| Over \$200,000 but not over \$500,000 | \$44,298, plus 35% of the excess over \$200,000. |
| Over \$500,000 | \$149,298, plus 37% of the excess over \$500,000. |

“(C) UNMARRIED INDIVIDUALS OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS.—The following table shall be applied in lieu of the table contained in subsection (c):

| “If taxable income is: | The tax is: |
|---|--|
| Not over \$9,525 | 10% of taxable income. |
| Over \$9,525 but not over \$38,700 | \$952.50, plus 12% of the excess over \$9,525. |
| Over \$38,700 but not over \$82,500 | \$4,453.50, plus 22% of the excess over \$38,700. |
| Over \$82,500 but not over \$157,500 | \$14,089.50, plus 24% of the excess over \$82,500. |
| Over \$157,500 but not over \$200,000 | \$32,089.50, plus 32% of the excess over \$157,500. |
| Over \$200,000 but not over \$500,000 | \$45,689.50, plus 35% of the excess over \$200,000. |
| Over \$500,000 | \$150,689.50, plus 37% of the excess over \$500,000. |

“(D) MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—The following table shall be applied in lieu of the table contained in subsection (d):

| “If taxable income is: | The tax is: |
|---|---|
| Not over \$9,525 | 10% of taxable income. |
| Over \$9,525 but not over \$38,700 | \$952.50, plus 12% of the excess over \$9,525. |
| Over \$38,700 but not over \$82,500 | \$4,453.50, plus 22% of the excess over \$38,700. |
| Over \$82,500 but not over \$157,500 | \$14,089.50, plus 24% of the excess over \$82,500. |
| Over \$157,500 but not over \$200,000 | \$32,089.50, plus 32% of the excess over \$157,500. |
| Over \$200,000 but not over \$300,000 | \$45,689.50, plus 35% of the excess over \$200,000. |

| “If taxable income is: | The tax is: |
|------------------------|---|
| Over \$300,000 | \$80,689.50, plus 37% of the excess over \$300,000. |

“(E) ESTATES AND TRUSTS.—The following table shall be applied in lieu of the table contained in subsection (e):

| “If taxable income is: | The tax is: |
|--|---|
| Not over \$2,550 | 10% of taxable income. |
| Over \$2,550 but not over \$9,150 | \$255, plus 24% of the excess over \$2,550. |
| Over \$9,150 but not over \$12,500 | \$1,839, plus 35% of the excess over \$9,150. |
| Over \$12,500 | \$3,011.50, plus 37% of the excess over \$12,500. |

“(F) REFERENCES TO RATE TABLES.—Any reference in this title to a rate of tax under subsection (c) shall be treated as a reference to the corresponding rate bracket under subparagraph (C) of this paragraph, except that the reference in section 3402(q)(1) to the third lowest rate of tax applicable under subsection (c) shall be treated as a reference to the fourth lowest rate of tax under subparagraph (C).

“(3) ADJUSTMENTS.—

“(A) NO ADJUSTMENT IN 2018.—The tables contained in paragraph (2) shall apply without adjustment for taxable years beginning after December 31, 2017, and before January 1, 2019.

“(B) SUBSEQUENT YEARS.—For taxable years beginning after December 31, 2018, the Secretary shall prescribe tables which shall apply in lieu of the tables contained in paragraph (2) in the same manner as under paragraphs (1) and (2) of subsection (f) (applied without regard to clauses (i) and (ii) of subsection (f)(2)(A)), except that in prescribing such tables—

“(i) subsection (f)(3) shall be applied by substituting ‘calendar year 2017’ for ‘calendar year 2016’ in subparagraph (A)(ii) thereof,

“(ii) subsection (f)(7)(B) shall apply to any unmarried individual other than a surviving spouse or head of household, and

“(iii) subsection (f)(8) shall not apply.

“(4) SPECIAL RULES FOR CERTAIN CHILDREN WITH UNEARNED INCOME.—

“(A) IN GENERAL.—In the case of a child to whom subsection (g) applies for the taxable year, the rules of subparagraphs (B) and (C) shall apply in lieu of the rule under subsection (g)(1).

“(B) MODIFICATIONS TO APPLICABLE RATE BRACKETS.—In determining the amount of tax imposed by this section for the taxable year on a child described in subparagraph (A), the income tax table otherwise applicable under this subsection to the child shall be applied with the following modifications:

“(i) 24-PERCENT BRACKET.—The maximum taxable income which is taxed at a rate below 24 percent shall not be more than the sum of—

“(I) the earned taxable income of such child,

plus

“(II) the minimum taxable income for the 24-percent bracket in the table under paragraph (2)(E) (as adjusted under paragraph (3)) for the taxable year.

“(ii) 35-PERCENT BRACKET.—The maximum taxable income which is taxed at a rate below 35 percent shall not be more than the sum of—

“(I) the earned taxable income of such child,

plus

“(II) the minimum taxable income for the 35-percent bracket in the table under paragraph (2)(E) (as adjusted under paragraph (3)) for the taxable year.

“(iii) 37-PERCENT BRACKET.—The maximum taxable income which is taxed at a rate below 37 percent shall not be more than the sum of—

“(I) the earned taxable income of such child,

plus

“(II) the minimum taxable income for the 37-percent bracket in the table under paragraph (2)(E) (as adjusted under paragraph (3)) for the taxable year.

“(C) COORDINATION WITH CAPITAL GAINS RATES.—For purposes of applying section 1(h) (after the modifications under paragraph (5)(A))—

“(i) the maximum zero rate amount shall not be more than the sum of—

“(I) the earned taxable income of such child,

plus

“(II) the amount in effect under paragraph (5)(B)(i)(IV) for the taxable year, and

“(ii) the maximum 15-percent rate amount shall not be more than the sum of—

“(I) the earned taxable income of such child,

plus

“(II) the amount in effect under paragraph (5)(B)(ii)(IV) for the taxable year.

“(D) EARNED TAXABLE INCOME.—For purposes of this paragraph, the term ‘earned taxable income’ means, with respect to any child for any taxable year, the taxable income of such child reduced (but not below zero) by the net unearned income (as defined in subsection (g)(4)) of such child.

“(5) APPLICATION OF CURRENT INCOME TAX BRACKETS TO CAPITAL GAINS BRACKETS.—

“(A) IN GENERAL.—Section 1(h)(1) shall be applied—

“(i) by substituting ‘below the maximum zero rate amount’ for ‘which would (without regard to this paragraph) be taxed at a rate below 25 percent’ in subparagraph (B)(i), and

“(ii) by substituting ‘below the maximum 15-percent rate amount’ for ‘which would (without regard

to this paragraph) be taxed at a rate below 39.6 percent in subparagraph (C)(ii)(I).

“(B) MAXIMUM AMOUNTS DEFINED.—For purposes of applying section 1(h) with the modifications described in subparagraph (A)—

“(i) MAXIMUM ZERO RATE AMOUNT.—The maximum zero rate amount shall be—

“(I) in the case of a joint return or surviving spouse, \$77,200,

“(II) in the case of an individual who is a head of household (as defined in section 2(b)), \$51,700,

“(III) in the case of any other individual (other than an estate or trust), an amount equal to ½ of the amount in effect for the taxable year under subclause (I), and

“(IV) in the case of an estate or trust, \$2,600.

“(ii) MAXIMUM 15-PERCENT RATE AMOUNT.—The maximum 15-percent rate amount shall be—

“(I) in the case of a joint return or surviving spouse, \$479,000 (½ such amount in the case of a married individual filing a separate return),

“(II) in the case of an individual who is the head of a household (as defined in section 2(b)), \$452,400,

“(III) in the case of any other individual (other than an estate or trust), \$425,800, and

“(IV) in the case of an estate or trust, \$12,700.

“(C) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 2018, each of the dollar amounts in clauses (i) and (ii) of subparagraph (B) shall be increased by an amount equal to—

“(i) such dollar amount, multiplied by

“(ii) the cost-of-living adjustment determined under subsection (f)(3) for the calendar year in which the taxable year begins, determined by substituting ‘calendar year 2017’ for ‘calendar year 2016’ in subparagraph (A)(ii) thereof.

If any increase under this subparagraph is not a multiple of \$50, such increase shall be rounded to the next lowest multiple of \$50.

“(6) SECTION 15 NOT TO APPLY.—Section 15 shall not apply to any change in a rate of tax by reason of this subsection.”

(b) DUE DILIGENCE TAX PREPARER REQUIREMENT WITH RESPECT TO HEAD OF HOUSEHOLD FILING STATUS.—Subsection (g) of section 6695 is amended to read as follows:

“(g) FAILURE TO BE DILIGENT IN DETERMINING ELIGIBILITY FOR CERTAIN TAX BENEFITS.—Any person who is a tax return preparer with respect to any return or claim for refund who fails to comply with due diligence requirements imposed by the Secretary by regulations with respect to determining—

“(1) eligibility to file as a head of household (as defined in section 2(b)) on the return, or

“(2) eligibility for, or the amount of, the credit allowable by section 24, 25A(a)(1), or 32,

shall pay a penalty of \$500 for each such failure.”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 11002. INFLATION ADJUSTMENTS BASED ON CHAINED CPI.

(a) IN GENERAL.—Subsection (f) of section 1 is amended by striking paragraph (3) and by inserting after paragraph (2) the following new paragraph:

“(3) COST-OF-LIVING ADJUSTMENT.—For purposes of this subsection—

“(A) IN GENERAL.—The cost-of-living adjustment for any calendar year is the percentage (if any) by which—

“(i) the C-CPI-U for the preceding calendar year, exceeds

“(ii) the CPI for calendar year 2016, multiplied by the amount determined under subparagraph (B).

“(B) AMOUNT DETERMINED.—The amount determined under this clause is the amount obtained by dividing—

“(i) the C-CPI-U for calendar year 2016, by

“(ii) the CPI for calendar year 2016.

“(C) SPECIAL RULE FOR ADJUSTMENTS WITH A BASE YEAR AFTER 2016.—For purposes of any provision of this title which provides for the substitution of a year after 2016 for ‘2016’ in subparagraph (A)(ii), subparagraph (A) shall be applied by substituting ‘the C-CPI-U for calendar year 2016’ for ‘the CPI for calendar year 2016’ and all that follows in clause (ii) thereof.”

(b) C-CPI-U.—Subsection (f) of section 1 is amended by striking paragraph (7), by redesignating paragraph (6) as paragraph (7), and by inserting after paragraph (5) the following new paragraph:

“(6) C-CPI-U.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘C-CPI-U’ means the Chained Consumer Price Index for All Urban Consumers (as published by the Bureau of Labor Statistics of the Department of Labor). The values of the Chained Consumer Price Index for All Urban Consumers taken into account for purposes of determining the cost-of-living adjustment for any calendar year under this subsection shall be the latest values so published as of the date on which such Bureau publishes the initial value of the Chained Consumer Price Index for All Urban Consumers for the month of August for the preceding calendar year.

“(B) DETERMINATION FOR CALENDAR YEAR.—The C-CPI-U for any calendar year is the average of the C-CPI-U as of the close of the 12-month period ending on August 31 of such calendar year.”

(c) APPLICATION TO PERMANENT TAX TABLES.—

(1) IN GENERAL.—Section 1(f)(2)(A) is amended to read as follows:

“(A) except as provided in paragraph (8), by increasing the minimum and maximum dollar amounts for each bracket for which a tax is imposed under such table by the cost-of-living adjustment for such calendar year, determined—

“(i) except as provided in clause (ii), by substituting ‘1992’ for ‘2016’ in paragraph (3)(A)(ii), and

“(ii) in the case of adjustments to the dollar amounts at which the 36 percent rate bracket begins

or at which the 39.6 percent rate bracket begins, by substituting '1993' for '2016' in paragraph (3)(A)(ii)."

(2) CONFORMING AMENDMENTS.—Section 1(i) is amended—

(A) by striking "for '1992' in subparagraph (B)" in paragraph (1)(C) and inserting "for '2016' in subparagraph (A)(ii)", and

(B) by striking "subsection (f)(3)(B) shall be applied by substituting '2012' for '1992'" in paragraph (3)(C) and inserting "subsection (f)(3)(A)(ii) shall be applied by substituting '2012' for '2016'".

(d) APPLICATION TO OTHER INTERNAL REVENUE CODE OF 1986 PROVISIONS.—

(1) The following sections are each amended by striking "for 'calendar year 1992' in subparagraph (B)" and inserting "for 'calendar year 2016' in subparagraph (A)(ii)":

- (A) Section 23(h)(2).
- (B) Paragraphs (1)(A)(ii) and (2)(A)(ii) of section 25A(h).
- (C) Section 25B(b)(3)(B).
- (D) Subsection (b)(2)(B)(ii)(II), and clauses (i) and (ii) of subsection (j)(1)(B), of section 32.
- (E) Section 36B(f)(2)(B)(ii)(II).
- (F) Section 41(e)(5)(C)(i).
- (G) Subsections (e)(3)(D)(ii) and (h)(3)(H)(i)(II) of section 42.
- (H) Section 45R(d)(3)(B)(ii).
- (I) Section 55(d)(4)(A)(ii).
- (J) Section 62(d)(3)(B).
- (K) Section 63(c)(4)(B).
- (L) Section 125(i)(2)(B).
- (M) Section 135(b)(2)(B)(ii).
- (N) Section 137(f)(2).
- (O) Section 146(d)(2)(B).
- (P) Section 147(c)(2)(H)(ii).
- (Q) Section 151(d)(4)(B).
- (R) Section 179(b)(6)(A)(ii).
- (S) Subsections (b)(5)(C)(i)(II) and (g)(8)(B) of section 219.
- (T) Section 220(g)(2).
- (U) Section 221(f)(1)(B).
- (V) Section 223(g)(1)(B).
- (W) Section 408A(c)(3)(D)(ii).
- (X) Section 430(c)(7)(D)(vii)(II).
- (Y) Section 512(d)(2)(B).
- (Z) Section 513(h)(2)(C)(ii).
- (AA) Section 831(b)(2)(D)(ii).
- (BB) Section 877A(a)(3)(B)(i)(II).
- (CC) Section 2010(c)(3)(B)(ii).
- (DD) Section 2032A(a)(3)(B).
- (EE) Section 2503(b)(2)(B).
- (FF) Section 4261(e)(4)(A)(ii).
- (GG) Section 5000A(c)(3)(D)(ii).
- (HH) Section 6323(i)(4)(B).
- (II) Section 6334(g)(1)(B).
- (JJ) Section 6601(j)(3)(B).
- (KK) Section 6651(i)(1).
- (LL) Section 6652(c)(7)(A).
- (MM) Section 6695(h)(1).

(NN) Section 6698(e)(1).
(OO) Section 6699(e)(1).
(PP) Section 6721(f)(1).
(QQ) Section 6722(f)(1).
(RR) Section 7345(f)(2).
(SS) Section 7430(c)(1).
(TT) Section 9831(d)(2)(D)(ii)(II).

(2) Sections 41(e)(5)(C)(ii) and 68(b)(2)(B) are each amended—

(A) by striking “1(f)(3)(B)” and inserting “1(f)(3)(A)(ii)”,
and

(B) by striking “1992” and inserting “2016”.

(3) Section 42(h)(6)(G) is amended—

(A) by striking “for ‘calendar year 1987’” in clause (i)(II) and inserting “for ‘calendar year 2016’ in subparagraph (A)(ii) thereof”, and

(B) by striking “if the CPI for any calendar year” and all that follows in clause (ii) and inserting “if the C-CPI-U for any calendar year (as defined in section 1(f)(6)) exceeds the C-CPI-U for the preceding calendar year by more than 5 percent, the C-CPI-U for the base calendar year shall be increased such that such excess shall never be taken into account under clause (i). In the case of a base calendar year before 2017, the C-CPI-U for such year shall be determined by multiplying the CPI for such year by the amount determined under section 1(f)(3)(B).”.

(4) Section 59(j)(2)(B) is amended by striking “for ‘1992’ in subparagraph (B)” and inserting “for ‘2016’ in subparagraph (A)(ii)”.

(5) Section 132(f)(6)(A)(ii) is amended by striking “for ‘calendar year 1992’” and inserting “for ‘calendar year 2016’ in subparagraph (A)(ii) thereof”.

(6) Section 162(o)(3) is amended by striking “adjusted for changes in the Consumer Price Index (as defined in section 1(f)(5)) since 1991” and inserting “adjusted by increasing any such amount under the 1991 agreement by an amount equal to—

“(A) such amount, multiplied by

“(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting ‘calendar year 1990’ for ‘calendar year 2016’ in subparagraph (A)(ii) thereof”.

(7) So much of clause (ii) of section 213(d)(10)(B) as precedes the last sentence is amended to read as follows:

“(ii) MEDICAL CARE COST ADJUSTMENT.—For purposes of clause (i), the medical care cost adjustment for any calendar year is the percentage (if any) by which—

“(I) the medical care component of the C-CPI-U (as defined in section 1(f)(6)) for August of the preceding calendar year, exceeds

“(II) such component of the CPI (as defined in section 1(f)(4)) for August of 1996, multiplied by the amount determined under section 1(f)(3)(B).”.

(8) Subparagraph (B) of section 280F(d)(7) is amended to read as follows:

“(B) AUTOMOBILE PRICE INFLATION ADJUSTMENT.—For purposes of this paragraph—

“(i) IN GENERAL.—The automobile price inflation adjustment for any calendar year is the percentage (if any) by which—

“(I) the C-CPI-U automobile component for October of the preceding calendar year, exceeds

“(II) the automobile component of the CPI (as defined in section 1(f)(4)) for October of 1987, multiplied by the amount determined under 1(f)(3)(B).

“(ii) C-CPI-U AUTOMOBILE COMPONENT.—The term ‘C-CPI-U automobile component’ means the automobile component of the Chained Consumer Price Index for All Urban Consumers (as described in section 1(f)(6)).”

(9) Section 911(b)(2)(D)(ii)(II) is amended by striking “for ‘1992’ in subparagraph (B)” and inserting “for ‘2016’ in subparagraph (A)(ii)”.

(10) Paragraph (2) of section 1274A(d) is amended to read as follows:

“(2) ADJUSTMENT FOR INFLATION.—In the case of any debt instrument arising out of a sale or exchange during any calendar year after 1989, each dollar amount contained in the preceding provisions of this section shall be increased by an amount equal to—

“(A) such amount, multiplied by

“(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting ‘calendar year 1988’ for ‘calendar year 2016’ in subparagraph (A)(ii) thereof.

Any increase under the preceding sentence shall be rounded to the nearest multiple of \$100 (or, if such increase is a multiple of \$50, such increase shall be increased to the nearest multiple of \$100).”

(11) Section 4161(b)(2)(C)(i)(II) is amended by striking “for ‘1992’ in subparagraph (B)” and inserting “for ‘2016’ in subparagraph (A)(ii)”.

(12) Section 4980I(b)(3)(C)(v)(II) is amended by striking “for ‘1992’ in subparagraph (B)” and inserting “for ‘2016’ in subparagraph (A)(ii)”.

(13) Section 6039F(d) is amended by striking “subparagraph (B) thereof shall be applied by substituting ‘1995’ for ‘1992’” and inserting “subparagraph (A)(ii) thereof shall be applied by substituting ‘1995’ for ‘2016’”.

(14) Section 7872(g)(5) is amended to read as follows:

“(5) ADJUSTMENT OF LIMIT FOR INFLATION.—In the case of any loan made during any calendar year after 1986, the dollar amount in paragraph (2) shall be increased by an amount equal to—

“(A) such amount, multiplied by

“(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting ‘calendar year 1985’ for ‘calendar year 2016’ in subparagraph (A)(ii) thereof.

Any increase under the preceding sentence shall be rounded to the nearest multiple of \$100 (or, if such increase is a multiple

of \$50, such increase shall be increased to the nearest multiple of \$100.”

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

PART II—DEDUCTION FOR QUALIFIED BUSINESS INCOME OF PASS-THRU ENTITIES

SEC. 11011. DEDUCTION FOR QUALIFIED BUSINESS INCOME.

(a) IN GENERAL.—Part VI of subchapter B of chapter 1 is amended by adding at the end the following new section:

“SEC. 199A. QUALIFIED BUSINESS INCOME.

“(a) IN GENERAL.—In the case of a taxpayer other than a corporation, there shall be allowed as a deduction for any taxable year an amount equal to the sum of—

“(1) the lesser of—

“(A) the combined qualified business income amount of the taxpayer, or

“(B) an amount equal to 20 percent of the excess (if any) of—

“(i) the taxable income of the taxpayer for the taxable year, over

“(ii) the sum of any net capital gain (as defined in section 1(h)), plus the aggregate amount of the qualified cooperative dividends, of the taxpayer for the taxable year, plus

“(2) the lesser of—

“(A) 20 percent of the aggregate amount of the qualified cooperative dividends of the taxpayer for the taxable year, or

“(B) taxable income (reduced by the net capital gain (as so defined)) of the taxpayer for the taxable year.

The amount determined under the preceding sentence shall not exceed the taxable income (reduced by the net capital gain (as so defined)) of the taxpayer for the taxable year.

“(b) COMBINED QUALIFIED BUSINESS INCOME AMOUNT.—For purposes of this section—

“(1) IN GENERAL.—The term ‘combined qualified business income amount’ means, with respect to any taxable year, an amount equal to—

“(A) the sum of the amounts determined under paragraph (2) for each qualified trade or business carried on by the taxpayer, plus

“(B) 20 percent of the aggregate amount of the qualified REIT dividends and qualified publicly traded partnership income of the taxpayer for the taxable year.

“(2) DETERMINATION OF DEDUCTIBLE AMOUNT FOR EACH TRADE OR BUSINESS.—The amount determined under this paragraph with respect to any qualified trade or business is the lesser of—

“(A) 20 percent of the taxpayer’s qualified business income with respect to the qualified trade or business, or

“(B) the greater of—

“(i) 50 percent of the W-2 wages with respect to the qualified trade or business, or

“(ii) the sum of 25 percent of the W-2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property.

“(3) MODIFICATIONS TO LIMIT BASED ON TAXABLE INCOME.—

“(A) EXCEPTION FROM LIMIT.—In the case of any taxpayer whose taxable income for the taxable year does not exceed the threshold amount, paragraph (2) shall be applied without regard to subparagraph (B).

“(B) PHASE-IN OF LIMIT FOR CERTAIN TAXPAYERS.—

“(i) IN GENERAL.—If—

“(I) the taxable income of a taxpayer for any taxable year exceeds the threshold amount, but does not exceed the sum of the threshold amount plus \$50,000 (\$100,000 in the case of a joint return), and

“(II) the amount determined under paragraph (2)(B) (determined without regard to this subparagraph) with respect to any qualified trade or business carried on by the taxpayer is less than the amount determined under paragraph (2)(A) with respect to such trade or business,

then paragraph (2) shall be applied with respect to such trade or business without regard to subparagraph (B) thereof and by reducing the amount determined under subparagraph (A) thereof by the amount determined under clause (ii).

“(ii) AMOUNT OF REDUCTION.—The amount determined under this subparagraph is the amount which bears the same ratio to the excess amount as—

“(I) the amount by which the taxpayer's taxable income for the taxable year exceeds the threshold amount, bears to

“(II) \$50,000 (\$100,000 in the case of a joint return).

“(iii) EXCESS AMOUNT.—For purposes of clause (ii), the excess amount is the excess of—

“(I) the amount determined under paragraph (2)(A) (determined without regard to this paragraph), over

“(II) the amount determined under paragraph (2)(B) (determined without regard to this paragraph).

“(4) WAGES, ETC.—

“(A) IN GENERAL.—The term ‘W-2 wages’ means, with respect to any person for any taxable year of such person, the amounts described in paragraphs (3) and (8) of section 6051(a) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year.

“(B) LIMITATION TO WAGES ATTRIBUTABLE TO QUALIFIED BUSINESS INCOME.—Such term shall not include any amount which is not properly allocable to qualified business income for purposes of subsection (c)(1).

“(C) RETURN REQUIREMENT.—Such term shall not include any amount which is not properly included in a return filed with the Social Security Administration on

or before the 60th day after the due date (including extensions) for such return.

“(5) ACQUISITIONS, DISPOSITIONS, AND SHORT TAXABLE YEARS.—The Secretary shall provide for the application of this subsection in cases of a short taxable year or where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of a separate unit of a trade or business during the taxable year.

“(6) QUALIFIED PROPERTY.—For purposes of this section:

“(A) IN GENERAL.—The term ‘qualified property’ means, with respect to any qualified trade or business for a taxable year, tangible property of a character subject to the allowance for depreciation under section 167—

“(i) which is held by, and available for use in, the qualified trade or business at the close of the taxable year,

“(ii) which is used at any point during the taxable year in the production of qualified business income, and

“(iii) the depreciable period for which has not ended before the close of the taxable year.

“(B) DEPRECIABLE PERIOD.—The term ‘depreciable period’ means, with respect to qualified property of a taxpayer, the period beginning on the date the property was first placed in service by the taxpayer and ending on the later of—

“(i) the date that is 10 years after such date,

or

“(ii) the last day of the last full year in the applicable recovery period that would apply to the property under section 168 (determined without regard to subsection (g) thereof).

“(c) QUALIFIED BUSINESS INCOME.—For purposes of this section—

“(1) IN GENERAL.—The term ‘qualified business income’ means, for any taxable year, the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. Such term shall not include any qualified REIT dividends, qualified cooperative dividends, or qualified publicly traded partnership income.

“(2) CARRYOVER OF LOSSES.—If the net amount of qualified income, gain, deduction, and loss with respect to qualified trades or businesses of the taxpayer for any taxable year is less than zero, such amount shall be treated as a loss from a qualified trade or business in the succeeding taxable year.

“(3) QUALIFIED ITEMS OF INCOME, GAIN, DEDUCTION, AND LOSS.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘qualified items of income, gain, deduction, and loss’ means items of income, gain, deduction, and loss to the extent such items are—

“(i) effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting ‘qualified trade or business’ (within the meaning of section 199A) for ‘nonresident alien individual or a foreign corporation’ or for ‘a foreign corporation’ each place it appears), and

“(ii) included or allowed in determining taxable income for the taxable year.

“(B) EXCEPTIONS.—The following investment items shall not be taken into account as a qualified item of income, gain, deduction, or loss:

“(i) Any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss.

“(ii) Any dividend, income equivalent to a dividend, or payment in lieu of dividends described in section 954(c)(1)(G).

“(iii) Any interest income other than interest income which is properly allocable to a trade or business.

“(iv) Any item of gain or loss described in subparagraph (C) or (D) of section 954(c)(1) (applied by substituting ‘qualified trade or business’ for ‘controlled foreign corporation’).

“(v) Any item of income, gain, deduction, or loss taken into account under section 954(c)(1)(F) (determined without regard to clause (ii) thereof and other than items attributable to notional principal contracts entered into in transactions qualifying under section 1221(a)(7)).

“(vi) Any amount received from an annuity which is not received in connection with the trade or business.

“(vii) Any item of deduction or loss properly allocable to an amount described in any of the preceding clauses.

“(4) TREATMENT OF REASONABLE COMPENSATION AND GUARANTEED PAYMENTS.—Qualified business income shall not include—

“(A) reasonable compensation paid to the taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business,

“(B) any guaranteed payment described in section 707(c) paid to a partner for services rendered with respect to the trade or business, and

“(C) to the extent provided in regulations, any payment described in section 707(a) to a partner for services rendered with respect to the trade or business.

“(d) QUALIFIED TRADE OR BUSINESS.—For purposes of this section—

“(1) IN GENERAL.—The term ‘qualified trade or business’ means any trade or business other than—

“(A) a specified service trade or business, or

“(B) the trade or business of performing services as an employee.

“(2) SPECIFIED SERVICE TRADE OR BUSINESS.—The term ‘specified service trade or business’ means any trade or business—

“(A) which is described in section 1202(e)(3)(A) (applied without regard to the words ‘engineering, architecture,’ or which would be so described if the term ‘employees or owners’ were substituted for ‘employees’ therein, or

“(B) which involves the performance of services that consist of investing and investment management, trading,

or dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2)).

“(3) EXCEPTION FOR SPECIFIED SERVICE BUSINESSES BASED ON TAXPAYER’S INCOME.—

“(A) IN GENERAL.—If, for any taxable year, the taxable income of any taxpayer is less than the sum of the threshold amount plus \$50,000 (\$100,000 in the case of a joint return), then—

“(i) any specified service trade or business of the taxpayer shall not fail to be treated as a qualified trade or business due to paragraph (1)(A), but

“(ii) only the applicable percentage of qualified items of income, gain, deduction, or loss, and the W-2 wages and the unadjusted basis immediately after acquisition of qualified property, of the taxpayer allocable to such specified service trade or business shall be taken into account in computing the qualified business income, W-2 wages, and the unadjusted basis immediately after acquisition of qualified property of the taxpayer for the taxable year for purposes of applying this section.

“(B) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A), the term ‘applicable percentage’ means, with respect to any taxable year, 100 percent reduced (not below zero) by the percentage equal to the ratio of—

“(i) the taxable income of the taxpayer for the taxable year in excess of the threshold amount, bears to

“(ii) \$50,000 (\$100,000 in the case of a joint return).

“(e) OTHER DEFINITIONS.—For purposes of this section—

“(1) TAXABLE INCOME.—Taxable income shall be computed without regard to the deduction allowable under this section.

“(2) THRESHOLD AMOUNT.—

“(A) IN GENERAL.—The term ‘threshold amount’ means \$157,500 (200 percent of such amount in the case of a joint return).

“(B) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 2018, the dollar amount in subparagraph (A) shall be increased by an amount equal to—

“(i) such dollar amount, multiplied by

“(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting ‘calendar year 2017’ for ‘calendar year 2016’ in subparagraph (A)(ii) thereof.

The amount of any increase under the preceding sentence shall be rounded as provided in section 1(f)(7).

“(3) QUALIFIED REIT DIVIDEND.—The term ‘qualified REIT dividend’ means any dividend from a real estate investment trust received during the taxable year which—

“(A) is not a capital gain dividend, as defined in section 857(b)(3), and

“(B) is not qualified dividend income, as defined in section 1(h)(11).

“(4) QUALIFIED COOPERATIVE DIVIDEND.—The term ‘qualified cooperative dividend’ means any patronage dividend (as defined in section 1388(a)), any per-unit retain allocation (as defined in section 1388(f)), and any qualified written notice of allocation (as defined in section 1388(c)), or any similar amount received from an organization described in subparagraph (B)(ii), which—

“(A) is includible in gross income, and

“(B) is received from—

“(i) an organization or corporation described in section 501(c)(12) or 1381(a), or

“(ii) an organization which is governed under this title by the rules applicable to cooperatives under this title before the enactment of subchapter T.

“(5) QUALIFIED PUBLICLY TRADED PARTNERSHIP INCOME.—The term ‘qualified publicly traded partnership income’ means, with respect to any qualified trade or business of a taxpayer, the sum of—

“(A) the net amount of such taxpayer’s allocable share of each qualified item of income, gain, deduction, and loss (as defined in subsection (c)(3) and determined after the application of subsection (c)(4)) from a publicly traded partnership (as defined in section 7704(a)) which is not treated as a corporation under section 7704(c), plus

“(B) any gain recognized by such taxpayer upon disposition of its interest in such partnership to the extent such gain is treated as an amount realized from the sale or exchange of property other than a capital asset under section 751(a).

“(f) SPECIAL RULES.—

“(1) APPLICATION TO PARTNERSHIPS AND S CORPORATIONS.—

“(A) IN GENERAL.—In the case of a partnership or S corporation—

“(i) this section shall be applied at the partner or shareholder level,

“(ii) each partner or shareholder shall take into account such person’s allocable share of each qualified item of income, gain, deduction, and loss, and

“(iii) each partner or shareholder shall be treated for purposes of subsection (b) as having W-2 wages and unadjusted basis immediately after acquisition of qualified property for the taxable year in an amount equal to such person’s allocable share of the W-2 wages and the unadjusted basis immediately after acquisition of qualified property of the partnership or S corporation for the taxable year (as determined under regulations prescribed by the Secretary).

For purposes of clause (iii), a partner’s or shareholder’s allocable share of W-2 wages shall be determined in the same manner as the partner’s or shareholder’s allocable share of wage expenses. For purposes of such clause, partner’s or shareholder’s allocable share of the unadjusted basis immediately after acquisition of qualified property shall be determined in the same manner as the partner’s or shareholder’s allocable share of depreciation. For purposes of this subparagraph, in the case of an S corporation,

an allocable share shall be the shareholder's pro rata share of an item.

“(B) APPLICATION TO TRUSTS AND ESTATES.—Rules similar to the rules under section 199(d)(1)(B)(i) (as in effect on December 1, 2017) for the apportionment of W-2 wages shall apply to the apportionment of W-2 wages and the apportionment of unadjusted basis immediately after acquisition of qualified property under this section.

“(C) TREATMENT OF TRADES OR BUSINESS IN PUERTO RICO.—

“(i) IN GENERAL.—In the case of any taxpayer with qualified business income from sources within the commonwealth of Puerto Rico, if all such income is taxable under section 1 for such taxable year, then for purposes of determining the qualified business income of such taxpayer for such taxable year, the term ‘United States’ shall include the Commonwealth of Puerto Rico.

“(ii) SPECIAL RULE FOR APPLYING LIMIT.—In the case of any taxpayer described in clause (i), the determination of W-2 wages of such taxpayer with respect to any qualified trade or business conducted in Puerto Rico shall be made without regard to any exclusion under section 3401(a)(8) for remuneration paid for services in Puerto Rico.

“(2) COORDINATION WITH MINIMUM TAX.—For purposes of determining alternative minimum taxable income under section 55, qualified business income shall be determined without regard to any adjustments under sections 56 through 59.

“(3) DEDUCTION LIMITED TO INCOME TAXES.—The deduction under subsection (a) shall only be allowed for purposes of this chapter.

“(4) REGULATIONS.—The Secretary shall prescribe such regulations as are necessary to carry out the purposes of this section, including regulations—

“(A) for requiring or restricting the allocation of items and wages under this section and such reporting requirements as the Secretary determines appropriate, and

“(B) for the application of this section in the case of tiered entities.

“(g) DEDUCTION ALLOWED TO SPECIFIED AGRICULTURAL OR HORTICULTURAL COOPERATIVES.—

“(1) IN GENERAL.—In the case of any taxable year of a specified agricultural or horticultural cooperative beginning after December 31, 2017, there shall be allowed a deduction in an amount equal to the lesser of—

“(A) 20 percent of the excess (if any) of—

“(i) the gross income of a specified agricultural or horticultural cooperative, over

“(ii) the qualified cooperative dividends (as defined in subsection (e)(4)) paid during the taxable year for the taxable year, or

“(B) the greater of—

“(i) 50 percent of the W-2 wages of the cooperative with respect to its trade or business, or

“(ii) the sum of 25 percent of the W-2 wages of the cooperative with respect to its trade or business,

plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property of the cooperative.

“(2) LIMITATION.—The amount determined under paragraph (1) shall not exceed the taxable income of the specified agricultural or horticultural for the taxable year.

“(3) SPECIFIED AGRICULTURAL OR HORTICULTURAL COOPERATIVE.—For purposes of this subsection, the term ‘specified agricultural or horticultural cooperative’ means an organization to which part I of subchapter T applies which is engaged in—

“(A) the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product,

“(B) the marketing of agricultural or horticultural products which its patrons have so manufactured, produced, grown, or extracted, or

“(C) the provision of supplies, equipment, or services to farmers or to organizations described in subparagraph (A) or (B).

“(h) ANTI-ABUSE RULES.—The Secretary shall—

“(1) apply rules similar to the rules under section 179(d)(2) in order to prevent the manipulation of the depreciable period of qualified property using transactions between related parties, and

“(2) prescribe rules for determining the unadjusted basis immediately after acquisition of qualified property acquired in like-kind exchanges or involuntary conversions.

“(i) TERMINATION.—This section shall not apply to taxable years beginning after December 31, 2025.”.

(b) TREATMENT OF DEDUCTION IN COMPUTING ADJUSTED GROSS AND TAXABLE INCOME.—

(1) DEDUCTION NOT ALLOWED IN COMPUTING ADJUSTED GROSS INCOME.—Section 62(a) is amended by adding at the end the following new sentence: “The deduction allowed by section 199A shall not be treated as a deduction described in any of the preceding paragraphs of this subsection.”.

(2) DEDUCTION ALLOWED TO NONITEMIZERS.—Section 63(b) is amended by striking “and” at the end of paragraph (1), by striking the period at the end of paragraph (2) and inserting “, and”, and by adding at the end the following new paragraph:

“(3) the deduction provided in section 199A.”.

(3) DEDUCTION ALLOWED TO ITEMIZERS WITHOUT LIMITS ON ITEMIZED DEDUCTIONS.—Section 63(d) is amended by striking “and” at the end of paragraph (1), by striking the period at the end of paragraph (2) and inserting “, and”, and by adding at the end the following new paragraph:

“(3) the deduction provided in section 199A.”.

(4) CONFORMING AMENDMENT.—Section 3402(m)(1) is amended by inserting “and the estimated deduction allowed under section 199A” after “chapter 1”.

(c) ACCURACY-RELATED PENALTY ON DETERMINATION OF APPLICABLE PERCENTAGE.—Section 6662(d)(1) is amended by inserting at the end the following new subparagraph:

“(C) SPECIAL RULE FOR TAXPAYERS CLAIMING SECTION 199A DEDUCTION.—In the case of any taxpayer who claims the deduction allowed under section 199A for the taxable

year, subparagraph (A) shall be applied by substituting '5 percent' for '10 percent'."

(d) CONFORMING AMENDMENTS.—

(1) Section 172(d) is amended by adding at the end the following new paragraph:

"(8) QUALIFIED BUSINESS INCOME DEDUCTION.—The deduction under section 199A shall not be allowed."

(2) Section 246(b)(1) is amended by inserting "199A," before "243(a)(1)".

(3) Section 613(a) is amended by inserting "and without the deduction under section 199A" after "and without the deduction under section 199".

(4) Section 613A(d)(1) is amended by redesignating subparagraphs (C), (D), and (E) as subparagraphs (D), (E), and (F), respectively, and by inserting after subparagraph (B), the following new subparagraph:

"(C) any deduction allowable under section 199A."

(5) Section 170(b)(2)(D) is amended by striking "and" in clause (iv), by striking the period at the end of clause (v), and by adding at the end the following new clause:

"(vi) section 199A(g)."

(6) The table of sections for part VI of subchapter B of chapter 1 is amended by inserting at the end the following new item:

"Sec. 199A. Qualified business income."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 11012. LIMITATION ON LOSSES FOR TAXPAYERS OTHER THAN CORPORATIONS.

(a) IN GENERAL.—Section 461 is amended by adding at the end the following new subsection:

"(1) LIMITATION ON EXCESS BUSINESS LOSSES OF NONCORPORATE TAXPAYERS.—

"(1) LIMITATION.—In the case of taxable year of a taxpayer other than a corporation beginning after December 31, 2017, and before January 1, 2026—

"(A) subsection (j) (relating to limitation on excess farm losses of certain taxpayers) shall not apply, and

"(B) any excess business loss of the taxpayer for the taxable year shall not be allowed.

"(2) DISALLOWED LOSS CARRYOVER.—Any loss which is disallowed under paragraph (1) shall be treated as a net operating loss carryover to the following taxable year under section 172.

"(3) EXCESS BUSINESS LOSS.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'excess business loss' means the excess (if any) of—

"(i) the aggregate deductions of the taxpayer for the taxable year which are attributable to trades or businesses of such taxpayer (determined without regard to whether or not such deductions are disallowed for such taxable year under paragraph (1)), over

"(ii) the sum of—

“(I) the aggregate gross income or gain of such taxpayer for the taxable year which is attributable to such trades or businesses, plus

“(II) \$250,000 (200 percent of such amount in the case of a joint return).

“(B) ADJUSTMENT FOR INFLATION.—In the case of any taxable year beginning after December 31, 2018, the \$250,000 amount in subparagraph (A)(ii)(II) shall be increased by an amount equal to—

“(i) such dollar amount, multiplied by

“(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting ‘2017’ for ‘2016’ in subparagraph (A)(ii) thereof.

If any amount as increased under the preceding sentence is not a multiple of \$1,000, such amount shall be rounded to the nearest multiple of \$1,000.

“(4) APPLICATION OF SUBSECTION IN CASE OF PARTNERSHIPS AND S CORPORATIONS.—In the case of a partnership or S corporation—

“(A) this subsection shall be applied at the partner or shareholder level, and

“(B) each partner’s or shareholder’s allocable share of the items of income, gain, deduction, or loss of the partnership or S corporation for any taxable year from trades or businesses attributable to the partnership or S corporation shall be taken into account by the partner or shareholder in applying this subsection to the taxable year of such partner or shareholder with or within which the taxable year of the partnership or S corporation ends.

For purposes of this paragraph, in the case of an S corporation, an allocable share shall be the shareholder’s pro rata share of an item.

“(5) ADDITIONAL REPORTING.—The Secretary shall prescribe such additional reporting requirements as the Secretary determines necessary to carry out the purposes of this subsection.

“(6) COORDINATION WITH SECTION 469.—This subsection shall be applied after the application of section 469.”

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

PART III—TAX BENEFITS FOR FAMILIES AND INDIVIDUALS

SEC. 11021. INCREASE IN STANDARD DEDUCTION.

(a) IN GENERAL.—Subsection (c) of section 63 is amended by adding at the end the following new paragraph:

“(7) SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026—

“(A) INCREASE IN STANDARD DEDUCTION.—Paragraph (2) shall be applied—

“(i) by substituting ‘\$18,000’ for ‘\$4,400’ in subparagraph (B), and

“(ii) by substituting ‘\$12,000’ for ‘\$3,000’ in subparagraph (C).

“(B) ADJUSTMENT FOR INFLATION.—

“(i) IN GENERAL.—Paragraph (4) shall not apply to the dollar amounts contained in paragraphs (2)(B) and (2)(C).

“(ii) ADJUSTMENT OF INCREASED AMOUNTS.—In the case of a taxable year beginning after 2018, the \$18,000 and \$12,000 amounts in subparagraph (A) shall each be increased by an amount equal to—

“(I) such dollar amount, multiplied by

“(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting ‘2017’ for ‘2016’ in subparagraph (A)(ii) thereof.

If any increase under this clause is not a multiple of \$50, such increase shall be rounded to the next lowest multiple of \$50.”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 11022. INCREASE IN AND MODIFICATION OF CHILD TAX CREDIT.

(a) IN GENERAL.—Section 24 is amended by adding at the end the following new subsection:

“(h) SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025.—

“(1) IN GENERAL.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026, this section shall be applied as provided in paragraphs (2) through (7).

“(2) CREDIT AMOUNT.—Subsection (a) shall be applied by substituting ‘\$2,000’ for ‘\$1,000’.

“(3) LIMITATION.—In lieu of the amount determined under subsection (b)(2), the threshold amount shall be \$400,000 in the case of a joint return (\$200,000 in any other case).

“(4) PARTIAL CREDIT ALLOWED FOR CERTAIN OTHER DEPENDENTS.—

“(A) IN GENERAL.—The credit determined under subsection (a) (after the application of paragraph (2)) shall be increased by \$500 for each dependent of the taxpayer (as defined in section 152) other than a qualifying child described in subsection (c).

“(B) EXCEPTION FOR CERTAIN NONCITIZENS.—Subparagraph (A) shall not apply with respect to any individual who would not be a dependent if subparagraph (A) of section 152(b)(3) were applied without regard to all that follows ‘resident of the United States’.

“(C) CERTAIN QUALIFYING CHILDREN.—In the case of any qualifying child with respect to whom a credit is not allowed under this section by reason of paragraph (7), such child shall be treated as a dependent to whom subparagraph (A) applies.

“(5) MAXIMUM AMOUNT OF REFUNDABLE CREDIT.—

“(A) IN GENERAL.—The amount determined under subsection (d)(1)(A) with respect to any qualifying child shall not exceed \$1,400, and such subsection shall be applied without regard to paragraph (4) of this subsection.

“(B) ADJUSTMENT FOR INFLATION.—In the case of a taxable year beginning after 2018, the \$1,400 amount in

subparagraph (A) shall be increased by an amount equal to—

“(i) such dollar amount, multiplied by

“(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting ‘2017’ for ‘2016’ in subparagraph (A)(ii) thereof.

If any increase under this clause is not a multiple of \$100, such increase shall be rounded to the next lowest multiple of \$100.

“(6) EARNED INCOME THRESHOLD FOR REFUNDABLE CREDIT.—Subsection (d)(1)(B)(i) shall be applied by substituting ‘\$2,500’ for ‘\$3,000’.

“(7) SOCIAL SECURITY NUMBER REQUIRED.—No credit shall be allowed under this section to a taxpayer with respect to any qualifying child unless the taxpayer includes the social security number of such child on the return of tax for the taxable year. For purposes of the preceding sentence, the term ‘social security number’ means a social security number issued to an individual by the Social Security Administration, but only if the social security number is issued—

“(A) to a citizen of the United States or pursuant to subclause (I) (or that portion of subclause (III) that relates to subclause (I)) of section 205(c)(2)(B)(i) of the Social Security Act, and

“(B) before the due date for such return.”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 11023. INCREASED LIMITATION FOR CERTAIN CHARITABLE CONTRIBUTIONS.

(a) IN GENERAL.—Section 170(b)(1) is amended by redesignating subparagraph (G) as subparagraph (H) and by inserting after subparagraph (F) the following new subparagraph:

“(G) INCREASED LIMITATION FOR CASH CONTRIBUTIONS.—

“(i) IN GENERAL.—In the case of any contribution of cash to an organization described in subparagraph (A), the total amount of such contributions which may be taken into account under subsection (a) for any taxable year beginning after December 31, 2017, and before January 1, 2026, shall not exceed 60 percent of the taxpayer’s contribution base for such year.

“(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the applicable limitation under clause (i) for any taxable year described in such clause, such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution to which clause (i) applies in each of the 5 succeeding years in order of time.

“(iii) COORDINATION WITH SUBPARAGRAPHS (A) AND (B).—

“(I) IN GENERAL.—Contributions taken into account under this subparagraph shall not be taken into account under subparagraph (A).

“(II) LIMITATION REDUCTION.—For each taxable year described in clause (i), and each taxable year to which any contribution under this subparagraph is carried over under clause (ii), subparagraph (A) shall be applied by reducing (but not below zero) the contribution limitation allowed for the taxable year under such subparagraph by the aggregate contributions allowed under this subparagraph for such taxable year, and subparagraph (B) shall be applied by treating any reference to subparagraph (A) as a reference to both subparagraph (A) and this subparagraph.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions in taxable years beginning after December 31, 2017.

SEC. 11024. INCREASED CONTRIBUTIONS TO ABLE ACCOUNTS.

(a) INCREASE IN LIMITATION FOR CONTRIBUTIONS FROM COMPENSATION OF INDIVIDUALS WITH DISABILITIES.—

(1) IN GENERAL.—Section 529A(b)(2)(B) is amended to read as follows:

“(B) except in the case of contributions under subsection (c)(1)(C), if such contribution to an ABLE account would result in aggregate contributions from all contributors to the ABLE account for the taxable year exceeding the sum of—

“(i) the amount in effect under section 2503(b) for the calendar year in which the taxable year begins, plus

“(ii) in the case of any contribution by a designated beneficiary described in paragraph (7) before January 1, 2026, the lesser of—

“(I) compensation (as defined by section 219(f)(1)) includible in the designated beneficiary’s gross income for the taxable year, or

“(II) an amount equal to the poverty line for a one-person household, as determined for the calendar year preceding the calendar year in which the taxable year begins.”

(2) RESPONSIBILITY FOR CONTRIBUTION LIMITATION.—Paragraph (2) of section 529A(b) is amended by adding at the end the following: “A designated beneficiary (or a person acting on behalf of such beneficiary) shall maintain adequate records for purposes of ensuring, and shall be responsible for ensuring, that the requirements of subparagraph (B)(ii) are met.”

(3) ELIGIBLE DESIGNATED BENEFICIARY.—Section 529A(b) is amended by adding at the end the following:

“(7) SPECIAL RULES RELATED TO CONTRIBUTION LIMIT.—For purposes of paragraph (2)(B)(ii)—

“(A) DESIGNATED BENEFICIARY.—A designated beneficiary described in this paragraph is an employee (including an employee within the meaning of section 401(c)) with respect to whom—

“(i) no contribution is made for the taxable year to a defined contribution plan (within the meaning of section 414(i)) with respect to which the requirements of section 401(a) or 403(a) are met,

“(ii) no contribution is made for the taxable year to an annuity contract described in section 403(b), and

“(iii) no contribution is made for the taxable year to an eligible deferred compensation plan described in section 457(b).

“(B) POVERTY LINE.—The term ‘poverty line’ has the meaning given such term by section 673 of the Community Services Block Grant Act (42 U.S.C. 9902).”

(b) ALLOWANCE OF SAVER'S CREDIT FOR ABLE CONTRIBUTIONS BY ACCOUNT HOLDER.—Section 25B(d)(1) is amended by striking “and” at the end of subparagraph (B)(ii), by striking the period at the end of subparagraph (C) and inserting “, and”, and by inserting at the end the following:

“(D) the amount of contributions made before January 1, 2026, by such individual to the ABLE account (within the meaning of section 529A) of which such individual is the designated beneficiary.”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 11025. ROLLOVERS TO ABLE PROGRAMS FROM 529 PROGRAMS.

(a) IN GENERAL.—Clause (i) of section 529(c)(3)(C) is amended by striking “or” at the end of subclause (I), by striking the period at the end of subclause (II) and inserting “, or”, and by adding at the end the following:

“(III) before January 1, 2026, to an ABLE account (as defined in section 529A(e)(6)) of the designated beneficiary or a member of the family of the designated beneficiary.

Subclause (III) shall not apply to so much of a distribution which, when added to all other contributions made to the ABLE account for the taxable year, exceeds the limitation under section 529A(b)(2)(B)(i).”

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after the date of the enactment of this Act.

SEC. 11026. TREATMENT OF CERTAIN INDIVIDUALS PERFORMING SERVICES IN THE SINAI PENINSULA OF EGYPT.

(a) IN GENERAL.—For purposes of the following provisions of the Internal Revenue Code of 1986, with respect to the applicable period, a qualified hazardous duty area shall be treated in the same manner as if it were a combat zone (as determined under section 112 of such Code):

(1) Section 2(a)(3) (relating to special rule where deceased spouse was in missing status).

(2) Section 112 (relating to the exclusion of certain combat pay of members of the Armed Forces).

(3) Section 692 (relating to income taxes of members of Armed Forces on death).

(4) Section 2201 (relating to members of the Armed Forces dying in combat zone or by reason of combat-zone-incurred wounds, etc.).

(5) Section 3401(a)(1) (defining wages relating to combat pay for members of the Armed Forces).

(6) Section 4253(d) (relating to the taxation of phone service originating from a combat zone from members of the Armed Forces).

(7) Section 6013(f)(1) (relating to joint return where individual is in missing status).

(8) Section 7508 (relating to time for performing certain acts postponed by reason of service in combat zone).

(b) QUALIFIED HAZARDOUS DUTY AREA.—For purposes of this section, the term “qualified hazardous duty area” means the Sinai Peninsula of Egypt, if as of the date of the enactment of this section any member of the Armed Forces of the United States is entitled to special pay under section 310 of title 37, United States Code (relating to special pay; duty subject to hostile fire or imminent danger), for services performed in such location. Such term includes such location only during the period such entitlement is in effect.

(c) APPLICABLE PERIOD.—

(1) IN GENERAL.—Except as provided in paragraph (2), the applicable period is—

(A) the portion of the first taxable year ending after June 9, 2015, which begins on such date, and

(B) any subsequent taxable year beginning before January 1, 2026.

(2) WITHHOLDING.—In the case of subsection (a)(5), the applicable period is—

(A) the portion of the first taxable year ending after the date of the enactment of this Act which begins on such date, and

(B) any subsequent taxable year beginning before January 1, 2026.

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the provisions of this section shall take effect on June 9, 2015.

(2) WITHHOLDING.—Subsection (a)(5) shall apply to remuneration paid after the date of the enactment of this Act.

SEC. 11027. TEMPORARY REDUCTION IN MEDICAL EXPENSE DEDUCTION FLOOR.

(a) IN GENERAL.—Subsection (f) of section 213 is amended to read as follows:

“(f) SPECIAL RULES FOR 2013 THROUGH 2018.—In the case of any taxable year—

“(1) beginning after December 31, 2012, and ending before January 1, 2017, in the case of a taxpayer if such taxpayer or such taxpayer’s spouse has attained age 65 before the close of such taxable year, and

“(2) beginning after December 31, 2016, and ending before January 1, 2019, in the case of any taxpayer, subsection (a) shall be applied with respect to a taxpayer by substituting ‘7.5 percent’ for ‘10 percent.’”

(b) MINIMUM TAX PREFERENCE NOT TO APPLY.—Section 56(b)(1)(B) is amended by adding at the end the following new sentence: “This subparagraph shall not apply to taxable years beginning after December 31, 2016, and ending before January 1, 2019”.

(c) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2016.

SEC. 11028. RELIEF FOR 2016 DISASTER AREAS.

(a) **IN GENERAL.**—For purposes of this section, the term “2016 disaster area” means any area with respect to which a major disaster has been declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act during calendar year 2016.

(b) **SPECIAL RULES FOR USE OF RETIREMENT FUNDS WITH RESPECT TO AREAS DAMAGED BY 2016 DISASTERS.**—

(1) **TAX-FAVORED WITHDRAWALS FROM RETIREMENT PLANS.**—

(A) **IN GENERAL.**—Section 72(t) of the Internal Revenue Code of 1986 shall not apply to any qualified 2016 disaster distribution.

(B) **AGGREGATE DOLLAR LIMITATION.**—

(i) **IN GENERAL.**—For purposes of this subsection, the aggregate amount of distributions received by an individual which may be treated as qualified 2016 disaster distributions for any taxable year shall not exceed the excess (if any) of—

(I) \$100,000, over

(II) the aggregate amounts treated as qualified 2016 disaster distributions received by such individual for all prior taxable years.

(ii) **TREATMENT OF PLAN DISTRIBUTIONS.**—If a distribution to an individual would (without regard to clause (i)) be a qualified 2016 disaster distribution, a plan shall not be treated as violating any requirement of this title merely because the plan treats such distribution as a qualified 2016 disaster distribution, unless the aggregate amount of such distributions from all plans maintained by the employer (and any member of any controlled group which includes the employer) to such individual exceeds \$100,000.

(iii) **CONTROLLED GROUP.**—For purposes of clause (ii), the term “controlled group” means any group treated as a single employer under subsection (b), (c), (m), or (o) of section 414 of the Internal Revenue Code of 1986.

(C) **AMOUNT DISTRIBUTED MAY BE REPAYED.**—

(i) **IN GENERAL.**—Any individual who receives a qualified 2016 disaster distribution may, at any time during the 3-year period beginning on the day after the date on which such distribution was received, make one or more contributions in an aggregate amount not to exceed the amount of such distribution to an eligible retirement plan of which such individual is a beneficiary and to which a rollover contribution of such distribution could be made under section 402(c), 403(a)(4), 403(b)(8), 408(d)(3), or 457(e)(16) of the Internal Revenue Code of 1986, as the case may be.

(ii) **TREATMENT OF REPAYMENTS OF DISTRIBUTIONS FROM ELIGIBLE RETIREMENT PLANS OTHER THAN IRAS.**—For purposes of the Internal Revenue Code of 1986, if a contribution is made pursuant to clause (i) with respect to a qualified 2016 disaster distribution from an eligible retirement plan other than an individual retirement plan, then the taxpayer shall, to the extent of the amount of the contribution, be treated as having

received the qualified 2016 disaster distribution in an eligible rollover distribution (as defined in section 402(c)(4) of the Internal Revenue Code of 1986) and as having transferred the amount to the eligible retirement plan in a direct trustee to trustee transfer within 60 days of the distribution.

(iii) TREATMENT OF REPAYMENTS FOR DISTRIBUTIONS FROM IRAS.—For purposes of the Internal Revenue Code of 1986, if a contribution is made pursuant to clause (i) with respect to a qualified 2016 disaster distribution from an individual retirement plan (as defined by section 7701(a)(37) of the Internal Revenue Code of 1986), then, to the extent of the amount of the contribution, the qualified 2016 disaster distribution shall be treated as a distribution described in section 408(d)(3) of such Code and as having been transferred to the eligible retirement plan in a direct trustee to trustee transfer within 60 days of the distribution.

(D) DEFINITIONS.—For purposes of this paragraph—

(i) QUALIFIED 2016 DISASTER DISTRIBUTION.—Except as provided in subparagraph (B), the term “qualified 2016 disaster distribution” means any distribution from an eligible retirement plan made on or after January 1, 2016, and before January 1, 2018, to an individual whose principal place of abode at any time during calendar year 2016 was located in a disaster area described in subsection (a) and who has sustained an economic loss by reason of the events giving rise to the Presidential declaration described in subsection (a) which was applicable to such area.

(ii) ELIGIBLE RETIREMENT PLAN.—The term “eligible retirement plan” shall have the meaning given such term by section 402(c)(8)(B) of the Internal Revenue Code of 1986.

(E) INCOME INCLUSION SPREAD OVER 3-YEAR PERIOD.—

(i) IN GENERAL.—In the case of any qualified 2016 disaster distribution, unless the taxpayer elects not to have this subparagraph apply for any taxable year, any amount required to be included in gross income for such taxable year shall be so included ratably over the 3-taxable-year period beginning with such taxable year.

(ii) SPECIAL RULE.—For purposes of clause (i), rules similar to the rules of subparagraph (E) of section 408A(d)(3) of the Internal Revenue Code of 1986 shall apply.

(F) SPECIAL RULES.—

(i) EXEMPTION OF DISTRIBUTIONS FROM TRUSTEE TO TRUSTEE TRANSFER AND WITHHOLDING RULES.—For purposes of sections 401(a)(31), 402(f), and 3405 of the Internal Revenue Code of 1986, qualified 2016 disaster distribution shall not be treated as eligible rollover distributions.

(ii) QUALIFIED 2016 DISASTER DISTRIBUTIONS TREATED AS MEETING PLAN DISTRIBUTION REQUIREMENTS.—For purposes of the Internal Revenue Code

of 1986, a qualified 2016 disaster distribution shall be treated as meeting the requirements of sections 401(k)(2)(B)(i), 403(b)(7)(A)(ii), 403(b)(11), and 457(d)(1)(A) of the Internal Revenue Code of 1986.

(2) PROVISIONS RELATING TO PLAN AMENDMENTS.—

(A) IN GENERAL.—If this paragraph applies to any amendment to any plan or annuity contract, such plan or contract shall be treated as being operated in accordance with the terms of the plan during the period described in subparagraph (B)(ii)(I).

(B) AMENDMENTS TO WHICH SUBSECTION APPLIES.—

(i) IN GENERAL.—This paragraph shall apply to any amendment to any plan or annuity contract which is made—

(I) pursuant to any provision of this section, or pursuant to any regulation under any provision of this section, and

(II) on or before the last day of the first plan year beginning on or after January 1, 2018, or such later date as the Secretary prescribes.

In the case of a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986), subclause (II) shall be applied by substituting the date which is 2 years after the date otherwise applied under subclause (II).

(ii) CONDITIONS.—This paragraph shall not apply to any amendment to a plan or contract unless such amendment applies retroactively for such period, and shall not apply to any such amendment unless the plan or contract is operated as if such amendment were in effect during the period—

(I) beginning on the date that this section or the regulation described in clause (i)(I) takes effect (or in the case of a plan or contract amendment not required by this section or such regulation, the effective date specified by the plan), and

(II) ending on the date described in clause (i)(II) (or, if earlier, the date the plan or contract amendment is adopted).

(c) SPECIAL RULES FOR PERSONAL CASUALTY LOSSES RELATED TO 2016 MAJOR DISASTER.—

(1) IN GENERAL.—If an individual has a net disaster loss for any taxable year beginning after December 31, 2015, and before January 1, 2018—

(A) the amount determined under section 165(h)(2)(A)(ii) of the Internal Revenue Code of 1986 shall be equal to the sum of—

(i) such net disaster loss, and

(ii) so much of the excess referred to in the matter preceding clause (i) of section 165(h)(2)(A) of such Code (reduced by the amount in clause (i) of this subparagraph) as exceeds 10 percent of the adjusted gross income of the individual,

(B) section 165(h)(1) of such Code shall be applied by substituting “\$500” for “\$500 (\$100 for taxable years beginning after December 31, 2009)”,

(C) the standard deduction determined under section 63(c) of such Code shall be increased by the net disaster loss, and

(D) section 56(b)(1)(E) of such Code shall not apply to so much of the standard deduction as is attributable to the increase under subparagraph (C) of this paragraph.

(2) NET DISASTER LOSS.—For purposes of this subsection, the term “net disaster loss” means the excess of qualified disaster-related personal casualty losses over personal casualty gains (as defined in section 165(h)(3)(A) of the Internal Revenue Code of 1986).

(3) QUALIFIED DISASTER-RELATED PERSONAL CASUALTY LOSSES.—For purposes of this paragraph, the term “qualified disaster-related personal casualty losses” means losses described in section 165(c)(3) of the Internal Revenue Code of 1986 which arise in a disaster area described in subsection (a) on or after January 1, 2016, and which are attributable to the events giving rise to the Presidential declaration described in subsection (a) which was applicable to such area.

PART IV—EDUCATION

SEC. 11031. TREATMENT OF STUDENT LOANS DISCHARGED ON ACCOUNT OF DEATH OR DISABILITY.

(a) IN GENERAL.—Section 108(f) is amended by adding at the end the following new paragraph:

“(5) DISCHARGES ON ACCOUNT OF DEATH OR DISABILITY.—

“(A) IN GENERAL.—In the case of an individual, gross income does not include any amount which (but for this subsection) would be includible in gross income for such taxable year by reasons of the discharge (in whole or in part) of any loan described in subparagraph (B) after December 31, 2017, and before January 1, 2026, if such discharge was—

“(i) pursuant to subsection (a) or (d) of section 437 of the Higher Education Act of 1965 or the parallel benefit under part D of title IV of such Act (relating to the repayment of loan liability),

“(ii) pursuant to section 464(c)(1)(F) of such Act,

or

“(iii) otherwise discharged on account of the death or total and permanent disability of the student.

“(B) LOANS DESCRIBED.—A loan is described in this subparagraph if such loan is—

“(i) a student loan (as defined in paragraph (2)),

or

“(ii) a private education loan (as defined in section 140(7) of the Consumer Credit Protection Act (15 U.S.C. 1650(7))).”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to discharges of indebtedness after December 31, 2017.

SEC. 11032. 529 ACCOUNT FUNDING FOR ELEMENTARY AND SECONDARY EDUCATION.

(a) IN GENERAL.—

(1) IN GENERAL.—Section 529(c) is amended by adding at the end the following new paragraph:

“(7) TREATMENT OF ELEMENTARY AND SECONDARY TUITION.—Any reference in this subsection to the term ‘qualified higher education expense’ shall include a reference to expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school.”

(2) LIMITATION.—Section 529(e)(3)(A) is amended by adding at the end the following: “The amount of cash distributions from all qualified tuition programs described in subsection (b)(1)(A)(ii) with respect to a beneficiary during any taxable year shall, in the aggregate, include not more than \$10,000 in expenses described in subsection (c)(7) incurred during the taxable year.”

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions made after December 31, 2017.

PART V—DEDUCTIONS AND EXCLUSIONS

SEC. 11041. SUSPENSION OF DEDUCTION FOR PERSONAL EXEMPTIONS.

(a) IN GENERAL.—Subsection (d) of section 151 is amended—
(1) by striking “In the case of” in paragraph (4) and inserting “Except as provided in paragraph (5), in the case of”, and

(2) by adding at the end the following new paragraph:

“(5) SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026—

“(A) EXEMPTION AMOUNT.—The term ‘exemption amount’ means zero.

“(B) REFERENCES.—For purposes of any other provision of this title, the reduction of the exemption amount to zero under subparagraph (A) shall not be taken into account in determining whether a deduction is allowed or allowable, or whether a taxpayer is entitled to a deduction, under this section.”

(b) APPLICATION TO ESTATES AND TRUSTS.—Section 642(b)(2)(C) is amended by adding at the end the following new clause:

“(iii) YEARS WHEN PERSONAL EXEMPTION AMOUNT IS ZERO.—

“(I) IN GENERAL.—In the case of any taxable year in which the exemption amount under section 151(d) is zero, clause (i) shall be applied by substituting ‘\$4,150’ for ‘the exemption amount under section 151(d)’.

“(II) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2018, the \$4,150 amount in subparagraph (A) shall be increased in the same manner as provided in section 6334(d)(4)(C).”

(c) MODIFICATION OF WAGE WITHHOLDING RULES.—

(1) IN GENERAL.—Section 3402(a)(2) is amended by striking “means the amount” and all that follows and inserting “means the amount by which the wages exceed the taxpayer’s withholding allowance, prorated to the payroll period.”

(2) CONFORMING AMENDMENTS.—

(A) Section 3401 is amended by striking subsection (e).

(B) Paragraphs (1) and (2) of section 3402(f) are amended to read as follows:

“(1) IN GENERAL.—Under rules determined by the Secretary, an employee receiving wages shall on any day be entitled to a withholding allowance determined based on—

“(A) whether the employee is an individual for whom a deduction is allowable with respect to another taxpayer under section 151;

“(B) if the employee is married, whether the employee’s spouse is entitled to an allowance, or would be so entitled if such spouse were an employee receiving wages, under subparagraph (A) or (D), but only if such spouse does not have in effect a withholding allowance certificate claiming such allowance;

“(C) the number of individuals with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable a credit under section 24(a) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a credit;

“(D) any additional amounts to which the employee elects to take into account under subsection (m), but only if the employee’s spouse does not have in effect a withholding allowance certificate making such an election;

“(E) the standard deduction allowable to such employee (one-half of such standard deduction in the case of an employee who is married (as determined under section 7703) and whose spouse is an employee receiving wages subject to withholding); and

“(F) whether the employee has withholding allowance certificates in effect with respect to more than 1 employer.

“(2) ALLOWANCE CERTIFICATES.—

“(A) ON COMMENCEMENT OF EMPLOYMENT.—On or before the date of the commencement of employment with an employer, the employee shall furnish the employer with a signed withholding allowance certificate relating to the withholding allowance claimed by the employee, which shall in no event exceed the amount to which the employee is entitled.

“(B) CHANGE OF STATUS.—If, on any day during the calendar year, an employee’s withholding allowance is in excess of the withholding allowance to which the employee would be entitled had the employee submitted a true and accurate withholding allowance certificate to the employer on that day, the employee shall within 10 days thereafter furnish the employer with a new withholding allowance certificate. If, on any day during the calendar year, an employee’s withholding allowance is greater than the withholding allowance claimed, the employee may furnish the employer with a new withholding allowance certificate relating to the withholding allowance to which the employee is so entitled, which shall in no event exceed the amount to which the employee is entitled on such day.

“(C) CHANGE OF STATUS WHICH AFFECTS NEXT CALENDAR YEAR.—If on any day during the calendar year the

withholding allowance to which the employee will be, or may reasonably be expected to be, entitled at the beginning of the employee's next taxable year under subtitle A is different from the allowance to which the employee is entitled on such day, the employee shall, in such cases and at such times as the Secretary shall by regulations prescribe, furnish the employer with a withholding allowance certificate relating to the withholding allowance which the employee claims with respect to such next taxable year, which shall in no event exceed the withholding allowance to which the employee will be, or may reasonably be expected to be, so entitled."

(C) Subsections (b)(1), (b)(2), (f)(3), (f)(4), (f)(5), (f)(7) (including the heading thereof), (g)(4), (l)(1), (l)(2), and (n) of section 3402 are each amended by striking "exemption" each place it appears and inserting "allowance".

(D) The heading of section 3402(f) is amended by striking "EXEMPTIONS" and inserting "ALLOWANCE".

(E) Section 3402(m) is amended by striking "additional withholding allowances or additional reductions in withholding under this subsection. In determining the number of additional withholding allowances" and inserting "an additional withholding allowance or additional reductions in withholding under this subsection. In determining the additional withholding allowance".

(F) Paragraphs (3) and (4) of section 3405(a) (and the heading for such paragraph (4)) are each amended by striking "exemption" each place it appears and inserting "allowance".

(G) Section 3405(a)(4) is amended by striking "shall be determined" and all that follows through "3 withholding exemptions" and inserting "shall be determined under rules prescribed by the Secretary".

(d) EXCEPTION FOR DETERMINING PROPERTY EXEMPT FROM LEVY.—Section 6334(d) is amended by adding at the end the following new paragraph:

"(4) YEARS WHEN PERSONAL EXEMPTION AMOUNT IS ZERO.—
 "(A) IN GENERAL.—In the case of any taxable year in which the exemption amount under section 151(d) is zero, paragraph (2) shall not apply and for purposes of paragraph (1) the term 'exempt amount' means an amount equal to—

"(i) the sum of the amount determined under subparagraph (B) and the standard deduction, divided by

"(ii) 52.

"(B) AMOUNT DETERMINED.—For purposes of subparagraph (A), the amount determined under this subparagraph is \$4,150 multiplied by the number of the taxpayer's dependents for the taxable year in which the levy occurs.

"(C) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2018, the \$4,150 amount in subparagraph (B) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which

the taxable year begins, determined by substituting '2017' for '2016' in subparagraph (A)(ii) thereof.
If any increase determined under the preceding sentence is not a multiple of \$100, such increase shall be rounded to the next lowest multiple of \$100.

"(D) VERIFIED STATEMENT.—Unless the taxpayer submits to the Secretary a written and properly verified statement specifying the facts necessary to determine the proper amount under subparagraph (A), subparagraph (A) shall be applied as if the taxpayer were a married individual filing a separate return with no dependents."

(e) PERSONS REQUIRED TO MAKE RETURNS OF INCOME.—Section 6012 is amended by adding at the end the following new subsection:

"(f) SPECIAL RULE FOR TAXABLE YEARS 2018 THROUGH 2025.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026, subsection (a)(1) shall not apply, and every individual who has gross income for the taxable year shall be required to make returns with respect to income taxes under subtitle A, except that a return shall not be required of—

"(1) an individual who is not married (determined by applying section 7703) and who has gross income for the taxable year which does not exceed the standard deduction applicable to such individual for such taxable year under section 63,
or

"(2) an individual entitled to make a joint return if—

"(A) the gross income of such individual, when combined with the gross income of such individual's spouse, for the taxable year does not exceed the standard deduction which would be applicable to the taxpayer for such taxable year under section 63 if such individual and such individual's spouse made a joint return,

"(B) such individual and such individual's spouse have the same household as their home at the close of the taxable year,

"(C) such individual's spouse does not make a separate return, and

"(D) neither such individual nor such individual's spouse is an individual described in section 63(c)(5) who has income (other than earned income) in excess of the amount in effect under section 63(c)(5)(A)."

(f) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) WAGE WITHHOLDING.—The Secretary of the Treasury may administer section 3402 for taxable years beginning before January 1, 2019, without regard to the amendments made by subsections (a) and (c).

SEC. 11042. LIMITATION ON DEDUCTION FOR STATE AND LOCAL, ETC. TAXES.

(a) IN GENERAL.—Subsection (b) of section 164 is amended by adding at the end the following new paragraph:

"(6) LIMITATION ON INDIVIDUAL DEDUCTIONS FOR TAXABLE YEARS 2018 THROUGH 2025.—In the case of an individual and a taxable year beginning after December 31, 2017, and before January 1, 2026—

“(A) foreign real property taxes shall not be taken into account under subsection (a)(1), and

“(B) the aggregate amount of taxes taken into account under paragraphs (1), (2), and (3) of subsection (a) and paragraph (5) of this subsection for any taxable year shall not exceed \$10,000 (\$5,000 in the case of a married individual filing a separate return).

The preceding sentence shall not apply to any foreign taxes described in subsection (a)(3) or to any taxes described in paragraph (1) and (2) of subsection (a) which are paid or accrued in carrying on a trade or business or an activity described in section 212. For purposes of subparagraph (B), an amount paid in a taxable year beginning before January 1, 2018, with respect to a State or local income tax imposed for a taxable year beginning after December 31, 2017, shall be treated as paid on the last day of the taxable year for which such tax is so imposed.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2016.

SEC. 11043. LIMITATION ON DEDUCTION FOR QUALIFIED RESIDENCE INTEREST.

(a) IN GENERAL.—Section 163(h)(3) is amended by adding at the end the following new subparagraph:

“(F) SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025.—

“(i) IN GENERAL.—In the case of taxable years beginning after December 31, 2017, and before January 1, 2026—

“(I) DISALLOWANCE OF HOME EQUITY INDEBTEDNESS INTEREST.—Subparagraph (A)(ii) shall not apply.

“(II) LIMITATION ON ACQUISITION INDEBTEDNESS.—Subparagraph (B)(ii) shall be applied by substituting ‘\$750,000 (\$375,000)’ for ‘\$1,000,000 (\$500,000)’.

“(III) TREATMENT OF INDEBTEDNESS INCURRED ON OR BEFORE DECEMBER 15, 2017.—Subclause (II) shall not apply to any indebtedness incurred on or before December 15, 2017, and, in applying such subclause to any indebtedness incurred after such date, the limitation under such subclause shall be reduced (but not below zero) by the amount of any indebtedness incurred on or before December 15, 2017, which is treated as acquisition indebtedness for purposes of this subsection for the taxable year.

“(IV) BINDING CONTRACT EXCEPTION.—In the case of a taxpayer who enters into a written binding contract before December 15, 2017, to close on the purchase of a principal residence before January 1, 2018, and who purchases such residence before April 1, 2018, subclause (III) shall be applied by substituting ‘April 1, 2018’ for ‘December 15, 2017’.

“(ii) TREATMENT OF LIMITATION IN TAXABLE YEARS AFTER DECEMBER 31, 2025.—In the case of taxable years

beginning after December 31, 2025, the limitation under subparagraph (B)(ii) shall be applied to the aggregate amount of indebtedness of the taxpayer described in subparagraph (B)(i) without regard to the taxable year in which the indebtedness was incurred.

“(iii) TREATMENT OF REFINANCINGS OF INDEBTEDNESS.—

“(I) IN GENERAL.—In the case of any indebtedness which is incurred to refinance indebtedness, such refinanced indebtedness shall be treated for purposes of clause (i)(III) as incurred on the date that the original indebtedness was incurred to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness.

“(II) LIMITATION ON PERIOD OF REFINANCING.—Subclause (I) shall not apply to any indebtedness after the expiration of the term of the original indebtedness or, if the principal of such original indebtedness is not amortized over its term, the expiration of the term of the 1st refinancing of such indebtedness (or if earlier, the date which is 30 years after the date of such 1st refinancing).

“(iv) COORDINATION WITH EXCLUSION OF INCOME FROM DISCHARGE OF INDEBTEDNESS.—Section 108(h)(2) shall be applied without regard to this subparagraph.”.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 11044. MODIFICATION OF DEDUCTION FOR PERSONAL CASUALTY LOSSES.

(a) IN GENERAL.—Subsection (h) of section 165 is amended by adding at the end the following new paragraph:

“(5) LIMITATION FOR TAXABLE YEARS 2018 THROUGH 2025.—

“(A) IN GENERAL.—In the case of an individual, except as provided in subparagraph (B), any personal casualty loss which (but for this paragraph) would be deductible in a taxable year beginning after December 31, 2017, and before January 1, 2026, shall be allowed as a deduction under subsection (a) only to the extent it is attributable to a Federally declared disaster (as defined in subsection (i)(5)).

“(B) EXCEPTION RELATED TO PERSONAL CASUALTY GAINS.—If a taxpayer has personal casualty gains for any taxable year to which subparagraph (A) applies—

“(i) subparagraph (A) shall not apply to the portion of the personal casualty loss not attributable to a Federally declared disaster (as so defined) to the extent such loss does not exceed such gains, and

“(ii) in applying paragraph (2) for purposes of subparagraph (A) to the portion of personal casualty loss which is so attributable to such a disaster, the amount of personal casualty gains taken into account under paragraph (2)(A) shall be reduced by the portion of such gains taken into account under clause (i).”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to losses incurred in taxable years beginning after December 31, 2017.

SEC. 11045. SUSPENSION OF MISCELLANEOUS ITEMIZED DEDUCTIONS.

(a) IN GENERAL.—Section 67 is amended by adding at the end the following new subsection:

“(g) SUSPENSION FOR TAXABLE YEARS 2018 THROUGH 2025.—Notwithstanding subsection (a), no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017, and before January 1, 2026.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 11046. SUSPENSION OF OVERALL LIMITATION ON ITEMIZED DEDUCTIONS.

(a) IN GENERAL.—Section 68 is amended by adding at the end the following new subsection:

“(f) SECTION NOT TO APPLY.—This section shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.”

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 11047. SUSPENSION OF EXCLUSION FOR QUALIFIED BICYCLE COMMUTING REIMBURSEMENT.

(a) IN GENERAL.—Section 132(f) is amended by adding at the end the following new paragraph:

“(8) SUSPENSION OF QUALIFIED BICYCLE COMMUTING REIMBURSEMENT EXCLUSION.—Paragraph (1)(D) shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 11048. SUSPENSION OF EXCLUSION FOR QUALIFIED MOVING EXPENSE REIMBURSEMENT.

(a) IN GENERAL.—Section 132(g) is amended—

(1) by striking “For purposes of this section, the term” and inserting “For purposes of this section—

“(1) IN GENERAL.—The term”, and

(2) by adding at the end the following new paragraph:

“(2) SUSPENSION FOR TAXABLE YEARS 2018 THROUGH 2025.—Except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order and incident to a permanent change of station, subsection (a)(6) shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.”

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 11049. SUSPENSION OF DEDUCTION FOR MOVING EXPENSES.

(a) IN GENERAL.—Section 217 is amended by adding at the end the following new subsection:

“(k) SUSPENSION OF DEDUCTION FOR TAXABLE YEARS 2018 THROUGH 2025.—Except in the case of an individual to whom subsection (g) applies, this section shall not apply to any taxable

year beginning after December 31, 2017, and before January 1, 2026.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 11050. LIMITATION ON WAGERING LOSSES.

(a) IN GENERAL.—Section 165(d) is amended by adding at the end the following: “For purposes of the preceding sentence, in the case of taxable years beginning after December 31, 2017, and before January 1, 2026, the term ‘losses from wagering transactions’ includes any deduction otherwise allowable under this chapter incurred in carrying on any wagering transaction.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 11051. REPEAL OF DEDUCTION FOR ALIMONY PAYMENTS.

(a) IN GENERAL.—Part VII of subchapter B is amended by striking section 215 (and by striking the item relating to such section in the table of sections for such subpart).

(b) CONFORMING AMENDMENTS.—

(1) CORRESPONDING REPEAL OF PROVISIONS PROVIDING FOR INCLUSION OF ALIMONY IN GROSS INCOME.—

(A) Subsection (a) of section 61 is amended by striking paragraph (8) and by redesignating paragraphs (9) through (15) as paragraphs (8) through (14), respectively.

(B) Part II of subchapter B of chapter 1 is amended by striking section 71 (and by striking the item relating to such section in the table of sections for such part).

(C) Subpart F of part I of subchapter J of chapter 1 is amended by striking section 682 (and by striking the item relating to such section in the table of sections for such subpart).

(2) RELATED TO REPEAL OF SECTION 215.—

(A) Section 62(a) is amended by striking paragraph (10).

(B) Section 3402(m)(1) is amended by striking “(other than paragraph (10) thereof)”.

(C) Section 6724(d)(3) is amended by striking subparagraph (C) and by redesignating subparagraph (D) as subparagraph (C).

(3) RELATED TO REPEAL OF SECTION 71.—

(A) Section 121(d)(3) is amended—

(i) by striking “(as defined in section 71(b)(2))” in subparagraph (B), and

(ii) by adding at the end the following new subparagraph:

“(C) DIVORCE OR SEPARATION INSTRUMENT.—For purposes of this paragraph, the term ‘divorce or separation instrument’ means—

“(i) a decree of divorce or separate maintenance or a written instrument incident to such a decree,

“(ii) a written separation agreement, or

“(iii) a decree (not described in clause (i)) requiring a spouse to make payments for the support or maintenance of the other spouse.”

(B) Section 152(d)(5) is amended to read as follows:

“(5) SPECIAL RULES FOR SUPPORT.—

“(A) IN GENERAL.—For purposes of this subsection—

“(i) payments to a spouse of alimony or separate maintenance payments shall not be treated as a payment by the payor spouse for the support of any dependent, and

“(ii) in the case of the remarriage of a parent, support of a child received from the parent’s spouse shall be treated as received from the parent.

“(B) ALIMONY OR SEPARATE MAINTENANCE PAYMENT.—For purposes of subparagraph (A), the term ‘alimony or separate maintenance payment’ means any payment in cash if—

“(i) such payment is received by (or on behalf of) a spouse under a divorce or separation instrument (as defined in section 121(d)(3)(C)),

“(ii) in the case of an individual legally separated from the individual’s spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and

“(iii) there is no liability to make any such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payments after the death of the payee spouse.”

(C) Section 219(f)(1) is amended by striking the third sentence.

(D) Section 220(f)(7) is amended by striking “subparagraph (A) of section 71(b)(2)” and inserting “clause (i) of section 121(d)(3)(C)”.

(E) Section 223(f)(7) is amended by striking “subparagraph (A) of section 71(b)(2)” and inserting “clause (i) of section 121(d)(3)(C)”.

(F) Section 382(1)(3)(B)(iii) is amended by striking “section 71(b)(2)” and inserting “section 121(d)(3)(C)”.

(G) Section 408(d)(6) is amended by striking “subparagraph (A) of section 71(b)(2)” and inserting “clause (i) of section 121(d)(3)(C)”.

(4) ADDITIONAL CONFORMING AMENDMENTS.—Section 7701(a)(17) is amended—

(A) by striking “sections 682 and 2516” and inserting “section 2516”, and

(B) by striking “such sections” each place it appears and inserting “such section”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to—

(1) any divorce or separation instrument (as defined in section 71(b)(2) of the Internal Revenue Code of 1986 as in effect before the date of the enactment of this Act) executed after December 31, 2018, and

(2) any divorce or separation instrument (as so defined) executed on or before such date and modified after such date if the modification expressly provides that the amendments made by this section apply to such modification.

PART VI—INCREASE IN ESTATE AND GIFT TAX EXEMPTION

SEC. 11061. INCREASE IN ESTATE AND GIFT TAX EXEMPTION.

(a) **IN GENERAL.**—Section 2010(c)(3) is amended by adding at the end the following new subparagraph:

“(C) **INCREASE IN BASIC EXCLUSION AMOUNT.**—In the case of estates of decedents dying or gifts made after December 31, 2017, and before January 1, 2026, subparagraph (A) shall be applied by substituting ‘\$10,000,000’ for ‘\$5,000,000.’”

(b) **CONFORMING AMENDMENT.**—Subsection (g) of section 2001 is amended to read as follows:

“(g) **MODIFICATIONS TO TAX PAYABLE.**—

“(1) **MODIFICATIONS TO GIFT TAX PAYABLE TO REFLECT DIFFERENT TAX RATES.**—For purposes of applying subsection (b)(2) with respect to 1 or more gifts, the rates of tax under subsection (c) in effect at the decedent’s death shall, in lieu of the rates of tax in effect at the time of such gifts, be used both to compute—

“(A) the tax imposed by chapter 12 with respect to such gifts, and

“(B) the credit allowed against such tax under section 2505, including in computing—

“(i) the applicable credit amount under section 2505(a)(1), and

“(ii) the sum of the amounts allowed as a credit for all preceding periods under section 2505(a)(2).

“(2) **MODIFICATIONS TO ESTATE TAX PAYABLE TO REFLECT DIFFERENT BASIC EXCLUSION AMOUNTS.**—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this section with respect to any difference between—

“(A) the basic exclusion amount under section 2010(c)(3) applicable at the time of the decedent’s death, and

“(B) the basic exclusion amount under such section applicable with respect to any gifts made by the decedent.”

(c) **EFFECTIVE DATE.**—The amendments made by this section shall apply to estates of decedents dying and gifts made after December 31, 2017.

PART VII—EXTENSION OF TIME LIMIT FOR CONTESTING IRS LEVY

SEC. 11071. EXTENSION OF TIME LIMIT FOR CONTESTING IRS LEVY.

(a) **EXTENSION OF TIME FOR RETURN OF PROPERTY SUBJECT TO LEVY.**—Subsection (b) of section 6343 is amended by striking “9 months” and inserting “2 years”.

(b) **PERIOD OF LIMITATION ON SUITS.**—Subsection (c) of section 6532 is amended—

(1) by striking “9 months” in paragraph (1) and inserting “2 years”, and

(2) by striking “9-month” in paragraph (2) and inserting “2-year”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to—

- (1) levies made after the date of the enactment of this Act, and
- (2) levies made on or before such date if the 9-month period has not expired under section 6343(b) of the Internal Revenue Code of 1986 (without regard to this section) as of such date.

PART VIII—INDIVIDUAL MANDATE

SEC. 11081. ELIMINATION OF SHARED RESPONSIBILITY PAYMENT FOR INDIVIDUALS FAILING TO MAINTAIN MINIMUM ESSENTIAL COVERAGE.

- (a) IN GENERAL.—Section 5000A(c) is amended—
- (1) in paragraph (2)(B)(iii), by striking “2.5 percent” and inserting “Zero percent”, and
 - (2) in paragraph (3)—
 - (A) by striking “\$695” in subparagraph (A) and inserting “\$0”, and
 - (B) by striking subparagraph (D).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to months beginning after December 31, 2018.

Subtitle B—Alternative Minimum Tax

SEC. 12001. REPEAL OF TAX FOR CORPORATIONS.

(a) IN GENERAL.—Section 55(a) is amended by striking “There” and inserting “In the case of a taxpayer other than a corporation, there”.

(b) CONFORMING AMENDMENTS.—

(1) Section 38(c)(6) is amended by adding at the end the following new subparagraph:

“(E) CORPORATIONS.—In the case of a corporation, this subsection shall be applied by treating the corporation as having a tentative minimum tax of zero.”

(2) Section 53(d)(2) is amended by inserting “, except that in the case of a corporation, the tentative minimum tax shall be treated as zero” before the period at the end.

(3)(A) Section 55(b)(1) is amended to read as follows:

“(1) AMOUNT OF TENTATIVE TAX.—

“(A) IN GENERAL.—The tentative minimum tax for the taxable year is the sum of—

“(i) 26 percent of so much of the taxable excess as does not exceed \$175,000, plus

“(ii) 28 percent of so much of the taxable excess as exceeds \$175,000.

The amount determined under the preceding sentence shall be reduced by the alternative minimum tax foreign tax credit for the taxable year.

“(B) TAXABLE EXCESS.—For purposes of this subsection, the term ‘taxable excess’ means so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount.

“(C) MARRIED INDIVIDUAL FILING SEPARATE RETURN.—In the case of a married individual filing a separate return,

subparagraph (A) shall be applied by substituting 50 percent of the dollar amount otherwise applicable under clause (i) and clause (ii) thereof. For purposes of the preceding sentence, marital status shall be determined under section 7703.”

(B) Section 55(b)(3) is amended by striking “paragraph (1)(A)(i)” and inserting “paragraph (1)(A)”.

(C) Section 59(a) is amended—

(i) by striking “subparagraph (A)(i) or (B)(i) of section 55(b)(1) (whichever applies) in lieu of the highest rate of tax specified in section 1 or 11 (whichever applies)” in paragraph (1)(C) and inserting “section 55(b)(1) in lieu of the highest rate of tax specified in section 1”, and

(ii) in paragraph (2), by striking “means” and all that follows and inserting “means the amount determined under the first sentence of section 55(b)(1)(A)”.

(D) Section 897(a)(2)(A) is amended by striking “section 55(b)(1)(A)” and inserting “section 55(b)(1)”.

(E) Section 911(f) is amended—

(i) in paragraph (1)(B)—

(I) by striking “section 55(b)(1)(A)(ii)” and inserting “section 55(b)(1)(B)”, and

(II) by striking “section 55(b)(1)(A)(i)” and inserting “section 55(b)(1)(A)”, and

(ii) in paragraph (2)(B), by striking “section 55(b)(1)(A)(ii)” each place it appears and inserting “section 55(b)(1)(B)”.

(4) Section 55(c)(1) is amended by striking “, the section 936 credit allowable under section 27(b), and the Puerto Rico economic activity credit under section 30A”.

(5) Section 55(d), as amended by section 11002, is amended—

(A) by striking paragraph (2) and redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively,

(B) in paragraph (2) (as so redesignated), by inserting “and” at the end of subparagraph (B), by striking “, and” at the end of subparagraph (C) and inserting a period, and by striking subparagraph (D), and

(C) in paragraph (3) (as so redesignated)—

(i) by striking “(b)(1)(A)(i)” in subparagraph (B)(i) and inserting “(b)(1)(A)”, and

(ii) by striking “paragraph (3)” in subparagraph (B)(iii) and inserting “paragraph (2)”.

(6) Section 55 is amended by striking subsection (e).

(7) Section 56(b)(2) is amended by striking subparagraph (C) and by redesignating subparagraph (D) as subparagraph (C).

(8)(A) Section 56 is amended by striking subsections (c) and (g).

(B) Section 847 is amended by striking the last sentence of paragraph (9).

(C) Section 848 is amended by striking subsection (i).

(9) Section 58(a) is amended by striking paragraph (3) and redesignating paragraph (4) as paragraph (3).

(10) Section 59 is amended by striking subsections (b) and (f).

(11) Section 11(d) is amended by striking “the taxes imposed by subsection (a) and section 55” and inserting “the tax imposed by subsection (a)”.

(12) Section 12 is amended by striking paragraph (7).

(13) Section 168(k) is amended by striking paragraph (4).

(14) Section 882(a)(1) is amended by striking “, 55.”.

(15) Section 962(a)(1) is amended by striking “sections 11 and 55” and inserting “section 11”.

(16) Section 1561(a) is amended—

(A) by inserting “and” at the end of paragraph (1), by striking “, and” at the end of paragraph (2) and inserting a period, and by striking paragraph (3), and

(B) by striking the last sentence.

(17) Section 6425(c)(1)(A) is amended to read as follows:

“(A) the tax imposed by section 11 or 1201(a), or subchapter L of chapter 1, whichever is applicable, over”.

(18) Section 6655(e)(2) is amended by striking “and alternative minimum taxable income” each place it appears in subparagraphs (A) and (B)(i).

(19) Section 6655(g)(1)(A) is amended by inserting “plus” at the end of clause (i), by striking clause (ii), and by redesignating clause (iii) as clause (ii).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 12002. CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY OF CORPORATIONS.

(a) CREDITS TREATED AS REFUNDABLE.—Section 53 is amended by adding at the end the following new subsection:

“(e) PORTION OF CREDIT TREATED AS REFUNDABLE.—

“(1) IN GENERAL.—In the case of any taxable year of a corporation beginning in 2018, 2019, 2020, or 2021, the limitation under subsection (c) shall be increased by the AMT refundable credit amount for such year.

“(2) AMT REFUNDABLE CREDIT AMOUNT.—For purposes of paragraph (1), the AMT refundable credit amount is an amount equal to 50 percent (100 percent in the case of a taxable year beginning in 2021) of the excess (if any) of—

“(A) the minimum tax credit determined under subsection (b) for the taxable year, over

“(B) the minimum tax credit allowed under subsection (a) for such year (before the application of this subsection for such year).

“(3) CREDIT REFUNDABLE.—For purposes of this title (other than this section), the credit allowed by reason of this subsection shall be treated as a credit allowed under subpart C (and not this subpart).

“(4) SHORT TAXABLE YEARS.—In the case of any taxable year of less than 365 days, the AMT refundable credit amount determined under paragraph (2) with respect to such taxable year shall be the amount which bears the same ratio to such amount determined without regard to this paragraph as the number of days in such taxable year bears to 365.”.

(b) TREATMENT OF REFERENCES.—Section 53(d) is amended by adding at the end the following new paragraph:

“(3) AMT TERM REFERENCES.—In the case of a corporation, any references in this subsection to section 55, 56, or 57 shall

be treated as a reference to such section as in effect before the amendments made by Tax Cuts and Jobs Act.”

(c) CONFORMING AMENDMENT.—Section 1374(b)(3)(B) is amended by striking the last sentence thereof.

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) CONFORMING AMENDMENT.—The amendment made by subsection (c) shall apply to taxable years beginning after December 31, 2021.

SEC. 12003. INCREASED EXEMPTION FOR INDIVIDUALS.

(a) IN GENERAL.—Section 55(d), as amended by the preceding provisions of this Act, is amended by adding at the end the following new paragraph:

“(4) SPECIAL RULE FOR TAXABLE YEARS BEGINNING AFTER 2017 AND BEFORE 2026.—

“(A) IN GENERAL.—In the case of any taxable year beginning after December 31, 2017, and before January 1, 2026—

“(i) paragraph (1) shall be applied—

“(I) by substituting ‘\$109,400’ for ‘\$78,750’ in subparagraph (A), and

“(II) by substituting ‘\$70,300’ for ‘\$50,600’ in subparagraph (B), and

“(ii) paragraph (2) shall be applied—

“(I) by substituting ‘\$1,000,000’ for ‘\$150,000’ in subparagraph (A),

“(II) by substituting ‘50 percent of the dollar amount applicable under subparagraph (A)’ for ‘\$112,500’ in subparagraph (B), and

“(III) in the case of a taxpayer described in paragraph (1)(D), without regard to the substitution under subclause (I).

“(B) INFLATION ADJUSTMENT.—

“(i) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 2018, the amounts described in clause (ii) shall each be increased by an amount equal to—

“(I) such dollar amount, multiplied by

“(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting ‘calendar year 2017’ for ‘calendar year 2016’ in subparagraph (A)(ii) thereof.

“(ii) AMOUNTS DESCRIBED.—The amounts described in this clause are the \$109,400 amount in subparagraph (A)(i)(I), the \$70,300 amount in subparagraph (A)(i)(II), and the \$1,000,000 amount in subparagraph (A)(ii)(I).

“(iii) ROUNDING.—Any increased amount determined under clause (i) shall be rounded to the nearest multiple of \$100.

“(iv) COORDINATION WITH CURRENT ADJUSTMENTS.—In the case of any taxable year to which subparagraph (A) applies, no adjustment shall be made under paragraph (3) to any of the numbers which

are substituted under subparagraph (A) and adjusted under this subparagraph.”

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

Subtitle C—Business-related Provisions

PART I—CORPORATE PROVISIONS

SEC. 13001. 21-PERCENT CORPORATE TAX RATE.

(a) IN GENERAL.—Subsection (b) of section 11 is amended to read as follows:

“(b) AMOUNT OF TAX.—The amount of the tax imposed by subsection (a) shall be 21 percent of taxable income.”

(b) CONFORMING AMENDMENTS.—

(1) The following sections are each amended by striking “section 11(b)(1)” and inserting “section 11(b)”:

(A) Section 280C(c)(3)(B)(ii)(II).

(B) Paragraphs (2)(B) and (6)(A)(ii) of section 860E(e).

(C) Section 7874(e)(1)(B).

(2)(A) Part I of subchapter P of chapter 1 is amended by striking section 1201 (and by striking the item relating to such section in the table of sections for such part).

(B) Section 12 is amended by striking paragraphs (4) and (6), and by redesignating paragraph (5) as paragraph (4).

(C) Section 453A(c)(3) is amended by striking “or 1201 (whichever is appropriate)”.

(D) Section 527(b) is amended—

(i) by striking paragraph (2), and

(ii) by striking all that precedes “is hereby imposed”

and inserting:

“(b) TAX IMPOSED.—A tax”.

(E) Sections 594(a) is amended by striking “taxes imposed by section 11 or 1201(a)” and inserting “tax imposed by section 11”.

(F) Section 691(c)(4) is amended by striking “1201”.

(G) Section 801(a) is amended—

(i) by striking paragraph (2), and

(ii) by striking all that precedes “is hereby imposed”

and inserting:

“(a) TAX IMPOSED.—A tax”.

(H) Section 831(e) is amended by striking paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(I) Sections 832(c)(5) and 834(b)(1)(D) are each amended by striking “sec. 1201 and following”.

(J) Section 852(b)(3)(A) is amended by striking “section 1201(a)” and inserting “section 11(b)”.

(K) Section 857(b)(3) is amended—

(i) by striking subparagraph (A) and redesignating subparagraphs (B) through (F) as subparagraphs (A) through (E), respectively,

(ii) in subparagraph (C), as so redesignated—

(I) by striking “subparagraph (A)(ii)” in clause (i) thereof and inserting “paragraph (1)”.

- (II) by striking “the tax imposed by subparagraph (A)(ii)” in clauses (ii) and (iv) thereof and inserting “the tax imposed by paragraph (1) on undistributed capital gain”,
- (iii) in subparagraph (E), as so redesignated, by striking “subparagraph (B) or (D)” and inserting “subparagraph (A) or (C)”, and
- (iv) by adding at the end the following new subparagraph:
- “(F) **UNDISTRIBUTED CAPITAL GAIN.**—For purposes of this paragraph, the term ‘undistributed capital gain’ means the excess of the net capital gain over the deduction for dividends paid (as defined in section 561) determined with reference to capital gain dividends only.”.
- (L) Section 882(a)(1), as amended by section 12001, is further amended by striking “or 1201(a)”.
- (M) Section 904(b) is amended—
- (i) by striking “or 1201(a)” in paragraph (2)(C),
- (ii) by striking paragraph (3)(D) and inserting the following:
- “(D) **CAPITAL GAIN RATE DIFFERENTIAL.**—There is a capital gain rate differential for any year if subsection (h) of section 1 applies to such taxable year.”, and
- (iii) by striking paragraph (3)(E) and inserting the following:
- “(E) **RATE DIFFERENTIAL PORTION.**—The rate differential portion of foreign source net capital gain, net capital gain, or the excess of net capital gain from sources within the United States over net capital gain, as the case may be, is the same proportion of such amount as—
- “(i) the excess of—
- “(I) the highest rate of tax set forth in subsection (a), (b), (c), (d), or (e) of section 1 (whichever applies), over
- “(II) the alternative rate of tax determined under section 1(h), bears to
- “(ii) that rate referred to in subclause (I).”.
- (N) Section 1374(b) is amended by striking paragraph (4).
- (O) Section 1381(b) is amended by striking “taxes imposed by section 11 or 1201” and inserting “tax imposed by section 11”.
- (P) Sections 6425(c)(1)(A), as amended by section 12001, and 6655(g)(1)(A)(i) are each amended by striking “or 1201(a)”.
- (Q) Section 7518(g)(6)(A) is amended by striking “or 1201(a)”.
- (3)(A) Section 1445(e)(1) is amended—
- (i) by striking “35 percent” and inserting “the highest rate of tax in effect for the taxable year under section 11(b)”, and
- (ii) by striking “of the gain” and inserting “multiplied by the gain”.
- (B) Section 1445(e)(2) is amended by striking “35 percent of the amount” and inserting “the highest rate of tax in effect for the taxable year under section 11(b) multiplied by the amount”.
- (C) Section 1445(e)(6) is amended—

(i) by striking "35 percent" and inserting "the highest rate of tax in effect for the taxable year under section 11(b)", and

(ii) by striking "of the amount" and inserting "multiplied by the amount".

(D) Section 1446(b)(2)(B) is amended by striking "section 11(b)(1)" and inserting "section 11(b)".

(4) Section 852(b)(1) is amended by striking the last sentence.

(5)(A) Part I of subchapter B of chapter 5 is amended by striking section 1551 (and by striking the item relating to such section in the table of sections for such part).

(B) Section 535(c)(5) is amended to read as follows:

"(5) CROSS REFERENCE.—For limitation on credit provided in paragraph (2) or (3) in the case of certain controlled corporations, see section 1561."

(6)(A) Section 1561, as amended by section 12001, is amended to read as follows:

"SEC. 1561. LIMITATION ON ACCUMULATED EARNINGS CREDIT IN THE CASE OF CERTAIN CONTROLLED CORPORATIONS.

"(a) IN GENERAL.—The component members of a controlled group of corporations on a December 31 shall, for their taxable years which include such December 31, be limited for purposes of this subtitle to one \$250,000 (\$150,000 if any component member is a corporation described in section 535(c)(2)(B)) amount for purposes of computing the accumulated earnings credit under section 535(c)(2) and (3). Such amount shall be divided equally among the component members of such group on such December 31 unless the Secretary prescribes regulations permitting an unequal allocation of such amount.

"(b) CERTAIN SHORT TAXABLE YEARS.—If a corporation has a short taxable year which does not include a December 31 and is a component member of a controlled group of corporations with respect to such taxable year, then for purposes of this subtitle, the amount to be used in computing the accumulated earnings credit under section 535(c)(2) and (3) of such corporation for such taxable year shall be the amount specified in subsection (a) with respect to such group, divided by the number of corporations which are component members of such group on the last day of such taxable year. For purposes of the preceding sentence, section 1563(b) shall be applied as if such last day were substituted for December 31."

(B) The table of sections for part II of subchapter B of chapter 5 is amended by striking the item relating to section 1561 and inserting the following new item:

"Sec. 1561. Limitation on accumulated earnings credit in the case of certain controlled corporations."

(7) Section 7518(g)(6)(A) is amended—

(A) by striking "With respect to the portion" and inserting "In the case of a taxpayer other than a corporation, with respect to the portion", and

(B) by striking "(34 percent in the case of a corporation)".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by subsections (a) and (b) shall apply to taxable years beginning after December 31, 2017.

(2) WITHHOLDING.—The amendments made by subsection (b)(3) shall apply to distributions made after December 31, 2017.

(3) CERTAIN TRANSFERS.—The amendments made by subsection (b)(6) shall apply to transfers made after December 31, 2017.

(d) NORMALIZATION REQUIREMENTS.—

(1) IN GENERAL.—A normalization method of accounting shall not be treated as being used with respect to any public utility property for purposes of section 167 or 168 of the Internal Revenue Code of 1986 if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method.

(2) ALTERNATIVE METHOD FOR CERTAIN TAXPAYERS.—If, as of the first day of the taxable year that includes the date of enactment of this Act—

(A) the taxpayer was required by a regulatory agency to compute depreciation for public utility property on the basis of an average life or composite rate method, and

(B) the taxpayer's books and underlying records did not contain the vintage account data necessary to apply the average rate assumption method,

the taxpayer will be treated as using a normalization method of accounting if, with respect to such jurisdiction, the taxpayer uses the alternative method for public utility property that is subject to the regulatory authority of that jurisdiction.

(3) DEFINITIONS.—For purposes of this subsection—

(A) EXCESS TAX RESERVE.—The term "excess tax reserve" means the excess of—

(i) the reserve for deferred taxes (as described in section 168(i)(9)(A)(ii) of the Internal Revenue Code of 1986) as of the day before the corporate rate reductions provided in the amendments made by this section take effect, over

(ii) the amount which would be the balance in such reserve if the amount of such reserve were determined by assuming that the corporate rate reductions provided in this Act were in effect for all prior periods.

(B) AVERAGE RATE ASSUMPTION METHOD.—The average rate assumption method is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes. Under such method, during the time period in which the timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying—

(i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by

(ii) the amount of the timing differences which reverse during such period.

(C) ALTERNATIVE METHOD.—The “alternative method” is the method in which the taxpayer—

(i) computes the excess tax reserve on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation for regulatory purposes, and

(ii) reduces the excess tax reserve ratably over the remaining regulatory life of the property.

(4) TAX INCREASED FOR NORMALIZATION VIOLATION.—If, for any taxable year ending after the date of the enactment of this Act, the taxpayer does not use a normalization method of accounting for the corporate rate reductions provided in the amendments made by this section—

(A) the taxpayer’s tax for the taxable year shall be increased by the amount by which it reduces its excess tax reserve more rapidly than permitted under a normalization method of accounting, and

(B) such taxpayer shall not be treated as using a normalization method of accounting for purposes of subsections (f)(2) and (i)(9)(C) of section 168 of the Internal Revenue Code of 1986.

SEC. 13002. REDUCTION IN DIVIDEND RECEIVED DEDUCTIONS TO REFLECT LOWER CORPORATE INCOME TAX RATES.

(a) DIVIDENDS RECEIVED BY CORPORATIONS.—

(1) IN GENERAL.—Section 243(a)(1) is amended by striking “70 percent” and inserting “50 percent”.

(2) DIVIDENDS FROM 20-PERCENT OWNED CORPORATIONS.—Section 243(c)(1) is amended—

(A) by striking “80 percent” and inserting “65 percent”, and

(B) by striking “70 percent” and inserting “50 percent”.

(3) CONFORMING AMENDMENT.—The heading for section 243(c) is amended by striking “RETENTION OF 80-PERCENT DIVIDEND RECEIVED DEDUCTION” and inserting “INCREASED PERCENTAGE”.

(b) DIVIDENDS RECEIVED FROM FSC.—Section 245(c)(1)(B) is amended—

(1) by striking “70 percent” and inserting “50 percent”, and

(2) by striking “80 percent” and inserting “65 percent”.

(c) LIMITATION ON AGGREGATE AMOUNT OF DEDUCTIONS.—Section 246(b)(3) is amended—

(1) by striking “80 percent” in subparagraph (A) and inserting “65 percent”, and

(2) by striking “70 percent” in subparagraph (B) and inserting “50 percent”.

(d) REDUCTION IN DEDUCTION WHERE PORTFOLIO STOCK IS DEBT-FINANCED.—Section 246A(a)(1) is amended—

(1) by striking “70 percent” and inserting “50 percent”, and

(2) by striking “80 percent” and inserting “65 percent”.

(e) INCOME FROM SOURCES WITHIN THE UNITED STATES.—Section 861(a)(2) is amended—

- (1) by striking “100/70th” and inserting “100/50th” in subparagraph (B), and
- (2) in the flush sentence at the end—
 - (A) by striking “100/80th” and inserting “100/65th”, and
 - (B) by striking “100/70th” and inserting “100/50th”.
- (f) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

PART II—SMALL BUSINESS REFORMS

SEC. 13101. MODIFICATIONS OF RULES FOR EXPENSING DEPRECIABLE BUSINESS ASSETS.

- (a) INCREASE IN LIMITATION.—
 - (1) DOLLAR LIMITATION.—Section 179(b)(1) is amended by striking “\$500,000” and inserting “\$1,000,000”.
 - (2) REDUCTION IN LIMITATION.—Section 179(b)(2) is amended by striking “\$2,000,000” and inserting “\$2,500,000”.
 - (3) INFLATION ADJUSTMENTS.—
 - (A) IN GENERAL.—Subparagraph (A) of section 179(b)(6), as amended by section 11002(d), is amended—
 - (i) by striking “2015” and inserting “2018”, and
 - (ii) in clause (ii), by striking “calendar year 2014” and inserting “calendar year 2017”.
 - (B) SPORT UTILITY VEHICLES.—Section 179(b)(6) is amended—
 - (i) in subparagraph (A), by striking “paragraphs (1) and (2)” and inserting “paragraphs (1), (2), and (5)(A)”, and
 - (ii) in subparagraph (B), by inserting “(\$100 in the case of any increase in the amount under paragraph (5)(A))” after “\$10,000”.
- (b) SECTION 179 PROPERTY TO INCLUDE QUALIFIED REAL PROPERTY.—
 - (1) IN GENERAL.—Subparagraph (B) of section 179(d)(1) is amended to read as follows:
 - “(B) which is—
 - “(i) section 1245 property (as defined in section 1245(a)(3)), or
 - “(ii) at the election of the taxpayer, qualified real property (as defined in subsection (f)), and”.
 - (2) QUALIFIED REAL PROPERTY DEFINED.—Subsection (f) of section 179 is amended to read as follows:
 - “(f) QUALIFIED REAL PROPERTY.—For purposes of this section, the term ‘qualified real property’ means—
 - “(1) any qualified improvement property described in section 168(e)(6), and
 - “(2) any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service:
 - “(A) Roofs.
 - “(B) Heating, ventilation, and air-conditioning property.
 - “(C) Fire protection and alarm systems.
 - “(D) Security systems.”.

(c) REPEAL OF EXCLUSION FOR CERTAIN PROPERTY.—The last sentence of section 179(d)(1) is amended by inserting “(other than paragraph (2) thereof)” after “section 50(b)”.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service in taxable years beginning after December 31, 2017.

SEC. 13102. SMALL BUSINESS ACCOUNTING METHOD REFORM AND SIMPLIFICATION.

(a) MODIFICATION OF LIMITATION ON CASH METHOD OF ACCOUNTING.—

(1) INCREASED LIMITATION.—So much of section 448(c) as precedes paragraph (2) is amended to read as follows:

“(c) GROSS RECEIPTS TEST.—For purposes of this section—

“(1) IN GENERAL.—A corporation or partnership meets the gross receipts test of this subsection for any taxable year if the average annual gross receipts of such entity for the 3-taxable-year period ending with the taxable year which precedes such taxable year does not exceed \$25,000,000.”.

(2) APPLICATION OF EXCEPTION ON ANNUAL BASIS.—Section 448(b)(3) is amended to read as follows:

“(3) ENTITIES WHICH MEET GROSS RECEIPTS TEST.—Paragraphs (1) and (2) of subsection (a) shall not apply to any corporation or partnership for any taxable year if such entity (or any predecessor) meets the gross receipts test of subsection (c) for such taxable year.”.

(3) INFLATION ADJUSTMENT.—Section 448(c) is amended by adding at the end the following new paragraph:

“(4) ADJUSTMENT FOR INFLATION.—In the case of any taxable year beginning after December 31, 2018, the dollar amount in paragraph (1) shall be increased by an amount equal to—

“(A) such dollar amount, multiplied by

“(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting ‘calendar year 2017’ for ‘calendar year 2016’ in subparagraph (A)(ii) thereof.

If any amount as increased under the preceding sentence is not a multiple of \$1,000,000, such amount shall be rounded to the nearest multiple of \$1,000,000.”.

(4) COORDINATION WITH SECTION 481.—Section 448(d)(7) is amended to read as follows:

“(7) COORDINATION WITH SECTION 481.—Any change in method of accounting made pursuant to this section shall be treated for purposes of section 481 as initiated by the taxpayer and made with the consent of the Secretary.”.

(5) APPLICATION OF EXCEPTION TO CORPORATIONS ENGAGED IN FARMING.—

(A) IN GENERAL.—Section 447(c) is amended—

(i) by inserting “for any taxable year” after “not being a corporation” in the matter preceding paragraph (1), and

(ii) by amending paragraph (2) to read as follows:

“(2) a corporation which meets the gross receipts test of section 448(c) for such taxable year.”.

(B) COORDINATION WITH SECTION 481.—Section 447(f) is amended to read as follows:

“(f) COORDINATION WITH SECTION 481.—Any change in method of accounting made pursuant to this section shall be treated for purposes of section 481 as initiated by the taxpayer and made with the consent of the Secretary.”

(C) CONFORMING AMENDMENTS.—Section 447 is amended—

(i) by striking subsections (d), (e), (h), and (i), and

(ii) by redesignating subsections (f) and (g) (as amended by subparagraph (B)) as subsections (d) and (e), respectively.

(b) EXEMPTION FROM UNICAP REQUIREMENTS.—

(1) IN GENERAL.—Section 263A is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

“(i) EXEMPTION FOR CERTAIN SMALL BUSINESSES.—

“(1) IN GENERAL.—In the case of any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c) for any taxable year, this section shall not apply with respect to such taxpayer for such taxable year.

“(2) APPLICATION OF GROSS RECEIPTS TEST TO INDIVIDUALS, ETC.— In the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if each trade or business of such taxpayer were a corporation or partnership.

“(3) COORDINATION WITH SECTION 481.—Any change in method of accounting made pursuant to this subsection shall be treated for purposes of section 481 as initiated by the taxpayer and made with the consent of the Secretary.”

(2) CONFORMING AMENDMENT.—Section 263A(b)(2) is amended to read as follows:

“(2) PROPERTY ACQUIRED FOR RESALE.—Real or personal property described in section 1221(a)(1) which is acquired by the taxpayer for resale.”

(c) EXEMPTION FROM INVENTORIES.—Section 471 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

“(c) EXEMPTION FOR CERTAIN SMALL BUSINESSES.—

“(1) IN GENERAL.—In the case of any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c) for any taxable year—

“(A) subsection (a) shall not apply with respect to such taxpayer for such taxable year, and

“(B) the taxpayer's method of accounting for inventory for such taxable year shall not be treated as failing to clearly reflect income if such method either—

“(i) treats inventory as non-incidental materials and supplies, or

“(ii) conforms to such taxpayer's method of accounting reflected in an applicable financial statement of the taxpayer with respect to such taxable year or, if the taxpayer does not have any applicable financial statement with respect to such taxable year,

the books and records of the taxpayer prepared in accordance with the taxpayer's accounting procedures.

“(2) APPLICABLE FINANCIAL STATEMENT.—For purposes of this subsection, the term ‘applicable financial statement’ has the meaning given the term in section 451(b)(3).

“(3) APPLICATION OF GROSS RECEIPTS TEST TO INDIVIDUALS, ETC.—In the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if each trade or business of such taxpayer were a corporation or partnership.

“(4) COORDINATION WITH SECTION 481.—Any change in method of accounting made pursuant to this subsection shall be treated for purposes of section 481 as initiated by the taxpayer and made with the consent of the Secretary.”.

(d) EXEMPTION FROM PERCENTAGE COMPLETION FOR LONG-TERM

CONTRACTS.—

(1) IN GENERAL.—Section 460(e)(1)(B) is amended—

(A) by inserting “(other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3))” after “taxpayer” in the matter preceding clause (i), and

(B) by amending clause (ii) to read as follows:

“(ii) who meets the gross receipts test of section 448(c) for the taxable year in which such contract is entered into.”.

(2) CONFORMING AMENDMENTS.—Section 460(e) is amended by striking paragraphs (2) and (3), by redesignating paragraphs (4), (5), and (6) as paragraphs (3), (4), and (5), respectively, and by inserting after paragraph (1) the following new paragraph:

“(2) RULES RELATED TO GROSS RECEIPTS TEST.—

“(A) APPLICATION OF GROSS RECEIPTS TEST TO INDIVIDUALS, ETC.— For purposes of paragraph (1)(B)(ii), in the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if each trade or business of such taxpayer were a corporation or partnership.

“(B) COORDINATION WITH SECTION 481.—Any change in method of accounting made pursuant to paragraph (1)(B)(ii) shall be treated as initiated by the taxpayer and made with the consent of the Secretary. Such change shall be effected on a cut-off basis for all similarly classified contracts entered into on or after the year of change.”.

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) PRESERVATION OF SUSPENSE ACCOUNT RULES WITH RESPECT TO ANY EXISTING SUSPENSE ACCOUNTS.—So much of the amendments made by subsection (a)(5)(C) as relate to section 447(i) of the Internal Revenue Code of 1986 shall not apply with respect to any suspense account established under such section before the date of the enactment of this Act.

(3) EXEMPTION FROM PERCENTAGE COMPLETION FOR LONG-TERM CONTRACTS.—The amendments made by subsection (d) shall apply to contracts entered into after December 31, 2017, in taxable years ending after such date.

**PART III—COST RECOVERY AND ACCOUNTING
METHODS**

Subpart A—Cost Recovery

SEC. 13201. TEMPORARY 100-PERCENT EXPENSING FOR CERTAIN BUSINESS ASSETS.

(a) INCREASED EXPENSING.—

(1) IN GENERAL.—Section 168(k) is amended—

(A) in paragraph (1)(A), by striking “50 percent” and inserting “the applicable percentage”, and

(B) in paragraph (5)(A)(i), by striking “50 percent” and inserting “the applicable percentage”.

(2) APPLICABLE PERCENTAGE.—Paragraph (6) of section 168(k) is amended to read as follows:

“(6) APPLICABLE PERCENTAGE.—For purposes of this subsection—

“(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term ‘applicable percentage’ means—

“(i) in the case of property placed in service after September 27, 2017, and before January 1, 2023, 100 percent,

“(ii) in the case of property placed in service after December 31, 2022, and before January 1, 2024, 80 percent,

“(iii) in the case of property placed in service after December 31, 2023, and before January 1, 2025, 60 percent,

“(iv) in the case of property placed in service after December 31, 2024, and before January 1, 2026, 40 percent, and

“(v) in the case of property placed in service after December 31, 2025, and before January 1, 2027, 20 percent.

“(B) RULE FOR PROPERTY WITH LONGER PRODUCTION PERIODS.—In the case of property described in subparagraph (B) or (C) of paragraph (2), the term ‘applicable percentage’ means—

“(i) in the case of property placed in service after September 27, 2017, and before January 1, 2024, 100 percent,

“(ii) in the case of property placed in service after December 31, 2023, and before January 1, 2025, 80 percent,

“(iii) in the case of property placed in service after December 31, 2024, and before January 1, 2026, 60 percent,

“(iv) in the case of property placed in service after December 31, 2025, and before January 1, 2027, 40 percent, and

“(v) in the case of property placed in service after December 31, 2026, and before January 1, 2028, 20 percent.

“(C) RULE FOR PLANTS BEARING FRUITS AND NUTS.—In the case of a specified plant described in paragraph (5), the term ‘applicable percentage’ means—

“(i) in the case of a plant which is planted or grafted after September 27, 2017, and before January 1, 2023, 100 percent,

“(ii) in the case of a plant which is planted or grafted after December 31, 2022, and before January 1, 2024, 80 percent,

“(iii) in the case of a plant which is planted or grafted after December 31, 2023, and before January 1, 2025, 60 percent,

“(iv) in the case of a plant which is planted or grafted after December 31, 2024, and before January 1, 2026, 40 percent, and

“(v) in the case of a plant which is planted or grafted after December 31, 2025, and before January 1, 2027, 20 percent.”

(3) CONFORMING AMENDMENT.—

(A) Paragraph (5) of section 168(k) is amended by striking subparagraph (F).

(B) Section 168(k) is amended by adding at the end the following new paragraph:

“(8) PHASE DOWN.—In the case of qualified property acquired by the taxpayer before September 28, 2017, and placed in service by the taxpayer after September 27, 2017, paragraph (6) shall be applied by substituting for each percentage therein—

“(A) ‘50 percent’ in the case of—

“(i) property placed in service before January 1, 2018, and

“(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service in 2018,

“(B) ‘40 percent’ in the case of—

“(i) property placed in service in 2018 (other than property described in subparagraph (B) or (C) of paragraph (2)), and

“(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service in 2019,

“(C) ‘30 percent’ in the case of—

“(i) property placed in service in 2019 (other than property described in subparagraph (B) or (C) of paragraph (2)), and

“(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service in 2020, and

“(D) ‘0 percent’ in the case of—

“(i) property placed in service after 2019 (other than property described in subparagraph (B) or (C) of paragraph (2)), and

“(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service after 2020.”

(b) EXTENSION.—

(1) IN GENERAL.—Section 168(k) is amended—

(A) in paragraph (2)—

(i) in subparagraph (A)(iii), clauses (i)(III) and (ii) of subparagraph (B), and subparagraph (E)(i), by striking “January 1, 2020” each place it appears and inserting “January 1, 2027”, and

(ii) in subparagraph (B)—

(I) in clause (i)(II), by striking “January 1, 2021” and inserting “January 1, 2028”, and

(II) in the heading of clause (ii), by striking “PRE-JANUARY 1, 2020” and inserting “PRE-JANUARY 1, 2027”, and

(B) in paragraph (5)(A), by striking “January 1, 2020” and inserting “January 1, 2027”.

(2) CONFORMING AMENDMENTS.—

(A) Clause (ii) of section 460(c)(6)(B) is amended by striking “January 1, 2020 (January 1, 2021” and inserting “January 1, 2027 (January 1, 2028”.

(B) The heading of section 168(k) is amended by striking “ACQUIRED AFTER DECEMBER 31, 2007, AND BEFORE JANUARY 1, 2020”.

(c) APPLICATION TO USED PROPERTY.—

(1) IN GENERAL.—Section 168(k)(2)(A)(ii) is amended to read as follows:

“(ii) the original use of which begins with the taxpayer or the acquisition of which by the taxpayer meets the requirements of clause (ii) of subparagraph (E), and”.

(2) ACQUISITION REQUIREMENTS.—Section 168(k)(2)(E)(ii) is amended to read as follows:

“(ii) ACQUISITION REQUIREMENTS.—An acquisition

of property meets the requirements of this clause if—

“(I) such property was not used by the taxpayer at any time prior to such acquisition, and

“(II) the acquisition of such property meets

the requirements of paragraphs (2)(A), (2)(B),

(2)(C), and (3) of section 179(d).”.

(3) ANTI-ABUSE RULES.—Section 168(k)(2)(E) is further amended by amending clause (iii)(I) to read as follows:

“(I) property is used by a lessor of such property and such use is the lessor’s first use of such

property.”.

(d) EXCEPTION FOR CERTAIN PROPERTY.—Section 168(k), as

amended by this section, is amended by adding at the end the

following new paragraph:

“(9) EXCEPTION FOR CERTAIN PROPERTY.—The term ‘qualified

property’ shall not include—

“(A) any property which is primarily used in a trade

or business described in clause (iv) of section 163(j)(7)(A),

or

“(B) any property used in a trade or business that

has had floor plan financing indebtedness (as defined in

paragraph (9) of section 163(j)), if the floor plan financing

interest related to such indebtedness was taken into

account under paragraph (1)(C) of such section.”.

(e) SPECIAL RULE.—Section 168(k), as amended by this section,

is amended by adding at the end the following new paragraph:

“(10) SPECIAL RULE FOR PROPERTY PLACED IN SERVICE

DURING CERTAIN PERIODS.—

“(A) IN GENERAL.—In the case of qualified property

placed in service by the taxpayer during the first taxable

year ending after September 27, 2017, if the taxpayer

elects to have this paragraph apply for such taxable year,

paragraphs (1)(A) and (5)(A)(i) shall be applied by substituting '50 percent' for 'the applicable percentage'.

"(B) FORM OF ELECTION.—Any election under this paragraph shall be made at such time and in such form and manner as the Secretary may prescribe."

(f) COORDINATION WITH SECTION 280F.—Clause (iii) of section 168(k)(2)(F) is amended by striking "placed in service by the taxpayer after December 31, 2017" and inserting "acquired by the taxpayer before September 28, 2017, and placed in service by the taxpayer after September 27, 2017".

(g) QUALIFIED FILM AND TELEVISION AND LIVE THEATRICAL PRODUCTIONS.—

(1) IN GENERAL.—Clause (i) of section 168(k)(2)(A), as amended by section 13204, is amended—

(A) in subclause (II), by striking "or",

(B) in subclause (III), by adding "or" after the comma, and

(C) by adding at the end the following:

"(IV) which is a qualified film or television production (as defined in subsection (d) of section 181) for which a deduction would have been allowable under section 181 without regard to subsections (a)(2) and (g) of such section or this subsection, or

"(V) which is a qualified live theatrical production (as defined in subsection (e) of section 181) for which a deduction would have been allowable under section 181 without regard to subsections (a)(2) and (g) of such section or this subsection,"

(2) PRODUCTION PLACED IN SERVICE.—Paragraph (2) of section 168(k) is amended by adding at the end the following:

"(H) PRODUCTION PLACED IN SERVICE.—For purposes of subparagraph (A)—

"(i) a qualified film or television production shall be considered to be placed in service at the time of initial release or broadcast, and

"(ii) a qualified live theatrical production shall be considered to be placed in service at the time of the initial live staged performance."

(h) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided by paragraph (2), the amendments made by this section shall apply to property which—

(A) is acquired after September 27, 2017, and

(B) is placed in service after such date.

For purposes of the preceding sentence, property shall not be treated as acquired after the date on which a written binding contract is entered into for such acquisition.

(2) SPECIFIED PLANTS.—The amendments made by this section shall apply to specified plants planted or grafted after September 27, 2017.

SEC. 13202. MODIFICATIONS TO DEPRECIATION LIMITATIONS ON LUXURY AUTOMOBILES AND PERSONAL USE PROPERTY.

(a) LUXURY AUTOMOBILES.—

(1) IN GENERAL.—280F(a)(1)(A) is amended—

(A) in clause (i), by striking "\$2,560" and inserting "\$10,000",

(B) in clause (ii), by striking “\$4,100” and inserting “\$16,000”,

(C) in clause (iii), by striking “\$2,450” and inserting “\$9,600”, and

(D) in clause (iv), by striking “\$1,475” and inserting “\$5,760”.

(2) CONFORMING AMENDMENTS.—

(A) Clause (ii) of section 280F(a)(1)(B) is amended by striking “\$1,475” in the text and heading and inserting “\$5,760”.

(B) Paragraph (7) of section 280F(d) is amended—

(i) in subparagraph (A), by striking “1988” and inserting “2018”, and

(ii) in subparagraph (B)(i)(II), by striking “1987” and inserting “2017”.

(b) REMOVAL OF COMPUTER EQUIPMENT FROM LISTED PROPERTY.—

(1) IN GENERAL.—Section 280F(d)(4)(A) is amended—

(A) by inserting “and” at the end of clause (iii),

(B) by striking clause (iv), and

(C) by redesignating clause (v) as clause (iv).

(2) CONFORMING AMENDMENT.—Section 280F(d)(4) is amended by striking subparagraph (B) and by redesignating subparagraph (C) as subparagraph (B).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service after December 31, 2017, in taxable years ending after such date.

SEC. 13203. MODIFICATIONS OF TREATMENT OF CERTAIN FARM PROPERTY.

(a) TREATMENT OF CERTAIN FARM PROPERTY AS 5-YEAR PROPERTY.—Clause (vii) of section 168(e)(3)(B) is amended by striking “after December 31, 2008, and which is placed in service before January 1, 2010” and inserting “after December 31, 2017”.

(b) REPEAL OF REQUIRED USE OF 150-PERCENT DECLINING BALANCE METHOD.—Section 168(b)(2) is amended by striking subparagraph (B) and by redesignating subparagraphs (C) and (D) as subparagraphs (B) and (C), respectively.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service after December 31, 2017, in taxable years ending after such date.

SEC. 13204. APPLICABLE RECOVERY PERIOD FOR REAL PROPERTY.

(a) IMPROVEMENTS TO REAL PROPERTY.—

(1) ELIMINATION OF QUALIFIED LEASEHOLD IMPROVEMENT, QUALIFIED RESTAURANT, AND QUALIFIED RETAIL IMPROVEMENT PROPERTY.—Subsection (e) of section 168 is amended—

(A) in subparagraph (E) of paragraph (3)—

(i) by striking clauses (iv), (v), and (ix),

(ii) in clause (vii), by inserting “and” at the end,

(iii) in clause (viii), by striking “, and” and inserting a period, and

(iv) by redesignating clauses (vi), (vii), and (viii), as so amended, as clauses (iv), (v), and (vi), respectively, and

(B) by striking paragraphs (6), (7), and (8).

(2) APPLICATION OF STRAIGHT LINE METHOD TO QUALIFIED IMPROVEMENT PROPERTY.—Paragraph (3) of section 168(b) is amended—

(A) by striking subparagraphs (G), (H), and (I), and (B) by inserting after subparagraph (F) the following new subparagraph:

“(G) Qualified improvement property described in subsection (e)(6).”

(3) ALTERNATIVE DEPRECIATION SYSTEM.—

(A) ELECTING REAL PROPERTY TRADE OR BUSINESS.—Subsection (g) of section 168 is amended—

(i) in paragraph (1)—

(I) in subparagraph (D), by striking “and” at the end,

(II) in subparagraph (E), by inserting “and” at the end, and

(III) by inserting after subparagraph (E) the following new subparagraph:

“(F) any property described in paragraph (8),” and

(ii) by adding at the end the following new paragraph:

“(8) ELECTING REAL PROPERTY TRADE OR BUSINESS.—The property described in this paragraph shall consist of any non-residential real property, residential rental property, and qualified improvement property held by an electing real property trade or business (as defined in 163(j)(7)(B)).”

(B) QUALIFIED IMPROVEMENT PROPERTY.—The table contained in subparagraph (B) of section 168(g)(3) is amended—

(i) by inserting after the item relating to subparagraph (D)(ii) the following new item:

“(D)(v) 20”

, and

(ii) by striking the item relating to subparagraph (E)(iv) and all that follows through the item relating to subparagraph (E)(ix) and inserting the following:

| | |
|----------------|------|
| “(E)(iv) | 20 |
| “(E)(v) | 30 |
| “(E)(vi) | 35”. |

(C) APPLICABLE RECOVERY PERIOD FOR RESIDENTIAL RENTAL PROPERTY.—The table contained in subparagraph (C) of section 168(g)(2) is amended by striking clauses (iii) and (iv) and inserting the following:

| | |
|--|------------|
| “(iii) Residential rental property | 30 years |
| “(iv) Nonresidential real property | 40 years |
| “(v) Any railroad grading or tunnel bore or water utility property | 50 years”. |

(4) CONFORMING AMENDMENTS.—

(A) Clause (i) of section 168(k)(2)(A) is amended—

(i) in subclause (II), by inserting “or” after the comma,

(ii) in subclause (III), by striking “or” at the end, and

(iii) by striking subclause (IV).

(B) Section 168 is amended—

(i) in subsection (e), as amended by paragraph (1)(B), by adding at the end the following:

“(6) QUALIFIED IMPROVEMENT PROPERTY.—

“(A) IN GENERAL.—The term ‘qualified improvement property’ means any improvement to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service.

“(B) CERTAIN IMPROVEMENTS NOT INCLUDED.—Such term shall not include any improvement for which the expenditure is attributable to—

“(i) the enlargement of the building,

“(ii) any elevator or escalator, or

“(iii) the internal structural framework of the building,” and

(ii) in subsection (k), by striking paragraph (3).

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to property placed in service after December 31, 2017.

(2) AMENDMENTS RELATED TO ELECTING REAL PROPERTY TRADE OR BUSINESS.—The amendments made by subsection (a)(3)(A) shall apply to taxable years beginning after December 31, 2017.

SEC. 13205. USE OF ALTERNATIVE DEPRECIATION SYSTEM FOR ELECTING FARMING BUSINESSES.

(a) IN GENERAL.—Section 168(g)(1), as amended by section 13204, is amended by striking “and” at the end of subparagraph (E), by inserting “and” at the end of subparagraph (F), and by inserting after subparagraph (F) the following new subparagraph:

“(G) any property with a recovery period of 10 years or more which is held by an electing farming business (as defined in section 163(j)(7)(C)).”.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13206. AMORTIZATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.

(a) IN GENERAL.—Section 174 is amended to read as follows:

“SEC. 174. AMORTIZATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.

“(a) IN GENERAL.—In the case of a taxpayer’s specified research or experimental expenditures for any taxable year—

“(1) except as provided in paragraph (2), no deduction shall be allowed for such expenditures, and

“(2) the taxpayer shall—

“(A) charge such expenditures to capital account, and

“(B) be allowed an amortization deduction of such expenditures ratably over the 5-year period (15-year period in the case of any specified research or experimental expenditures which are attributable to foreign research (within the meaning of section 41(d)(4)(F))) beginning with the midpoint of the taxable year in which such expenditures are paid or incurred.

“(b) SPECIFIED RESEARCH OR EXPERIMENTAL EXPENDITURES.—For purposes of this section, the term ‘specified research or experimental expenditures’ means, with respect to any taxable year, research or experimental expenditures which are paid or incurred

by the taxpayer during such taxable year in connection with the taxpayer's trade or business.

“(c) SPECIAL RULES.—

“(1) LAND AND OTHER PROPERTY.—This section shall not apply to any expenditure for the acquisition or improvement of land, or for the acquisition or improvement of property to be used in connection with the research or experimentation and of a character which is subject to the allowance under section 167 (relating to allowance for depreciation, etc.) or section 611 (relating to allowance for depletion); but for purposes of this section allowances under section 167, and allowances under section 611, shall be considered as expenditures.

“(2) EXPLORATION EXPENDITURES.—This section shall not apply to any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

“(3) SOFTWARE DEVELOPMENT.—For purposes of this section, any amount paid or incurred in connection with the development of any software shall be treated as a research or experimental expenditure.

“(d) TREATMENT UPON DISPOSITION, RETIREMENT, OR ABANDONMENT.—If any property with respect to which specified research or experimental expenditures are paid or incurred is disposed, retired, or abandoned during the period during which such expenditures are allowed as an amortization deduction under this section, no deduction shall be allowed with respect to such expenditures on account of such disposition, retirement, or abandonment and such amortization deduction shall continue with respect to such expenditures.”.

(b) CHANGE IN METHOD OF ACCOUNTING.—The amendments made by subsection (a) shall be treated as a change in method of accounting for purposes of section 481 of the Internal Revenue Code of 1986 and—

(1) such change shall be treated as initiated by the taxpayer,

(2) such change shall be treated as made with the consent of the Secretary, and

(3) such change shall be applied only on a cut-off basis for any research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021, and no adjustments under section 481(a) shall be made.

(c) CLERICAL AMENDMENT.—The table of sections for part VI of subchapter B of chapter 1 is amended by striking the item relating to section 174 and inserting the following new item:

“Sec. 174. Amortization of research and experimental expenditures.”.

(d) CONFORMING AMENDMENTS.—

(1) Section 41(d)(1)(A) is amended by striking “expenses under section 174” and inserting “specified research or experimental expenditures under section 174”.

(2) Subsection (c) of section 280C is amended—

(A) by striking paragraph (1) and inserting the following:

“(1) IN GENERAL.—If—

“(A) the amount of the credit determined for the taxable year under section 41(a)(1), exceeds

“(B) the amount allowable as a deduction for such taxable year for qualified research expenses or basic research expenses, the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess.”

(B) by striking paragraph (2),
(C) by redesignating paragraphs (3) (as amended by this Act) and (4) as paragraphs (2) and (3), respectively, and

(D) in paragraph (2), as redesignated by subparagraph (C), by striking “paragraphs (1) and (2)” and inserting “paragraph (1)”.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred in taxable years beginning after December 31, 2021.

SEC. 13207. EXPENSING OF CERTAIN COSTS OF REPLANTING CITRUS PLANTS LOST BY REASON OF CASUALTY.

(a) IN GENERAL.—Section 263A(d)(2) is amended by adding at the end the following new subparagraph:

“(C) SPECIAL TEMPORARY RULE FOR CITRUS PLANTS LOST BY REASON OF CASUALTY.—

“(i) IN GENERAL.—In the case of the replanting of citrus plants, subparagraph (A) shall apply to amounts paid or incurred by a person (other than the taxpayer described in subparagraph (A)) if—

“(I) the taxpayer described in subparagraph (A) has an equity interest of not less than 50 percent in the replanted citrus plants at all times during the taxable year in which such amounts were paid or incurred and such other person holds any part of the remaining equity interest, or

“(II) such other person acquired the entirety of such taxpayer’s equity interest in the land on which the lost or damaged citrus plants were located at the time of such loss or damage, and the replanting is on such land.

“(ii) TERMINATION.—Clause (i) shall not apply to any cost paid or incurred after the date which is 10 years after the date of the enactment of the Tax Cuts and Jobs Act.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to costs paid or incurred after the date of the enactment of this Act.

Subpart B—Accounting Methods

SEC. 13221. CERTAIN SPECIAL RULES FOR TAXABLE YEAR OF INCLUSION.

(a) INCLUSION NOT LATER THAN FOR FINANCIAL ACCOUNTING PURPOSES.—Section 451 is amended by redesignating subsections (b) through (i) as subsections (c) through (j), respectively, and by inserting after subsection (a) the following new subsection:

“(b) INCLUSION NOT LATER THAN FOR FINANCIAL ACCOUNTING PURPOSES.—

“(1) INCOME TAKEN INTO ACCOUNT IN FINANCIAL STATEMENT.—

“(A) IN GENERAL.—In the case of a taxpayer the taxable income of which is computed under an accrual method of accounting, the all events test with respect to any item of gross income (or portion thereof) shall not be treated as met any later than when such item (or portion thereof) is taken into account as revenue in—

“(i) an applicable financial statement of the taxpayer, or

“(ii) such other financial statement as the Secretary may specify for purposes of this subsection.

“(B) EXCEPTION.—This paragraph shall not apply to—

“(i) a taxpayer which does not have a financial statement described in clause (i) or (ii) of subparagraph (A) for a taxable year, or

“(ii) any item of gross income in connection with a mortgage servicing contract.

“(C) ALL EVENTS TEST.—For purposes of this section, the all events test is met with respect to any item of gross income if all the events have occurred which fix the right to receive such income and the amount of such income can be determined with reasonable accuracy.

“(2) COORDINATION WITH SPECIAL METHODS OF ACCOUNTING.—Paragraph (1) shall not apply with respect to any item of gross income for which the taxpayer uses a special method of accounting provided under any other provision of this chapter, other than any provision of part V of subchapter P (except as provided in clause (ii) of paragraph (1)(B)).

“(3) APPLICABLE FINANCIAL STATEMENT.—For purposes of this subsection, 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,

“(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 United States Securities and Exchange Commission 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).

“(4) ALLOCATION OF TRANSACTION PRICE.—For purposes of this subsection, in the case of a contract which contains multiple performance obligations, the allocation of the transaction price to each performance obligation shall be equal to the amount allocated to each performance obligation for purposes of including such item in revenue in the applicable financial statement of the taxpayer.

“(5) GROUP OF ENTITIES.—For purposes of paragraph (1), if the financial results of a taxpayer are reported on the applicable financial statement (as defined in paragraph (3)) for a group of entities, such statement shall be treated as the applicable financial statement of the taxpayer.”

(b) TREATMENT OF ADVANCE PAYMENTS.—Section 451, as amended by subsection (a), is amended by redesignating subsections (c) through (j) as subsections (d) through (k), respectively, and by inserting after subsection (b) the following new subsection:

“(c) TREATMENT OF ADVANCE PAYMENTS.—

“(1) IN GENERAL.—A taxpayer which computes taxable income under the accrual method of accounting, and receives any advance payment during the taxable year, shall—

“(A) except as provided in subparagraph (B), include such advance payment in gross income for such taxable year, or

“(B) if the taxpayer elects the application of this subparagraph with respect to the category of advance payments to which such advance payment belongs, the taxpayer shall—

“(i) to the extent that any portion of such advance payment is required under subsection (b) to be included in gross income in the taxable year in which such payment is received, so include such portion, and

“(ii) include the remaining portion of such advance payment in gross income in the taxable year following the taxable year in which such payment is received.

“(2) ELECTION.—

“(A) IN GENERAL.—Except as otherwise provided in this paragraph, the election under paragraph (1)(B) 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.

“(B) PERIOD TO WHICH ELECTION APPLIES.—An election under paragraph (1)(B) shall be effective for the taxable year with respect to which it is first made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to revoke such election. For purposes of this title, the computation of taxable income under an election made under paragraph (1)(B) shall be treated as a method of accounting.

“(3) TAXPAYERS CEASING TO EXIST.—Except as otherwise provided by the Secretary, the election under paragraph (1)(B) shall not apply with respect to advance payments received

by the taxpayer during a taxable year if such taxpayer ceases to exist during (or with the close of) such taxable year.

“(4) ADVANCE PAYMENT.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘advance payment’ means any payment—

“(i) the full inclusion of which in the gross income of the taxpayer for the taxable year of receipt is a permissible method of accounting under this section (determined without regard to this subsection),

“(ii) any portion of which is included in revenue by the taxpayer in a financial statement described in clause (i) or (ii) of subsection (b)(1)(A) for a subsequent taxable year, and

“(iii) which is for goods, services, or such other items as may be identified by the Secretary for purposes of this clause.

“(B) EXCLUSIONS.—Except as otherwise provided by the Secretary, such term shall not include—

“(i) rent,

“(ii) insurance premiums governed by subchapter L,

“(iii) payments with respect to financial instruments,

“(iv) payments with respect to warranty or guarantee contracts under which a third party is the primary obligor,

“(v) payments subject to section 871(a), 881, 1441, or 1442,

“(vi) payments in property to which section 83 applies, and

“(vii) any other payment identified by the Secretary for purposes of this subparagraph.

“(C) RECEIPT.—For purposes of this subsection, an item of gross income is received by the taxpayer if it is actually or constructively received, or if it is due and payable to the taxpayer.

“(D) ALLOCATION OF TRANSACTION PRICE.—For purposes of this subsection, rules similar to subsection (b)(4) shall apply.”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(d) COORDINATION WITH SECTION 481.—

(1) IN GENERAL.—In the case of any qualified change in method of accounting for the taxpayer’s first taxable year beginning after December 31, 2017—

(A) such change shall be treated as initiated by the taxpayer, and

(B) such change shall be treated as made with the consent of the Secretary of the Treasury.

(2) QUALIFIED CHANGE IN METHOD OF ACCOUNTING.—For purposes of this subsection, the term “qualified change in method of accounting” means any change in method of accounting which—

(A) is required by the amendments made by this section, or

(B) was prohibited under the Internal Revenue Code of 1986 prior to such amendments and is permitted under such Code after such amendments.

(e) SPECIAL RULES FOR ORIGINAL ISSUE DISCOUNT.—Notwithstanding subsection (c), in the case of income from a debt instrument having original issue discount—

(1) the amendments made by this section shall apply to taxable years beginning after December 31, 2018, and

(2) the period for taking into account any adjustments under section 481 by reason of a qualified change in method of accounting (as defined in subsection (d)) shall be 6 years.

PART IV—BUSINESS-RELATED EXCLUSIONS AND DEDUCTIONS

SEC. 13301. LIMITATION ON DEDUCTION FOR INTEREST.

(a) IN GENERAL.—Section 163(j) is amended to read as follows:

“(j) LIMITATION ON BUSINESS INTEREST.—

“(1) IN GENERAL.—The amount allowed as a deduction under this chapter for any taxable year for business interest shall not exceed the sum of—

“(A) the business interest income of such taxpayer for such taxable year,

“(B) 30 percent of the adjusted taxable income of such taxpayer for such taxable year, plus

“(C) the floor plan financing interest of such taxpayer for such taxable year.

The amount determined under subparagraph (B) shall not be less than zero.

“(2) CARRYFORWARD OF DISALLOWED BUSINESS INTEREST.—

The amount of any business interest not allowed as a deduction for any taxable year by reason of paragraph (1) shall be treated as business interest paid or accrued in the succeeding taxable year.

“(3) EXEMPTION FOR CERTAIN SMALL BUSINESSES.—In the case of any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c) for any taxable year, paragraph (1) shall not apply to such taxpayer for such taxable year. In the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if such taxpayer were a corporation or partnership.

“(4) APPLICATION TO PARTNERSHIPS, ETC.—

“(A) IN GENERAL.—In the case of any partnership—

“(i) this subsection shall be applied at the partnership level and any deduction for business interest shall be taken into account in determining the non-separately stated taxable income or loss of the partnership, and

“(ii) the adjusted taxable income of each partner of such partnership—

“(I) shall be determined without regard to such partner's distributive share of any items of income, gain, deduction, or loss of such partnership, and

“(II) shall be increased by such partner’s distributive share of such partnership’s excess taxable income.

For purposes of clause (ii)(II), a partner’s distributive share of partnership excess taxable income shall be determined in the same manner as the partner’s distributive share of nonseparately stated taxable income or loss of the partnership.

“(B) SPECIAL RULES FOR CARRYFORWARDS.—

“(i) IN GENERAL.—The amount of any business interest not allowed as a deduction to a partnership for any taxable year by reason of paragraph (1) for any taxable year—

“(I) shall not be treated under paragraph (2) as business interest paid or accrued by the partnership in the succeeding taxable year, and

“(II) shall, subject to clause (ii), be treated as excess business interest which is allocated to each partner in the same manner as the nonseparately stated taxable income or loss of the partnership.

“(ii) TREATMENT OF EXCESS BUSINESS INTEREST ALLOCATED TO PARTNERS.—If a partner is allocated any excess business interest from a partnership under clause (i) for any taxable year—

“(I) such excess business interest shall be treated as business interest paid or accrued by the partner in the next succeeding taxable year in which the partner is allocated excess taxable income from such partnership, but only to the extent of such excess taxable income, and

“(II) any portion of such excess business interest remaining after the application of subclause (I) shall, subject to the limitations of subclause (I), be treated as business interest paid or accrued in succeeding taxable years.

For purposes of applying this paragraph, excess taxable income allocated to a partner from a partnership for any taxable year shall not be taken into account under paragraph (1)(A) with respect to any business interest other than excess business interest from the partnership until all such excess business interest for such taxable year and all preceding taxable years has been treated as paid or accrued under clause (ii).

“(iii) BASIS ADJUSTMENTS.—

“(I) IN GENERAL.—The adjusted basis of a partner in a partnership interest shall be reduced (but not below zero) by the amount of excess business interest allocated to the partner under clause (i)(II).

“(II) SPECIAL RULE FOR DISPOSITIONS.—If a partner disposes of a partnership interest, the adjusted basis of the partner in the partnership interest shall be increased immediately before the disposition by the amount of the excess (if any) of the amount of the basis reduction under subclause (I) over the portion of any excess business

interest allocated to the partner under clause (i)(II) which has previously been treated under clause (ii) as business interest paid or accrued by the partner. The preceding sentence shall also apply to transfers of the partnership interest (including by reason of death) in a transaction in which gain is not recognized in whole or in part. No deduction shall be allowed to the transferor or transferee under this chapter for any excess business interest resulting in a basis increase under this subclause.

“(C) EXCESS TAXABLE INCOME.—The term ‘excess taxable income’ means, with respect to any partnership, the amount which bears the same ratio to the partnership’s adjusted taxable income as—

“(i) the excess (if any) of—

“(I) the amount determined for the partnership under paragraph (1)(B), over

“(II) the amount (if any) by which the business interest of the partnership, reduced by the floor plan financing interest, exceeds the business interest income of the partnership, bears to

“(ii) the amount determined for the partnership under paragraph (1)(B).

“(D) APPLICATION TO S CORPORATIONS.—Rules similar to the rules of subparagraphs (A) and (C) shall apply with respect to any S corporation and its shareholders.

“(5) BUSINESS INTEREST.—For purposes of this subsection, the term ‘business interest’ means any interest paid or accrued on indebtedness properly allocable to a trade or business. Such term shall not include investment interest (within the meaning of subsection (d)).

“(6) BUSINESS INTEREST INCOME.—For purposes of this subsection, the term ‘business interest income’ means the amount of interest includible in the gross income of the taxpayer for the taxable year which is properly allocable to a trade or business. Such term shall not include investment income (within the meaning of subsection (d)).

“(7) TRADE OR BUSINESS.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘trade or business’ shall not include—

“(i) the trade or business of performing services as an employee,

“(ii) any electing real property trade or business,

“(iii) any electing farming business, or

“(iv) the trade or business of the furnishing or sale of—

“(I) electrical energy, water, or sewage disposal services,

“(II) gas or steam through a local distribution system, or

“(III) transportation of gas or steam by pipeline,

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, by a public service or public utility commission or other similar

body of any State or political subdivision thereof, or by the governing or ratemaking body of an electric cooperative.

“(B) ELECTING REAL PROPERTY TRADE OR BUSINESS.—For purposes of this paragraph, the term ‘electing real property trade or business’ means any trade or business which is described in section 469(c)(7)(C) and which makes an election under this subparagraph. Any such election shall be made at such time and in such manner as the Secretary shall prescribe, and, once made, shall be irrevocable.

“(C) ELECTING FARMING BUSINESS.—For purposes of this paragraph, the term ‘electing farming business’ means—

“(i) a farming business (as defined in section 263A(e)(4)) which makes an election under this subparagraph, or

“(ii) any trade or business of a specified agricultural or horticultural cooperative (as defined in section 199A(g)(2)) with respect to which the cooperative makes an election under this subparagraph.

Any such election shall be made at such time and in such manner as the Secretary shall prescribe, and, once made, shall be irrevocable.

“(8) ADJUSTED TAXABLE INCOME.—For purposes of this subsection, the term ‘adjusted taxable income’ means the taxable income of the taxpayer—

“(A) computed without regard to—

“(i) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business,

“(ii) any business interest or business interest income,

“(iii) the amount of any net operating loss deduction under section 172,

“(iv) the amount of any deduction allowed under section 199A, and

“(v) in the case of taxable years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion, and

“(B) computed with such other adjustments as provided by the Secretary.

“(9) FLOOR PLAN FINANCING INTEREST DEFINED.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘floor plan financing interest’ means interest paid or accrued on floor plan financing indebtedness.

“(B) FLOOR PLAN FINANCING INDEBTEDNESS.—The term ‘floor plan financing indebtedness’ means indebtedness—

“(i) used to finance the acquisition of motor vehicles held for sale or lease, and

“(ii) secured by the inventory so acquired.

“(C) MOTOR VEHICLE.—The term ‘motor vehicle’ means a motor vehicle that is any of the following:

“(i) Any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road.

“(ii) A boat.

“(iii) Farm machinery or equipment.

“(10) CROSS REFERENCES.—

“(A) For requirement that an electing real property trade or business use the alternative depreciation system, see section 168(g)(1)(F).

“(B) For requirement that an electing farming business use the alternative depreciation system, see section 168(g)(1)(G).”

(b) TREATMENT OF CARRYFORWARD OF DISALLOWED BUSINESS INTEREST IN CERTAIN CORPORATE ACQUISITIONS.—

(1) IN GENERAL.—Section 381(c) is amended by inserting after paragraph (19) the following new paragraph:

“(20) CARRYFORWARD OF DISALLOWED BUSINESS INTEREST.—The carryover of disallowed business interest described in section 163(j)(2) to taxable years ending after the date of distribution or transfer.”

(2) APPLICATION OF LIMITATION.—Section 382(d) is amended by adding at the end the following new paragraph:

“(3) APPLICATION TO CARRYFORWARD OF DISALLOWED INTEREST.—The term ‘pre-change loss’ shall include any carryover of disallowed interest described in section 163(j)(2) under rules similar to the rules of paragraph (1).”

(3) CONFORMING AMENDMENT.—Section 382(k)(1) is amended by inserting after the first sentence the following: “Such term shall include any corporation entitled to use a carryforward of disallowed interest described in section 381(c)(20).”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13302. MODIFICATION OF NET OPERATING LOSS DEDUCTION.

(a) LIMITATION ON DEDUCTION.—

(1) IN GENERAL.—Section 172(a) is amended to read as follows:

“(a) DEDUCTION ALLOWED.—There shall be allowed as a deduction for the taxable year an amount equal to the lesser of—

“(1) the aggregate of the net operating loss carryovers to such year, plus the net operating loss carrybacks to such year, or

“(2) 80 percent of taxable income computed without regard to the deduction allowable under this section.

For purposes of this subtitle, the term ‘net operating loss deduction’ means the deduction allowed by this subsection.”

(2) COORDINATION OF LIMITATION WITH CARRYBACKS AND CARRYOVERS.—Section 172(b)(2) is amended by striking “shall be computed—” and all that follows and inserting “shall—

“(A) be computed with the modifications specified in subsection (d) other than paragraphs (1), (4), and (5) thereof, and by determining the amount of the net operating loss deduction without regard to the net operating loss for the loss year or for any taxable year thereafter,

“(B) not be considered to be less than zero, and

“(C) not exceed the amount determined under subsection (a)(2) for such prior taxable year.”

(3) CONFORMING AMENDMENT.—Section 172(d)(6) is amended by striking “and” at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and

inserting “; and”, and by adding at the end the following new subparagraph:

“(C) subsection (a)(2) shall be applied by substituting ‘real estate investment trust taxable income (as defined in section 857(b)(2) but without regard to the deduction for dividends paid (as defined in section 561))’ for ‘taxable income’.”

(b) REPEAL OF NET OPERATING LOSS CARRYBACK; INDEFINITE CARRYFORWARD.—

(1) IN GENERAL.—Section 172(b)(1)(A) is amended—

(A) by striking “shall be a net operating loss carryback to each of the 2 taxable years” in clause (i) and inserting “except as otherwise provided in this paragraph, shall not be a net operating loss carryback to any taxable year”, and

(B) by striking “to each of the 20 taxable years” in clause (ii) and inserting “to each taxable year”.

(2) CONFORMING AMENDMENT.—Section 172(b)(1) is amended by striking subparagraphs (B) through (F).

(c) TREATMENT OF FARMING LOSSES.—

(1) ALLOWANCE OF CARRYBACKS.—Section 172(b)(1), as amended by subsection (b)(2), is amended by adding at the end the following new subparagraph:

“(B) FARMING LOSSES.—

“(i) IN GENERAL.—In the case of any portion of a net operating loss for the taxable year which is a farming loss with respect to the taxpayer, such loss shall be a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss.

“(ii) FARMING LOSS.—For purposes of this section, the term ‘farming loss’ means the lesser of—

“(I) the amount which would be the net operating loss for the taxable year if only income and deductions attributable to farming businesses (as defined in section 263A(e)(4)) are taken into account, or

“(II) the amount of the net operating loss for such taxable year.

“(iii) COORDINATION WITH PARAGRAPH (2).—For purposes of applying paragraph (2), a farming loss for any taxable year shall be treated as a separate net operating loss for such taxable year to be taken into account after the remaining portion of the net operating loss for such taxable year.

“(iv) ELECTION.—Any taxpayer entitled to a 2-year carryback under clause (i) from any loss year may elect not to have such clause apply to such loss year. Such election shall be made in such manner as prescribed by the Secretary and shall be made by the due date (including extensions of time) for filing the taxpayer’s return for the taxable year of the net operating loss. Such election, once made for any taxable year, shall be irrevocable for such taxable year.”

(2) CONFORMING AMENDMENTS.—

(A) Section 172 is amended by striking subsections (f), (g), and (h), and by redesignating subsection (i) as subsection (f).

(B) Section 537(b)(4) is amended by inserting “(as in effect before the date of enactment of the Tax Cuts and Jobs Act)” after “as defined in section 172(f)”.

(d) TREATMENT OF CERTAIN INSURANCE LOSSES.—

(1) TREATMENT OF CARRYFORWARDS AND CARRYBACKS.—Section 172(b)(1), as amended by subsections (b)(2) and (c)(1), is amended by adding at the end the following new subparagraph:

“(C) INSURANCE COMPANIES.—In the case of an insurance company (as defined in section 816(a)) other than a life insurance company, the net operating loss for any taxable year—

“(i) shall be a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, and

“(ii) shall be a net operating loss carryover to each of the 20 taxable years following the taxable year of the loss.”.

(2) EXEMPTION FROM LIMITATION.—Section 172, as amended by subsection (c)(2)(A), is amended by redesignating subsection (f) as subsection (g) and inserting after subsection (e) the following new subsection:

“(f) SPECIAL RULE FOR INSURANCE COMPANIES.—In the case of an insurance company (as defined in section 816(a)) other than a life insurance company—

“(1) the amount of the deduction allowed under subsection (a) shall be the aggregate of the net operating loss carryovers to such year, plus the net operating loss carrybacks to such year, and

“(2) subparagraph (C) of subsection (b)(2) shall not apply.”.

(e) EFFECTIVE DATE.—

(1) NET OPERATING LOSS LIMITATION.—The amendments made by subsections (a) and (d)(2) shall apply to losses arising in taxable years beginning after December 31, 2017.

(2) CARRYFORWARDS AND CARRYBACKS.—The amendments made by subsections (b), (c), and (d)(1) shall apply to net operating losses arising in taxable years ending after December 31, 2017.

SEC. 13303. LIKE-KIND EXCHANGES OF REAL PROPERTY.

(a) IN GENERAL.—Section 1031(a)(1) is amended by striking “property” each place it appears and inserting “real property”.

(b) CONFORMING AMENDMENTS.—

(1)(A) Paragraph (2) of section 1031(a) is amended to read as follows:

“(2) EXCEPTION FOR REAL PROPERTY HELD FOR SALE.—This subsection shall not apply to any exchange of real property held primarily for sale.”.

(B) Section 1031 is amended by striking subsection (i).

(2) Section 1031 is amended by striking subsection (e).

(3) Section 1031, as amended by paragraph (2), is amended by inserting after subsection (d) the following new subsection:

“(e) APPLICATION TO CERTAIN PARTNERSHIPS.—For purposes of this section, an interest in a partnership which has in effect a

valid election under section 761(a) to be excluded from the application of all of subchapter K shall be treated as an interest in each of the assets of such partnership and not as an interest in a partnership.”

(4) Section 1031(h) is amended to read as follows:

“(h) SPECIAL RULES FOR FOREIGN REAL PROPERTY.—Real property located in the United States and real property located outside the United States are not property of a like kind.”

(5) The heading of section 1031 is amended by striking “PROPERTY” and inserting “REAL PROPERTY”.

(6) The table of sections for part III of subchapter O of chapter 1 is amended by striking the item relating to section 1031 and inserting the following new item:

“Sec. 1031. Exchange of real property held for productive use or investment.”

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to exchanges completed after December 31, 2017.

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any exchange if—

(A) the property disposed of by the taxpayer in the exchange is disposed of on or before December 31, 2017, or

(B) the property received by the taxpayer in the exchange is received on or before December 31, 2017.

SEC. 13304. LIMITATION ON DEDUCTION BY EMPLOYERS OF EXPENSES FOR FRINGE BENEFITS.

(a) NO DEDUCTION ALLOWED FOR ENTERTAINMENT EXPENSES.—

(1) IN GENERAL.—Section 274(a) is amended—

(A) in paragraph (1)(A), by striking “unless” and all that follows through “trade or business,”

(B) by striking the flush sentence at the end of paragraph (1), and

(C) by striking paragraph (2)(C).

(2) CONFORMING AMENDMENTS.—

(A) Section 274(d) is amended—

(i) by striking paragraph (2) and redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively, and

(ii) in the flush text following paragraph (3) (as so redesignated)—

(I) by striking “, entertainment, amusement, recreation, or use of the facility or property,” in item (B), and

(II) by striking “(D) the business relationship to the taxpayer of persons entertained, using the facility or property, or receiving the gift” and inserting “(D) the business relationship to the taxpayer of the person receiving the benefit”.

(B) Section 274 is amended by striking subsection (1).

(C) Section 274(n) is amended by striking “AND ENTERTAINMENT” in the heading.

(D) Section 274(n)(1) is amended to read as follows:

“(1) IN GENERAL.—The amount allowable as a deduction under this chapter for any expense for food or beverages shall

not exceed 50 percent of the amount of such expense which would (but for this paragraph) be allowable as a deduction under this chapter.”

(E) Section 274(n)(2) is amended—

(i) in subparagraph (B), by striking “in the case of an expense for food or beverages,”

(ii) by striking subparagraph (C) and redesignating subparagraphs (D) and (E) as subparagraphs (C) and (D), respectively,

(iii) by striking “of subparagraph (E)” the last sentence and inserting “of subparagraph (D)”, and

(iv) by striking “in subparagraph (D)” in the last sentence and inserting “in subparagraph (C)”.

(F) Clause (iv) of section 7701(b)(5)(A) is amended to read as follows:

“(iv) a professional athlete who is temporarily in the United States to compete in a sports event—

“(I) which is organized for the primary purpose of benefiting an organization which is described in section 501(c)(3) and exempt from tax under section 501(a),

“(II) all of the net proceeds of which are contributed to such organization, and,

“(III) which utilizes volunteers for substantially all of the work performed in carrying out such event.”

(b) ONLY 50 PERCENT OF EXPENSES FOR MEALS PROVIDED ON OR NEAR BUSINESS PREMISES ALLOWED AS DEDUCTION.—Paragraph (2) of section 274(n), as amended by subsection (a), is amended—

(1) by striking subparagraph (B),

(2) by redesignating subparagraphs (C) and (D) as subparagraphs (B) and (C), respectively,

(3) by striking “of subparagraph (D)” in the last sentence and inserting “of subparagraph (C)”, and

(4) by striking “in subparagraph (C)” in the last sentence and inserting “in subparagraph (B)”.

(c) TREATMENT OF TRANSPORTATION BENEFITS.—Section 274, as amended by subsection (a), is amended—

(1) in subsection (a)—

(A) in the heading, by striking “OR RECREATION” and inserting “RECREATION, OR QUALIFIED TRANSPORTATION FRINGES”, and

(B) by adding at the end the following new paragraph:

“(4) QUALIFIED TRANSPORTATION FRINGES.—No deduction shall be allowed under this chapter for the expense of any qualified transportation fringe (as defined in section 132(f)) provided to an employee of the taxpayer.” and

(2) by inserting after subsection (k) the following new subsection:

“(1) TRANSPORTATION AND COMMUTING BENEFITS.—

“(1) IN GENERAL.—No deduction shall be allowed under this chapter for any expense incurred for providing any transportation, or any payment or reimbursement, to an employee of the taxpayer in connection with travel between the employee’s residence and place of employment, except as necessary for ensuring the safety of the employee.

“(2) EXCEPTION.—In the case of any qualified bicycle commuting reimbursement (as described in section 132(f)(5)(F)), this subsection shall not apply for any amounts paid or incurred after December 31, 2017, and before January 1, 2026.”.

(d) ELIMINATION OF DEDUCTION FOR MEALS PROVIDED AT CONVENIENCE OF EMPLOYER.—Section 274, as amended by subsection (c), is amended—

- (1) by redesignating subsection (o) as subsection (p), and
- (2) by inserting after subsection (n) the following new subsection:

“(o) MEALS PROVIDED AT CONVENIENCE OF EMPLOYER.—No deduction shall be allowed under this chapter for—

“(1) any expense for the operation of a facility described in section 132(e)(2), and any expense for food or beverages, including under section 132(e)(1), associated with such facility, or

“(2) any expense for meals described in section 119(a).”.

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to amounts incurred or paid after December 31, 2017.

(2) EFFECTIVE DATE FOR ELIMINATION OF DEDUCTION FOR MEALS PROVIDED AT CONVENIENCE OF EMPLOYER.—The amendments made by subsection (d) shall apply to amounts incurred or paid after December 31, 2025.

SEC. 13305. REPEAL OF DEDUCTION FOR INCOME ATTRIBUTABLE TO DOMESTIC PRODUCTION ACTIVITIES.

(a) IN GENERAL.—Part VI of subchapter B of chapter 1 is amended by striking section 199 (and by striking the item relating to such section in the table of sections for such part).

(b) CONFORMING AMENDMENTS.—

(1) Sections 74(d)(2)(B), 86(b)(2)(A), 135(c)(4)(A), 137(b)(3)(A), 219(g)(3)(A)(ii), 221(b)(2)(C), 222(b)(2)(C), 246(b)(1), and 469(i)(3)(F)(iii) are each amended by striking “199.”.

(2) Section 170(b)(2)(D), as amended by subtitle A, is amended by striking clause (iv), and by redesignating clauses (v) and (vi) as clauses (iv) and (v).

(3) Section 172(d) is amended by striking paragraph (7).

(4) Section 613(a), as amended by section 11011, is amended by striking “and without the deduction under section 199”.

(5) Section 613A(d)(1), as amended by section 11011, is amended by striking subparagraph (B) and by redesignating subparagraphs (C), (D), (E), and (F) as subparagraphs (B), (C), (D), and (E), respectively.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13306. DENIAL OF DEDUCTION FOR CERTAIN FINES, PENALTIES, AND OTHER AMOUNTS.

(a) DENIAL OF DEDUCTION.—

(1) IN GENERAL.—Subsection (f) of section 162 is amended to read as follows:

“(f) FINES, PENALTIES, AND OTHER AMOUNTS.—

“(1) IN GENERAL.—Except as provided in the following paragraphs of this subsection, no deduction otherwise allowable

shall be allowed under this chapter for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law.

“(2) EXCEPTION FOR AMOUNTS CONSTITUTING RESTITUTION OR PAID TO COME INTO COMPLIANCE WITH LAW.—

“(A) IN GENERAL.—Paragraph (1) shall not apply to any amount that—

“(i) the taxpayer establishes—

“(I) constitutes restitution (including remediation of property) for damage or harm which was or may be caused by the violation of any law or the potential violation of any law, or

“(II) is paid to come into compliance with any law which was violated or otherwise involved in the investigation or inquiry described in paragraph (1),

“(ii) is identified as restitution or as an amount paid to come into compliance with such law, as the case may be, in the court order or settlement agreement, and

“(iii) in the case of any amount of restitution for failure to pay any tax imposed under this title in the same manner as if such amount were such tax, would have been allowed as a deduction under this chapter if it had been timely paid.

The identification under clause (ii) alone shall not be sufficient to make the establishment required under clause (i).

“(B) LIMITATION.—Subparagraph (A) shall not apply to any amount paid or incurred as reimbursement to the government or entity for the costs of any investigation or litigation.

“(3) EXCEPTION FOR AMOUNTS PAID OR INCURRED AS THE RESULT OF CERTAIN COURT ORDERS.—Paragraph (1) shall not apply to any amount paid or incurred by reason of any order of a court in a suit in which no government or governmental entity is a party.

“(4) EXCEPTION FOR TAXES DUE.—Paragraph (1) shall not apply to any amount paid or incurred as taxes due.

“(5) TREATMENT OF CERTAIN NONGOVERNMENTAL REGULATORY ENTITIES.—For purposes of this subsection, the following nongovernmental entities shall be treated as governmental entities:

“(A) Any nongovernmental entity which exercises self-regulatory powers (including imposing sanctions) in connection with a qualified board or exchange (as defined in section 1256(g)(7)).

“(B) To the extent provided in regulations, any nongovernmental entity which exercises self-regulatory powers (including imposing sanctions) as part of performing an essential governmental function.”

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to amounts paid or incurred on or after

the date of the enactment of this Act, except that such amendments shall not apply to amounts paid or incurred under any binding order or agreement entered into before such date. Such exception shall not apply to an order or agreement requiring court approval unless the approval was obtained before such date.

(b) REPORTING OF DEDUCTIBLE AMOUNTS.—

(1) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 is amended by inserting after section 6050W the following new section:

“SEC. 6050X. INFORMATION WITH RESPECT TO CERTAIN FINES, PENALTIES, AND OTHER AMOUNTS.

“(a) REQUIREMENT OF REPORTING.—

“(1) IN GENERAL.—The appropriate official of any government or any entity described in section 162(f)(5) which is involved in a suit or agreement described in paragraph (2) shall make a return in such form as determined by the Secretary setting forth—

“(A) the amount required to be paid as a result of the suit or agreement to which paragraph (1) of section 162(f) applies,

“(B) any amount required to be paid as a result of the suit or agreement which constitutes restitution or remediation of property, and

“(C) any amount required to be paid as a result of the suit or agreement for the purpose of coming into compliance with any law which was violated or involved in the investigation or inquiry.

“(2) SUIT OR AGREEMENT DESCRIBED.—

“(A) IN GENERAL.—A suit or agreement is described in this paragraph if—

“(i) it is—

“(I) a suit with respect to a violation of any law over which the government or entity has authority and with respect to which there has been a court order, or

“(II) an agreement which is entered into with respect to a violation of any law over which the government or entity has authority, or with respect to an investigation or inquiry by the government or entity into the potential violation of any law over which such government or entity has authority, and

“(ii) the aggregate amount involved in all court orders and agreements with respect to the violation, investigation, or inquiry is \$600 or more.

“(B) ADJUSTMENT OF REPORTING THRESHOLD.—The Secretary shall adjust the \$600 amount in subparagraph (A)(ii) as necessary in order to ensure the efficient administration of the internal revenue laws.

“(3) TIME OF FILING.—The return required under this subsection shall be filed at the time the agreement is entered into, as determined by the Secretary.

“(b) STATEMENTS TO BE FURNISHED TO INDIVIDUALS INVOLVED IN THE SETTLEMENT.—Every person required to make a return

under subsection (a) shall furnish to each person who is a party to the suit or agreement a written statement showing—

- “(1) the name of the government or entity, and
- “(2) the information supplied to the Secretary under subsection (a)(1).

The written statement required under the preceding sentence shall be furnished to the person at the same time the government or entity provides the Secretary with the information required under subsection (a).

“(c) APPROPRIATE OFFICIAL DEFINED.—For purposes of this section, the term ‘appropriate official’ means the officer or employee having control of the suit, investigation, or inquiry or the person appropriately designated for purposes of this section.”.

(2) CONFORMING AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by inserting after the item relating to section 6050W the following new item:

“Sec. 6050X. Information with respect to certain fines, penalties, and other amounts.”.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to amounts paid or incurred on or after the date of the enactment of this Act, except that such amendments shall not apply to amounts paid or incurred under any binding order or agreement entered into before such date. Such exception shall not apply to an order or agreement requiring court approval unless the approval was obtained before such date.

SEC. 13307. DENIAL OF DEDUCTION FOR SETTLEMENTS SUBJECT TO NONDISCLOSURE AGREEMENTS PAID IN CONNECTION WITH SEXUAL HARASSMENT OR SEXUAL ABUSE.

(a) DENIAL OF DEDUCTION.—Section 162 is amended by redesignating subsection (q) as subsection (r) and by inserting after subsection (p) the following new subsection:

“(q) PAYMENTS RELATED TO SEXUAL HARASSMENT AND SEXUAL ABUSE.—No deduction shall be allowed under this chapter for—

- “(1) any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or
- “(2) attorney’s fees related to such a settlement or payment.”.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after the date of the enactment of this Act.

SEC. 13308. REPEAL OF DEDUCTION FOR LOCAL LOBBYING EXPENSES.

(a) IN GENERAL.—Section 162(e) is amended by striking paragraphs (2) and (7) and by redesignating paragraphs (3), (4), (5), (6), and (8) as paragraphs (2), (3), (4), (5), and (6), respectively.

(b) CONFORMING AMENDMENT.—Section 6033(e)(1)(B)(ii) is amended by striking “section 162(e)(5)(B)(ii)” and inserting “section 162(e)(4)(B)(ii)”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred on or after the date of the enactment of this Act.

SEC. 13309. RECHARACTERIZATION OF CERTAIN GAINS IN THE CASE OF PARTNERSHIP PROFITS INTERESTS HELD IN CONNECTION WITH PERFORMANCE OF INVESTMENT SERVICES.

(a) IN GENERAL.—Part IV of subchapter O of chapter 1 is amended—

- (1) by redesignating section 1061 as section 1062, and
- (2) by inserting after section 1060 the following new section:

“SEC. 1061. PARTNERSHIP INTERESTS HELD IN CONNECTION WITH PERFORMANCE OF SERVICES.

“(a) IN GENERAL.—If one or more applicable partnership interests are held by a taxpayer at any time during the taxable year, the excess (if any) of—

“(1) the taxpayer's net long-term capital gain with respect to such interests for such taxable year, over

“(2) the taxpayer's net long-term capital gain with respect to such interests for such taxable year computed by applying paragraphs (3) and (4) of sections 1222 by substituting ‘3 years’ for ‘1 year’,

shall be treated as short-term capital gain, notwithstanding section 83 or any election in effect under section 83(b).

“(b) SPECIAL RULE.—To the extent provided by the Secretary, subsection (a) shall not apply to income or gain attributable to any asset not held for portfolio investment on behalf of third party investors.

“(c) APPLICABLE PARTNERSHIP INTEREST.—For purposes of this section—

“(1) IN GENERAL.—Except as provided in this paragraph or paragraph (4), the term ‘applicable partnership interest’ means any interest in a partnership which, directly or indirectly, is transferred to (or is held by) the taxpayer in connection with the performance of substantial services by the taxpayer, or any other related person, in any applicable trade or business. The previous sentence shall not apply to an interest held by a person who is employed by another entity that is conducting a trade or business (other than an applicable trade or business) and only provides services to such other entity.

“(2) APPLICABLE TRADE OR BUSINESS.—The term ‘applicable trade or business’ means any activity conducted on a regular, continuous, and substantial basis which, regardless of whether the activity is conducted in one or more entities, consists, in whole or in part, of—

“(A) raising or returning capital, and

“(B) either—

“(i) investing in (or disposing of) specified assets (or identifying specified assets for such investing or disposition), or

“(ii) developing specified assets.

“(3) SPECIFIED ASSET.—The term ‘specified asset’ means securities (as defined in section 475(c)(2) without regard to the last sentence thereof), commodities (as defined in section 475(e)(2)), real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to any of the foregoing, and an interest in a partnership to the extent of the partnership's proportionate interest in any of the foregoing.

“(4) EXCEPTIONS.—The term ‘applicable partnership interest’ shall not include—

“(A) any interest in a partnership directly or indirectly held by a corporation, or

“(B) any capital interest in the partnership which provides the taxpayer with a right to share in partnership capital commensurate with—

“(i) the amount of capital contributed (determined at the time of receipt of such partnership interest), or

“(ii) the value of such interest subject to tax under section 83 upon the receipt or vesting of such interest.

“(5) THIRD PARTY INVESTOR.—The term ‘third party investor’ means a person who—

“(A) holds an interest in the partnership which does not constitute property held in connection with an applicable trade or business; and

“(B) is not (and has not been) actively engaged, and is (and was) not related to a person so engaged, in (directly or indirectly) providing substantial services described in paragraph (1) for such partnership or any applicable trade or business.

“(d) TRANSFER OF APPLICABLE PARTNERSHIP INTEREST TO RELATED PERSON.—

“(1) IN GENERAL.—If a taxpayer transfers any applicable partnership interest, directly or indirectly, to a person related to the taxpayer, the taxpayer shall include in gross income (as short term capital gain) the excess (if any) of—

“(A) so much of the taxpayer’s long-term capital gains with respect to such interest for such taxable year attributable to the sale or exchange of any asset held for not more than 3 years as is allocable to such interest, over

“(B) any amount treated as short term capital gain under subsection (a) with respect to the transfer of such interest.

“(2) RELATED PERSON.—For purposes of this paragraph, a person is related to the taxpayer if—

“(A) the person is a member of the taxpayer’s family within the meaning of section 318(a)(1), or

“(B) the person performed a service within the current calendar year or the preceding three calendar years in any applicable trade or business in which or for which the taxpayer performed a service.

“(e) REPORTING.—The Secretary shall require such reporting (at the time and in the manner prescribed by the Secretary) as is necessary to carry out the purposes of this section.

“(f) REGULATIONS.—The Secretary shall issue such regulations or other guidance as is necessary or appropriate to carry out the purposes of this section”.

(b) CLERICAL AMENDMENT.—The table of sections for part IV of subchapter O of chapter 1 is amended by striking the item relating to 1061 and inserting the following new items:

“Sec. 1061. Partnership interests held in connection with performance of services.
“Sec. 1062. Cross references.”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13310. PROHIBITION ON CASH, GIFT CARDS, AND OTHER NON-TANGIBLE PERSONAL PROPERTY AS EMPLOYEE ACHIEVEMENT AWARDS.

(a) **IN GENERAL.**—Subparagraph (A) of section 274(j)(3) is amended—

(1) by striking “The term” and inserting the following:

“(i) **IN GENERAL.**—The term”.

(2) by redesignating clauses (i), (ii), and (iii) as subclauses (I), (II), and (III), respectively, and conforming the margins accordingly, and

(3) by adding at the end the following new clause:

“(ii) **TANGIBLE PERSONAL PROPERTY.**—For purposes of clause (i), the term ‘tangible personal property’ shall not include—

“(I) cash, cash equivalents, gift cards, gift coupons, or gift certificates (other than arrangements conferring only the right to select and receive tangible personal property from a limited array of such items pre-selected or pre-approved by the employer), or

“(II) vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items.”.

(b) **EFFECTIVE DATE.**—The amendments made by this section shall apply to amounts paid or incurred after December 31, 2017.

SEC. 13311. ELIMINATION OF DEDUCTION FOR LIVING EXPENSES INCURRED BY MEMBERS OF CONGRESS.

(a) **IN GENERAL.**—Subsection (a) of section 162 is amended in the matter following paragraph (3) by striking “in excess of \$3,000”.

(b) **EFFECTIVE DATE.**—The amendment made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 13312. CERTAIN CONTRIBUTIONS BY GOVERNMENTAL ENTITIES NOT TREATED AS CONTRIBUTIONS TO CAPITAL.

(a) **IN GENERAL.**—Section 118 is amended—

(1) by striking subsections (b), (c), and (d),

(2) by redesignating subsection (e) as subsection (d), and

(3) by inserting after subsection (a) the following new subsections:

“(b) **EXCEPTIONS.**—For purposes of subsection (a), the term ‘contribution to the capital of the taxpayer’ does not include—

“(1) any contribution in aid of construction or any other contribution as a customer or potential customer, and

“(2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such).

“(c) **REGULATIONS.**—The Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out this section, including regulations or other guidance for determining whether any contribution constitutes a contribution in aid of construction.”.

(b) **EFFECTIVE DATE.**—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to contributions made after the date of enactment of this Act.

(2) EXCEPTION.—The amendments made by this section shall not apply to any contribution, made after the date of enactment of this Act by a governmental entity, which is made pursuant to a master development plan that has been approved prior to such date by a governmental entity.

SEC. 13313. REPEAL OF ROLLOVER OF PUBLICLY TRADED SECURITIES GAIN INTO SPECIALIZED SMALL BUSINESS INVESTMENT COMPANIES.

(a) IN GENERAL.—Part III of subchapter O of chapter 1 is amended by striking section 1044 (and by striking the item relating to such section in the table of sections of such part).

(b) CONFORMING AMENDMENTS.—Section 1016(a)(23) is amended—

- (1) by striking “1044,” and
- (2) by striking “1044(d).”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to sales after December 31, 2017.

SEC. 13314. CERTAIN SELF-CREATED PROPERTY NOT TREATED AS A CAPITAL ASSET.

(a) PATENTS, ETC.—Section 1221(a)(3) is amended by inserting “a patent, invention, model or design (whether or not patented), a secret formula or process,” before “a copyright”.

(b) CONFORMING AMENDMENT.—Section 1231(b)(1)(C) is amended by inserting “a patent, invention, model or design (whether or not patented), a secret formula or process,” before “a copyright”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to dispositions after December 31, 2017.

PART V—BUSINESS CREDITS

SEC. 13401. MODIFICATION OF ORPHAN DRUG CREDIT.

(a) CREDIT RATE.—Subsection (a) of section 45C is amended by striking “50 percent” and inserting “25 percent”.

(b) ELECTION OF REDUCED CREDIT.—Subsection (b) of section 280C is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

“(3) ELECTION OF REDUCED CREDIT.—

“(A) IN GENERAL.—In the case of any taxable year for which an election is made under this paragraph—

- “(i) paragraphs (1) and (2) shall not apply, and
- “(ii) the amount of the credit under section 45C(a) shall be the amount determined under subparagraph (B).

“(B) AMOUNT OF REDUCED CREDIT.—The amount of credit determined under this subparagraph for any taxable year shall be the amount equal to the excess of—

- “(i) the amount of credit determined under section 45C(a) without regard to this paragraph, over
- “(ii) the product of—

- “(I) the amount described in clause (i), and
- “(II) the maximum rate of tax under section 11(b).

“(C) ELECTION.—An election under this paragraph for any taxable year shall be made not later than the time for filing the return of tax for such year (including extensions), shall be made on such return, and shall be made in such manner as the Secretary shall prescribe. Such an election, once made, shall be irrevocable.”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13402. REHABILITATION CREDIT LIMITED TO CERTIFIED HISTORIC STRUCTURES.

(a) IN GENERAL.—Subsection (a) of section 47 is amended to read as follows:

“(a) GENERAL RULE.—

“(1) IN GENERAL.—For purposes of section 46, for any taxable year during the 5-year period beginning in the taxable year in which a qualified rehabilitated building is placed in service, the rehabilitation credit for such year is an amount equal to the ratable share for such year.

“(2) RATABLE SHARE.—For purposes of paragraph (1), the ratable share for any taxable year during the period described in such paragraph is the amount equal to 20 percent of the qualified rehabilitation expenditures with respect to the qualified rehabilitated building, as allocated ratably to each year during such period.”

(b) CONFORMING AMENDMENTS.—

(1) Section 47(c) is amended—

(A) in paragraph (1)—

(i) in subparagraph (A), by amending clause (iii) to read as follows:

“(iii) such building is a certified historic structure, and”

(ii) by striking subparagraph (B), and

(iii) by redesignating subparagraphs (C) and (D) as subparagraphs (B) and (C), respectively, and

(B) in paragraph (2)(B), by amending clause (iv) to read as follows:

“(iv) CERTIFIED HISTORIC STRUCTURE.—Any expenditure attributable to the rehabilitation of a qualified rehabilitated building unless the rehabilitation is a certified rehabilitation (within the meaning of subparagraph (C)).”

(2) Paragraph (4) of section 145(d) is amended—

(A) by striking “of section 47(c)(1)(C)” each place it appears and inserting “of section 47(c)(1)(B)”, and

(B) by striking “section 47(c)(1)(C)(i)” and inserting “section 47(c)(1)(B)(i)”.

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to amounts paid or incurred after December 31, 2017.

(2) TRANSITION RULE.—In the case of qualified rehabilitation expenditures with respect to any building—

(A) owned or leased by the taxpayer during the entirety of the period after December 31, 2017, and

(B) with respect to which the 24-month period selected by the taxpayer under clause (i) of section 47(c)(1)(B) of

the Internal Revenue Code (as amended by subsection (b)), or the 60-month period applicable under clause (ii) of such section, begins not later than 180 days after the date of the enactment of this Act, the amendments made by this section shall apply to such expenditures paid or incurred after the end of the taxable year in which the 24-month period, or the 60-month period, referred to in subparagraph (B) ends.

SEC. 13403. EMPLOYER CREDIT FOR PAID FAMILY AND MEDICAL LEAVE.

(a) IN GENERAL.—

(1) ALLOWANCE OF CREDIT.—Subpart D of part IV of subchapter A of chapter 1 is amended by adding at the end the following new section:

“SEC. 45S. EMPLOYER CREDIT FOR PAID FAMILY AND MEDICAL LEAVE.

“(a) ESTABLISHMENT OF CREDIT.—

“(1) IN GENERAL.—For purposes of section 38, in the case of an eligible employer, the paid family and medical leave credit is an amount equal to the applicable percentage of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave.

“(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the term ‘applicable percentage’ means 12.5 percent increased (but not above 25 percent) by 0.25 percentage points for each percentage point by which the rate of payment (as described under subsection (c)(1)(B)) exceeds 50 percent.

“(b) LIMITATION.—

“(1) IN GENERAL.—The credit allowed under subsection (a) with respect to any employee for any taxable year shall not exceed an amount equal to the product of the normal hourly wage rate of such employee for each hour (or fraction thereof) of actual services performed for the employer and the number of hours (or fraction thereof) for which family and medical leave is taken.

“(2) NON-HOURLY WAGE RATE.—For purposes of paragraph (1), in the case of any employee who is not paid on an hourly wage rate, the wages of such employee shall be prorated to an hourly wage rate under regulations established by the Secretary.

“(3) MAXIMUM AMOUNT OF LEAVE SUBJECT TO CREDIT.—The amount of family and medical leave that may be taken into account with respect to any employee under subsection (a) for any taxable year shall not exceed 12 weeks.

“(c) ELIGIBLE EMPLOYER.—For purposes of this section—

“(1) IN GENERAL.—The term ‘eligible employer’ means any employer who has in place a written policy that meets the following requirements:

“(A) The policy provides—

“(i) in the case of a qualifying employee who is not a part-time employee (as defined in section 4980E(d)(4)(B)), not less than 2 weeks of annual paid family and medical leave, and

“(ii) in the case of a qualifying employee who is a part-time employee, an amount of annual paid family and medical leave that is not less than an amount which bears the same ratio to the amount of annual

paid family and medical leave that is provided to a qualifying employee described in clause (i) as—

“(I) the number of hours the employee is expected to work during any week, bears to

“(II) the number of hours an equivalent qualifying employee described in clause (i) is expected to work during the week.

“(B) The policy requires that the rate of payment under the program is not less than 50 percent of the wages normally paid to such employee for services performed for the employer.

“(2) SPECIAL RULE FOR CERTAIN EMPLOYERS.—

“(A) IN GENERAL.—An added employer shall not be treated as an eligible employer unless such employer provides paid family and medical leave in compliance with a written policy which ensures that the employer—

“(i) will not interfere with, restrain, or deny the exercise of or the attempt to exercise, any right provided under the policy, and

“(ii) will not discharge or in any other manner discriminate against any individual for opposing any practice prohibited by the policy.

“(B) ADDED EMPLOYER; ADDED EMPLOYEE.—For purposes of this paragraph—

“(i) ADDED EMPLOYEE.—The term ‘added employee’ means a qualifying employee who is not covered by title I of the Family and Medical Leave Act of 1993, as amended.

“(ii) ADDED EMPLOYER.—The term ‘added employer’ means an eligible employer (determined without regard to this paragraph), whether or not covered by that title I, who offers paid family and medical leave to added employees.

“(3) AGGREGATION RULE.—All persons which are treated as a single employer under subsections (a) and (b) of section 52 shall be treated as a single taxpayer.

“(4) TREATMENT OF BENEFITS MANDATED OR PAID FOR BY STATE OR LOCAL GOVERNMENTS.—For purposes of this section, any leave which is paid by a State or local government or required by State or local law shall not be taken into account in determining the amount of paid family and medical leave provided by the employer.

“(5) NO INFERENCE.—Nothing in this subsection shall be construed as subjecting an employer to any penalty, liability, or other consequence (other than ineligibility for the credit allowed by reason of subsection (a) or recapturing the benefit of such credit) for failure to comply with the requirements of this subsection.

“(d) QUALIFYING EMPLOYEES.—For purposes of this section, the term ‘qualifying employee’ means any employee (as defined in section 3(e) of the Fair Labor Standards Act of 1938, as amended) who—

“(1) has been employed by the employer for 1 year or more, and

“(2) for the preceding year, had compensation not in excess of an amount equal to 60 percent of the amount applicable for such year under clause (i) of section 414(q)(1)(B).

“(e) FAMILY AND MEDICAL LEAVE.—

“(1) IN GENERAL.—Except as provided in paragraph (2), for purposes of this section, the term ‘family and medical leave’ means leave for any 1 or more of the purposes described under subparagraph (A), (B), (C), (D), or (E) of paragraph (1), or paragraph (3), of section 102(a) of the Family and Medical Leave Act of 1993, as amended, whether the leave is provided under that Act or by a policy of the employer.

“(2) EXCLUSION.—If an employer provides paid leave as vacation leave, personal leave, or medical or sick leave (other than leave specifically for 1 or more of the purposes referred to in paragraph (1)), that paid leave shall not be considered to be family and medical leave under paragraph (1).

“(3) DEFINITIONS.—In this subsection, the terms ‘vacation leave’, ‘personal leave’, and ‘medical or sick leave’ mean those 3 types of leave, within the meaning of section 102(d)(2) of that Act.

“(f) DETERMINATIONS MADE BY SECRETARY OF TREASURY.—For purposes of this section, any determination as to whether an employer or an employee satisfies the applicable requirements for an eligible employer (as described in subsection (c)) or qualifying employee (as described in subsection (d)), respectively, shall be made by the Secretary based on such information, to be provided by the employer, as the Secretary determines to be necessary or appropriate.

“(g) WAGES.—For purposes of this section, the term ‘wages’ has the meaning given such term by subsection (b) of section 3306 (determined without regard to any dollar limitation contained in such section). Such term shall not include any amount taken into account for purposes of determining any other credit allowed under this subpart.

“(h) ELECTION TO HAVE CREDIT NOT APPLY.—

“(1) IN GENERAL.—A taxpayer may elect to have this section not apply for any taxable year.

“(2) OTHER RULES.—Rules similar to the rules of paragraphs (2) and (3) of section 51(j) shall apply for purposes of this subsection.

“(i) TERMINATION.—This section shall not apply to wages paid in taxable years beginning after December 31, 2019.”

(b) CREDIT PART OF GENERAL BUSINESS CREDIT.—Section 38(b) is amended by striking “plus” at the end of paragraph (35), by striking the period at the end of paragraph (36) and inserting “, plus”, and by adding at the end the following new paragraph:

“(37) in the case of an eligible employer (as defined in section 45S(c)), the paid family and medical leave credit determined under section 45S(a).”

(c) CREDIT ALLOWED AGAINST AMT.—Subparagraph (B) of section 38(c)(4) is amended by redesignating clauses (ix) through (xi) as clauses (x) through (xii), respectively, and by inserting after clause (viii) the following new clause:

“(ix) the credit determined under section 45S.”

(d) CONFORMING AMENDMENTS.—

(1) DENIAL OF DOUBLE BENEFIT.—Section 280C(a) is amended by inserting “45S(a),” after “45P(a).”

(2) ELECTION TO HAVE CREDIT NOT APPLY.—Section 6501(m) is amended by inserting “45S(h),” after “45H(g).”

(3) CLERICAL AMENDMENT.—The table of sections for subpart D of part IV of subchapter A of chapter 1 is amended by adding at the end the following new item:

“Sec. 45S. Employer credit for paid family and medical leave.”.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to wages paid in taxable years beginning after December 31, 2017.

SEC. 13404. REPEAL OF TAX CREDIT BONDS.

(a) IN GENERAL.—Part IV of subchapter A of chapter 1 is amended by striking subparts H, I, and J (and by striking the items relating to such subparts in the table of subparts for such part).

(b) PAYMENTS TO ISSUERS.—Subchapter B of chapter 65 is amended by striking section 6431 (and by striking the item relating to such section in the table of sections for such subchapter).

(c) CONFORMING AMENDMENTS.—

(1) Part IV of subchapter U of chapter 1 is amended by striking section 1397E (and by striking the item relating to such section in the table of sections for such part).

(2) Section 54(l)(3)(B) is amended by inserting “(as in effect before its repeal by the Tax Cuts and Jobs Act)” after “section 1397E(l)”.

(3) Section 6211(b)(4)(A) is amended by striking “, and 6431” and inserting “and” before “36B”.

(4) Section 6401(b)(1) is amended by striking “G, H, I, and J” and inserting “and G”.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to bonds issued after December 31, 2017.

PART VI—PROVISIONS RELATED TO SPECIFIC ENTITIES AND INDUSTRIES

Subpart A—Partnership Provisions

SEC. 13501. TREATMENT OF GAIN OR LOSS OF FOREIGN PERSONS FROM SALE OR EXCHANGE OF INTERESTS IN PARTNERSHIPS ENGAGED IN TRADE OR BUSINESS WITHIN THE UNITED STATES.

(a) AMOUNT TREATED AS EFFECTIVELY CONNECTED.—

(1) IN GENERAL.—Section 864(c) is amended by adding at the end the following:

“(8) GAIN OR LOSS OF FOREIGN PERSONS FROM SALE OR EXCHANGE OF CERTAIN PARTNERSHIP INTERESTS.—

“(A) IN GENERAL.—Notwithstanding any other provision of this subtitle, if a nonresident alien individual or foreign corporation owns, directly or indirectly, an interest in a partnership which is engaged in any trade or business within the United States, gain or loss on the sale or exchange of all (or any portion of) such interest shall be treated as effectively connected with the conduct of such trade or business to the extent such gain or loss does not exceed the amount determined under subparagraph (B).

“(B) AMOUNT TREATED AS EFFECTIVELY CONNECTED.—The amount determined under this subparagraph with respect to any partnership interest sold or exchanged—

“(i) in the case of any gain on the sale or exchange of the partnership interest, is—

“(I) the portion of the partner’s distributive share of the amount of gain which would have been effectively connected with the conduct of a trade or business within the United States if the partnership had sold all of its assets at their fair market value as of the date of the sale or exchange of such interest, or

“(II) zero if no gain on such deemed sale would have been so effectively connected, and

“(ii) in the case of any loss on the sale or exchange of the partnership interest, is—

“(I) the portion of the partner’s distributive share of the amount of loss on the deemed sale described in clause (i)(I) which would have been so effectively connected, or

“(II) zero if no loss on such deemed sale would be have been so effectively connected.

For purposes of this subparagraph, a partner’s distributive share of gain or loss on the deemed sale shall be determined in the same manner as such partner’s distributive share of the non-separately stated taxable income or loss of such partnership.

“(C) COORDINATION WITH UNITED STATES REAL PROPERTY INTERESTS.—If a partnership described in subparagraph (A) holds any United States real property interest (as defined in section 897(c)) at the time of the sale or exchange of the partnership interest, then the gain or loss treated as effectively connected income under subparagraph (A) shall be reduced by the amount so treated with respect to such United States real property interest under section 897.

“(D) SALE OR EXCHANGE.—For purposes of this paragraph, the term ‘sale or exchange’ means any sale, exchange, or other disposition.

“(E) SECRETARIAL AUTHORITY.—The Secretary shall prescribe such regulations or other guidance as the Secretary determines appropriate for the application of this paragraph, including with respect to exchanges described in section 332, 351, 354, 355, 356, or 361.”.

(2) CONFORMING AMENDMENTS.—Section 864(c)(1) is amended—

(A) by striking “and (7)” in subparagraph (A), and inserting “(7), and (8)”, and

(B) by striking “or (7)” in subparagraph (B), and inserting “(7), or (8)”.

(b) WITHHOLDING REQUIREMENTS.—Section 1446 is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following:

“(f) SPECIAL RULES FOR WITHHOLDING ON DISPOSITIONS OF PARTNERSHIP INTERESTS.—

“(1) IN GENERAL.—Except as provided in this subsection, if any portion of the gain (if any) on any disposition of an

interest in a partnership would be treated under section 864(c)(8) as effectively connected with the conduct of a trade or business within the United States, the transferee shall be required to deduct and withhold a tax equal to 10 percent of the amount realized on the disposition.

“(2) EXCEPTION IF NONFOREIGN AFFIDAVIT FURNISHED.—

“(A) IN GENERAL.—No person shall be required to deduct and withhold any amount under paragraph (1) with respect to any disposition if the transferor furnishes to the transferee an affidavit by the transferor stating, under penalty of perjury, the transferor’s United States taxpayer identification number and that the transferor is not a foreign person.

“(B) FALSE AFFIDAVIT.—Subparagraph (A) shall not apply to any disposition if—

“(i) the transferee has actual knowledge that the affidavit is false, or the transferee receives a notice (as described in section 1445(d)) from a transferor’s agent or transferee’s agent that such affidavit or statement is false, or

“(ii) the Secretary by regulations requires the transferee to furnish a copy of such affidavit or statement to the Secretary and the transferee fails to furnish a copy of such affidavit or statement to the Secretary at such time and in such manner as required by such regulations.

“(C) RULES FOR AGENTS.—The rules of section 1445(d) shall apply to a transferor’s agent or transferee’s agent with respect to any affidavit described in subparagraph (A) in the same manner as such rules apply with respect to the disposition of a United States real property interest under such section.

“(3) AUTHORITY OF SECRETARY TO PRESCRIBE REDUCED AMOUNT.—At the request of the transferor or transferee, the Secretary may prescribe a reduced amount to be withheld under this section if the Secretary determines that to substitute such reduced amount will not jeopardize the collection of the tax imposed under this title with respect to gain treated under section 864(c)(8) as effectively connected with the conduct of a trade or business within the United States.

“(4) PARTNERSHIP TO WITHHOLD AMOUNTS NOT WITHHELD BY THE TRANSFEREE.—If a transferee fails to withhold any amount required to be withheld under paragraph (1), the partnership shall be required to deduct and withhold from distributions to the transferee a tax in an amount equal to the amount the transferee failed to withhold (plus interest under this title on such amount).

“(5) DEFINITIONS.—Any term used in this subsection which is also used under section 1445 shall have the same meaning as when used in such section.

“(6) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary to carry out the purposes of this subsection, including regulations providing for exceptions from the provisions of this subsection.”.

(c) EFFECTIVE DATES.—

(1) SUBSECTION (a).—The amendments made by subsection (a) shall apply to sales, exchanges, and dispositions on or after November 27, 2017.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall apply to sales, exchanges, and dispositions after December 31, 2017.

SEC. 13502. MODIFY DEFINITION OF SUBSTANTIAL BUILT-IN LOSS IN THE CASE OF TRANSFER OF PARTNERSHIP INTEREST.

(a) IN GENERAL.—Paragraph (1) of section 743(d) is to read as follows:

“(1) IN GENERAL.—For purposes of this section, a partnership has a substantial built-in loss with respect to a transfer of an interest in the partnership if—

“(A) the partnership’s adjusted basis in the partnership property exceeds by more than \$250,000 the fair market value of such property, or

“(B) the transferee partner would be allocated a loss of more than \$250,000 if the partnership assets were sold for cash equal to their fair market value immediately after such transfer.”.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers of partnership interests after December 31, 2017.

SEC. 13503. CHARITABLE CONTRIBUTIONS AND FOREIGN TAXES TAKEN INTO ACCOUNT IN DETERMINING LIMITATION ON ALLOWANCE OF PARTNER’S SHARE OF LOSS.

(a) IN GENERAL.—Subsection (d) of section 704 is amended—
(1) by striking “A partner’s distributive share” and inserting the following:

“(1) IN GENERAL.—A partner’s distributive share”,

(2) by striking “Any excess of such loss” and inserting the following:

“(2) CARRYOVER.—Any excess of such loss”, and

(3) by adding at the end the following new paragraph:

“(3) SPECIAL RULES.—

“(A) IN GENERAL.—In determining the amount of any loss under paragraph (1), there shall be taken into account the partner’s distributive share of amounts described in paragraphs (4) and (6) of section 702(a).

“(B) EXCEPTION.—In the case of a charitable contribution of property whose fair market value exceeds its adjusted basis, subparagraph (A) shall not apply to the extent of the partner’s distributive share of such excess.”.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to partnership taxable years beginning after December 31, 2017.

SEC. 13504. REPEAL OF TECHNICAL TERMINATION OF PARTNERSHIPS.

(a) IN GENERAL.—Paragraph (1) of section 708(b) is amended—
(1) by striking “, or” at the end of subparagraph (A) and all that follows and inserting a period, and

(2) by striking “only if—” and all that follows through “no part of any business” and inserting the following: “only if no part of any business”.

(b) CONFORMING AMENDMENT.—

(1) Section 168(i)(7)(B) is amended by striking the second sentence.

(2) Section 743(e) is amended by striking paragraph (4) and redesignating paragraphs (5), (6), and (7) as paragraphs (4), (5), and (6).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to partnership taxable years beginning after December 31, 2017.

Subpart B—Insurance Reforms

SEC. 13511. NET OPERATING LOSSES OF LIFE INSURANCE COMPANIES.

(a) IN GENERAL.—Section 805(b) is amended by striking paragraph (4) and by redesignating paragraph (5) as paragraph (4).

(b) CONFORMING AMENDMENTS.—

(1) Part I of subchapter L of chapter 1 is amended by striking section 810 (and by striking the item relating to such section in the table of sections for such part).

(2)(A) Part III of subchapter L of chapter 1 is amended by striking section 844 (and by striking the item relating to such section in the table of sections for such part).

(B) Section 831(b)(3) is amended by striking “except as provided in section 844,”

(3) Section 381 is amended by striking subsection (d).

(4) Section 805(a)(4)(B)(ii) is amended to read as follows:

“(ii) the deduction allowed under section 172.”

(5) Section 805(a) is amended by striking paragraph (5).

(6) Section 805(b)(2)(A)(iv) is amended to read as follows:

“(iv) any net operating loss carryback to the taxable year under section 172, and”.

(7) Section 953(b)(1)(B) is amended to read as follows:

“(B) So much of section 805(a)(8) as relates to the deduction allowed under section 172.”

(8) Section 1351(i)(3) is amended by striking “or the operations loss deduction under section 810,”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to losses arising in taxable years beginning after December 31, 2017.

SEC. 13512. REPEAL OF SMALL LIFE INSURANCE COMPANY DEDUCTION.

(a) IN GENERAL.—Part I of subchapter L of chapter 1 is amended by striking section 806 (and by striking the item relating to such section in the table of sections for such part).

(b) CONFORMING AMENDMENTS.—

(1) Section 453B(e) is amended—

(A) by striking “(as defined in section 806(b)(3))” in paragraph (2)(B), and

(B) by adding at the end the following new paragraph:

“(3) NONINSURANCE BUSINESS.—

“(A) IN GENERAL.—For purposes of this subsection, the term ‘noninsurance business’ means any activity which is not an insurance business.

“(B) CERTAIN ACTIVITIES TREATED AS INSURANCE BUSINESSES.—For purposes of subparagraph (A), any activity which is not an insurance business shall be treated as an insurance business if—

"(i) it is of a type traditionally carried on by life insurance companies for investment purposes, but only if the carrying on of such activity (other than in the case of real estate) does not constitute the active conduct of a trade or business, or

"(ii) it involves the performance of administrative services in connection with plans providing life insurance, pension, or accident and health benefits."

(2) Section 465(c)(7)(D)(v)(II) is amended by striking "section 806(b)(3)" and inserting "section 453B(e)(3)".

(3) Section 801(a)(2) is amended by striking subparagraph (C).

(4) Section 804 is amended by striking "means—" and all that follows and inserting "means the general deductions provided in section 805."

(5) Section 805(a)(4)(B), as amended by this Act, is amended by striking clause (i) and by redesignating clauses (ii), (iii), and (iv) as clauses (i), (ii), and (iii), respectively.

(6) Section 805(b)(2)(A), as amended by this Act, is amended by striking clause (iii) and by redesignating clauses (iv) and (v) as clauses (iii) and (iv), respectively.

(7) Section 842(c) is amended by striking paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(8) Section 953(b)(1), as amended by section 13511, is amended by striking subparagraph (A) and by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13513. ADJUSTMENT FOR CHANGE IN COMPUTING RESERVES.

(a) IN GENERAL.—Paragraph (1) of section 807(f) is amended to read as follows:

"(1) TREATMENT AS CHANGE IN METHOD OF ACCOUNTING.—If the basis for determining any item referred to in subsection (c) as of the close of any taxable year differs from the basis for such determination as of the close of the preceding taxable year, then so much of the difference between—

"(A) the amount of the item at the close of the taxable year, computed on the new basis, and

"(B) the amount of the item at the close of the taxable year, computed on the old basis,

as is attributable to contracts issued before the taxable year shall be taken into account under section 481 as adjustments attributable to a change in method of accounting initiated by the taxpayer and made with the consent of the Secretary."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13514. REPEAL OF SPECIAL RULE FOR DISTRIBUTIONS TO SHAREHOLDERS FROM PRE-1984 POLICYHOLDERS SURPLUS ACCOUNT.

(a) IN GENERAL.—Subpart D of part I of subchapter L is amended by striking section 815 (and by striking the item relating to such section in the table of sections for such subpart).

(b) CONFORMING AMENDMENT.—Section 801 is amended by striking subsection (c).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(d) PHASED INCLUSION OF REMAINING BALANCE OF POLICYHOLDERS SURPLUS ACCOUNTS.—In the case of any stock life insurance company which has a balance (determined as of the close of such company's last taxable year beginning before January 1, 2018) in an existing policyholders surplus account (as defined in section 815 of the Internal Revenue Code of 1986, as in effect before its repeal), the tax imposed by section 801 of such Code for the first 8 taxable years beginning after December 31, 2017, shall be the amount which would be imposed by such section for such year on the sum of—

- (1) life insurance company taxable income for such year (within the meaning of such section 801 but not less than zero), plus
- (2) $\frac{1}{8}$ of such balance.

SEC. 13515. MODIFICATION OF PRORATION RULES FOR PROPERTY AND CASUALTY INSURANCE COMPANIES.

(a) IN GENERAL.—Section 832(b)(5)(B) is amended—

- (1) by striking “15 percent” and inserting “the applicable percentage”, and
- (2) by inserting at the end the following new sentence: “For purposes of this subparagraph, the applicable percentage is 5.25 percent divided by the highest rate in effect under section 11(b).”.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13516. REPEAL OF SPECIAL ESTIMATED TAX PAYMENTS.

(a) IN GENERAL.—Part III of subchapter L of chapter 1 is amended by striking section 847 (and by striking the item relating to such section in the table of sections for such part).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13517. COMPUTATION OF LIFE INSURANCE TAX RESERVES.

(a) IN GENERAL.—

(1) APPROPRIATE RATE OF INTEREST.—The second sentence of section 807(c) is amended to read as follows: “For purposes of paragraph (3), the appropriate rate of interest is the highest rate or rates permitted to be used to discount the obligations by the National Association of Insurance Commissioners as of the date the reserve is determined.”.

(2) METHOD OF COMPUTING RESERVES.—Section 807(d) is amended—

- (A) by striking paragraphs (1), (2), (4), and (5),
- (B) by redesignating paragraph (6) as paragraph (4),
- (C) by inserting before paragraph (3) the following new paragraphs:

“(1) DETERMINATION OF RESERVE.—

“(A) IN GENERAL.—For purposes of this part (other than section 816), the amount of the life insurance reserves for any contract (other than a contract to which subparagraph (B) applies) shall be the greater of—

- “(i) the net surrender value of such contract, or
- “(ii) 92.81 percent of the reserve determined under paragraph (2).

“(B) VARIABLE CONTRACTS.—For purposes of this part (other than section 816), the amount of the life insurance reserves for a variable contract shall be equal to the sum of—

“(i) the greater of—

“(I) the net surrender value of such contract,

or

“(II) the portion of the reserve that is separately accounted for under section 817, plus

“(ii) 92.81 percent of the excess (if any) of the reserve determined under paragraph (2) over the amount in clause (i).

“(C) STATUTORY CAP.—In no event shall the reserves determined under subparagraphs (A) or (B) for any contract as of any time exceed the amount which would be taken into account with respect to such contract as of such time in determining statutory reserves (as defined in paragraph (4)).

“(D) NO DOUBLE COUNTING.—In no event shall any amount or item be taken into account more than once in determining any reserve under this subchapter.

“(2) AMOUNT OF RESERVE.—The amount of the reserve determined under this paragraph with respect to any contract shall be determined by using the tax reserve method applicable to such contract.”

(D) by striking “(other than a qualified long-term care insurance contract, as defined in section 7702B(b)), a 2-year full preliminary term method” in paragraph (3)(A)(iii) and inserting “, the reserve method prescribed by the National Association of Insurance Commissioners which covers such contract as of the date the reserve is determined”,

(E) by striking “(as of the date of issuance)” in paragraph (3)(A)(iv)(I) and inserting “(as of the date the reserve is determined)”,

(F) by striking “as of the date of the issuance of” in paragraph (3)(A)(iv)(II) and inserting “as of the date the reserve is determined for”,

(G) by striking “in effect on the date of the issuance of the contract” in paragraph (3)(B)(i) and inserting “applicable to the contract and in effect as of the date the reserve is determined”, and

(H) by striking “in effect on the date of the issuance of the contract” in paragraph (3)(B)(ii) and inserting “applicable to the contract and in effect as of the date the reserve is determined”.

(3) SPECIAL RULES.—Section 807(e) is amended—

(A) by striking paragraphs (2) and (5),

(B) by redesignating paragraphs (3), (4), (6), and (7) as paragraphs (2), (3), (4), and (5), respectively,

(C) by amending paragraph (2) (as so redesignated) to read as follows:

“(2) QUALIFIED SUPPLEMENTAL BENEFITS.—

“(A) QUALIFIED SUPPLEMENTAL BENEFITS TREATED SEPARATELY.—For purposes of this part, the amount of the life insurance reserve for any qualified supplemental

benefit shall be computed separately as though such benefit were under a separate contract.

“(B) QUALIFIED SUPPLEMENTAL BENEFIT.—For purposes of this paragraph, the term ‘qualified supplemental benefit’ means any supplemental benefit described in subparagraph (C) if—

“(i) there is a separately identified premium or charge for such benefit, and

“(ii) any net surrender value under the contract attributable to any other benefit is not available to fund such benefit.

“(C) SUPPLEMENTAL BENEFITS.—For purposes of this paragraph, the supplemental benefits described in this subparagraph are any—

“(i) guaranteed insurability,

“(ii) accidental death or disability benefit,

“(iii) convertibility,

“(iv) disability waiver benefit, or

“(v) other benefit prescribed by regulations,

which is supplemental to a contract for which there is a reserve described in subsection (c).”, and

(D) by adding at the end the following new paragraph:

“(6) REPORTING RULES.—The Secretary shall require reporting (at such time and in such manner as the Secretary shall prescribe) with respect to the opening balance and closing balance of reserves and with respect to the method of computing reserves for purposes of determining income.”

(4) DEFINITION OF LIFE INSURANCE CONTRACT.—Section 7702 is amended—

(A) by striking clause (i) of subsection (c)(3)(B) and inserting the following:

“(i) reasonable mortality charges which meet the requirements prescribed in regulations to be promulgated by the Secretary or that do not exceed the mortality charges specified in the prevailing commissioners’ standard tables as defined in subsection (f)(10),” and

(B) by adding at the end of subsection (f) the following new paragraph:

“(10) PREVAILING COMMISSIONERS’ STANDARD TABLES.—For purposes of subsection (c)(3)(B)(i), the term ‘prevailing commissioners’ standard tables’ means the most recent commissioners’ standard tables prescribed by the National Association of Insurance Commissioners which are permitted to be used in computing reserves for that type of contract under the insurance laws of at least 26 States when the contract was issued. If the prevailing commissioners’ standard tables as of the beginning of any calendar year (hereinafter in this paragraph referred to as the ‘year of change’) are different from the prevailing commissioners’ standard tables as of the beginning of the preceding calendar year, the issuer may use the prevailing commissioners’ standard tables as of the beginning of the preceding calendar year with respect to any contract issued after the change and before the close of the 3-year period beginning on the first day of the year of change.”

(b) CONFORMING AMENDMENTS.—

(1) Section 808 is amended by adding at the end the following new subsection:

“(g) PREVAILING STATE ASSUMED INTEREST RATE.—For purposes of this subchapter—

“(1) IN GENERAL.—The term ‘prevailing State assumed interest rate’ means, with respect to any contract, the highest assumed interest rate permitted to be used in computing life insurance reserves for insurance contracts or annuity contracts (as the case may be) under the insurance laws of at least 26 States. For purposes of the preceding sentence, the effect of nonforfeiture laws of a State on interest rates for reserves shall not be taken into account.

“(2) WHEN RATE DETERMINED.—The prevailing State assumed interest rate with respect to any contract shall be determined as of the beginning of the calendar year in which the contract was issued.”

(2) Paragraph (1) of section 811(d) is amended by striking “the greater of the prevailing State assumed interest rate or applicable Federal interest rate in effect under section 807” and inserting “the interest rate in effect under section 808(g)”.

(3) Subparagraph (A) of section 846(f)(6) is amended by striking “except that” and all that follows and inserting “except that the limitation of subsection (a)(3) shall apply, and”.

(4) Section 848(e)(1)(B)(iii) is amended by striking “807(e)(4)” and inserting “807(e)(3)”.

(5) Subparagraph (B) of section 954(i)(5) is amended by striking “shall be substituted for the prevailing State assumed interest rate,” and inserting “shall apply.”

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) TRANSITION RULE.—For the first taxable year beginning after December 31, 2017, the reserve with respect to any contract (as determined under section 807(d) of the Internal Revenue Code of 1986) at the end of the preceding taxable year shall be determined as if the amendments made by this section had applied to such reserve in such preceding taxable year.

(3) TRANSITION RELIEF.—

(A) IN GENERAL.—If—

(i) the reserve determined under section 807(d) of the Internal Revenue Code of 1986 (determined after application of paragraph (2)) with respect to any contract as of the close of the year preceding the first taxable year beginning after December 31, 2017, differs from

(ii) the reserve which would have been determined with respect to such contract as of the close of such taxable year under such section determined without regard to paragraph (2),

then the difference between the amount of the reserve described in clause (i) and the amount of the reserve described in clause (ii) shall be taken into account under the method provided in subparagraph (B).

(B) METHOD.—The method provided in this subparagraph is as follows:

(i) If the amount determined under subparagraph (A)(i) exceeds the amount determined under subparagraph (A)(ii), 1/8 of such excess shall be taken into account, for each of the 8 succeeding taxable years, as a deduction under section 805(a)(2) or 832(c)(4) of such Code, as applicable.

(ii) If the amount determined under subparagraph (A)(ii) exceeds the amount determined under subparagraph (A)(i), 1/8 of such excess shall be included in gross income, for each of the 8 succeeding taxable years, under section 803(a)(2) or 832(b)(1)(C) of such Code, as applicable.

SEC. 13518. MODIFICATION OF RULES FOR LIFE INSURANCE PRORATION FOR PURPOSES OF DETERMINING THE DIVIDENDS RECEIVED DEDUCTION.

(a) **IN GENERAL.**—Section 812 is amended to read as follows:
“SEC. 812. DEFINITION OF COMPANY’S SHARE AND POLICYHOLDER’S SHARE.

“(a) **COMPANY’S SHARE.**—For purposes of section 805(a)(4), the term ‘company’s share’ means, with respect to any taxable year beginning after December 31, 2017, 70 percent.

“(b) **POLICYHOLDER’S SHARE.**—For purposes of section 807, the term ‘policyholder’s share’ means, with respect to any taxable year beginning after December 31, 2017, 30 percent.”.

(b) **CONFORMING AMENDMENT.**—Section 817A(e)(2) is amended by striking “, 807(d)(2)(B), and 812” and inserting “and 807(d)(2)(B)”.

(c) **EFFECTIVE DATE.**—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13519. CAPITALIZATION OF CERTAIN POLICY ACQUISITION EXPENSES.

(a) **IN GENERAL.**—

(1) Section 848(a)(2) is amended by striking “120-month” and inserting “180-month”.

(2) Section 848(c)(1) is amended by striking “1.75 percent” and inserting “2.09 percent”.

(3) Section 848(c)(2) is amended by striking “2.05 percent” and inserting “2.45 percent”.

(4) Section 848(c)(3) is amended by striking “7.7 percent” and inserting “9.2 percent”.

(b) **CONFORMING AMENDMENTS.**—Section 848(b)(1) is amended by striking “120-month” and inserting “180-month”.

(c) **EFFECTIVE DATE.**—

(1) **IN GENERAL.**—The amendments made by this section shall apply to net premiums for taxable years beginning after December 31, 2017.

(2) **TRANSITION RULE.**—Specified policy acquisition expenses first required to be capitalized in a taxable year beginning before January 1, 2018, will continue to be allowed as a deduction ratably over the 120-month period beginning with the first month in the second half of such taxable year.

SEC. 13520. TAX REPORTING FOR LIFE SETTLEMENT TRANSACTIONS.

(a) **IN GENERAL.**—Subpart B of part III of subchapter A of chapter 61, as amended by section 13306, is amended by adding at the end the following new section:

"SEC. 6050Y. RETURNS RELATING TO CERTAIN LIFE INSURANCE CONTRACT TRANSACTIONS.

"(a) REQUIREMENT OF REPORTING OF CERTAIN PAYMENTS.—

"(1) IN GENERAL.—Every person who acquires a life insurance contract or any interest in a life insurance contract in a reportable policy sale during any taxable year shall make a return for such taxable year (at such time and in such manner as the Secretary shall prescribe) setting forth—

"(A) the name, address, and TIN of such person,

"(B) the name, address, and TIN of each recipient of payment in the reportable policy sale,

"(C) the date of such sale,

"(D) the name of the issuer of the life insurance contract sold and the policy number of such contract, and

"(E) the amount of each payment.

"(2) STATEMENT TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under this subsection shall furnish to each person whose name is required to be set forth in such return a written statement showing—

"(A) the name, address, and phone number of the information contact of the person required to make such return, and

"(B) the information required to be shown on such return with respect to such person, except that in the case of an issuer of a life insurance contract, such statement is not required to include the information specified in paragraph (1)(E).

"(b) REQUIREMENT OF REPORTING OF SELLER'S BASIS IN LIFE INSURANCE CONTRACTS.—

"(1) IN GENERAL.—Upon receipt of the statement required under subsection (a)(2) or upon notice of a transfer of a life insurance contract to a foreign person, each issuer of a life insurance contract shall make a return (at such time and in such manner as the Secretary shall prescribe) setting forth—

"(A) the name, address, and TIN of the seller who transfers any interest in such contract in such sale,

"(B) the investment in the contract (as defined in section 72(e)(6)) with respect to such seller, and

"(C) the policy number of such contract.

"(2) STATEMENT TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under this subsection shall furnish to each person whose name is required to be set forth in such return a written statement showing—

"(A) the name, address, and phone number of the information contact of the person required to make such return, and

"(B) the information required to be shown on such return with respect to each seller whose name is required to be set forth in such return.

"(c) REQUIREMENT OF REPORTING WITH RESPECT TO REPORTABLE DEATH BENEFITS.—

"(1) IN GENERAL.—Every person who makes a payment of reportable death benefits during any taxable year shall make a return for such taxable year (at such time and in such manner as the Secretary shall prescribe) setting forth—

“(A) the name, address, and TIN of the person making such payment,

“(B) the name, address, and TIN of each recipient of such payment,

“(C) the date of each such payment,

“(D) the gross amount of each such payment, and

“(E) such person’s estimate of the investment in the contract (as defined in section 72(e)(6)) with respect to the buyer.

“(2) STATEMENT TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under this subsection shall furnish to each person whose name is required to be set forth in such return a written statement showing—

“(A) the name, address, and phone number of the information contact of the person required to make such return, and

“(B) the information required to be shown on such return with respect to each recipient of payment whose name is required to be set forth in such return.

“(d) DEFINITIONS.—For purposes of this section:

“(1) PAYMENT.—The term ‘payment’ means, with respect to any reportable policy sale, the amount of cash and the fair market value of any consideration transferred in the sale.

“(2) REPORTABLE POLICY SALE.—The term ‘reportable policy sale’ has the meaning given such term in section 101(a)(3)(B).

“(3) ISSUER.—The term ‘issuer’ means any life insurance company that bears the risk with respect to a life insurance contract on the date any return or statement is required to be made under this section.

“(4) REPORTABLE DEATH BENEFITS.—The term ‘reportable death benefits’ means amounts paid by reason of the death of the insured under a life insurance contract that has been transferred in a reportable policy sale.”

(b) CLERICAL AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61, as amended by section 13306, is amended by inserting after the item relating to section 6050X the following new item:

“Sec. 6050Y. Returns relating to certain life insurance contract transactions.”

(c) CONFORMING AMENDMENTS.—

(1) Subsection (d) of section 6724 is amended—

(A) by striking “or” at the end of clause (xxiv) of paragraph (1)(B), by striking “and” at the end of clause (xxv) of such paragraph and inserting “or”, and by inserting after such clause (xxv) the following new clause:

“(xxvi) section 6050Y (relating to returns relating to certain life insurance contract transactions), and”,

and

(B) by striking “or” at the end of subparagraph (HH) of paragraph (2), by striking the period at the end of subparagraph (II) of such paragraph and inserting “, or”, and by inserting after such subparagraph (II) the following new subparagraph:

“(JJ) subsection (a)(2), (b)(2), or (c)(2) of section 6050Y (relating to returns relating to certain life insurance contract transactions).”

(2) Section 6047 is amended—

(A) by redesignating subsection (g) as subsection (h),

(B) by inserting after subsection (f) the following new subsection:

“(g) INFORMATION RELATING TO LIFE INSURANCE CONTRACT TRANSACTIONS.—This section shall not apply to any information which is required to be reported under section 6050Y.”, and

(C) by adding at the end of subsection (h), as so redesignated, the following new paragraph:

“(4) For provisions requiring reporting of information relating to certain life insurance contract transactions, see section 6050Y.”

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to—

(1) reportable policy sales (as defined in section 6050Y(d)(2) of the Internal Revenue Code of 1986 (as added by subsection (a)) after December 31, 2017, and

(2) reportable death benefits (as defined in section 6050Y(d)(4) of such Code (as added by subsection (a)) paid after December 31, 2017.

SEC. 13521. CLARIFICATION OF TAX BASIS OF LIFE INSURANCE CONTRACTS.

(a) CLARIFICATION WITH RESPECT TO ADJUSTMENTS.—Paragraph (1) of section 1016(a) is amended by striking subparagraph (A) and all that follows and inserting the following:

“(A) for—

“(i) taxes or other carrying charges described in section 266; or

“(ii) expenditures described in section 173 (relating to circulation expenditures),

for which deductions have been taken by the taxpayer in determining taxable income for the taxable year or prior taxable years; or

“(B) for mortality, expense, or other reasonable charges incurred under an annuity or life insurance contract.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to transactions entered into after August 25, 2009.

SEC. 13522. EXCEPTION TO TRANSFER FOR VALUABLE CONSIDERATION RULES.

(a) IN GENERAL.—Subsection (a) of section 101 is amended by inserting after paragraph (2) the following new paragraph:

“(3) EXCEPTION TO VALUABLE CONSIDERATION RULES FOR COMMERCIAL TRANSFERS.—

“(A) IN GENERAL.—The second sentence of paragraph (2) shall not apply in the case of a transfer of a life insurance contract, or any interest therein, which is a reportable policy sale.

“(B) REPORTABLE POLICY SALE.—For purposes of this paragraph, the term ‘reportable policy sale’ means the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured apart from the acquirer’s interest in such life insurance contract. For purposes of the preceding sentence, the term ‘indirectly’ applies to the acquisition of an interest in a

partnership, trust, or other entity that holds an interest in the life insurance contract.”

(b) CONFORMING AMENDMENT.—Paragraph (1) of section 101(a) is amended by striking “paragraph (2)” and inserting “paragraphs (2) and (3)”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers after December 31, 2017.

SEC. 13523. MODIFICATION OF DISCOUNTING RULES FOR PROPERTY AND CASUALTY INSURANCE COMPANIES.

(a) MODIFICATION OF RATE OF INTEREST USED TO DISCOUNT UNPAID LOSSES.—Paragraph (2) of section 846(c) is amended to read as follows:

“(2) DETERMINATION OF ANNUAL RATE.—The annual rate determined by the Secretary under this paragraph for any calendar year shall be a rate determined on the basis of the corporate bond yield curve (as defined in section 430(h)(2)(D)(i), determined by substituting ‘60-month period’ for ‘24-month period’ therein).”

(b) MODIFICATION OF COMPUTATIONAL RULES FOR LOSS PAYMENT PATTERNS.—Section 846(d)(3) is amended by striking subparagraphs (B) through (G) and inserting the following new subparagraph:

“(B) TREATMENT OF CERTAIN LOSSES.—

“(i) 3-YEAR LOSS PAYMENT PATTERN.—In the case of any line of business not described in subparagraph (A)(ii), losses paid after the 1st year following the accident year shall be treated as paid equally in the 2nd and 3rd year following the accident year.

“(ii) 10-YEAR LOSS PAYMENT PATTERN.—

“(I) IN GENERAL.—The period taken into account under subparagraph (A)(ii) shall be extended to the extent required under subclause (II).

“(II) COMPUTATION OF EXTENSION.—The amount of losses which would have been treated as paid in the 10th year after the accident year shall be treated as paid in such 10th year and each subsequent year in an amount equal to the amount of the average of the losses treated as paid in the 7th, 8th, and 9th years after the accident year (or, if lesser, the portion of the unpaid losses not theretofore taken into account). To the extent such unpaid losses have not been treated as paid before the 24th year after the accident year, they shall be treated as paid in such 24th year.”

(c) REPEAL OF HISTORICAL PAYMENT PATTERN ELECTION.—Section 846, as amended by this Act, is amended by striking subsection (e) and by redesignating subsections (f) and (g) as subsections (e) and (f), respectively.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(e) TRANSITIONAL RULE.—For the first taxable year beginning after December 31, 2017—

(1) the unpaid losses and the expenses unpaid (as defined in paragraphs (5)(B) and (6) of section 832(b) of the Internal

Revenue Code of 1986) at the end of the preceding taxable year, and

(2) the unpaid losses as defined in sections 807(c)(2) and 805(a)(1) of such Code at the end of the preceding taxable year,

shall be determined as if the amendments made by this section had applied to such unpaid losses and expenses unpaid in the preceding taxable year and by using the interest rate and loss payment patterns applicable to accident years ending with calendar year 2018, and any adjustment shall be taken into account ratably in such first taxable year and the 7 succeeding taxable years. For subsequent taxable years, such amendments shall be applied with respect to such unpaid losses and expenses unpaid by using the interest rate and loss payment patterns applicable to accident years ending with calendar year 2018.

Subpart C—Banks and Financial Instruments

SEC. 13531. LIMITATION ON DEDUCTION FOR FDIC PREMIUMS.

(a) IN GENERAL.—Section 162, as amended by sections 13307, is amended by redesignating subsection (r) as subsection (s) and by inserting after subsection (q) the following new subsection:

“(r) DISALLOWANCE OF FDIC PREMIUMS PAID BY CERTAIN LARGE FINANCIAL INSTITUTIONS.—

“(1) IN GENERAL.—No deduction shall be allowed for the applicable percentage of any FDIC premium paid or incurred by the taxpayer.

“(2) EXCEPTION FOR SMALL INSTITUTIONS.—Paragraph (1) shall not apply to any taxpayer for any taxable year if the total consolidated assets of such taxpayer (determined as of the close of such taxable year) do not exceed \$10,000,000,000.

“(3) APPLICABLE PERCENTAGE.—For purposes of this subsection, the term ‘applicable percentage’ means, with respect to any taxpayer for any taxable year, the ratio (expressed as a percentage but not greater than 100 percent) which—

“(A) the excess of—

“(i) the total consolidated assets of such taxpayer (determined as of the close of such taxable year), over

“(ii) \$10,000,000,000, bears to

“(B) \$40,000,000,000.

“(4) FDIC PREMIUMS.—For purposes of this subsection, the term ‘FDIC premium’ means any assessment imposed under section 7(b) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)).

“(5) TOTAL CONSOLIDATED ASSETS.—For purposes of this subsection, the term ‘total consolidated assets’ has the meaning given such term under section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5365).

“(6) AGGREGATION RULE.—

“(A) IN GENERAL.—Members of an expanded affiliated group shall be treated as a single taxpayer for purposes of applying this subsection.

“(B) EXPANDED AFFILIATED GROUP.—

“(i) IN GENERAL.—For purposes of this paragraph, the term ‘expanded affiliated group’ means an affiliated group as defined in section 1504(a), determined—

“(I) by substituting ‘more than 50 percent’ for ‘at least 80 percent’ each place it appears, and
“(II) without regard to paragraphs (2) and (3) of section 1504(b).

“(ii) CONTROL OF NON-CORPORATE ENTITIES.—A partnership or any other entity (other than a corporation) shall be treated as a member of an expanded affiliated group if such entity is controlled (within the meaning of section 954(d)(3)) by members of such group (including any entity treated as a member of such group by reason of this clause).”

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13532. REPEAL OF ADVANCE REFUNDING BONDS.

(a) IN GENERAL.—Paragraph (1) of section 149(d) is amended by striking “as part of an issue described in paragraph (2), (3), or (4).” and inserting “to advance refund another bond.”

(b) CONFORMING AMENDMENTS.—

(1) Section 149(d) is amended by striking paragraphs (2), (3), (4), and (6) and by redesignating paragraphs (5) and (7) as paragraphs (2) and (3).

(2) Section 148(f)(4)(C) is amended by striking clause (xiv) and by redesignating clauses (xv) to (xvii) as clauses (xiv) to (xvi).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to advance refunding bonds issued after December 31, 2017.

Subpart D—S Corporations

SEC. 13541. EXPANSION OF QUALIFYING BENEFICIARIES OF AN ELECTING SMALL BUSINESS TRUST.

(a) NO LOOK-THROUGH FOR ELIGIBILITY PURPOSES.—Section 1361(c)(2)(B)(v) is amended by adding at the end the following new sentence: “This clause shall not apply for purposes of subsection (b)(1)(C).”

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on January 1, 2018.

SEC. 13542. CHARITABLE CONTRIBUTION DEDUCTION FOR ELECTING SMALL BUSINESS TRUSTS.

(a) IN GENERAL.—Section 641(c)(2) is amended by inserting after subparagraph (D) the following new subparagraph:

“(E)(i) Section 642(c) shall not apply.

“(ii) For purposes of section 170(b)(1)(G), adjusted gross income shall be computed in the same manner as in the case of an individual, except that the deductions for costs which are paid or incurred in connection with the administration of the trust and which would not have been incurred if the property were not held in such trust shall be treated as allowable in arriving at adjusted gross income.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13543. MODIFICATION OF TREATMENT OF S CORPORATION CONVERSIONS TO C CORPORATIONS.

(a) ADJUSTMENTS ATTRIBUTABLE TO CONVERSION FROM S CORPORATION TO C CORPORATION.—Section 481 is amended by adding at the end the following new subsection:

“(d) ADJUSTMENTS ATTRIBUTABLE TO CONVERSION FROM S CORPORATION TO C CORPORATION.—

“(1) IN GENERAL.—In the case of an eligible terminated S corporation, any adjustment required by subsection (a)(2) which is attributable to such corporation’s revocation described in paragraph (2)(A)(ii) shall be taken into account ratably during the 6-taxable year period beginning with the year of change.

“(2) ELIGIBLE TERMINATED S CORPORATION.—For purposes of this subsection, the term ‘eligible terminated S corporation’ means any C corporation—

“(A) which—

“(i) was an S corporation on the day before the date of the enactment of the Tax Cuts and Jobs Act, and

“(ii) during the 2-year period beginning on the date of such enactment makes a revocation of its election under section 1362(a), and

“(B) the owners of the stock of which, determined on the date such revocation is made, are the same owners (and in identical proportions) as on the date of such enactment.”

(b) CASH DISTRIBUTIONS FOLLOWING POST-TERMINATION TRANSITION PERIOD FROM S CORPORATION STATUS.—Section 1371 is amended by adding at the end the following new subsection:

“(f) CASH DISTRIBUTIONS FOLLOWING POST-TERMINATION TRANSITION PERIOD.—In the case of a distribution of money by an eligible terminated S corporation (as defined in section 481(d)) after the post-termination transition period, the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in the same ratio as the amount of such accumulated adjustments account bears to the amount of such accumulated earnings and profits.”

PART VII—EMPLOYMENT

Subpart A—Compensation

SEC. 13601. MODIFICATION OF LIMITATION ON EXCESSIVE EMPLOYEE REMUNERATION.

(a) REPEAL OF PERFORMANCE-BASED COMPENSATION AND COMMISSION EXCEPTIONS FOR LIMITATION ON EXCESSIVE EMPLOYEE REMUNERATION.—

(1) IN GENERAL.—Paragraph (4) of section 162(m) is amended by striking subparagraphs (B) and (C) and by redesignating subparagraphs (D), (E), (F), and (G) as subparagraphs (B), (C), (D), and (E), respectively.

(2) CONFORMING AMENDMENTS.—

(A) Paragraphs (5)(E) and (6)(D) of section 162(m) are each amended by striking “subparagraphs (B), (C), and (D)” and inserting “subparagraph (B)”.

(B) Paragraphs (5)(G) and (6)(G) of section 162(m) are each amended by striking “(F) and (G)” and inserting “(D) and (E)”.

(b) MODIFICATION OF DEFINITION OF COVERED EMPLOYEES.— Paragraph (3) of section 162(m) is amended—

(1) in subparagraph (A), by striking “as of the close of the taxable year, such employee is the chief executive officer of the taxpayer or is” and inserting “such employee is the principal executive officer or principal financial officer of the taxpayer at any time during the taxable year, or was”,

(2) in subparagraph (B)—

(A) by striking “4” and inserting “3”, and

(B) by striking “(other than the chief executive officer)” and inserting “(other than any individual described in subparagraph (A))”, and

(3) by striking “or” at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting “, or”, and by adding at the end the following:

“(C) was a covered employee of the taxpayer (or any predecessor) for any preceding taxable year beginning after December 31, 2016.”.

(c) EXPANSION OF APPLICABLE EMPLOYER.—

(1) IN GENERAL.—Section 162(m)(2) is amended to read as follows:

“(2) PUBLICLY HELD CORPORATION.—For purposes of this subsection, the term ‘publicly held corporation’ means any corporation which is an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c))—

“(A) the securities of which are required to be registered under section 12 of such Act (15 U.S.C. 78l), or

“(B) that is required to file reports under section 15(d) of such Act (15 U.S.C. 78o(d)).”.

(2) CONFORMING AMENDMENT.—Section 162(m)(3), as amended by subsection (b), is amended by adding at the end the following flush sentence:

“Such term shall include any employee who would be described in subparagraph (B) if the reporting described in such subparagraph were required as so described.”.

(d) SPECIAL RULE FOR REMUNERATION PAID TO BENEFICIARIES, ETC.—Paragraph (4) of section 162(m), as amended by subsection (a), is amended by adding at the end the following new subparagraph:

“(F) SPECIAL RULE FOR REMUNERATION PAID TO BENEFICIARIES, ETC.—Remuneration shall not fail to be applicable employee remuneration merely because it is includible in the income of, or paid to, a person other than the covered employee, including after the death of the covered employee.”.

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) EXCEPTION FOR BINDING CONTRACTS.—The amendments made by this section shall not apply to remuneration which is provided pursuant to a written binding contract which was in effect on November 2, 2017, and which was not modified in any material respect on or after such date.

SEC. 13602. EXCISE TAX ON EXCESS TAX-EXEMPT ORGANIZATION EXECUTIVE COMPENSATION.

(a) IN GENERAL.—Subchapter D of chapter 42 is amended by adding at the end the following new section:

“SEC. 4960. TAX ON EXCESS TAX-EXEMPT ORGANIZATION EXECUTIVE COMPENSATION.

“(a) TAX IMPOSED.—There is hereby imposed a tax equal to the product of the rate of tax under section 11 and the sum of—

“(1) so much of the remuneration paid (other than any excess parachute payment) by an applicable tax-exempt organization for the taxable year with respect to employment of any covered employee in excess of \$1,000,000, plus

“(2) any excess parachute payment paid by such an organization to any covered employee.

For purposes of the preceding sentence, remuneration shall be treated as paid when there is no substantial risk of forfeiture (within the meaning of section 457(f)(3)(B)) of the rights to such remuneration.

“(b) LIABILITY FOR TAX.—The employer shall be liable for the tax imposed under subsection (a).

“(c) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

“(1) APPLICABLE TAX-EXEMPT ORGANIZATION.—The term ‘applicable tax-exempt organization’ means any organization which for the taxable year—

“(A) is exempt from taxation under section 501(a),

“(B) is a farmers’ cooperative organization described in section 521(b)(1),

“(C) has income excluded from taxation under section 115(1), or

“(D) is a political organization described in section 527(e)(1).

“(2) COVERED EMPLOYEE.—For purposes of this section, the term ‘covered employee’ means any employee (including any former employee) of an applicable tax-exempt organization if the employee—

“(A) is one of the 5 highest compensated employees of the organization for the taxable year, or

“(B) was a covered employee of the organization (or any predecessor) for any preceding taxable year beginning after December 31, 2016.

“(3) REMUNERATION.—For purposes of this section:

“(A) IN GENERAL.—The term ‘remuneration’ means wages (as defined in section 3401(a)), except that such term shall not include any designated Roth contribution (as defined in section 402A(c)) and shall include amounts required to be included in gross income under section 457(f).

“(B) EXCEPTION FOR REMUNERATION FOR MEDICAL SERVICES.—The term ‘remuneration’ shall not include the portion of any remuneration paid to a licensed medical professional (including a veterinarian) which is for the performance of medical or veterinary services by such professional.

“(4) REMUNERATION FROM RELATED ORGANIZATIONS.—

“(A) IN GENERAL.—Remuneration of a covered employee by an applicable tax-exempt organization shall include any

remuneration paid with respect to employment of such employee by any related person or governmental entity.

“(B) RELATED ORGANIZATIONS.—A person or governmental entity shall be treated as related to an applicable tax-exempt organization if such person or governmental entity—

“(i) controls, or is controlled by, the organization,

“(ii) is controlled by one or more persons which control the organization,

“(iii) is a supported organization (as defined in section 509(f)(3)) during the taxable year with respect to the organization,

“(iv) is a supporting organization described in section 509(a)(3) during the taxable year with respect to the organization, or

“(v) in the case of an organization which is a voluntary employees’ beneficiary association described in section 501(c)(9), establishes, maintains, or makes contributions to such voluntary employees’ beneficiary association.

“(C) LIABILITY FOR TAX.—In any case in which remuneration from more than one employer is taken into account under this paragraph in determining the tax imposed by subsection (a), each such employer shall be liable for such tax in an amount which bears the same ratio to the total tax determined under subsection (a) with respect to such remuneration as—

“(i) the amount of remuneration paid by such employer with respect to such employee, bears to

“(ii) the amount of remuneration paid by all such employers to such employee.

“(5) EXCESS PARACHUTE PAYMENT.—For purposes of determining the tax imposed by subsection (a)(2)—

“(A) IN GENERAL.—The term ‘excess parachute payment’ means an amount equal to the excess of any parachute payment over the portion of the base amount allocated to such payment.

“(B) PARACHUTE PAYMENT.—The term ‘parachute payment’ means any payment in the nature of compensation to (or for the benefit of) a covered employee if—

“(i) such payment is contingent on such employee’s separation from employment with the employer, and

“(ii) the aggregate present value of the payments in the nature of compensation to (or for the benefit of) such individual which are contingent on such separation equals or exceeds an amount equal to 3 times the base amount.

“(C) EXCEPTION.—Such term does not include any payment—

“(i) described in section 280G(b)(6) (relating to exemption for payments under qualified plans),

“(ii) made under or to an annuity contract described in section 403(b) or a plan described in section 457(b),

“(iii) to a licensed medical professional (including a veterinarian) to the extent that such payment is

for the performance of medical or veterinary services by such professional, or

“(iv) to an individual who is not a highly compensated employee as defined in section 414(q).

“(D) BASE AMOUNT.—Rules similar to the rules of 280G(b)(3) shall apply for purposes of determining the base amount.

“(E) PROPERTY TRANSFERS; PRESENT VALUE.—Rules similar to the rules of paragraphs (3) and (4) of section 280G(d) shall apply.

“(6) COORDINATION WITH DEDUCTION LIMITATION.—Remuneration the deduction for which is not allowed by reason of section 162(m) shall not be taken into account for purposes of this section.

“(d) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to prevent avoidance of the tax under this section, including regulations to prevent avoidance of such tax through the performance of services other than as an employee or by providing compensation through a pass-through or other entity to avoid such tax.”

(b) CLERICAL AMENDMENT.—The table of sections for subchapter D of chapter 42 is amended by adding at the end the following new item:

“Sec. 4960. Tax on excess tax-exempt organization executive compensation.”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13603. TREATMENT OF QUALIFIED EQUITY GRANTS.

(a) IN GENERAL.—Section 83 is amended by adding at the end the following new subsection:

“(i) QUALIFIED EQUITY GRANTS.—

“(1) IN GENERAL.—For purposes of this subtitle—

“(A) TIMING OF INCLUSION.—If qualified stock is transferred to a qualified employee who makes an election with respect to such stock under this subsection, subsection (a) shall be applied by including the amount determined under such subsection with respect to such stock in income of the employee in the taxable year determined under subparagraph (B) in lieu of the taxable year described in subsection (a).

“(B) TAXABLE YEAR DETERMINED.—The taxable year determined under this subparagraph is the taxable year of the employee which includes the earliest of—

“(i) the first date such qualified stock becomes transferable (including, solely for purposes of this clause, becoming transferable to the employer),

“(ii) the date the employee first becomes an excluded employee,

“(iii) the first date on which any stock of the corporation which issued the qualified stock becomes readily tradable on an established securities market (as determined by the Secretary, but not including any market unless such market is recognized as an established securities market by the Secretary for purposes of a provision of this title other than this subsection),

“(iv) the date that is 5 years after the first date the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, or

“(v) the date on which the employee revokes (at such time and in such manner as the Secretary provides) the election under this subsection with respect to such stock.

“(2) QUALIFIED STOCK.—

“(A) IN GENERAL.—For purposes of this subsection, the term ‘qualified stock’ means, with respect to any qualified employee, any stock in a corporation which is the employer of such employee, if—

“(i) such stock is received—

“(I) in connection with the exercise of an option, or

“(II) in settlement of a restricted stock unit,

and

“(ii) such option or restricted stock unit was granted by the corporation—

“(I) in connection with the performance of services as an employee, and

“(II) during a calendar year in which such corporation was an eligible corporation.

“(B) LIMITATION.—The term ‘qualified stock’ shall not include any stock if the employee may sell such stock to, or otherwise receive cash in lieu of stock from, the corporation at the time that the rights of the employee in such stock first become transferable or not subject to a substantial risk of forfeiture.

“(C) ELIGIBLE CORPORATION.—For purposes of subparagraph (A)(i)(II)—

“(i) IN GENERAL.—The term ‘eligible corporation’ means, with respect to any calendar year, any corporation if—

“(I) no stock of such corporation (or any predecessor of such corporation) is readily tradable on an established securities market (as determined under paragraph (1)(B)(iii)) during any preceding calendar year, and

“(II) such corporation has a written plan under which, in such calendar year, not less than 80 percent of all employees who provide services to such corporation in the United States (or any possession of the United States) are granted stock options, or are granted restricted stock units, with the same rights and privileges to receive qualified stock.

“(ii) SAME RIGHTS AND PRIVILEGES.—For purposes of clause (i)(II)—

“(I) except as provided in subclauses (II) and (III), the determination of rights and privileges with respect to stock shall be made in a similar manner as under section 423(b)(5),

“(II) employees shall not fail to be treated as having the same rights and privileges to receive qualified stock solely because the number of shares

available to all employees is not equal in amount, so long as the number of shares available to each employee is more than a de minimis amount, and “(III) rights and privileges with respect to the exercise of an option shall not be treated as the same as rights and privileges with respect to the settlement of a restricted stock unit.

“(iii) EMPLOYEE.—For purposes of clause (i)(II), the term ‘employee’ shall not include any employee described in section 4980E(d)(4) or any excluded employee.

“(iv) SPECIAL RULE FOR CALENDAR YEARS BEFORE 2018.—In the case of any calendar year beginning before January 1, 2018, clause (i)(II) shall be applied without regard to whether the rights and privileges with respect to the qualified stock are the same.

“(3) QUALIFIED EMPLOYEE; EXCLUDED EMPLOYEE.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘qualified employee’ means any individual who—

“(i) is not an excluded employee, and

“(ii) agrees in the election made under this subsection to meet such requirements as are determined by the Secretary to be necessary to ensure that the withholding requirements of the corporation under chapter 24 with respect to the qualified stock are met.

“(B) EXCLUDED EMPLOYEE.—The term ‘excluded employee’ means, with respect to any corporation, any individual—

“(i) who is a 1-percent owner (within the meaning of section 416(i)(1)(B)(ii)) at any time during the calendar year or who was such a 1 percent owner at any time during the 10 preceding calendar years,

“(ii) who is or has been at any prior time—

“(I) the chief executive officer of such corporation or an individual acting in such a capacity, or

“(II) the chief financial officer of such corporation or an individual acting in such a capacity,

“(iii) who bears a relationship described in section 318(a)(1) to any individual described in subclause (I) or (II) of clause (ii), or

“(iv) who is one of the 4 highest compensated officers of such corporation for the taxable year, or was one of the 4 highest compensated officers of such corporation for any of the 10 preceding taxable years, determined with respect to each such taxable year on the basis of the shareholder disclosure rules for compensation under the Securities Exchange Act of 1934 (as if such rules applied to such corporation).

“(4) ELECTION.—

“(A) TIME FOR MAKING ELECTION.—An election with respect to qualified stock shall be made under this subsection no later than 30 days after the first date the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, and shall be made in a manner similar to the

manner in which an election is made under subsection (b).

“(B) LIMITATIONS.—No election may be made under this section with respect to any qualified stock if—

“(i) the qualified employee has made an election under subsection (b) with respect to such qualified stock.

“(ii) any stock of the corporation which issued the qualified stock is readily tradable on an established securities market (as determined under paragraph (1)(B)(iii)) at any time before the election is made, or

“(iii) such corporation purchased any of its outstanding stock in the calendar year preceding the calendar year which includes the first date the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, unless—

“(I) not less than 25 percent of the total dollar amount of the stock so purchased is deferral stock, and

“(II) the determination of which individuals from whom deferral stock is purchased is made on a reasonable basis.

“(C) DEFINITIONS AND SPECIAL RULES RELATED TO LIMITATION ON STOCK REDEMPTIONS.—

“(i) DEFERRAL STOCK.—For purposes of this paragraph, the term ‘deferral stock’ means stock with respect to which an election is in effect under this subsection.

“(ii) DEFERRAL STOCK WITH RESPECT TO ANY INDIVIDUAL NOT TAKEN INTO ACCOUNT IF INDIVIDUAL HOLDS DEFERRAL STOCK WITH LONGER DEFERRAL PERIOD.—Stock purchased by a corporation from any individual shall not be treated as deferral stock for purposes of subparagraph (B)(iii) if such individual (immediately after such purchase) holds any deferral stock with respect to which an election has been in effect under this subsection for a longer period than the election with respect to the stock so purchased.

“(iii) PURCHASE OF ALL OUTSTANDING DEFERRAL STOCK.—The requirements of subclauses (I) and (II) of subparagraph (B)(iii) shall be treated as met if the stock so purchased includes all of the corporation’s outstanding deferral stock.

“(iv) REPORTING.—Any corporation which has outstanding deferral stock as of the beginning of any calendar year and which purchases any of its outstanding stock during such calendar year shall include on its return of tax for the taxable year in which, or with which, such calendar year ends the total dollar amount of its outstanding stock so purchased during such calendar year and such other information as the Secretary requires for purposes of administering this paragraph.

“(5) CONTROLLED GROUPS.—For purposes of this subsection, all persons treated as a single employer under section 414(b) shall be treated as 1 corporation.

“(6) NOTICE REQUIREMENT.—Any corporation which transfers qualified stock to a qualified employee shall, at the time that (or a reasonable period before) an amount attributable to such stock would (but for this subsection) first be includible in the gross income of such employee—

“(A) certify to such employee that such stock is qualified stock, and

“(B) notify such employee—

“(i) that the employee may be eligible to elect to defer income on such stock under this subsection, and

“(ii) that, if the employee makes such an election—

“(I) the amount of income recognized at the end of the deferral period will be based on the value of the stock at the time at which the rights of the employee in such stock first become transferable or not subject to substantial risk of forfeiture, notwithstanding whether the value of the stock has declined during the deferral period,

“(II) the amount of such income recognized at the end of the deferral period will be subject to withholding under section 3401(j) at the rate determined under section 3402(t), and

“(III) the responsibilities of the employee (as determined by the Secretary under paragraph (3)(A)(ii)) with respect to such withholding.

“(7) RESTRICTED STOCK UNITS.—This section (other than this subsection), including any election under subsection (b), shall not apply to restricted stock units.”

(b) WITHHOLDING.—

(1) TIME OF WITHHOLDING.—Section 3401 is amended by adding at the end the following new subsection:

“(i) QUALIFIED STOCK FOR WHICH AN ELECTION IS IN EFFECT UNDER SECTION 83(i).—For purposes of subsection (a), qualified stock (as defined in section 83(i)) with respect to which an election is made under section 83(i) shall be treated as wages—

“(1) received on the earliest date described in section 83(i)(1)(B), and

“(2) in an amount equal to the amount included in income under section 83 for the taxable year which includes such date.”

(2) AMOUNT OF WITHHOLDING.—Section 3402 is amended by adding at the end the following new subsection:

“(t) RATE OF WITHHOLDING FOR CERTAIN STOCK.—In the case of any qualified stock (as defined in section 83(i)(2)) with respect to which an election is made under section 83(i)—

“(1) the rate of tax under subsection (a) shall not be less than the maximum rate of tax in effect under section 1, and

“(2) such stock shall be treated for purposes of section 3501(b) in the same manner as a non-cash fringe benefit.”

(c) COORDINATION WITH OTHER DEFERRED COMPENSATION RULES.—

(1) ELECTION TO APPLY DEFERRAL TO STATUTORY OPTIONS.—

(A) INCENTIVE STOCK OPTIONS.—Section 422(b) is amended by adding at the end the following: “Such term shall not include any option if an election is made under

section 83(i) with respect to the stock received in connection with the exercise of such option.”

(B) EMPLOYEE STOCK PURCHASE PLANS.—Section 423 is amended—

(i) in subsection (b)(5), by striking “and” before “the plan” and by inserting “, and the rules of section 83(i) shall apply in determining which employees have a right to make an election under such section” before the semicolon at the end, and

(ii) by adding at the end the following new subsection:

“(d) COORDINATION WITH QUALIFIED EQUITY GRANTS.—An option for which an election is made under section 83(i) with respect to the stock received in connection with its exercise shall not be considered as granted pursuant an employee stock purchase plan.”

(2) EXCLUSION FROM DEFINITION OF NONQUALIFIED DEFERRED COMPENSATION PLAN.—Subsection (d) of section 409A is amended by adding at the end the following new paragraph:

“(7) TREATMENT OF QUALIFIED STOCK.—An arrangement under which an employee may receive qualified stock (as defined in section 83(i)(2)) shall not be treated as a nonqualified deferred compensation plan with respect to such employee solely because of such employee’s election, or ability to make an election, to defer recognition of income under section 83(i).”

(d) INFORMATION REPORTING.—Section 6051(a) is amended by striking “and” at the end of paragraph (14)(B), by striking the period at the end of paragraph (15) and inserting a comma, and by inserting after paragraph (15) the following new paragraphs:

“(16) the amount includible in gross income under subparagraph (A) of section 83(i)(1) with respect to an event described in subparagraph (B) of such section which occurs in such calendar year, and

“(17) the aggregate amount of income which is being deferred pursuant to elections under section 83(i), determined as of the close of the calendar year.”

(e) PENALTY FOR FAILURE OF EMPLOYER TO PROVIDE NOTICE OF TAX CONSEQUENCES.—Section 6652 is amended by adding at the end the following new subsection:

“(p) FAILURE TO PROVIDE NOTICE UNDER SECTION 83(i).—In the case of each failure to provide a notice as required by section 83(i)(6), at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such notice, an amount equal to \$100 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed \$50,000.”

(f) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to stock attributable to options exercised, or restricted stock units settled, after December 31, 2017.

(2) REQUIREMENT TO PROVIDE NOTICE.—The amendments made by subsection (e) shall apply to failures after December 31, 2017.

(g) TRANSITION RULE.—Until such time as the Secretary (or the Secretary’s delegate) issues regulations or other guidance for

purposes of implementing the requirements of paragraph (2)(C)(i)(II) of section 83(i) of the Internal Revenue Code of 1986 (as added by this section), or the requirements of paragraph (6) of such section, a corporation shall be treated as being in compliance with such requirements (respectively) if such corporation complies with a reasonable good faith interpretation of such requirements.

SEC. 13604. INCREASE IN EXCISE TAX RATE FOR STOCK COMPENSATION OF INSIDERS IN EXPATRIATED CORPORATIONS.

(a) **IN GENERAL.**—Section 4985(a)(1) is amended by striking “section 1(h)(1)(C)” and inserting “section 1(h)(1)(D)”.

(b) **EFFECTIVE DATE.**—The amendment made by this section shall apply to corporations first becoming expatriated corporations (as defined in section 4985 of the Internal Revenue Code of 1986) after the date of enactment of this Act.

Subpart B—Retirement Plans

SEC. 13611. REPEAL OF SPECIAL RULE PERMITTING RECHARACTERIZATION OF ROTH CONVERSIONS.

(a) **IN GENERAL.**—Section 408A(d)(6)(B) is amended by adding at the end the following new clause:

“(iii) **CONVERSIONS.**—Subparagraph (A) shall not apply in the case of a qualified rollover contribution to which subsection (d)(3) applies (including by reason of subparagraph (C) thereof).”

(b) **EFFECTIVE DATE.**—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13612. MODIFICATION OF RULES APPLICABLE TO LENGTH OF SERVICE AWARD PLANS.

(a) **MAXIMUM DEFERRAL AMOUNT.**—Clause (ii) of section 457(e)(11)(B) is amended by striking “\$3,000” and inserting “\$6,000”.

(b) **COST OF LIVING ADJUSTMENT.**—Subparagraph (B) of section 457(e)(11) is amended by adding at the end the following:

“(iii) **COST OF LIVING ADJUSTMENT.**—In the case of taxable years beginning after December 31, 2017, the Secretary shall adjust the \$6,000 amount under clause (ii) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2016, and any increase under this paragraph that is not a multiple of \$500 shall be rounded to the next lowest multiple of \$500.”

(c) **APPLICATION OF LIMITATION ON ACCRUALS.**—Subparagraph (B) of section 457(e)(11), as amended by subsection (b), is amended by adding at the end the following:

“(iv) **SPECIAL RULE FOR APPLICATION OF LIMITATION ON ACCRUALS FOR CERTAIN PLANS.**—In the case of a plan described in subparagraph (A)(ii) which is a defined benefit plan (as defined in section 414(j)), the limitation under clause (ii) shall apply to the actuarial present value of the aggregate amount of length of service awards accruing with respect to any year of service. Such actuarial present value with respect to any year shall be calculated using reasonable actuarial assumptions and methods, assuming payment will be

made under the most valuable form of payment under the plan with payment commencing at the later of the earliest age at which unreduced benefits are payable under the plan or the participant's age at the time of the calculation.”

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13613. EXTENDED ROLLOVER PERIOD FOR PLAN LOAN OFFSET AMOUNTS.

(a) IN GENERAL.—Paragraph (3) of section 402(c) is amended by adding at the end the following new subparagraph:

“(C) ROLLOVER OF CERTAIN PLAN LOAN OFFSET AMOUNTS.—

“(i) IN GENERAL.—In the case of a qualified plan loan offset amount, paragraph (1) shall not apply to any transfer of such amount made after the due date (including extensions) for filing the return of tax for the taxable year in which such amount is treated as distributed from a qualified employer plan.

“(ii) QUALIFIED PLAN LOAN OFFSET AMOUNT.—For purposes of this subparagraph, the term ‘qualified plan loan offset amount’ means a plan loan offset amount which is treated as distributed from a qualified employer plan to a participant or beneficiary solely by reason of—

“(I) the termination of the qualified employer plan, or

“(II) the failure to meet the repayment terms of the loan from such plan because of the severance from employment of the participant.

“(iii) PLAN LOAN OFFSET AMOUNT.—For purposes of clause (ii), the term ‘plan loan offset amount’ means the amount by which the participant's accrued benefit under the plan is reduced in order to repay a loan from the plan.

“(iv) LIMITATION.—This subparagraph shall not apply to any plan loan offset amount unless such plan loan offset amount relates to a loan to which section 72(p)(1) does not apply by reason of section 72(p)(2).

“(v) QUALIFIED EMPLOYER PLAN.—For purposes of this subsection, the term ‘qualified employer plan’ has the meaning given such term by section 72(p)(4).”

(b) CONFORMING AMENDMENTS.—Section 402(c)(3) is amended—

(1) by striking “TRANSFER MUST BE MADE WITHIN 60 DAYS OF RECEIPT” in the heading and inserting “TIME LIMIT ON TRANSFERS”, and

(2) by striking “subparagraph (B)” in subparagraph (A) and inserting “subparagraphs (B) and (C)”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan loan offset amounts which are treated as distributed in taxable years beginning after December 31, 2017.

PART VIII—EXEMPT ORGANIZATIONS

SEC. 13701. EXCISE TAX BASED ON INVESTMENT INCOME OF PRIVATE COLLEGES AND UNIVERSITIES.

(a) IN GENERAL.—Chapter 42 is amended by adding at the end the following new subchapter:

“Subchapter H—Excise Tax Based on Investment Income of Private Colleges and Universities

“Sec. 4968. Excise tax based on investment income of private colleges and universities.

“SEC. 4968. EXCISE TAX BASED ON INVESTMENT INCOME OF PRIVATE COLLEGES AND UNIVERSITIES.

“(a) TAX IMPOSED.—There is hereby imposed on each applicable educational institution for the taxable year a tax equal to 1.4 percent of the net investment income of such institution for the taxable year.

“(b) APPLICABLE EDUCATIONAL INSTITUTION.—For purposes of this subchapter—

“(1) IN GENERAL.—The term ‘applicable educational institution’ means an eligible educational institution (as defined in section 25A(f)(2))—

“(A) which had at least 500 students during the preceding taxable year,

“(B) more than 50 percent of the students of which are located in the United States,

“(C) which is not described in the first sentence of section 511(a)(2)(B) (relating to State colleges and universities), and

“(D) the aggregate fair market value of the assets of which at the end of the preceding taxable year (other than those assets which are used directly in carrying out the institution’s exempt purpose) is at least \$500,000 per student of the institution.

“(2) STUDENTS.—For purposes of paragraph (1), the number of students of an institution (including for purposes of determining the number of students at a particular location) shall be based on the daily average number of full-time students attending such institution (with part-time students taken into account on a full-time student equivalent basis).

“(c) NET INVESTMENT INCOME.—For purposes of this section, net investment income shall be determined under rules similar to the rules of section 4940(c).

“(d) ASSETS AND NET INVESTMENT INCOME OF RELATED ORGANIZATIONS.—

“(1) IN GENERAL.—For purposes of subsections (b)(1)(C) and (c), assets and net investment income of any related organization with respect to an educational institution shall be treated as assets and net investment income, respectively, of the educational institution, except that—

“(A) no such amount shall be taken into account with respect to more than 1 educational institution, and

“(B) unless such organization is controlled by such institution or is described in section 509(a)(3) with respect to such institution for the taxable year, assets and net

investment income which are not intended or available for the use or benefit of the educational institution shall not be taken into account.

“(2) RELATED ORGANIZATION.—For purposes of this subsection, the term ‘related organization’ means, with respect to an educational institution, any organization which—

“(A) controls, or is controlled by, such institution,

“(B) is controlled by 1 or more persons which also control such institution, or

“(C) is a supported organization (as defined in section 509(f)(3)), or an organization described in section 509(a)(3), during the taxable year with respect to such institution.”.

(b) CLERICAL AMENDMENT.—The table of subchapters for chapter 42 is amended by adding at the end the following new item:

“SUBCHAPTER H—EXCISE TAX BASED ON INVESTMENT INCOME OF PRIVATE COLLEGES AND UNIVERSITIES”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13702. UNRELATED BUSINESS TAXABLE INCOME SEPARATELY COMPUTED FOR EACH TRADE OR BUSINESS ACTIVITY.

(a) IN GENERAL.—Subsection (a) of section 512 is amended by adding at the end the following new paragraph:

“(6) SPECIAL RULE FOR ORGANIZATION WITH MORE THAN 1 UNRELATED TRADE OR BUSINESS.—In the case of any organization with more than 1 unrelated trade or business—

“(A) unrelated business taxable income, including for purposes of determining any net operating loss deduction, shall be computed separately with respect to each such trade or business and without regard to subsection (b)(12),

“(B) the unrelated business taxable income of such organization shall be the sum of the unrelated business taxable income so computed with respect to each such trade or business, less a specific deduction under subsection (b)(12), and

“(C) for purposes of subparagraph (B), unrelated business taxable income with respect to any such trade or business shall not be less than zero.”.

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except to the extent provided in paragraph (2), the amendment made by this section shall apply to taxable years beginning after December 31, 2017.

(2) CARRYOVERS OF NET OPERATING LOSSES.—If any net operating loss arising in a taxable year beginning before January 1, 2018, is carried over to a taxable year beginning on or after such date—

(A) subparagraph (A) of section 512(a)(6) of the Internal Revenue Code of 1986, as added by this Act, shall not apply to such net operating loss, and

(B) the unrelated business taxable income of the organization, after the application of subparagraph (B) of such section, shall be reduced by the amount of such net operating loss.

SEC. 13703. UNRELATED BUSINESS TAXABLE INCOME INCREASED BY AMOUNT OF CERTAIN FRINGE BENEFIT EXPENSES FOR WHICH DEDUCTION IS DISALLOWED.

(a) IN GENERAL.—Section 512(a), as amended by this Act, is further amended by adding at the end the following new paragraph:

“(7) INCREASE IN UNRELATED BUSINESS TAXABLE INCOME BY DISALLOWED FRINGE.—Unrelated business taxable income of an organization shall be increased by any amount for which a deduction is not allowable under this chapter by reason of section 274 and which is paid or incurred by such organization for any qualified transportation fringe (as defined in section 132(f)), any parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C)), or any on-premises athletic facility (as defined in section 132(j)(4)(B)). The preceding sentence shall not apply to the extent the amount paid or incurred is directly connected with an unrelated trade or business which is regularly carried on by the organization. The Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations or other guidance providing for the appropriate allocation of depreciation and other costs with respect to facilities used for parking or for on-premises athletic facilities.”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to amounts paid or incurred after December 31, 2017.

SEC. 13704. REPEAL OF DEDUCTION FOR AMOUNTS PAID IN EXCHANGE FOR COLLEGE ATHLETIC EVENT SEATING RIGHTS.

(a) IN GENERAL.—Section 170(l) is amended—

(1) by striking paragraph (1) and inserting the following:

“(1) IN GENERAL.—No deduction shall be allowed under this section for any amount described in paragraph (2).”, and

(2) in paragraph (2)(B), by striking “such amount would be allowable as a deduction under this section but for the fact that”.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to contributions made in taxable years beginning after December 31, 2017.

SEC. 13705. REPEAL OF SUBSTANTIATION EXCEPTION IN CASE OF CONTRIBUTIONS REPORTED BY DONEE.

(a) IN GENERAL.—Section 170(f)(8) is amended by striking subparagraph (D) and by redesignating subparagraph (E) as subparagraph (D).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to contributions made in taxable years beginning after December 31, 2016.

PART IX—OTHER PROVISIONS

Subpart A—Craft Beverage Modernization and Tax Reform

SEC. 13801. PRODUCTION PERIOD FOR BEER, WINE, AND DISTILLED SPIRITS.

(a) IN GENERAL.—Section 263A(f) is amended—

(1) by redesignating paragraph (4) as paragraph (5), and

(2) by inserting after paragraph (3) the following new paragraph:

“(4) EXEMPTION FOR AGING PROCESS OF BEER, WINE, AND DISTILLED SPIRITS.—

“(A) IN GENERAL.—For purposes of this subsection, the production period shall not include the aging period for—

“(i) beer (as defined in section 5052(a)),

“(ii) wine (as described in section 5041(a)), or

“(iii) distilled spirits (as defined in section 5002(a)(8)), except such spirits that are unfit for use for beverage purposes.

“(B) TERMINATION.—This paragraph shall not apply to interest costs paid or accrued after December 31, 2019.”

(b) CONFORMING AMENDMENT.—Paragraph (5)(B)(ii) of section 263A(f), as redesignated by this section, is amended by inserting “except as provided in paragraph (4),” before “ending on the date”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to interest costs paid or accrued in calendar years beginning after December 31, 2017.

SEC. 13802. REDUCED RATE OF EXCISE TAX ON BEER.

(a) IN GENERAL.—Paragraph (1) of section 5051(a) is amended to read as follows:

“(1) IN GENERAL.—

“(A) IMPOSITION OF TAX.—A tax is hereby imposed on all beer brewed or produced, and removed for consumption or sale, within the United States, or imported into the United States. Except as provided in paragraph (2), the rate of such tax shall be the amount determined under this paragraph.

“(B) RATE.—Except as provided in subparagraph (C), the rate of tax shall be \$18 for per barrel.

“(C) SPECIAL RULE.—In the case of beer removed after December 31, 2017, and before January 1, 2020, the rate of tax shall be—

“(i) \$16 on the first 6,000,000 barrels of beer—

“(I) brewed by the brewer and removed during the calendar year for consumption or sale, or

“(II) imported by the importer into the United States during the calendar year, and

“(ii) \$18 on any barrels of beer to which clause

(i) does not apply.

“(D) BARREL.—For purposes of this section, a barrel shall contain not more than 31 gallons of beer, and any tax imposed under this section shall be applied at a like rate for any other quantity or for fractional parts of a barrel.”

(b) REDUCED RATE FOR CERTAIN DOMESTIC PRODUCTION.—Subparagraph (A) of section 5051(a)(2) is amended—

(1) in the heading, by striking “\$7 A BARREL”, and

(2) by inserting “(\$3.50 in the case of beer removed after December 31, 2017, and before January 1, 2020)” after “\$7”.

(c) APPLICATION OF REDUCED TAX RATE FOR FOREIGN MANUFACTURERS AND IMPORTERS.—Subsection (a) of section 5051 is amended—

(1) in subparagraph (C)(i)(II) of paragraph (1), as amended by subsection (a), by inserting “but only if the importer is

an electing importer under paragraph (4) and the barrels have been assigned to the importer pursuant to such paragraph” after “during the calendar year”, and

(2) by adding at the end the following new paragraph:

“(4) REDUCED TAX RATE FOR FOREIGN MANUFACTURERS AND IMPORTERS.—

“(A) IN GENERAL.—In the case of any barrels of beer which have been brewed or produced outside of the United States and imported into the United States, the rate of tax applicable under clause (i) of paragraph (1)(C) (referred to in this paragraph as the ‘reduced tax rate’) may be assigned by the brewer (provided that the brewer makes an election described in subparagraph (B)(ii)) to any electing importer of such barrels pursuant to the requirements established by the Secretary under subparagraph (B).

“(B) ASSIGNMENT.—The Secretary shall, through such rules, regulations, and procedures as are determined appropriate, establish procedures for assignment of the reduced tax rate provided under this paragraph, which shall include—

“(i) a limitation to ensure that the number of barrels of beer for which the reduced tax rate has been assigned by a brewer—

“(I) to any importer does not exceed the number of barrels of beer brewed or produced by such brewer during the calendar year which were imported into the United States by such importer, and

“(II) to all importers does not exceed the 6,000,000 barrels to which the reduced tax rate applies,

“(ii) procedures that allow the election of a brewer to assign and an importer to receive the reduced tax rate provided under this paragraph,

“(iii) requirements that the brewer provide any information as the Secretary determines necessary and appropriate for purposes of carrying out this paragraph, and

“(iv) procedures that allow for revocation of eligibility of the brewer and the importer for the reduced tax rate provided under this paragraph in the case of any erroneous or fraudulent information provided under clause (iii) which the Secretary deems to be material to qualifying for such reduced rate.

“(C) CONTROLLED GROUP.—For purposes of this section, any importer making an election described in subparagraph (B)(ii) shall be deemed to be a member of the controlled group of the brewer, as described under paragraph (5).”.

(d) CONTROLLED GROUP AND SINGLE TAXPAYER RULES.—Subsection (a) of section 5051, as amended by this section, is amended—

(1) in paragraph (2)—

(A) by striking subparagraph (B), and

(B) by redesignating subparagraph (C) as subparagraph (B), and

(2) by adding at the end the following new paragraph:

“(5) CONTROLLED GROUP AND SINGLE TAXPAYER RULES.—

“(A) IN GENERAL.—Except as provided in subparagraph (B), in the case of a controlled group, the 6,000,000 barrel quantity specified in paragraph (1)(C)(i) and the 2,000,000 barrel quantity specified in paragraph (2)(A) shall be applied to the controlled group, and the 6,000,000 barrel quantity specified in paragraph (1)(C)(i) and the 60,000 barrel quantity specified in paragraph (2)(A) shall be apportioned among the brewers who are members of such group in such manner as the Secretary or their delegate shall by regulations prescribe. For purposes of the preceding sentence, the term ‘controlled group’ has the meaning assigned to it by subsection (a) of section 1563, except that for such purposes the phrase ‘more than 50 percent’ shall be substituted for the phrase ‘at least 80 percent’ in each place it appears in such subsection. Under regulations prescribed by the Secretary, principles similar to the principles of the preceding two sentences shall be applied to a group of brewers under common control where one or more of the brewers is not a corporation.

“(B) FOREIGN MANUFACTURERS AND IMPORTERS.—For purposes of paragraph (4), in the case of a controlled group, the 6,000,000 barrel quantity specified in paragraph (1)(C)(i) shall be applied to the controlled group and apportioned among the members of such group in such manner as the Secretary shall by regulations prescribe. For purposes of the preceding sentence, the term ‘controlled group’ has the meaning given such term under subparagraph (A). Under regulations prescribed by the Secretary, principles similar to the principles of the preceding two sentences shall be applied to a group of brewers under common control where one or more of the brewers is not a corporation.

“(C) SINGLE TAXPAYER.—Pursuant to rules issued by the Secretary, two or more entities (whether or not under common control) that produce beer marketed under a similar brand, license, franchise, or other arrangement shall be treated as a single taxpayer for purposes of the application of this subsection.”.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to beer removed after December 31, 2017.

SEC. 13803. TRANSFER OF BEER BETWEEN BONDED FACILITIES.

(a) IN GENERAL.—Section 5414 is amended—

(1) by striking “Beer may be removed” and inserting “(a) IN GENERAL.—Beer may be removed”, and

(2) by adding at the end the following:

“(b) TRANSFER OF BEER BETWEEN BONDED FACILITIES.—

“(1) IN GENERAL.—Beer may be removed from one bonded brewery to another bonded brewery, without payment of tax, and may be mingled with beer at the receiving brewery, subject to such conditions, including payment of the tax, and in such containers, as the Secretary by regulations shall prescribe, which shall include—

“(A) any removal from one brewery to another brewery belonging to the same brewer,

“(B) any removal from a brewery owned by one corporation to a brewery owned by another corporation when—

“(i) one such corporation owns the controlling interest in the other such corporation, or
“(ii) the controlling interest in each such corporation is owned by the same person or persons, and
“(C) any removal from one brewery to another brewery
when—

“(i) the proprietors of transferring and receiving premises are independent of each other and neither has a proprietary interest, directly or indirectly, in the business of the other, and

“(ii) the transferor has divested itself of all interest in the beer so transferred and the transferee has accepted responsibility for payment of the tax.

“(2) TRANSFER OF LIABILITY FOR TAX.—For purposes of paragraph (1)(C), such relief from liability shall be effective from the time of removal from the transferor's bonded premises, or from the time of divestment of interest, whichever is later.

“(3) TERMINATION.—This subsection shall not apply to any calendar quarter beginning after December 31, 2019.”

(b) REMOVAL FROM BREWERY BY PIPELINE.—Section 5412 is amended by inserting “pursuant to section 5414 or” before “by pipeline”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to any calendar quarters beginning after December 31, 2017.

SEC. 13804. REDUCED RATE OF EXCISE TAX ON CERTAIN WINE.

(a) IN GENERAL.—Section 5041(c) is amended by adding at the end the following new paragraph:

“(8) SPECIAL RULE FOR 2018 AND 2019.—

“(A) IN GENERAL.—In the case of wine removed after December 31, 2017, and before January 1, 2020, paragraphs (1) and (2) shall not apply and there shall be allowed as a credit against any tax imposed by this title (other than chapters 2, 21, and 22) an amount equal to the sum of—

“(i) \$1 per wine gallon on the first 30,000 wine gallons of wine, plus

“(ii) 90 cents per wine gallon on the first 100,000 wine gallons of wine to which clause (i) does not apply, plus

“(iii) 53.5 cents per wine gallon on the first 620,000 wine gallons of wine to which clauses (i) and (ii) do not apply,

which are produced by the producer and removed during the calendar year for consumption or sale, or which are imported by the importer into the United States during the calendar year.

“(B) ADJUSTMENT OF CREDIT FOR HARD CIDER.—In the case of wine described in subsection (b)(6), subparagraph (A) of this paragraph shall be applied—

“(i) in clause (i) of such subparagraph, by substituting ‘6.2 cents’ for ‘\$1’,

“(ii) in clause (ii) of such subparagraph, by substituting ‘5.6 cents’ for ‘90 cents’, and

“(iii) in clause (iii) of such subparagraph, by substituting ‘3.3 cents’ for ‘53.5 cents.’.”

(b) CONTROLLED GROUP AND SINGLE TAXPAYER RULES.—Paragraph (4) of section 5041(c) is amended by striking “section 5051(a)(2)(B)” and inserting “section 5051(a)(5)”.

(c) ALLOWANCE OF CREDIT FOR FOREIGN MANUFACTURERS AND IMPORTERS.—Subsection (c) of section 5041, as amended by subsection (a), is amended—

(1) in subparagraph (A) of paragraph (8), by inserting “but only if the importer is an electing importer under paragraph (9) and the wine gallons of wine have been assigned to the importer pursuant to such paragraph” after “into the United States during the calendar year”, and

(2) by adding at the end the following new paragraph:

“(9) ALLOWANCE OF CREDIT FOR FOREIGN MANUFACTURERS AND IMPORTERS.—

“(A) IN GENERAL.—In the case of any wine gallons of wine which have been produced outside of the United States and imported into the United States, the credit allowable under paragraph (8) (referred to in this paragraph as the ‘tax credit’) may be assigned by the person who produced such wine (referred to in this paragraph as the ‘foreign producer’), provided that such person makes an election described in subparagraph (B)(ii), to any electing importer of such wine gallons pursuant to the requirements established by the Secretary under subparagraph (B).

“(B) ASSIGNMENT.—The Secretary shall, through such rules, regulations, and procedures as are determined appropriate, establish procedures for assignment of the tax credit provided under this paragraph, which shall include—

“(i) a limitation to ensure that the number of wine gallons of wine for which the tax credit has been assigned by a foreign producer—

“(I) to any importer does not exceed the number of wine gallons of wine produced by such foreign producer during the calendar year which were imported into the United States by such importer, and

“(II) to all importers does not exceed the 750,000 wine gallons of wine to which the tax credit applies,

“(ii) procedures that allow the election of a foreign producer to assign and an importer to receive the tax credit provided under this paragraph,

“(iii) requirements that the foreign producer provide any information as the Secretary determines necessary and appropriate for purposes of carrying out this paragraph, and

“(iv) procedures that allow for revocation of eligibility of the foreign producer and the importer for the tax credit provided under this paragraph in the case of any erroneous or fraudulent information provided under clause (iii) which the Secretary deems to be material to qualifying for such credit.

“(C) CONTROLLED GROUP.—For purposes of this section, any importer making an election described in subparagraph (B)(ii) shall be deemed to be a member of the controlled

group of the foreign producer, as described under paragraph (4).”

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to wine removed after December 31, 2017.

SEC. 13805. ADJUSTMENT OF ALCOHOL CONTENT LEVEL FOR APPLICATION OF EXCISE TAX RATES.

(a) IN GENERAL.—Paragraphs (1) and (2) of section 5041(b) are each amended by inserting “16 percent in the case of wine removed after December 31, 2017, and before January 1, 2020” after “14 percent”.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to wine removed after December 31, 2017.

SEC. 13806. DEFINITION OF MEAD AND LOW ALCOHOL BY VOLUME WINE.

(a) IN GENERAL.—Section 5041 is amended—

(1) in subsection (a), by striking “Still wines” and inserting “Subject to subsection (h), still wines”, and

(2) by adding at the end the following new subsection:

“(h) MEAD AND LOW ALCOHOL BY VOLUME WINE.—

“(1) IN GENERAL.—For purposes of subsections (a) and (b)(1), mead and low alcohol by volume wine shall be deemed to be still wines containing not more than 16 percent of alcohol by volume.

“(2) DEFINITIONS.—

“(A) MEAD.—For purposes of this section, the term ‘mead’ means a wine—

“(i) containing not more than 0.64 gram of carbon dioxide per hundred milliliters of wine, except that the Secretary shall by regulations prescribe such tolerances to this limitation as may be reasonably necessary in good commercial practice,

“(ii) which is derived solely from honey and water,

“(iii) which contains no fruit product or fruit flavoring, and

“(iv) which contains less than 8.5 percent alcohol by volume.

“(B) LOW ALCOHOL BY VOLUME WINE.—For purposes of this section, the term ‘low alcohol by volume wine’ means a wine—

“(i) containing not more than 0.64 gram of carbon dioxide per hundred milliliters of wine, except that the Secretary shall by regulations prescribe such tolerances to this limitation as may be reasonably necessary in good commercial practice,

“(ii) which is derived—

“(I) primarily from grapes, or

“(II) from grape juice concentrate and water,

“(iii) which contains no fruit product or fruit flavoring other than grape, and

“(iv) which contains less than 8.5 percent alcohol by volume.

“(3) TERMINATION.—This subsection shall not apply to wine removed after December 31, 2019.”

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to wine removed after December 31, 2017.

SEC. 13807. REDUCED RATE OF EXCISE TAX ON CERTAIN DISTILLED SPIRITS.

(a) IN GENERAL.—Section 5001 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

“(c) REDUCED RATE FOR 2018 AND 2019.—

“(1) IN GENERAL.—In the case of a distilled spirits operation, the otherwise applicable tax rate under subsection (a)(1) shall be—

“(A) \$2.70 per proof gallon on the first 100,000 proof gallons of distilled spirits, and

“(B) \$13.34 per proof gallon on the first 22,130,000 of proof gallons of distilled spirits to which subparagraph (A) does not apply,

which have been distilled or processed by such operation and removed during the calendar year for consumption or sale, or which have been imported by the importer into the United States during the calendar year.

“(2) CONTROLLED GROUPS.—

“(A) IN GENERAL.—In the case of a controlled group, the proof gallon quantities specified under subparagraphs (A) and (B) of paragraph (1) shall be applied to such group and apportioned among the members of such group in such manner as the Secretary or their delegate shall by regulations prescribe.

“(B) DEFINITION.—For purposes of subparagraph (A), the term ‘controlled group’ shall have the meaning given such term by subsection (a) of section 1563, except that ‘more than 50 percent’ shall be substituted for ‘at least 80 percent’ each place it appears in such subsection.

“(C) RULES FOR NON-CORPORATIONS.—Under regulations prescribed by the Secretary, principles similar to the principles of subparagraphs (A) and (B) shall be applied to a group under common control where one or more of the persons is not a corporation.

“(D) SINGLE TAXPAYER.—Pursuant to rules issued by the Secretary, two or more entities (whether or not under common control) that produce distilled spirits marketed under a similar brand, license, franchise, or other arrangement shall be treated as a single taxpayer for purposes of the application of this subsection.

“(3) TERMINATION.—This subsection shall not apply to distilled spirits removed after December 31, 2019.”

(b) CONFORMING AMENDMENT.—Section 7652(f)(2) is amended by striking “section 5001(a)(1)” and inserting “subsection (a)(1) of section 5001, determined as if subsection (c)(1) of such section did not apply”.

(c) APPLICATION OF REDUCED TAX RATE FOR FOREIGN MANUFACTURERS AND IMPORTERS.—Subsection (c) of section 5001, as added by subsection (a), is amended—

(1) in paragraph (1), by inserting “but only if the importer is an electing importer under paragraph (3) and the proof gallons of distilled spirits have been assigned to the importer pursuant to such paragraph” after “into the United States during the calendar year”, and

(2) by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

“(3) REDUCED TAX RATE FOR FOREIGN MANUFACTURERS AND IMPORTERS.—

“(A) IN GENERAL.—In the case of any proof gallons of distilled spirits which have been produced outside of the United States and imported into the United States, the rate of tax applicable under paragraph (1) (referred to in this paragraph as the ‘reduced tax rate’) may be assigned by the distilled spirits operation (provided that such operation makes an election described in subparagraph (B)(ii)) to any electing importer of such proof gallons pursuant to the requirements established by the Secretary under subparagraph (B).

“(B) ASSIGNMENT.—The Secretary shall, through such rules, regulations, and procedures as are determined appropriate, establish procedures for assignment of the reduced tax rate provided under this paragraph, which shall include—

“(i) a limitation to ensure that the number of proof gallons of distilled spirits for which the reduced tax rate has been assigned by a distilled spirits operation—

“(I) to any importer does not exceed the number of proof gallons produced by such operation during the calendar year which were imported into the United States by such importer, and

“(II) to all importers does not exceed the 22,230,000 proof gallons of distilled spirits to which the reduced tax rate applies,

“(ii) procedures that allow the election of a distilled spirits operation to assign and an importer to receive the reduced tax rate provided under this paragraph,

“(iii) requirements that the distilled spirits operation provide any information as the Secretary determines necessary and appropriate for purposes of carrying out this paragraph, and

“(iv) procedures that allow for revocation of eligibility of the distilled spirits operation and the importer for the reduced tax rate provided under this paragraph in the case of any erroneous or fraudulent information provided under clause (iii) which the Secretary deems to be material to qualifying for such reduced rate.

“(C) CONTROLLED GROUP.—

“(i) IN GENERAL.—For purposes of this section, any importer making an election described in subparagraph (B)(ii) shall be deemed to be a member of the controlled group of the distilled spirits operation, as described under paragraph (2).

“(ii) APPORTIONMENT.—For purposes of this paragraph, in the case of a controlled group, rules similar to section 5051(a)(5)(B) shall apply.”

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to distilled spirits removed after December 31, 2017.

SEC. 13808. BULK DISTILLED SPIRITS.

(a) IN GENERAL.—Section 5212 is amended by adding at the end the following sentence: “In the case of distilled spirits transferred in bond after December 31, 2017, and before January 1,

2020, this section shall be applied without regard to whether distilled spirits are bulk distilled spirits.”

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to distilled spirits transferred in bond after December 31, 2017.

Subpart B—Miscellaneous Provisions

SEC. 13821. MODIFICATION OF TAX TREATMENT OF ALASKA NATIVE CORPORATIONS AND SETTLEMENT TRUSTS.

(a) EXCLUSION FOR ANCSA PAYMENTS ASSIGNED TO ALASKA NATIVE SETTLEMENT TRUSTS.—

(1) IN GENERAL.—Part III of subchapter B of chapter 1 is amended by inserting before section 140 the following new section:

“SEC. 139G. ASSIGNMENTS TO ALASKA NATIVE SETTLEMENT TRUSTS.

“(a) IN GENERAL.—In the case of a Native Corporation, gross income shall not include the value of any payments that would otherwise be made, or treated as being made, to such Native Corporation pursuant to, or as required by, any provision of the Alaska Native Claims Settlement Act (43 U.S.C. 1601 et seq.), including any payment that would otherwise be made to a Village Corporation pursuant to section 7(j) of the Alaska Native Claims Settlement Act (43 U.S.C. 1606(j)), provided that any such payments—

“(1) are assigned in writing to a Settlement Trust, and

“(2) were not received by such Native Corporation prior to the assignment described in paragraph (1).

“(b) INCLUSION IN GROSS INCOME.—In the case of a Settlement Trust which has been assigned payments described in subsection (a), gross income shall include such payments when received by such Settlement Trust pursuant to the assignment and shall have the same character as if such payments were received by the Native Corporation.

“(c) AMOUNT AND SCOPE OF ASSIGNMENT.—The amount and scope of any assignment under subsection (a) shall be described with reasonable particularity and may either be in a percentage of one or more such payments or in a fixed dollar amount.

“(d) DURATION OF ASSIGNMENT; REVOCABILITY.—Any assignment under subsection (a) shall specify—

“(1) a duration either in perpetuity or for a period of time, and

“(2) whether such assignment is revocable.

“(e) PROHIBITION ON DEDUCTION.—Notwithstanding section 247, no deduction shall be allowed to a Native Corporation for purposes of any amounts described in subsection (a).

“(f) DEFINITIONS.—For purposes of this section, the terms ‘Native Corporation’ and ‘Settlement Trust’ have the same meaning given such terms under section 646(h).”

(2) CONFORMING AMENDMENT.—The table of sections for part III of subchapter B of chapter 1 is amended by inserting before the item relating to section 140 the following new item:

“Sec. 139G. Assignments to Alaska Native Settlement Trusts.”

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after December 31, 2016.

(b) DEDUCTION OF CONTRIBUTIONS TO ALASKA NATIVE SETTLEMENT TRUSTS.—

(1) IN GENERAL.—Part VIII of subchapter B of chapter 1 is amended by inserting before section 248 the following new section:

“SEC. 247. CONTRIBUTIONS TO ALASKA NATIVE SETTLEMENT TRUSTS.

“(a) IN GENERAL.—In the case of a Native Corporation, there shall be allowed a deduction for any contributions made by such Native Corporation to a Settlement Trust (regardless of whether an election under section 646 is in effect for such Settlement Trust) for which the Native Corporation has made an annual election under subsection (e).

“(b) AMOUNT OF DEDUCTION.—The amount of the deduction under subsection (a) shall be equal to—

“(1) in the case of a cash contribution (regardless of the method of payment, including currency, coins, money order, or check), the amount of such contribution, or

“(2) in the case of a contribution not described in paragraph (1), the lesser of—

“(A) the Native Corporation’s adjusted basis in the property contributed, or

“(B) the fair market value of the property contributed.

“(c) LIMITATION AND CARRYOVER.—

“(1) IN GENERAL.—Subject to paragraph (2), the deduction allowed under subsection (a) for any taxable year shall not exceed the taxable income (as determined without regard to such deduction) of the Native Corporation for the taxable year in which the contribution was made.

“(2) CARRYOVER.—If the aggregate amount of contributions described in subsection (a) for any taxable year exceeds the limitation under paragraph (1), such excess shall be treated as a contribution described in subsection (a) in each of the 15 succeeding years in order of time.

“(d) DEFINITIONS.—For purposes of this section, the terms ‘Native Corporation’ and ‘Settlement Trust’ have the same meaning given such terms under section 646(h).

“(e) MANNER OF MAKING ELECTION.—

“(1) IN GENERAL.—For each taxable year, a Native Corporation may elect to have this section apply for such taxable year on the income tax return or an amendment or supplement to the return of the Native Corporation, with such election to have effect solely for such taxable year.

“(2) REVOCATION.—Any election made by a Native Corporation pursuant to this subsection may be revoked pursuant to a timely filed amendment or supplement to the income tax return of such Native Corporation.

“(f) ADDITIONAL RULES.—

“(1) EARNINGS AND PROFITS.—Notwithstanding section 646(d)(2), in the case of a Native Corporation which claims a deduction under this section for any taxable year, the earnings and profits of such Native Corporation for such taxable year shall be reduced by the amount of such deduction.

“(2) GAIN OR LOSS.—No gain or loss shall be recognized by the Native Corporation with respect to a contribution of property for which a deduction is allowed under this section.

“(3) INCOME.—Subject to subsection (g), a Settlement Trust shall include in income the amount of any deduction allowed under this section in the taxable year in which the Settlement Trust actually receives such contribution.

“(4) PERIOD.—The holding period under section 1223 of the Settlement Trust shall include the period the property was held by the Native Corporation.

“(5) BASIS.—The basis that a Settlement Trust has for which a deduction is allowed under this section shall be equal to the lesser of—

“(A) the adjusted basis of the Native Corporation in such property immediately before such contribution, or

“(B) the fair market value of the property immediately before such contribution.

“(6) PROHIBITION.—No deduction shall be allowed under this section with respect to any contributions made to a Settlement Trust which are in violation of subsection (a)(2) or (c)(2) of section 39 of the Alaska Native Claims Settlement Act (43 U.S.C. 1629e).

“(g) ELECTION BY SETTLEMENT TRUST TO DEFER INCOME RECOGNITION.—

“(1) IN GENERAL.—In the case of a contribution which consists of property other than cash, a Settlement Trust may elect to defer recognition of any income related to such property until the sale or exchange of such property, in whole or in part, by the Settlement Trust.

“(2) TREATMENT.—In the case of property described in paragraph (1), any income or gain realized on the sale or exchange of such property shall be treated as—

“(A) for such amount of the income or gain as is equal to or less than the amount of income which would be included in income at the time of contribution under subsection (f)(3) but for the taxpayer's election under this subsection, ordinary income, and

“(B) for any amounts of the income or gain which are in excess of the amount of income which would be included in income at the time of contribution under subsection (f)(3) but for the taxpayer's election under this subsection, having the same character as if this subsection did not apply.

“(3) ELECTION.—

“(A) IN GENERAL.—For each taxable year, a Settlement Trust may elect to apply this subsection for any property described in paragraph (1) which was contributed during such year. Any property to which the election applies shall be identified and described with reasonable particularity on the income tax return or an amendment or supplement to the return of the Settlement Trust, with such election to have effect solely for such taxable year.

“(B) REVOCATION.—Any election made by a Settlement Trust pursuant to this subsection may be revoked pursuant to a timely filed amendment or supplement to the income tax return of such Settlement Trust.

“(C) CERTAIN DISPOSITIONS.—

“(i) IN GENERAL.—In the case of any property for which an election is in effect under this subsection and which is disposed of within the first taxable year

subsequent to the taxable year in which such property was contributed to the Settlement Trust—

“(I) this section shall be applied as if the election under this subsection had not been made,

“(II) any income or gain which would have been included in the year of contribution under subsection (f)(3) but for the taxpayer's election under this subsection shall be included in income for the taxable year of such contribution, and

“(III) the Settlement Trust shall pay any increase in tax resulting from such inclusion, including any applicable interest, and increased by 10 percent of the amount of such increase with interest.

“(ii) ASSESSMENT.—Notwithstanding section 6501(a), any amount described in subclause (III) of clause (i) may be assessed, or a proceeding in court with respect to such amount may be initiated without assessment, within 4 years after the date on which the return making the election under this subsection for such property was filed.”

(2) CONFORMING AMENDMENT.—The table of sections for part VIII of subchapter B of chapter 1 is amended by inserting before the item relating to section 248 the following new item:

“Sec. 247. Contributions to Alaska Native Settlement Trusts.”

(3) EFFECTIVE DATE.—

(A) IN GENERAL.—The amendments made by this subsection shall apply to taxable years for which the period of limitation on refund or credit under section 6511 of the Internal Revenue Code of 1986 has not expired.

(B) ONE-YEAR WAIVER OF STATUTE OF LIMITATIONS.—If the period of limitation on a credit or refund resulting from the amendments made by paragraph (1) expires before the end of the 1-year period beginning on the date of the enactment of this Act, refund or credit of such overpayment (to the extent attributable to such amendments) may, nevertheless, be made or allowed if claim therefor is filed before the close of such 1-year period.

(c) INFORMATION REPORTING FOR DEDUCTIBLE CONTRIBUTIONS TO ALASKA NATIVE SETTLEMENT TRUSTS.—

(1) IN GENERAL.—Section 6039H is amended—

(A) in the heading, by striking “SPONSORING”, and

(B) by adding at the end the following new subsection:

“(e) DEDUCTIBLE CONTRIBUTIONS BY NATIVE CORPORATIONS TO ALASKA NATIVE SETTLEMENT TRUSTS.—

“(1) IN GENERAL.—Any Native Corporation (as defined in subsection (m) of section 3 of the Alaska Native Claims Settlement Act (43 U.S.C. 1602(m))) which has made a contribution to a Settlement Trust (as defined in subsection (t) of such section) to which an election under subsection (e) of section 247 applies shall provide such Settlement Trust with a statement regarding such election not later than January 31 of the calendar year subsequent to the calendar year in which the contribution was made.

“(2) CONTENT OF STATEMENT.—The statement described in paragraph (1) shall include—

“(A) the total amount of contributions to which the election under subsection (e) of section 247 applies,

“(B) for each contribution, whether such contribution was in cash,

“(C) for each contribution which consists of property other than cash, the date that such property was acquired by the Native Corporation and the adjusted basis and fair market value of such property on the date such property was contributed to the Settlement Trust,

“(D) the date on which each contribution was made to the Settlement Trust, and

“(E) such information as the Secretary determines to be necessary or appropriate for the identification of each contribution and the accurate inclusion of income relating to such contributions by the Settlement Trust.”.

(2) CONFORMING AMENDMENT.—The item relating to section 6039H in the table of sections for subpart A of part III of subchapter A of chapter 61 is amended to read as follows:

“Sec. 6039H. Information With Respect to Alaska Native Settlement Trusts and Native Corporations.”.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after December 31, 2016.

SEC. 13822. AMOUNTS PAID FOR AIRCRAFT MANAGEMENT SERVICES.

(a) IN GENERAL.—Subsection (e) of section 4261 is amended by adding at the end the following new paragraph:

“(5) AMOUNTS PAID FOR AIRCRAFT MANAGEMENT SERVICES.—

“(A) IN GENERAL.—No tax shall be imposed by this section or section 4271 on any amounts paid by an aircraft owner for aircraft management services related to—

“(i) maintenance and support of the aircraft owner’s aircraft, or

“(ii) flights on the aircraft owner’s aircraft.

“(B) AIRCRAFT MANAGEMENT SERVICES.—For purposes of subparagraph (A), the term ‘aircraft management services’ includes—

“(i) assisting an aircraft owner with administrative and support services, such as scheduling, flight planning, and weather forecasting,

“(ii) obtaining insurance,

“(iii) maintenance, storage and fueling of aircraft,

“(iv) hiring, training, and provision of pilots and crew,

“(v) establishing and complying with safety standards, and

“(vi) such other services as are necessary to support flights operated by an aircraft owner.

“(C) LESSEE TREATED AS AIRCRAFT OWNER.—

“(i) IN GENERAL.—For purposes of this paragraph, the term ‘aircraft owner’ includes a person who leases the aircraft other than under a disqualified lease.

“(ii) DISQUALIFIED LEASE.—For purposes of clause (i), the term ‘disqualified lease’ means a lease from a person providing aircraft management services with respect to such aircraft (or a related person (within

the meaning of section 465(b)(3)(C)) to the person providing such services), if such lease is for a term of 31 days or less.

“(D) PRO RATA ALLOCATION.—In the case of amounts paid to any person which (but for this subsection) are subject to the tax imposed by subsection (a), a portion of which consists of amounts described in subparagraph (A), this paragraph shall apply on a pro rata basis only to the portion which consists of amounts described in such subparagraph.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to amounts paid after the date of the enactment of this Act.

SEC. 13823. OPPORTUNITY ZONES.

(a) IN GENERAL.—Chapter 1 is amended by adding at the end the following:

“Subchapter Z—Opportunity Zones

“Sec. 1400Z-1. Designation.

“Sec. 1400Z-2. Special rules for capital gains invested in opportunity zones.

“SEC. 1400Z-1. DESIGNATION.

“(a) QUALIFIED OPPORTUNITY ZONE DEFINED.—For the purposes of this subchapter, the term ‘qualified opportunity zone’ means a population census tract that is a low-income community that is designated as a qualified opportunity zone.

“(b) DESIGNATION.—

“(1) IN GENERAL.—For purposes of subsection (a), a population census tract that is a low-income community is designated as a qualified opportunity zone if—

“(A) not later than the end of the determination period, the chief executive officer of the State in which the tract is located—

“(i) nominates the tract for designation as a qualified opportunity zone, and

“(ii) notifies the Secretary in writing of such nomination, and

“(B) the Secretary certifies such nomination and designates such tract as a qualified opportunity zone before the end of the consideration period.

“(2) EXTENSION OF PERIODS.—A chief executive officer of a State may request that the Secretary extend either the determination or consideration period, or both (determined without regard to this subparagraph), for an additional 30 days.

“(c) OTHER DEFINITIONS.—For purposes of this subsection—

“(1) LOW-INCOME COMMUNITIES.—The term ‘low-income community’ has the same meaning as when used in section 45D(e).

“(2) DEFINITION OF PERIODS.—

“(A) CONSIDERATION PERIOD.—The term ‘consideration period’ means the 30-day period beginning on the date on which the Secretary receives notice under subsection (b)(1)(A)(ii), as extended under subsection (b)(2).

“(B) DETERMINATION PERIOD.—The term ‘determination period’ means the 90-day period beginning on the date

of the enactment of the Tax Cuts and Jobs Act, as extended under subsection (b)(2).

“(3) STATE.—For purposes of this section, the term ‘State’ includes any possession of the United States.

“(d) NUMBER OF DESIGNATIONS.—

“(1) IN GENERAL.—Except as provided by paragraph (2), the number of population census tracts in a State that may be designated as qualified opportunity zones under this section may not exceed 25 percent of the number of low-income communities in the State.

“(2) EXCEPTION.—If the number of low-income communities in a State is less than 100, then a total of 25 of such tracts may be designated as qualified opportunity zones.

“(e) DESIGNATION OF TRACTS CONTIGUOUS WITH LOW-INCOME COMMUNITIES.—

“(1) IN GENERAL.—A population census tract that is not a low-income community may be designated as a qualified opportunity zone under this section if—

“(A) the tract is contiguous with the low-income community that is designated as a qualified opportunity zone, and

“(B) the median family income of the tract does not exceed 125 percent of the median family income of the low-income community with which the tract is contiguous.

“(2) LIMITATION.—Not more than 5 percent of the population census tracts designated in a State as a qualified opportunity zone may be designated under paragraph (1).

“(f) PERIOD FOR WHICH DESIGNATION IS IN EFFECT.—A designation as a qualified opportunity zone shall remain in effect for the period beginning on the date of the designation and ending at the close of the 10th calendar year beginning on or after such date of designation.

“SEC. 1400Z-2. SPECIAL RULES FOR CAPITAL GAINS INVESTED IN OPPORTUNITY ZONES.

“(a) IN GENERAL.—

“(1) TREATMENT OF GAINS.—In the case of gain from the sale to, or exchange with, an unrelated person of any property held by the taxpayer, at the election of the taxpayer—

“(A) gross income for the taxable year shall not include so much of such gain as does not exceed the aggregate amount invested by the taxpayer in a qualified opportunity fund during the 180-day period beginning on the date of such sale or exchange,

“(B) the amount of gain excluded by subparagraph (A) shall be included in gross income as provided by subsection (b), and

“(C) subsection (c) shall apply.

“(2) ELECTION.—No election may be made under paragraph

(1)—

“(A) with respect to a sale or exchange if an election previously made with respect to such sale or exchange is in effect, or

“(B) with respect to any sale or exchange after December 31, 2026.

“(b) DEFERRAL OF GAIN INVESTED IN OPPORTUNITY ZONE PROPERTY.—

“(1) YEAR OF INCLUSION.—Gain to which subsection (a)(1)(B) applies shall be included in income in the taxable year which includes the earlier of—

“(A) the date on which such investment is sold or exchanged, or

“(B) December 31, 2026.

“(2) AMOUNT INCLUDIBLE.—

“(A) IN GENERAL.—The amount of gain included in gross income under subsection (a)(1)(A) shall be the excess of—

“(i) the lesser of the amount of gain excluded under paragraph (1) or the fair market value of the investment as determined as of the date described in paragraph (1), over

“(ii) the taxpayer’s basis in the investment.

“(B) DETERMINATION OF BASIS.—

“(i) IN GENERAL.—Except as otherwise provided in this clause or subsection (c), the taxpayer’s basis in the investment shall be zero.

“(ii) INCREASE FOR GAIN RECOGNIZED UNDER SUBSECTION (a)(1)(B).—The basis in the investment shall be increased by the amount of gain recognized by reason of subsection (a)(1)(B) with respect to such property.

“(iii) INVESTMENTS HELD FOR 5 YEARS.—In the case of any investment held for at least 5 years, the basis of such investment shall be increased by an amount equal to 10 percent of the amount of gain deferred by reason of subsection (a)(1)(A).

“(iv) INVESTMENTS HELD FOR 7 YEARS.—In the case of any investment held by the taxpayer for at least 7 years, in addition to any adjustment made under clause (iii), the basis of such property shall be increased by an amount equal to 5 percent of the amount of gain deferred by reason of subsection (a)(1)(A).

“(c) SPECIAL RULE FOR INVESTMENTS HELD FOR AT LEAST 10 YEARS.—In the case of any investment held by the taxpayer for at least 10 years and with respect to which the taxpayer makes an election under this clause, the basis of such property shall be equal to the fair market value of such investment on the date that the investment is sold or exchanged.

“(d) QUALIFIED OPPORTUNITY FUND.—For purposes of this section—

“(1) IN GENERAL.—The term ‘qualified opportunity fund’ means any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property, determined by the average of the percentage of qualified opportunity zone property held in the fund as measured—

“(A) on the last day of the first 6-month period of the taxable year of the fund, and

“(B) on the last day of the taxable year of the fund.

“(2) QUALIFIED OPPORTUNITY ZONE PROPERTY.—

“(A) IN GENERAL.—The term ‘qualified opportunity zone property’ means property which is—

“(i) qualified opportunity zone stock,
“(ii) qualified opportunity zone partnership interest, or

“(iii) qualified opportunity zone business property.
“(B) QUALIFIED OPPORTUNITY ZONE STOCK.—

“(i) IN GENERAL.—Except as provided in clause (ii), the term ‘qualified opportunity zone stock’ means any stock in a domestic corporation if—

“(I) such stock is acquired by the qualified opportunity fund after December 31, 2017, at its original issue (directly or through an underwriter) from the corporation solely in exchange for cash,

“(II) as of the time such stock was issued, such corporation was a qualified opportunity zone business (or, in the case of a new corporation, such corporation was being organized for purposes of being a qualified opportunity zone business), and

“(III) during substantially all of the qualified opportunity fund’s holding period for such stock, such corporation qualified as a qualified opportunity zone business.

“(ii) REDEMPTIONS.—A rule similar to the rule of section 1202(c)(3) shall apply for purposes of this paragraph.

“(C) QUALIFIED OPPORTUNITY ZONE PARTNERSHIP INTEREST.—The term ‘qualified opportunity zone partnership interest’ means any capital or profits interest in a domestic partnership if—

“(i) such interest is acquired by the qualified opportunity fund after December 31, 2017, from the partnership solely in exchange for cash,

“(ii) as of the time such interest was acquired, such partnership was a qualified opportunity zone business (or, in the case of a new partnership, such partnership was being organized for purposes of being a qualified opportunity zone business), and

“(iii) during substantially all of the qualified opportunity fund’s holding period for such interest, such partnership qualified as a qualified opportunity zone business.

“(D) QUALIFIED OPPORTUNITY ZONE BUSINESS PROPERTY.—

“(i) IN GENERAL.—The term ‘qualified opportunity zone business property’ means tangible property used in a trade or business of the qualified opportunity fund if—

“(I) such property was acquired by the qualified opportunity fund by purchase (as defined in section 179(d)(2)) after December 31, 2017,

“(II) the original use of such property in the qualified opportunity zone commences with the qualified opportunity fund or the qualified opportunity fund substantially improves the property, and

“(III) during substantially all of the qualified opportunity fund’s holding period for such property, substantially all of the use of such property was in a qualified opportunity zone.

“(ii) SUBSTANTIAL IMPROVEMENT.—For purposes of subparagraph (A)(ii), property shall be treated as substantially improved by the qualified opportunity fund only if, during any 30-month period beginning after the date of acquisition of such property, additions to basis with respect to such property in the hands of the qualified opportunity fund exceed an amount equal to the adjusted basis of such property at the beginning of such 30-month period in the hands of the qualified opportunity fund.

“(iii) RELATED PARTY.—For purposes of subparagraph (A)(i), the related person rule of section 179(d)(2) shall be applied pursuant to paragraph (8) of this subsection in lieu of the application of such rule in section 179(d)(2)(A).

“(3) QUALIFIED OPPORTUNITY ZONE BUSINESS.—

“(A) IN GENERAL.—The term ‘qualified opportunity zone business’ means a trade or business—

“(i) in which substantially all of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property (determined by substituting ‘qualified opportunity zone business’ for ‘qualified opportunity fund’ each place it appears in paragraph (2)(D)),

“(ii) which satisfies the requirements of paragraphs (2), (4), and (8) of section 1397C(b), and

“(iii) which is not described in section 144(c)(6)(B).

“(B) SPECIAL RULE.—For purposes of subparagraph (A), tangible property that ceases to be a qualified opportunity zone business property shall continue to be treated as a qualified opportunity zone business property for the lesser of—

“(i) 5 years after the date on which such tangible property ceases to be so qualified, or

“(ii) the date on which such tangible property is no longer held by the qualified opportunity zone business.

“(e) APPLICABLE RULES.—

“(1) TREATMENT OF INVESTMENTS WITH MIXED FUNDS.—In the case of any investment in a qualified opportunity fund only a portion of which consists of investments of gain to which an election under subsection (a) is in effect—

“(A) such investment shall be treated as 2 separate investments, consisting of—

“(i) one investment that only includes amounts to which the election under subsection (a) applies, and

“(ii) a separate investment consisting of other amounts, and

“(B) subsections (a), (b), and (c) shall only apply to the investment described in subparagraph (A)(i).

“(2) RELATED PERSONS.—For purposes of this section, persons are related to each other if such persons are described

in section 267(b) or 707(b)(1), determined by substituting '20 percent' for '50 percent' each place it occurs in such sections.

"(3) DECEDENTS.—In the case of a decedent, amounts recognized under this section shall, if not properly includible in the gross income of the decedent, be includible in gross income as provided by section 691.

"(4) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including—

"(A) rules for the certification of qualified opportunity funds for the purposes of this section,

"(B) rules to ensure a qualified opportunity fund has a reasonable period of time to reinvest the return of capital from investments in qualified opportunity zone stock and qualified opportunity zone partnership interests, and to reinvest proceeds received from the sale or disposition of qualified opportunity zone property, and

"(C) rules to prevent abuse.

"(f) FAILURE OF QUALIFIED OPPORTUNITY FUND TO MAINTAIN INVESTMENT STANDARD.—

"(1) IN GENERAL.—If a qualified opportunity fund fails to meet the 90-percent requirement of subsection (c)(1), the qualified opportunity fund shall pay a penalty for each month it fails to meet the requirement in an amount equal to the product of—

"(A) the excess of—

"(i) the amount equal to 90 percent of its aggregate assets, over

"(ii) the aggregate amount of qualified opportunity zone property held by the fund, multiplied by

"(B) the underpayment rate established under section 6621(a)(2) for such month.

"(2) SPECIAL RULE FOR PARTNERSHIPS.—In the case that the qualified opportunity fund is a partnership, the penalty imposed by paragraph (1) shall be taken into account proportionately as part of the distributive share of each partner of the partnership.

"(3) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed under this subsection with respect to any failure if it is shown that such failure is due to reasonable cause."

(b) BASIS ADJUSTMENTS.—Section 1016(a) is amended by striking "and" at the end of paragraph (36), by striking the period at the end of paragraph (37) and inserting ", and", and by inserting after paragraph (37) the following:

"(38) to the extent provided in subsections (b)(2) and (c) of section 1400Z-2."

(c) CLERICAL AMENDMENT.—The table of subchapters for chapter 1 is amended by adding at the end the following new item:

"SUBCHAPTER Z. OPPORTUNITY ZONES".

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

Subtitle D—International Tax Provisions

PART I—OUTBOUND TRANSACTIONS

Subpart A—Establishment of Participation Exemption System for Taxation of Foreign Income

SEC. 14101. DEDUCTION FOR FOREIGN-SOURCE PORTION OF DIVIDENDS RECEIVED BY DOMESTIC CORPORATIONS FROM SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS.

(a) IN GENERAL.—Part VIII of subchapter B of chapter 1 is amended by inserting after section 245 the following new section:

“SEC. 245A. DEDUCTION FOR FOREIGN SOURCE-PORION OF DIVIDENDS RECEIVED BY DOMESTIC CORPORATIONS FROM SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS.

“(a) IN GENERAL.—In the case of any dividend received from a specified 10-percent owned foreign corporation by a domestic corporation which is a United States shareholder with respect to such foreign corporation, there shall be allowed as a deduction an amount equal to the foreign-source portion of such dividend.

“(b) SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATION.—For purposes of this section—

“(1) IN GENERAL.—The term ‘specified 10-percent owned foreign corporation’ means any foreign corporation with respect to which any domestic corporation is a United States shareholder with respect to such corporation.

“(2) EXCLUSION OF PASSIVE FOREIGN INVESTMENT COMPANIES.—Such term shall not include any corporation which is a passive foreign investment company (as defined in section 1297) with respect to the shareholder and which is not a controlled foreign corporation.

“(c) FOREIGN-SOURCE PORTION.—For purposes of this section—

“(1) IN GENERAL.—The foreign-source portion of any dividend from a specified 10-percent owned foreign corporation is an amount which bears the same ratio to such dividend as—

“(A) the undistributed foreign earnings of the specified 10-percent owned foreign corporation, bears to

“(B) the total undistributed earnings of such foreign corporation.

“(2) UNDISTRIBUTED EARNINGS.—The term ‘undistributed earnings’ means the amount of the earnings and profits of the specified 10-percent owned foreign corporation (computed in accordance with sections 964(a) and 986)—

“(A) as of the close of the taxable year of the specified 10-percent owned foreign corporation in which the dividend is distributed, and

“(B) without diminution by reason of dividends distributed during such taxable year.

“(3) UNDISTRIBUTED FOREIGN EARNINGS.—The term ‘undistributed foreign earnings’ means the portion of the undistributed earnings which is attributable to neither—

“(A) income described in subparagraph (A) of section 245(a)(5), nor

“(B) dividends described in subparagraph (B) of such section (determined without regard to section 245(a)(12)).

“(d) DISALLOWANCE OF FOREIGN TAX CREDIT, ETC.—

“(1) IN GENERAL.—No credit shall be allowed under section 901 for any taxes paid or accrued (or treated as paid or accrued) with respect to any dividend for which a deduction is allowed under this section.

“(2) DENIAL OF DEDUCTION.—No deduction shall be allowed under this chapter for any tax for which credit is not allowable under section 901 by reason of paragraph (1) (determined by treating the taxpayer as having elected the benefits of subpart A of part III of subchapter N).

“(e) SPECIAL RULES FOR HYBRID DIVIDENDS.—

“(1) IN GENERAL.—Subsection (a) shall not apply to any dividend received by a United States shareholder from a controlled foreign corporation if the dividend is a hybrid dividend.

“(2) HYBRID DIVIDENDS OF TIERED CORPORATIONS.—If a controlled foreign corporation with respect to which a domestic corporation is a United States shareholder receives a hybrid dividend from any other controlled foreign corporation with respect to which such domestic corporation is also a United States shareholder, then, notwithstanding any other provision of this title—

“(A) the hybrid dividend shall be treated for purposes of section 951(a)(1)(A) as subpart F income of the receiving controlled foreign corporation for the taxable year of the controlled foreign corporation in which the dividend was received, and

“(B) the United States shareholder shall include in gross income an amount equal to the shareholder's pro rata share (determined in the same manner as under section 951(a)(2)) of the subpart F income described in subparagraph (A).

“(3) DENIAL OF FOREIGN TAX CREDIT, ETC.—The rules of subsection (d) shall apply to any hybrid dividend received by, or any amount included under paragraph (2) in the gross income of, a United States shareholder.

“(4) HYBRID DIVIDEND.—The term ‘hybrid dividend’ means an amount received from a controlled foreign corporation—

“(A) for which a deduction would be allowed under subsection (a) but for this subsection, and

“(B) for which the controlled foreign corporation received a deduction (or other tax benefit) with respect to any income, war profits, or excess profits taxes imposed by any foreign country or possession of the United States.

“(f) SPECIAL RULE FOR PURGING DISTRIBUTIONS OF PASSIVE FOREIGN INVESTMENT COMPANIES.—Any amount which is treated as a dividend under section 1291(d)(2)(B) shall not be treated as a dividend for purposes of this section.

“(g) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section, including regulations for the treatment of United States shareholders owning stock of a specified 10 percent owned foreign corporation through a partnership.”.

(b) APPLICATION OF HOLDING PERIOD REQUIREMENT.—Subsection (c) of section 246 is amended—

(1) by striking “or 245” in paragraph (1) and inserting “245, or 245A”, and

(2) by adding at the end the following new paragraph:

“(5) SPECIAL RULES FOR FOREIGN SOURCE PORTION OF DIVIDENDS RECEIVED FROM SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS.—

“(A) 1-YEAR HOLDING PERIOD REQUIREMENT.—For purposes of section 245A—

“(i) paragraph (1)(A) shall be applied—

“(I) by substituting ‘365 days’ for ‘45 days’ each place it appears, and

“(II) by substituting ‘731-day period’ for ‘91-day period’, and

“(ii) paragraph (2) shall not apply.

“(B) STATUS MUST BE MAINTAINED DURING HOLDING PERIOD.—For purposes of applying paragraph (1) with respect to section 245A, the taxpayer shall be treated as holding the stock referred to in paragraph (1) for any period only if—

“(i) the specified 10-percent owned foreign corporation referred to in section 245A(a) is a specified 10-percent owned foreign corporation at all times during such period, and

“(ii) the taxpayer is a United States shareholder with respect to such specified 10-percent owned foreign corporation at all times during such period.”.

(c) APPLICATION OF RULES GENERALLY APPLICABLE TO DEDUCTIONS FOR DIVIDENDS RECEIVED.—

(1) TREATMENT OF DIVIDENDS FROM CERTAIN CORPORATIONS.—Paragraph (1) of section 246(a) is amended by striking “and 245” and inserting “245, and 245A”.

(2) COORDINATION WITH SECTION 1059.—Subparagraph (B) of section 1059(b)(2) is amended by striking “or 245” and inserting “245, or 245A”.

(d) COORDINATION WITH FOREIGN TAX CREDIT LIMITATION.—Subsection (b) of section 904 is amended by adding at the end the following new paragraph:

“(5) TREATMENT OF DIVIDENDS FOR WHICH DEDUCTION IS ALLOWED UNDER SECTION 245A.—For purposes of subsection (a), in the case of a domestic corporation which is a United States shareholder with respect to a specified 10-percent owned foreign corporation, such shareholder’s taxable income from sources without the United States (and entire taxable income) shall be determined without regard to—

“(A) the foreign-source portion of any dividend received from such foreign corporation, and

“(B) any deductions properly allocable or apportioned to—

“(i) income (other than amounts includible under section 951(a)(1) or 951A(a)) with respect to stock of such specified 10-percent owned foreign corporation, or

“(ii) such stock to the extent income with respect to such stock is other than amounts includible under section 951(a)(1) or 951A(a).

Any term which is used in section 245A and in this paragraph shall have the same meaning for purposes of this paragraph as when used in such section.”

(e) CONFORMING AMENDMENTS.—

(1) Subsection (b) of section 951 is amended by striking “subpart” and inserting “title”.

(2) Subsection (a) of section 957 is amended by striking “subpart” in the matter preceding paragraph (1) and inserting “title”.

(3) The table of sections for part VIII of subchapter B of chapter 1 is amended by inserting after the item relating to section 245 the following new item:

“Sec. 245A. Deduction for foreign source-portion of dividends received by domestic corporations from certain 10-percent owned foreign corporations.”

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions made after (and, in the case of the amendments made by subsection (d), deductions with respect to taxable years ending after) December 31, 2017.

SEC. 14102. SPECIAL RULES RELATING TO SALES OR TRANSFERS INVOLVING SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS.

(a) SALES BY UNITED STATES PERSONS OF STOCK.—

(1) IN GENERAL.—Section 1248 is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

“(j) COORDINATION WITH DIVIDENDS RECEIVED DEDUCTION.—In the case of the sale or exchange by a domestic corporation of stock in a foreign corporation held for 1 year or more, any amount received by the domestic corporation which is treated as a dividend by reason of this section shall be treated as a dividend for purposes of applying section 245A.”

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to sales or exchanges after December 31, 2017.

(b) BASIS IN SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATION REDUCED BY NONTAXED PORTION OF DIVIDEND FOR PURPOSES OF DETERMINING LOSS.—

(1) IN GENERAL.—Section 961 is amended by adding at the end the following new subsection:

“(d) BASIS IN SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATION REDUCED BY NONTAXED PORTION OF DIVIDEND FOR PURPOSES OF DETERMINING LOSS.—If a domestic corporation received a dividend from a specified 10-percent owned foreign corporation (as defined in section 245A) in any taxable year, solely for purposes of determining loss on any disposition of stock of such foreign corporation in such taxable year or any subsequent taxable year, the basis of such domestic corporation in such stock shall be reduced (but not below zero) by the amount of any deduction allowable to such domestic corporation under section 245A with respect to such stock except to the extent such basis was reduced under section 1059 by reason of a dividend for which such a deduction was allowable.”

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to distributions made after December 31, 2017.

(c) SALE BY A CFC OF A LOWER TIER CFC.—

(1) IN GENERAL.—Section 964(e) is amended by adding at the end the following new paragraph:

“(4) COORDINATION WITH DIVIDENDS RECEIVED DEDUCTION.—

“(A) IN GENERAL.—If, for any taxable year of a controlled foreign corporation beginning after December 31, 2017, any amount is treated as a dividend under paragraph (1) by reason of a sale or exchange by the controlled foreign corporation of stock in another foreign corporation held for 1 year or more, then, notwithstanding any other provision of this title—

“(i) the foreign-source portion of such dividend shall be treated for purposes of section 951(a)(1)(A) as subpart F income of the selling controlled foreign corporation for such taxable year,

“(ii) a United States shareholder with respect to the selling controlled foreign corporation shall include in gross income for the taxable year of the shareholder with or within which such taxable year of the controlled foreign corporation ends an amount equal to the shareholder's pro rata share (determined in the same manner as under section 951(a)(2)) of the amount treated as subpart F income under clause (i), and

“(iii) the deduction under section 245A(a) shall be allowable to the United States shareholder with respect to the subpart F income included in gross income under clause (ii) in the same manner as if such subpart F income were a dividend received by the shareholder from the selling controlled foreign corporation.

“(B) APPLICATION OF BASIS OR SIMILAR ADJUSTMENT.—For purposes of this title, in the case of a sale or exchange by a controlled foreign corporation of stock in another foreign corporation in a taxable year of the selling controlled foreign corporation beginning after December 31, 2017, rules similar to the rules of section 961(d) shall apply.

“(C) FOREIGN-SOURCE PORTION.—For purposes of this paragraph, the foreign-source portion of any amount treated as a dividend under paragraph (1) shall be determined in the same manner as under section 245A(c).”

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to sales or exchanges after December 31, 2017.

(d) TREATMENT OF FOREIGN BRANCH LOSSES TRANSFERRED TO SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS.—

(1) IN GENERAL.—Part II of subchapter B of chapter 1 is amended by adding at the end the following new section:

“SEC. 91. CERTAIN FOREIGN BRANCH LOSSES TRANSFERRED TO SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS.

“(a) IN GENERAL.—If a domestic corporation transfers substantially all of the assets of a foreign branch (within the meaning of section 367(a)(3)(C), as in effect before the date of the enactment of the Tax Cuts and Jobs Act) to a specified 10-percent owned foreign corporation (as defined in section 245A) with respect to which it is a United States shareholder after such transfer, such domestic corporation shall include in gross income for the taxable

year which includes such transfer an amount equal to the transferred loss amount with respect to such transfer.

“(b) TRANSFERRED LOSS AMOUNT.—For purposes of this section, the term ‘transferred loss amount’ means, with respect to any transfer of substantially all of the assets of a foreign branch, the excess (if any) of—

“(1) the sum of losses—

“(A) which were incurred by the foreign branch after December 31, 2017, and before the transfer, and

“(B) with respect to which a deduction was allowed to the taxpayer, over

“(2) the sum of—

“(A) any taxable income of such branch for a taxable year after the taxable year in which the loss was incurred and through the close of the taxable year of the transfer, and

“(B) any amount which is recognized under section 904(f)(3) on account of the transfer.

“(c) REDUCTION FOR RECOGNIZED GAINS.—The transferred loss amount shall be reduced (but not below zero) by the amount of gain recognized by the taxpayer on account of the transfer (other than amounts taken into account under subsection (b)(2)(B)).

“(d) SOURCE OF INCOME.—Amounts included in gross income under this section shall be treated as derived from sources within the United States.

“(e) BASIS ADJUSTMENTS.—Consistent with such regulations or other guidance as the Secretary shall prescribe, proper adjustments shall be made in the adjusted basis of the taxpayer’s stock in the specified 10-percent owned foreign corporation to which the transfer is made, and in the transferee’s adjusted basis in the property transferred, to reflect amounts included in gross income under this section.”

(2) CLERICAL AMENDMENT.—The table of sections for part II of subchapter B of chapter 1 is amended by adding at the end the following new item:

“Sec. 91. Certain foreign branch losses transferred to specified 10-percent owned foreign corporations.”

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to transfers after December 31, 2017.

(4) TRANSITION RULE.—The amount of gain taken into account under section 91(c) of the Internal Revenue Code of 1986, as added by this subsection, shall be reduced by the amount of gain which would be recognized under section 367(a)(3)(C) (determined without regard to the amendments made by subsection (e)) with respect to losses incurred before January 1, 2018.

(e) REPEAL OF ACTIVE TRADE OR BUSINESS EXCEPTION UNDER SECTION 367.—

(1) IN GENERAL.—Section 367(a) is amended by striking paragraph (3) and redesignating paragraphs (4), (5), and (6) as paragraphs (3), (4), and (5), respectively.

(2) CONFORMING AMENDMENTS.—Section 367(a)(4), as redesignated by paragraph (1), is amended—

(A) by striking “Paragraphs (2) and (3)” and inserting “Paragraph (2)”, and

(B) by striking "PARAGRAPHS (2) AND (3)" in the heading and inserting "PARAGRAPH (2)".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to transfers after December 31, 2017.

SEC. 14103. TREATMENT OF DEFERRED FOREIGN INCOME UPON TRANSITION TO PARTICIPATION EXEMPTION SYSTEM OF TAXATION.

(a) IN GENERAL.—Section 965 is amended to read as follows:

"SEC. 965. TREATMENT OF DEFERRED FOREIGN INCOME UPON TRANSITION TO PARTICIPATION EXEMPTION SYSTEM OF TAXATION.

"(a) TREATMENT OF DEFERRED FOREIGN INCOME AS SUBPART F INCOME.—In the case of the last taxable year of a deferred foreign corporation which begins before January 1, 2018, the subpart F income of such foreign corporation (as otherwise determined for such taxable year under section 952) shall be increased by the greater of—

"(1) the accumulated post-1986 deferred foreign income of such corporation determined as of November 2, 2017, or

"(2) the accumulated post-1986 deferred foreign income of such corporation determined as of December 31, 2017.

"(b) REDUCTION IN AMOUNTS INCLUDED IN GROSS INCOME OF UNITED STATES SHAREHOLDERS OF SPECIFIED FOREIGN CORPORATIONS WITH DEFICITS IN EARNINGS AND PROFITS.—

"(1) IN GENERAL.—In the case of a taxpayer which is a United States shareholder with respect to at least one deferred foreign income corporation and at least one E&P deficit foreign corporation, the amount which would (but for this subsection) be taken into account under section 951(a)(1) by reason of subsection (a) as such United States shareholder's pro rata share of the subpart F income of each deferred foreign income corporation shall be reduced by the amount of such United States shareholder's aggregate foreign E&P deficit which is allocated under paragraph (2) to such deferred foreign income corporation.

"(2) ALLOCATION OF AGGREGATE FOREIGN E&P DEFICIT.—The aggregate foreign E&P deficit of any United States shareholder shall be allocated among the deferred foreign income corporations of such United States shareholder in an amount which bears the same proportion to such aggregate as—

"(A) such United States shareholder's pro rata share of the accumulated post-1986 deferred foreign income of each such deferred foreign income corporation, bears to

"(B) the aggregate of such United States shareholder's pro rata share of the accumulated post-1986 deferred foreign income of all deferred foreign income corporations of such United States shareholder.

"(3) DEFINITIONS RELATED TO E&P DEFICITS.—For purposes of this subsection—

"(A) AGGREGATE FOREIGN E&P DEFICIT.—

"(i) IN GENERAL.—The term 'aggregate foreign E&P deficit' means, with respect to any United States shareholder, the lesser of—

"(I) the aggregate of such shareholder's pro rata shares of the specified E&P deficits of the

E&P deficit foreign corporations of such shareholder, or

“(II) the amount determined under paragraph (2)(B).

“(ii) ALLOCATION OF DEFICIT.—If the amount described in clause (i)(II) is less than the amount described in clause (i)(I), then the shareholder shall designate, in such form and manner as the Secretary determines—

“(I) the amount of the specified E&P deficit which is to be taken into account for each E&P deficit corporation with respect to the taxpayer, and

“(II) in the case of an E&P deficit corporation which has a qualified deficit (as defined in section 952), the portion (if any) of the deficit taken into account under subclause (I) which is attributable to a qualified deficit, including the qualified activities to which such portion is attributable.

“(B) E&P DEFICIT FOREIGN CORPORATION.—The term ‘E&P deficit foreign corporation’ means, with respect to any taxpayer, any specified foreign corporation with respect to which such taxpayer is a United States shareholder, if, as of November 2, 2017—

“(i) such specified foreign corporation has a deficit in post-1986 earnings and profits,

“(ii) such corporation was a specified foreign corporation, and

“(iii) such taxpayer was a United States shareholder of such corporation.

“(C) SPECIFIED E&P DEFICIT.—The term ‘specified E&P deficit’ means, with respect to any E&P deficit foreign corporation, the amount of the deficit referred to in subparagraph (B).

“(4) TREATMENT OF EARNINGS AND PROFITS IN FUTURE YEARS.—

“(A) REDUCED EARNINGS AND PROFITS TREATED AS PREVIOUSLY TAXED INCOME WHEN DISTRIBUTED.—For purposes of applying section 959 in any taxable year beginning with the taxable year described in subsection (a), with respect to any United States shareholder of a deferred foreign income corporation, an amount equal to such shareholder’s reduction under paragraph (1) which is allocated to such deferred foreign income corporation under this subsection shall be treated as an amount which was included in the gross income of such United States shareholder under section 951(a).

“(B) E&P DEFICITS.—For purposes of this title, with respect to any taxable year beginning with the taxable year described in subsection (a), a United States shareholder’s pro rata share of the earnings and profits of any E&P deficit foreign corporation under this subsection shall be increased by the amount of the specified E&P deficit of such corporation taken into account by such shareholder under paragraph (1), and, for purposes of section 952, such increase shall be attributable to the same activity to which the deficit so taken into account was attributable.

“(5) NETTING AMONG UNITED STATES SHAREHOLDERS IN SAME AFFILIATED GROUP.—

“(A) IN GENERAL.—In the case of any affiliated group which includes at least one E&P net surplus shareholder and one E&P net deficit shareholder, the amount which would (but for this paragraph) be taken into account under section 951(a)(1) by reason of subsection (a) by each such E&P net surplus shareholder shall be reduced (but not below zero) by such shareholder’s applicable share of the affiliated group’s aggregate unused E&P deficit.

“(B) E&P NET SURPLUS SHAREHOLDER.—For purposes of this paragraph, the term ‘E&P net surplus shareholder’ means any United States shareholder which would (determined without regard to this paragraph) take into account an amount greater than zero under section 951(a)(1) by reason of subsection (a).

“(C) E&P NET DEFICIT SHAREHOLDER.—For purposes of this paragraph, the term ‘E&P net deficit shareholder’ means any United States shareholder if—

“(i) the aggregate foreign E&P deficit with respect to such shareholder (as defined in paragraph (3)(A) without regard to clause (i)(II) thereof), exceeds

“(ii) the amount which would (but for this subsection) be taken into account by such shareholder under section 951(a)(1) by reason of subsection (a).

“(D) AGGREGATE UNUSED E&P DEFICIT.—For purposes of this paragraph—

“(i) IN GENERAL.—The term ‘aggregate unused E&P deficit’ means, with respect to any affiliated group, the lesser of—

“(I) the sum of the excesses described in subparagraph (C), determined with respect to each E&P net deficit shareholder in such group, or

“(II) the amount determined under subparagraph (E)(ii).

“(ii) REDUCTION WITH RESPECT TO E&P NET DEFICIT SHAREHOLDERS WHICH ARE NOT WHOLLY OWNED BY THE AFFILIATED GROUP.—If the group ownership percentage of any E&P net deficit shareholder is less than 100 percent, the amount of the excess described in subparagraph (C) which is taken into account under clause (i)(I) with respect to such E&P net deficit shareholder shall be such group ownership percentage of such amount.

“(E) APPLICABLE SHARE.—For purposes of this paragraph, the term ‘applicable share’ means, with respect to any E&P net surplus shareholder in any affiliated group, the amount which bears the same proportion to such group’s aggregate unused E&P deficit as—

“(i) the product of—

“(I) such shareholder’s group ownership percentage, multiplied by

“(II) the amount which would (but for this paragraph) be taken into account under section 951(a)(1) by reason of subsection (a) by such shareholder, bears to

“(ii) the aggregate amount determined under clause (i) with respect to all E&P net surplus shareholders in such group.

“(F) GROUP OWNERSHIP PERCENTAGE.—For purposes of this paragraph, the term ‘group ownership percentage’ means, with respect to any United States shareholder in any affiliated group, the percentage of the value of the stock of such United States shareholder which is held by other includible corporations in such affiliated group. Notwithstanding the preceding sentence, the group ownership percentage of the common parent of the affiliated group is 100 percent. Any term used in this subparagraph which is also used in section 1504 shall have the same meaning as when used in such section.

“(c) APPLICATION OF PARTICIPATION EXEMPTION TO INCLUDED INCOME.—

“(1) IN GENERAL.—In the case of a United States shareholder of a deferred foreign income corporation, there shall be allowed as a deduction for the taxable year in which an amount is included in the gross income of such United States shareholder under section 951(a)(1) by reason of this section an amount equal to the sum of—

“(A) the United States shareholder’s 8 percent rate equivalent percentage of the excess (if any) of—

“(i) the amount so included as gross income, over

“(ii) the amount of such United States shareholder’s aggregate foreign cash position, plus

“(B) the United States shareholder’s 15.5 percent rate equivalent percentage of so much of the amount described in subparagraph (A)(ii) as does not exceed the amount described in subparagraph (A)(i).

“(2) 8 AND 15.5 PERCENT RATE EQUIVALENT PERCENTAGES.—

For purposes of this subsection—

“(A) 8 PERCENT RATE EQUIVALENT PERCENTAGE.—The term ‘8 percent rate equivalent percentage’ means, with respect to any United States shareholder for any taxable year, the percentage which would result in the amount to which such percentage applies being subject to a 8 percent rate of tax determined by only taking into account a deduction equal to such percentage of such amount and the highest rate of tax specified in section 11 for such taxable year. In the case of any taxable year of a United States shareholder to which section 15 applies, the highest rate of tax under section 11 before the effective date of the change in rates and the highest rate of tax under section 11 after the effective date of such change shall each be taken into account under the preceding sentence in the same proportions as the portion of such taxable year which is before and after such effective date, respectively.

“(B) 15.5 PERCENT RATE EQUIVALENT PERCENTAGE.—The term ‘15.5 percent rate equivalent percentage’ means, with respect to any United States shareholder for any taxable year, the percentage determined under subparagraph (A) applied by substituting ‘15.5 percent rate of tax’ for ‘8 percent rate of tax’.

“(3) AGGREGATE FOREIGN CASH POSITION.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘aggregate foreign cash position’ means, with respect to any United States shareholder, the greater of—

“(i) the aggregate of such United States shareholder’s pro rata share of the cash position of each specified foreign corporation of such United States shareholder determined as of the close of the last taxable year of such specified foreign corporation which begins before January 1, 2018, or

“(ii) one half of the sum of—

“(I) the aggregate described in clause (i) determined as of the close of the last taxable year of each such specified foreign corporation which ends before November 2, 2017, plus

“(II) the aggregate described in clause (i) determined as of the close of the taxable year of each such specified foreign corporation which precedes the taxable year referred to in subclause (I).

“(B) CASH POSITION.—For purposes of this paragraph, the cash position of any specified foreign corporation is the sum of—

“(i) cash held by such foreign corporation,

“(ii) the net accounts receivable of such foreign corporation, plus

“(iii) the fair market value of the following assets held by such corporation:

“(I) Personal property which is of a type that is actively traded and for which there is an established financial market.

“(II) Commercial paper, certificates of deposit, the securities of the Federal government and of any State or foreign government.

“(III) Any foreign currency.

“(IV) Any obligation with a term of less than one year.

“(V) Any asset which the Secretary identifies as being economically equivalent to any asset described in this subparagraph.

“(C) NET ACCOUNTS RECEIVABLE.—For purposes of this paragraph, the term ‘net accounts receivable’ means, with respect to any specified foreign corporation, the excess (if any) of—

“(i) such corporation’s accounts receivable, over

“(ii) such corporation’s accounts payable (determined consistent with the rules of section 461).

“(D) PREVENTION OF DOUBLE COUNTING.—Cash positions of a specified foreign corporation described in clause (ii), (iii)(I), or (iii)(IV) of subparagraph (B) shall not be taken into account by a United States shareholder under subparagraph (A) to the extent that such United States shareholder demonstrates to the satisfaction of the Secretary that such amount is so taken into account by such United States shareholder with respect to another specified foreign corporation.

“(E) CASH POSITIONS OF CERTAIN NON-CORPORATE ENTITIES TAKEN INTO ACCOUNT.—An entity (other than a corporation) shall be treated as a specified foreign corporation of a United States shareholder for purposes of determining such United States shareholder's aggregate foreign cash position if any interest in such entity is held by a specified foreign corporation of such United States shareholder (determined after application of this subparagraph) and such entity would be a specified foreign corporation of such United States shareholder if such entity were a foreign corporation.

“(F) ANTI-ABUSE.—If the Secretary determines that a principal purpose of any transaction was to reduce the aggregate foreign cash position taken into account under this subsection, such transaction shall be disregarded for purposes of this subsection.

“(d) DEFERRED FOREIGN INCOME CORPORATION; ACCUMULATED POST-1986 DEFERRED FOREIGN INCOME.—For purposes of this section—

“(1) DEFERRED FOREIGN INCOME CORPORATION.—The term ‘deferred foreign income corporation’ means, with respect to any United States shareholder, any specified foreign corporation of such United States shareholder which has accumulated post-1986 deferred foreign income (as of the date referred to in paragraph (1) or (2) of subsection (a)) greater than zero.

“(2) ACCUMULATED POST-1986 DEFERRED FOREIGN INCOME.—The term ‘accumulated post-1986 deferred foreign income’ means the post-1986 earnings and profits except to the extent such earnings—

“(A) are attributable to income of the specified foreign corporation which is effectively connected with the conduct of a trade or business within the United States and subject to tax under this chapter, or

“(B) in the case of a controlled foreign corporation, if distributed, would be excluded from the gross income of a United States shareholder under section 959.

To the extent provided in regulations or other guidance prescribed by the Secretary, in the case of any controlled foreign corporation which has shareholders which are not United States shareholders, accumulated post-1986 deferred foreign income shall be appropriately reduced by amounts which would be described in subparagraph (B) if such shareholders were United States shareholders.

“(3) POST-1986 EARNINGS AND PROFITS.—The term ‘post-1986 earnings and profits’ means the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986, and by only taking into account periods when the foreign corporation was a specified foreign corporation) accumulated in taxable years beginning after December 31, 1986, and determined—

“(A) as of the date referred to in paragraph (1) or (2) of subsection (a), whichever is applicable with respect to such foreign corporation, and

“(B) without diminution by reason of dividends distributed during the taxable year described in subsection (a) other than dividends distributed to another specified foreign corporation.

“(e) SPECIFIED FOREIGN CORPORATION.—

“(1) IN GENERAL.—For purposes of this section, the term ‘specified foreign corporation’ means—

“(A) any controlled foreign corporation, and

“(B) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder.

“(2) APPLICATION TO CERTAIN FOREIGN CORPORATIONS.—For purposes of sections 951 and 961, a foreign corporation described in paragraph (1)(B) shall be treated as a controlled foreign corporation solely for purposes of taking into account the subpart F income of such corporation under subsection (a) (and for purposes of applying subsection (f)).

“(3) EXCLUSION OF PASSIVE FOREIGN INVESTMENT COMPANIES.—Such term shall not include any corporation which is a passive foreign investment company (as defined in section 1297) with respect to the shareholder and which is not a controlled foreign corporation.

“(f) DETERMINATIONS OF PRO RATA SHARE.—

“(1) IN GENERAL.—For purposes of this section, the determination of any United States shareholder’s pro rata share of any amount with respect to any specified foreign corporation shall be determined under rules similar to the rules of section 951(a)(2) by treating such amount in the same manner as subpart F income (and by treating such specified foreign corporation as a controlled foreign corporation).

“(2) SPECIAL RULES.—The portion which is included in the income of a United States shareholder under section 951(a)(1) by reason of subsection (a) which is equal to the deduction allowed under subsection (c) by reason of such inclusion—

“(A) shall be treated as income exempt from tax for purposes of sections 705(a)(1)(B) and 1367(a)(1)(A), and

“(B) shall not be treated as income exempt from tax for purposes of determining whether an adjustment shall be made to an accumulated adjustment account under section 1368(e)(1)(A).

“(g) DISALLOWANCE OF FOREIGN TAX CREDIT, ETC.—

“(1) IN GENERAL.—No credit shall be allowed under section 901 for the applicable percentage of any taxes paid or accrued (or treated as paid or accrued) with respect to any amount for which a deduction is allowed under this section.

“(2) APPLICABLE PERCENTAGE.—For purposes of this subsection, the term ‘applicable percentage’ means the amount (expressed as a percentage) equal to the sum of—

“(A) 0.771 multiplied by the ratio of—

“(i) the excess to which subsection (c)(1)(A) applies, divided by

“(ii) the sum of such excess plus the amount to which subsection (c)(1)(B) applies, plus

“(B) 0.557 multiplied by the ratio of—

“(i) the amount to which subsection (c)(1)(B) applies, divided by

“(ii) the sum described in subparagraph (A)(ii).

“(3) DENIAL OF DEDUCTION.—No deduction shall be allowed under this chapter for any tax for which credit is not allowable under section 901 by reason of paragraph (1) (determined by

treating the taxpayer as having elected the benefits of subpart A of part III of subchapter N).

“(4) COORDINATION WITH SECTION 78.—With respect to the taxes treated as paid or accrued by a domestic corporation with respect to amounts which are includible in gross income of such domestic corporation by reason of this section, section 78 shall apply only to so much of such taxes as bears the same proportion to the amount of such taxes as—

“(A) the excess of—

“(i) the amounts which are includible in gross income of such domestic corporation by reason of this section, over

“(ii) the deduction allowable under subsection (c) with respect to such amounts, bears to

“(B) such amounts.

“(h) ELECTION TO PAY LIABILITY IN INSTALLMENTS.—

“(1) IN GENERAL.—In the case of a United States shareholder of a deferred foreign income corporation, such United States shareholder may elect to pay the net tax liability under this section in 8 installments of the following amounts:

“(A) 8 percent of the net tax liability in the case of each of the first 5 of such installments,

“(B) 15 percent of the net tax liability in the case of the 6th such installment,

“(C) 20 percent of the net tax liability in the case of the 7th such installment, and

“(D) 25 percent of the net tax liability in the case of the 8th such installment.

“(2) DATE FOR PAYMENT OF INSTALLMENTS.—If an election is made under paragraph (1), the first installment shall be paid on the due date (determined without regard to any extension of time for filing the return) for the return of tax for the taxable year described in subsection (a) and each succeeding installment shall be paid on the due date (as so determined) for the return of tax for the taxable year following the taxable year with respect to which the preceding installment was made.

“(3) ACCELERATION OF PAYMENT.—If there is an addition to tax for failure to timely pay any installment required under this subsection, a liquidation or sale of substantially all the assets of the taxpayer (including in a title 11 or similar case), a cessation of business by the taxpayer, or any similar circumstance, then the unpaid portion of all remaining installments shall be due on the date of such event (or in the case of a title 11 or similar case, the day before the petition is filed). The preceding sentence shall not apply to the sale of substantially all the assets of a taxpayer to a buyer if such buyer enters into an agreement with the Secretary under which such buyer is liable for the remaining installments due under this subsection in the same manner as if such buyer were the taxpayer.

“(4) PRORATION OF DEFICIENCY TO INSTALLMENTS.—If an election is made under paragraph (1) to pay the net tax liability under this section in installments and a deficiency has been assessed with respect to such net tax liability, the deficiency shall be prorated to the installments payable under paragraph (1). The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be collected

at the same time as, and as a part of, such installment. The part of the deficiency so prorated to any installment the date for payment of which has arrived shall be paid upon notice and demand from the Secretary. This subsection shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

“(5) ELECTION.—Any election under paragraph (1) shall be made not later than the due date for the return of tax for the taxable year described in subsection (a) and shall be made in such manner as the Secretary shall provide.

“(6) NET TAX LIABILITY UNDER THIS SECTION.—For purposes of this subsection—

“(A) IN GENERAL.—The net tax liability under this section with respect to any United States shareholder is the excess (if any) of—

“(i) such taxpayer’s net income tax for the taxable year in which an amount is included in the gross income of such United States shareholder under section 951(a)(1) by reason of this section, over

“(ii) such taxpayer’s net income tax for such taxable year determined—

“(I) without regard to this section, and

“(II) without regard to any income or deduction properly attributable to a dividend received by such United States shareholder from any deferred foreign income corporation.

“(B) NET INCOME TAX.—The term ‘net income tax’ means the regular tax liability reduced by the credits allowed under subparts A, B, and D of part IV of subchapter A.

“(i) SPECIAL RULES FOR S CORPORATION SHAREHOLDERS.—

“(1) IN GENERAL.—In the case of any S corporation which is a United States shareholder of a deferred foreign income corporation, each shareholder of such S corporation may elect to defer payment of such shareholder’s net tax liability under this section with respect to such S corporation until the shareholder’s taxable year which includes the triggering event with respect to such liability. Any net tax liability payment of which is deferred under the preceding sentence shall be assessed on the return of tax as an addition to tax in the shareholder’s taxable year which includes such triggering event.

“(2) TRIGGERING EVENT.—

“(A) IN GENERAL.—In the case of any shareholder’s net tax liability under this section with respect to any S corporation, the triggering event with respect to such liability is whichever of the following occurs first:

“(i) Such corporation ceases to be an S corporation (determined as of the first day of the first taxable year that such corporation is not an S corporation).

“(ii) A liquidation or sale of substantially all the assets of such S corporation (including in a title 11 or similar case), a cessation of business by such S corporation, such S corporation ceases to exist, or any similar circumstance.

“(iii) A transfer of any share of stock in such S corporation by the taxpayer (including by reason of death, or otherwise).

“(B) PARTIAL TRANSFERS OF STOCK.—In the case of a transfer of less than all of the taxpayer’s shares of stock in the S corporation, such transfer shall only be a triggering event with respect to so much of the taxpayer’s net tax liability under this section with respect to such S corporation as is properly allocable to such stock.

“(C) TRANSFER OF LIABILITY.—A transfer described in clause (iii) of subparagraph (A) shall not be treated as a triggering event if the transferee enters into an agreement with the Secretary under which such transferee is liable for net tax liability with respect to such stock in the same manner as if such transferee were the taxpayer.

“(3) NET TAX LIABILITY.—A shareholder’s net tax liability under this section with respect to any S corporation is the net tax liability under this section which would be determined under subsection (h)(6) if the only subpart F income taken into account by such shareholder by reason of this section were allocations from such S corporation.

“(4) ELECTION TO PAY DEFERRED LIABILITY IN INSTALLMENTS.—In the case of a taxpayer which elects to defer payment under paragraph (1)—

“(A) subsection (h) shall be applied separately with respect to the liability to which such election applies,

“(B) an election under subsection (h) with respect to such liability shall be treated as timely made if made not later than the due date for the return of tax for the taxable year in which the triggering event with respect to such liability occurs,

“(C) the first installment under subsection (h) with respect to such liability shall be paid not later than such due date (but determined without regard to any extension of time for filing the return), and

“(D) if the triggering event with respect to any net tax liability is described in paragraph (2)(A)(ii), an election under subsection (h) with respect to such liability may be made only with the consent of the Secretary.

“(5) JOINT AND SEVERAL LIABILITY OF S CORPORATION.—If any shareholder of an S corporation elects to defer payment under paragraph (1), such S corporation shall be jointly and severally liable for such payment and any penalty, addition to tax, or additional amount attributable thereto.

“(6) EXTENSION OF LIMITATION ON COLLECTION.—Any limitation on the time period for the collection of a liability deferred under this subsection shall not be treated as beginning before the date of the triggering event with respect to such liability.

“(7) ANNUAL REPORTING OF NET TAX LIABILITY.—

“(A) IN GENERAL.—Any shareholder of an S corporation which makes an election under paragraph (1) shall report the amount of such shareholder’s deferred net tax liability on such shareholder’s return of tax for the taxable year for which such election is made and on the return of tax for each taxable year thereafter until such amount has been fully assessed on such returns.

“(B) DEFERRED NET TAX LIABILITY.—For purposes of this paragraph, the term ‘deferred net tax liability’ means, with respect to any taxable year, the amount of net tax liability payment of which has been deferred under paragraph (1) and which has not been assessed on a return of tax for any prior taxable year.

“(C) FAILURE TO REPORT.—In the case of any failure to report any amount required to be reported under subparagraph (A) with respect to any taxable year before the due date for the return of tax for such taxable year, there shall be assessed on such return as an addition to tax 5 percent of such amount.

“(8) ELECTION.—Any election under paragraph (1)—

“(A) shall be made by the shareholder of the S corporation not later than the due date for such shareholder’s return of tax for the taxable year which includes the close of the taxable year of such S corporation in which the amount described in subsection (a) is taken into account, and

“(B) shall be made in such manner as the Secretary shall provide.

“(j) REPORTING BY S CORPORATION.—Each S corporation which is a United States shareholder of a specified foreign corporation shall report in its return of tax under section 6037(a) the amount includible in its gross income for such taxable year by reason of this section and the amount of the deduction allowable by subsection (c). Any copy provided to a shareholder under section 6037(b) shall include a statement of such shareholder’s pro rata share of such amounts.

“(k) EXTENSION OF LIMITATION ON ASSESSMENT.—Notwithstanding section 6501, the limitation on the time period for the assessment of the net tax liability under this section (as defined in subsection (h)(6)) shall not expire before the date that is 6 years after the return for the taxable year described in such subsection was filed.

“(l) RECAPTURE FOR EXPATRIATED ENTITIES.—

“(1) IN GENERAL.—If a deduction is allowed under subsection (c) to a United States shareholder and such shareholder first becomes an expatriated entity at any time during the 10-year period beginning on the date of the enactment of the Tax Cuts and Jobs Act (with respect to a surrogate foreign corporation which first becomes a surrogate foreign corporation during such period), then—

“(A) the tax imposed by this chapter shall be increased for the first taxable year in which such taxpayer becomes an expatriated entity by an amount equal to 35 percent of the amount of the deduction allowed under subsection (c), and

“(B) no credits shall be allowed against the increase in tax under subparagraph (A).

“(2) EXPATRIATED ENTITY.—For purposes of this subsection, the term ‘expatriated entity’ has the same meaning given such term under section 7874(a)(2), except that such term shall not include an entity if the surrogate foreign corporation with respect to the entity is treated as a domestic corporation under section 7874(b).

“(3) SURROGATE FOREIGN CORPORATION.—For purposes of this subsection, the term ‘surrogate foreign corporation’ has the meaning given such term in section 7874(a)(2)(B).

“(m) SPECIAL RULES FOR UNITED STATES SHAREHOLDERS WHICH ARE REAL ESTATE INVESTMENT TRUSTS.—

“(1) IN GENERAL.—If a real estate investment trust is a United States shareholder in 1 or more deferred foreign income corporations—

“(A) any amount required to be taken into account under section 951(a)(1) by reason of this section shall not be taken into account as gross income of the real estate investment trust for purposes of applying paragraphs (2) and (3) of section 856(c) to any taxable year for which such amount is taken into account under section 951(a)(1), and

“(B) if the real estate investment trust elects the application of this subparagraph, notwithstanding subsection (a), any amount required to be taken into account under section 951(a)(1) by reason of this section shall, in lieu of the taxable year in which it would otherwise be included in gross income (for purposes of the computation of real estate investment trust taxable income under section 857(b)), be included in gross income as follows:

“(i) 8 percent of such amount in the case of each of the taxable years in the 5-taxable year period beginning with the taxable year in which such amount would otherwise be included.

“(ii) 15 percent of such amount in the case of the 1st taxable year following such period.

“(iii) 20 percent of such amount in the case of the 2nd taxable year following such period.

“(iv) 25 percent of such amount in the case of the 3rd taxable year following such period.

“(2) RULES FOR TRUSTS ELECTING DEFERRED INCLUSION.—

“(A) ELECTION.—Any election under paragraph (1)(B) shall be made not later than the due date for the first taxable year in the 5-taxable year period described in clause (i) of paragraph (1)(B) and shall be made in such manner as the Secretary shall provide.

“(B) SPECIAL RULES.—If an election under paragraph (1)(B) is in effect with respect to any real estate investment trust, the following rules shall apply:

“(i) APPLICATION OF PARTICIPATION EXEMPTION.—For purposes of subsection (c)(1)—

“(I) the aggregate amount to which subparagraph (A) or (B) of subsection (c)(1) applies shall be determined without regard to the election,

“(II) each such aggregate amount shall be allocated to each taxable year described in paragraph (1)(B) in the same proportion as the amount included in the gross income of such United States shareholder under section 951(a)(1) by reason of this section is allocated to each such taxable year.

“(III) NO INSTALLMENT PAYMENTS.—The real estate investment trust may not make an election under subsection (g) for any taxable year described in paragraph (1)(B).

“(ii) ACCELERATION OF INCLUSION.—If there is a liquidation or sale of substantially all the assets of the real estate investment trust (including in a title 11 or similar case), a cessation of business by such trust, or any similar circumstance, then any amount not yet included in gross income under paragraph (1)(B) shall be included in gross income as of the day before the date of the event and the unpaid portion of any tax liability with respect to such inclusion shall be due on the date of such event (or in the case of a title 11 or similar case, the day before the petition is filed).

“(n) ELECTION NOT TO APPLY NET OPERATING LOSS DEDUCTION.—

“(1) IN GENERAL.—If a United States shareholder of a deferred foreign income corporation elects the application of this subsection for the taxable year described in subsection (a), then the amount described in paragraph (2) shall not be taken into account—

“(A) in determining the amount of the net operating loss deduction under section 172 of such shareholder for such taxable year, or

“(B) in determining the amount of taxable income for such taxable year which may be reduced by net operating loss carryovers or carrybacks to such taxable year under section 172.

“(2) AMOUNT DESCRIBED.—The amount described in this paragraph is the sum of—

“(A) the amount required to be taken into account under section 951(a)(1) by reason of this section (determined after the application of subsection (c)), plus

“(B) in the case of a domestic corporation which chooses to have the benefits of subpart A of part III of subchapter N for the taxable year, the taxes deemed to be paid by such corporation under subsections (a) and (b) of section 960 for such taxable year with respect to the amount described in subparagraph (A) which are treated as a dividends under section 78.

“(3) ELECTION.—Any election under this subsection shall be made not later than the due date (including extensions) for filing the return of tax for the taxable year and shall be made in such manner as the Secretary shall prescribe.

“(o) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section, including—

“(1) regulations or other guidance to provide appropriate basis adjustments, and

“(2) regulations or other guidance to prevent the avoidance of the purposes of this section, including through a reduction in earnings and profits, through changes in entity classification or accounting methods, or otherwise.”.

(b) CLERICAL AMENDMENT.—The table of sections for subpart F of part III of subchapter N of chapter 1 is amended by striking the item relating to section 965 and inserting the following:

“Sec. 965. Treatment of deferred foreign income upon transition to participation exemption system of taxation.”.

Subpart B—Rules Related to Passive and Mobile Income

CHAPTER 1—TAXATION OF FOREIGN-DERIVED INTANGIBLE INCOME AND GLOBAL INTANGIBLE LOW-TAXED INCOME

SEC. 14201. CURRENT YEAR INCLUSION OF GLOBAL INTANGIBLE LOW-TAXED INCOME BY UNITED STATES SHAREHOLDERS.

(a) IN GENERAL.—Subpart F of part III of subchapter N of chapter 1 is amended by inserting after section 951 the following new section:

“SEC. 951A. GLOBAL INTANGIBLE LOW-TAXED INCOME INCLUDED IN GROSS INCOME OF UNITED STATES SHAREHOLDERS.

“(a) IN GENERAL.—Each person who is a United States shareholder of any controlled foreign corporation for any taxable year of such United States shareholder shall include in gross income such shareholder’s global intangible low-taxed income for such taxable year.

“(b) GLOBAL INTANGIBLE LOW-TAXED INCOME.—For purposes of this section—

“(1) IN GENERAL.—The term ‘global intangible low-taxed income’ means, with respect to any United States shareholder for any taxable year of such United States shareholder, the excess (if any) of—

“(A) such shareholder’s net CFC tested income for such taxable year, over

“(B) such shareholder’s net deemed tangible income return for such taxable year.

“(2) NET DEEMED TANGIBLE INCOME RETURN.—The term ‘net deemed tangible income return’ means, with respect to any United States shareholder for any taxable year, the excess of—

“(A) 10 percent of the aggregate of such shareholder’s pro rata share of the qualified business asset investment of each controlled foreign corporation with respect to which such shareholder is a United States shareholder for such taxable year (determined for each taxable year of each such controlled foreign corporation which ends in or with such taxable year of such United States shareholder), over

“(B) the amount of interest expense taken into account under subsection (c)(2)(A)(ii) in determining the shareholder’s net CFC tested income for the taxable year to the extent the interest income attributable to such expense is not taken into account in determining such shareholder’s net CFC tested income.

“(c) NET CFC TESTED INCOME.—For purposes of this section—

“(1) IN GENERAL.—The term ‘net CFC tested income’ means, with respect to any United States shareholder for any taxable

year of such United States shareholder, the excess (if any) of—

“(A) the aggregate of such shareholder’s pro rata share of the tested income of each controlled foreign corporation with respect to which such shareholder is a United States shareholder for such taxable year of such United States shareholder (determined for each taxable year of such controlled foreign corporation which ends in or with such taxable year of such United States shareholder), over

“(B) the aggregate of such shareholder’s pro rata share of the tested loss of each controlled foreign corporation with respect to which such shareholder is a United States shareholder for such taxable year of such United States shareholder (determined for each taxable year of such controlled foreign corporation which ends in or with such taxable year of such United States shareholder).

“(2) TESTED INCOME; TESTED LOSS.—For purposes of this section—

“(A) TESTED INCOME.—The term ‘tested income’ means, with respect to any controlled foreign corporation for any taxable year of such controlled foreign corporation, the excess (if any) of—

“(i) the gross income of such corporation determined without regard to—

“(I) any item of income described in section 952(b),

“(II) any gross income taken into account in determining the subpart F income of such corporation,

“(III) any gross income excluded from the foreign base company income (as defined in section 954) and the insurance income (as defined in section 953) of such corporation by reason of section 954(b)(4),

“(IV) any dividend received from a related person (as defined in section 954(d)(3)), and

“(V) any foreign oil and gas extraction income (as defined in section 907(c)(1)) of such corporation,

over
“(ii) the deductions (including taxes) properly allocable to such gross income under rules similar to the rules of section 954(b)(5) (or to which such deductions would be allocable if there were such gross income).

“(B) TESTED LOSS.—

“(i) IN GENERAL.—The term ‘tested loss’ means, with respect to any controlled foreign corporation for any taxable year of such controlled foreign corporation, the excess (if any) of the amount described in subparagraph (A)(ii) over the amount described in subparagraph (A)(i).

“(ii) COORDINATION WITH SUBPART F TO DENY DOUBLE BENEFIT OF LOSSES.—Section 952(c)(1)(A) shall be applied by increasing the earnings and profits of the controlled foreign corporation by the tested loss of such corporation.

“(d) QUALIFIED BUSINESS ASSET INVESTMENT.—For purposes of this section—

“(1) IN GENERAL.—The term ‘qualified business asset investment’ means, with respect to any controlled foreign corporation for any taxable year, the average of such corporation’s aggregate adjusted bases as of the close of each quarter of such taxable year in specified tangible property—

“(A) used in a trade or business of the corporation, and

“(B) of a type with respect to which a deduction is allowable under section 167.

“(2) SPECIFIED TANGIBLE PROPERTY.—

“(A) IN GENERAL.—The term ‘specified tangible property’ means, except as provided in subparagraph (B), any tangible property used in the production of tested income.

“(B) DUAL USE PROPERTY.—In the case of property used both in the production of tested income and income which is not tested income, such property shall be treated as specified tangible property in the same proportion that the gross income described in subsection (c)(1)(A) produced with respect to such property bears to the total gross income produced with respect to such property.

“(3) DETERMINATION OF ADJUSTED BASIS.—For purposes of this subsection, notwithstanding any provision of this title (or any other provision of law) which is enacted after the date of the enactment of this section, the adjusted basis in any property shall be determined—

“(A) by using the alternative depreciation system under section 168(g), and

“(B) by allocating the depreciation deduction with respect to such property ratably to each day during the period in the taxable year to which such depreciation relates.

“(3) PARTNERSHIP PROPERTY.—For purposes of this subsection, if a controlled foreign corporation holds an interest in a partnership at the close of such taxable year of the controlled foreign corporation, such controlled foreign corporation shall take into account under paragraph (1) the controlled foreign corporation’s distributive share of the aggregate of the partnership’s adjusted bases (determined as of such date in the hands of the partnership) in tangible property held by such partnership to the extent such property—

“(A) is used in the trade or business of the partnership,

“(B) is of a type with respect to which a deduction is allowable under section 167, and

“(C) is used in the production of tested income (determined with respect to such controlled foreign corporation’s distributive share of income with respect to such property). For purposes of this paragraph, the controlled foreign corporation’s distributive share of the adjusted basis of any property shall be the controlled foreign corporation’s distributive share of income with respect to such property.

“(4) REGULATIONS.—The Secretary shall issue such regulations or other guidance as the Secretary determines appropriate to prevent the avoidance of the purposes of this subsection, including regulations or other guidance which provide for the treatment of property if—

“(A) such property is transferred, or held, temporarily,

or

“(B) the avoidance of the purposes of this paragraph is a factor in the transfer or holding of such property.

“(e) DETERMINATION OF PRO RATA SHARE, ETC.—For purposes of this section—

“(1) IN GENERAL.—The pro rata shares referred to in subsections (b), (c)(1)(A), and (c)(1)(B), respectively, shall be determined under the rules of section 951(a)(2) in the same manner as such section applies to subpart F income and shall be taken into account in the taxable year of the United States shareholder in which or with which the taxable year of the controlled foreign corporation ends.

“(2) TREATMENT AS UNITED STATES SHAREHOLDER.—A person shall be treated as a United States shareholder of a controlled foreign corporation for any taxable year of such person only if such person owns (within the meaning of section 958(a)) stock in such foreign corporation on the last day in the taxable year of such foreign corporation on which such foreign corporation is a controlled foreign corporation.

“(3) TREATMENT AS CONTROLLED FOREIGN CORPORATION.—A foreign corporation shall be treated as a controlled foreign corporation for any taxable year if such foreign corporation is a controlled foreign corporation at any time during such taxable year.

“(f) TREATMENT AS SUBPART F INCOME FOR CERTAIN PURPOSES.—

“(1) IN GENERAL.—

“(A) APPLICATION.—Except as provided in subparagraph (B), any global intangible low-taxed income included in gross income under subsection (a) shall be treated in the same manner as an amount included under section 951(a)(1)(A) for purposes of applying sections 168(h)(2)(B), 535(b)(10), 851(b), 904(h)(1), 959, 961, 962, 993(a)(1)(E), 996(f)(1), 1248(b)(1), 1248(d)(1), 6501(e)(1)(C), 6654(d)(2)(D), and 6655(e)(4).

“(B) EXCEPTION.—The Secretary shall provide rules for the application of subparagraph (A) to other provisions of this title in any case in which the determination of subpart F income is required to be made at the level of the controlled foreign corporation.

“(2) ALLOCATION OF GLOBAL INTANGIBLE LOW-TAXED INCOME TO CONTROLLED FOREIGN CORPORATIONS.—For purposes of the sections referred to in paragraph (1), with respect to any controlled foreign corporation any pro rata amount from which is taken into account in determining the global intangible low-taxed income included in gross income of a United States shareholder under subsection (a), the portion of such global intangible low-taxed income which is treated as being with respect to such controlled foreign corporation is—

“(A) in the case of a controlled foreign corporation with no tested income, zero, and

“(B) in the case of a controlled foreign corporation with tested income, the portion of such global intangible low-taxed income which bears the same ratio to such global intangible low-taxed income as—

“(i) such United States shareholder's pro rata amount of the tested income of such controlled foreign corporation, bears to

“(ii) the aggregate amount described in subsection (c)(1)(A) with respect to such United States shareholder.”.

(b) FOREIGN TAX CREDIT.—

(1) APPLICATION OF DEEMED PAID FOREIGN TAX CREDIT.—Section 960 is amended adding at the end the following new subsection:

“(d) DEEMED PAID CREDIT FOR TAXES PROPERLY ATTRIBUTABLE TO TESTED INCOME.—

“(1) IN GENERAL.—For purposes of subpart A of this part, if any amount is includible in the gross income of a domestic corporation under section 951A, such domestic corporation shall be deemed to have paid foreign income taxes equal to 80 percent of the product of—

“(A) such domestic corporation’s inclusion percentage, multiplied by

“(B) the aggregate tested foreign income taxes paid or accrued by controlled foreign corporations.

“(2) INCLUSION PERCENTAGE.—For purposes of paragraph (1), the term ‘inclusion percentage’ means, with respect to any domestic corporation, the ratio (expressed as a percentage) of—

“(A) such corporation’s global intangible low-taxed income (as defined in section 951A(b)), divided by

“(B) the aggregate amount described in section 951A(c)(1)(A) with respect to such corporation.

“(3) TESTED FOREIGN INCOME TAXES.—For purposes of paragraph (1), the term ‘tested foreign income taxes’ means, with respect to any domestic corporation which is a United States shareholder of a controlled foreign corporation, the foreign income taxes paid or accrued by such foreign corporation which are properly attributable to the tested income of such foreign corporation taken into account by such domestic corporation under section 951A.”.

(2) APPLICATION OF FOREIGN TAX CREDIT LIMITATION.—

(A) SEPARATE BASKET FOR GLOBAL INTANGIBLE LOW-TAXED INCOME.—Section 904(d)(1) is amended by redesignating subparagraphs (A) and (B) as subparagraphs (B) and (C), respectively, and by inserting before subparagraph (B) (as so redesignated) the following new subparagraph: “(A) any amount includible in gross income under section 951A (other than passive category income).”.

(B) EXCLUSION FROM GENERAL CATEGORY INCOME.—Section 904(d)(2)(A)(ii) is amended by inserting “income described in paragraph (1)(A) and” before “passive category income”.

(C) NO CARRYOVER OR CARRYBACK OF EXCESS TAXES.—Section 904(c) is amended by adding at the end the following: “This subsection shall not apply to taxes paid or accrued with respect to amounts described in subsection (d)(1)(A).”.

(c) CLERICAL AMENDMENT.—The table of sections for subpart F of part III of subchapter N of chapter 1 is amended by inserting after the item relating to section 951 the following new item:

“Sec. 951A. Global intangible low-taxed income included in gross income of United States shareholders.”.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SEC. 14202. DEDUCTION FOR FOREIGN-DERIVED INTANGIBLE INCOME AND GLOBAL INTANGIBLE LOW-TAXED INCOME.

(a) IN GENERAL.—Part VIII of subchapter B of chapter 1 is amended by adding at the end the following new section:

“SEC. 250. FOREIGN-DERIVED INTANGIBLE INCOME AND GLOBAL INTANGIBLE LOW-TAXED INCOME.

“(a) ALLOWANCE OF DEDUCTION.—

“(1) IN GENERAL.—In the case of a domestic corporation for any taxable year, there shall be allowed as a deduction an amount equal to the sum of—

“(A) 37.5 percent of the foreign-derived intangible income of such domestic corporation for such taxable year, plus

“(B) 50 percent of—

“(i) the global intangible low-taxed income amount (if any) which is included in the gross income of such domestic corporation under section 951A for such taxable year, and

“(ii) the amount treated as a dividend received by such corporation under section 78 which is attributable to the amount described in clause (i).

“(2) LIMITATION BASED ON TAXABLE INCOME.—

“(A) IN GENERAL.—If, for any taxable year—

“(i) the sum of the foreign-derived intangible income and the global intangible low-taxed income amount otherwise taken into account by the domestic corporation under paragraph (1), exceeds

“(ii) the taxable income of the domestic corporation (determined without regard to this section), then the amount of the foreign-derived intangible income and the global intangible low-taxed income amount so taken into account shall be reduced as provided in subparagraph (B).

“(B) REDUCTION.—For purposes of subparagraph (A)—

“(i) foreign-derived intangible income shall be reduced by an amount which bears the same ratio to the excess described in subparagraph (A) as such foreign-derived intangible income bears to the sum described in subparagraph (A)(i), and

“(ii) the global intangible low-taxed income amount shall be reduced by the remainder of such excess.

“(3) REDUCTION IN DEDUCTION FOR TAXABLE YEARS AFTER 2025.—In the case of any taxable year beginning after December 31, 2025, paragraph (1) shall be applied by substituting—

“(A) ‘21.875 percent’ for ‘37.5 percent’ in subparagraph (A), and

“(B) ‘37.5 percent’ for ‘50 percent’ in subparagraph (B).

“(b) FOREIGN-DERIVED INTANGIBLE INCOME.—For purposes of this section—

“(1) IN GENERAL.—The foreign-derived intangible income of any domestic corporation is the amount which bears the same ratio to the deemed intangible income of such corporation as—

“(A) the foreign-derived deduction eligible income of such corporation, bears to

“(B) the deduction eligible income of such corporation.

“(2) DEEMED INTANGIBLE INCOME.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘deemed intangible income’ means the excess (if any) of—

“(i) the deduction eligible income of the domestic corporation, over

“(ii) the deemed tangible income return of the corporation.

“(B) DEEMED TANGIBLE INCOME RETURN.—The term ‘deemed tangible income return’ means, with respect to any corporation, an amount equal to 10 percent of the corporation’s qualified business asset investment (as defined in section 951A(d), determined by substituting ‘deduction eligible income’ for ‘tested income’ in paragraph (2) thereof and without regard to whether the corporation is a controlled foreign corporation).

“(3) DEDUCTION ELIGIBLE INCOME.—

“(A) IN GENERAL.—The term ‘deduction eligible income’ means, with respect to any domestic corporation, the excess (if any) of—

“(i) gross income of such corporation determined without regard to—

“(I) any amount included in the gross income of such corporation under section 951(a)(1),

“(II) the global intangible low-taxed income included in the gross income of such corporation under section 951A,

“(III) any financial services income (as defined in section 904(d)(2)(D)) of such corporation,

“(IV) any dividend received from a corporation which is a controlled foreign corporation of such domestic corporation,

“(V) any domestic oil and gas extraction income of such corporation, and

“(VI) any foreign branch income (as defined in section 904(d)(2)(J)), over

“(ii) the deductions (including taxes) properly allocable to such gross income.

“(B) DOMESTIC OIL AND GAS EXTRACTION INCOME.—For purposes of subparagraph (A), the term ‘domestic oil and gas extraction income’ means income described in section 907(c)(1), determined by substituting ‘within the United States’ for ‘without the United States’.

“(4) FOREIGN-DERIVED DEDUCTION ELIGIBLE INCOME.—The term ‘foreign-derived deduction eligible income’ means, with respect to any taxpayer for any taxable year, any deduction eligible income of such taxpayer which is derived in connection with—

“(A) property—

“(i) which is sold by the taxpayer to any person who is not a United States person, and

“(ii) which the taxpayer establishes to the satisfaction of the Secretary is for a foreign use, or

“(B) services provided by the taxpayer which the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States.

“(5) RULES RELATING TO FOREIGN USE PROPERTY OR SERVICES.—For purposes of this subsection—

“(A) FOREIGN USE.—The term ‘foreign use’ means any use, consumption, or disposition which is not within the United States.

“(B) PROPERTY OR SERVICES PROVIDED TO DOMESTIC INTERMEDIARIES.—

“(i) PROPERTY.—If a taxpayer sells property to another person (other than a related party) for further manufacture or other modification within the United States, such property shall not be treated as sold for a foreign use even if such other person subsequently uses such property for a foreign use.

“(ii) SERVICES.—If a taxpayer provides services to another person (other than a related party) located within the United States, such services shall not be treated as described in paragraph (4)(B) even if such other person uses such services in providing services which are so described.

“(C) SPECIAL RULES WITH RESPECT TO RELATED PARTY TRANSACTIONS.—

“(i) SALES TO RELATED PARTIES.—If property is sold to a related party who is not a United States person, such sale shall not be treated as for a foreign use unless—

“(I) such property is ultimately sold by a related party, or used by a related party in connection with property which is sold or the provision of services, to another person who is an unrelated party who is not a United States person, and

“(II) the taxpayer establishes to the satisfaction of the Secretary that such property is for a foreign use.

For purposes of this clause, a sale of property shall be treated as a sale of each of the components thereof.

“(ii) SERVICE PROVIDED TO RELATED PARTIES.—If a service is provided to a related party who is not located in the United States, such service shall not be treated described in subparagraph (A)(ii) unless the taxpayer established to the satisfaction of the Secretary that such service is not substantially similar to services provided by such related party to persons located within the United States.

“(D) RELATED PARTY.—For purposes of this paragraph, the term ‘related party’ means any member of an affiliated group as defined in section 1504(a), determined—

“(i) by substituting ‘more than 50 percent’ for ‘at least 80 percent’ each place it appears, and

“(ii) without regard to paragraphs (2) and (3) of section 1504(b).

Any person (other than a corporation) shall be treated as a member of such group if such person is controlled by members of such group (including any entity treated as a member of such group by reason of this sentence) or controls any such member. For purposes of the preceding sentence, control shall be determined under the rules of section 954(d)(3).

“(E) SOLD.—For purposes of this subsection, the terms ‘sold’, ‘sells’, and ‘sale’ shall include any lease, license, exchange, or other disposition.

“(c) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section.”.

(b) CONFORMING AMENDMENTS.—

(1) Section 172(d), as amended by this Act, is amended by adding at the end the following new paragraph:

“(9) DEDUCTION FOR FOREIGN-DERIVED INTANGIBLE INCOME.—The deduction under section 250 shall not be allowed.”.

(2) Section 246(b)(1) is amended—

(A) by striking “and subsection (a) and (b) of section 245” the first place it appears and inserting “, subsection (a) and (b) of section 245, and section 250”,

(B) by striking “and subsection (a) and (b) of section 245” the second place it appears and inserting “subsection (a) and (b) of section 245, and 250”.

(3) Section 469(i)(3)(F)(iii) is amended by striking “and 222” and inserting “222, and 250”.

(4) The table of sections for part VIII of subchapter B of chapter 1 is amended by adding at the end the following new item:

“Sec. 250. Foreign-derived intangible income and global intangible low-taxed income.”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

CHAPTER 2—OTHER MODIFICATIONS OF SUBPART F PROVISIONS

SEC. 14211. ELIMINATION OF INCLUSION OF FOREIGN BASE COMPANY OIL RELATED INCOME.

(a) REPEAL.—Subsection (a) of section 954 is amended—

(1) by inserting “and” at the end of paragraph (2),

(2) by striking the comma at the end of paragraph (3) and inserting a period, and

(3) by striking paragraph (5).

(b) CONFORMING AMENDMENTS.—

(1) Section 952(c)(1)(B)(iii) is amended by striking subclause (I) and redesignating subclauses (II) through (V) as subclauses (I) through (IV), respectively.

(2) Section 954(b) is amended—

(A) by striking the second sentence of paragraph (4),
(B) by striking “the foreign base company services income, and the foreign base company oil related income” in paragraph (5) and inserting “and the foreign base company services income”, and
(C) by striking paragraph (6).

(3) Section 954 is amended by striking subsection (g).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

SEC. 14212. REPEAL OF INCLUSION BASED ON WITHDRAWAL OF PREVIOUSLY EXCLUDED SUBPART F INCOME FROM QUALIFIED INVESTMENT.

(a) IN GENERAL.—Subpart F of part III of subchapter N of chapter 1 is amended by striking section 955.

(b) CONFORMING AMENDMENTS.—

(1)(A) Section 951(a)(1)(A) is amended to read as follows:
“(A) his pro rata share (determined under paragraph (2)) of the corporation’s subpart F income for such year, and”.

(B) Section 851(b) is amended by striking “section 951(a)(1)(A)(i)” in the flush language at the end and inserting “section 951(a)(1)(A)”.

(C) Section 952(c)(1)(B)(i) is amended by striking “section 951(a)(1)(A)(i)” and inserting “section 951(a)(1)(A)”.

(D) Section 953(c)(1)(C) is amended by striking “section 951(a)(1)(A)(i)” and inserting “section 951(a)(1)(A)”.

(2) Section 951(a) is amended by striking paragraph (3).

(3) Section 953(d)(4)(B)(iv)(II) is amended by striking “or amounts referred to in clause (ii) or (iii) of section 951(a)(1)(A)”.

(4) Section 964(b) is amended by striking “, 955,”.

(5) Section 970 is amended by striking subsection (b).

(6) The table of sections for subpart F of part III of subchapter N of chapter 1 is amended by striking the item relating to section 955.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SEC. 14213. MODIFICATION OF STOCK ATTRIBUTION RULES FOR DETERMINING STATUS AS A CONTROLLED FOREIGN CORPORATION.

(a) IN GENERAL.—Section 958(b) is amended—

(1) by striking paragraph (4), and
(2) by striking “Paragraphs (1) and (4)” in the last sentence and inserting “Paragraph (1)”.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to—

(1) the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent taxable year of such foreign corporations, and

(2) taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SEC. 14214. MODIFICATION OF DEFINITION OF UNITED STATES SHAREHOLDER.

(a) **IN GENERAL.**—Section 951(b) is amended by inserting “, or 10 percent or more of the total value of shares of all classes of stock of such foreign corporation” after “such foreign corporation”.

(b) **EFFECTIVE DATE.**—The amendment made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

SEC. 14215. ELIMINATION OF REQUIREMENT THAT CORPORATION MUST BE CONTROLLED FOR 30 DAYS BEFORE SUBPART F INCLUSIONS APPLY.

(a) **IN GENERAL.**—Section 951(a)(1) is amended by striking “for an uninterrupted period of 30 days or more” and inserting “at any time”.

(b) **EFFECTIVE DATE.**—The amendment made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

CHAPTER 3—PREVENTION OF BASE EROSION

SEC. 14221. LIMITATIONS ON INCOME SHIFTING THROUGH INTANGIBLE PROPERTY TRANSFERS.

(a) **DEFINITION OF INTANGIBLE ASSET.**—Section 936(h)(3)(B) is amended—

(1) by striking “or” at the end of clause (v),

(2) by striking clause (vi) and inserting the following:

“(vi) any goodwill, going concern value, or workforce in place (including its composition and terms and conditions (contractual or otherwise) of its employment); or

“(vii) any other item the value or potential value of which is not attributable to tangible property or the services of any individual.”, and

(3) by striking the flush language after clause (vii), as added by paragraph (2).

(b) **CLARIFICATION OF ALLOWABLE VALUATION METHODS.**—

(1) **FOREIGN CORPORATIONS.**—Section 367(d)(2) is amended by adding at the end the following new subparagraph:

“(D) **REGULATORY AUTHORITY.**—For purposes of the last sentence of subparagraph (A), the Secretary shall require—

“(i) the valuation of transfers of intangible property, including intangible property transferred with other property or services, on an aggregate basis, or

“(ii) the valuation of such a transfer on the basis of the realistic alternatives to such a transfer,

if the Secretary determines that such basis is the most reliable means of valuation of such transfers.”.

(2) ALLOCATION AMONG TAXPAYERS.—Section 482 is amended by adding at the end the following: “For purposes of this section, the Secretary shall require the valuation of transfers of intangible property (including intangible property transferred with other property or services) on an aggregate basis or the valuation of such a transfer on the basis of the realistic alternatives to such a transfer, if the Secretary determines that such basis is the most reliable means of valuation of such transfers.”

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to transfers in taxable years beginning after December 31, 2017.

(2) NO INFERENCE.—Nothing in the amendment made by subsection (a) shall be construed to create any inference with respect to the application of section 936(h)(3) of the Internal Revenue Code of 1986, or the authority of the Secretary of the Treasury to provide regulations for such application, with respect to taxable years beginning before January 1, 2018.

SEC. 14222. CERTAIN RELATED PARTY AMOUNTS PAID OR ACCRUED IN HYBRID TRANSACTIONS OR WITH HYBRID ENTITIES.

(a) IN GENERAL.—Part IX of subchapter B of chapter 1 is amended by inserting after section 267 the following:

“SEC. 267A. CERTAIN RELATED PARTY AMOUNTS PAID OR ACCRUED IN HYBRID TRANSACTIONS OR WITH HYBRID ENTITIES.

“(a) IN GENERAL.—No deduction shall be allowed under this chapter for any disqualified related party amount paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity.

“(b) DISQUALIFIED RELATED PARTY AMOUNT.—For purposes of this section—

“(1) DISQUALIFIED RELATED PARTY AMOUNT.—The term ‘disqualified related party amount’ means any interest or royalty paid or accrued to a related party to the extent that—

“(A) such amount is not included in the income of such related party under the tax law of the country of which such related party is a resident for tax purposes or is subject to tax, or

“(B) such related party is allowed a deduction with respect to such amount under the tax law of such country.

Such term shall not include any payment to the extent such payment is included in the gross income of a United States shareholder under section 951(a).

“(2) RELATED PARTY.—The term ‘related party’ means a related person as defined in section 954(d)(3), except that such section shall be applied with respect to the person making the payment described in paragraph (1) in lieu of the controlled foreign corporation otherwise referred to in such section.

“(c) HYBRID TRANSACTION.—For purposes of this section, the term ‘hybrid transaction’ means any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties for purposes of this chapter and which are not so treated for purposes the tax law of the foreign country of which the recipient of such payment is resident for tax purposes or is subject to tax.

“(d) HYBRID ENTITY.—For purposes of this section, the term ‘hybrid entity’ means any entity which is either—

“(1) treated as fiscally transparent for purposes of this chapter but not so treated for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax, or

“(2) treated as fiscally transparent for purposes of such tax law but not so treated for purposes of this chapter.

“(e) REGULATIONS.—The Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section, including regulations or other guidance providing for—

“(1) rules for treating certain conduit arrangements which involve a hybrid transaction or a hybrid entity as subject to subsection (a),

“(2) rules for the application of this section to branches or domestic entities,

“(3) rules for treating certain structured transactions as subject to subsection (a),

“(4) rules for treating a tax preference as an exclusion from income for purposes of applying subsection (b)(1) if such tax preference has the effect of reducing the generally applicable statutory rate by 25 percent or more,

“(5) rules for treating the entire amount of interest or royalty paid or accrued to a related party as a disqualified related party amount if such amount is subject to a participation exemption system or other system which provides for the exclusion or deduction of a substantial portion of such amount,

“(6) rules for determining the tax residence of a foreign entity if the entity is otherwise considered a resident of more than one country or of no country,

“(7) exceptions from subsection (a) with respect to—

“(A) cases in which the disqualified related party amount is taxed under the laws of a foreign country other than the country of which the related party is a resident for tax purposes, and

“(B) other cases which the Secretary determines do not present a risk of eroding the Federal tax base,

“(8) requirements for record keeping and information reporting in addition to any requirements imposed by section 6038A.”

(b) CONFORMING AMENDMENT.—The table of sections for part IX of subchapter B of chapter 1 is amended by inserting after the item relating to section 267 the following new item:

“Sec. 267A. Certain related party amounts paid or accrued in hybrid transactions or with hybrid entities.”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 14223. SHAREHOLDERS OF SURROGATE FOREIGN CORPORATIONS NOT ELIGIBLE FOR REDUCED RATE ON DIVIDENDS.

(a) IN GENERAL.—Section 1(h)(11)(C)(iii) is amended—

(1) by striking “shall not include any foreign corporation” and inserting “shall not include—

“(I) any foreign corporation”,

(2) by striking the period at the end and inserting “, and”, and

(3) by adding at the end the following new subclause:

“(II) any corporation which first becomes a surrogate foreign corporation (as defined in section 7874(a)(2)(B)) after the date of the enactment of this subclause, other than a foreign corporation which is treated as a domestic corporation under section 7874(b).”

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to dividends received after the date of the enactment of this Act.

Subpart C—Modifications Related to Foreign Tax Credit System

SEC. 14301. REPEAL OF SECTION 902 INDIRECT FOREIGN TAX CREDITS; DETERMINATION OF SECTION 960 CREDIT ON CURRENT YEAR BASIS.

(a) REPEAL OF SECTION 902 INDIRECT FOREIGN TAX CREDITS.—Subpart A of part III of subchapter N of chapter 1 is amended by striking section 902.

(b) DETERMINATION OF SECTION 960 CREDIT ON CURRENT YEAR BASIS.—Section 960, as amended by section 14201, is amended—

- (1) by striking subsection (c), by redesignating subsection (b) as subsection (c), by striking all that precedes subsection (c) (as so redesignated) and inserting the following:

“SEC. 960. DEEMED PAID CREDIT FOR SUBPART F INCLUSIONS.

“(a) IN GENERAL.—For purposes of subpart A of this part, if there is included in the gross income of a domestic corporation any item of income under section 951(a)(1) with respect to any controlled foreign corporation with respect to which such domestic corporation is a United States shareholder, such domestic corporation shall be deemed to have paid so much of such foreign corporation's foreign income taxes as are properly attributable to such item of income.

“(b) SPECIAL RULES FOR DISTRIBUTIONS FROM PREVIOUSLY TAXED EARNINGS AND PROFITS.—For purposes of subpart A of this part—

- “(1) IN GENERAL.—If any portion of a distribution from a controlled foreign corporation to a domestic corporation which is a United States shareholder with respect to such controlled foreign corporation is excluded from gross income under section 959(a), such domestic corporation shall be deemed to have paid so much of such foreign corporation's foreign income taxes as—

“(A) are properly attributable to such portion, and

“(B) have not been deemed to have to been paid by such domestic corporation under this section for the taxable year or any prior taxable year.

- “(2) TIERED CONTROLLED FOREIGN CORPORATIONS.—If section 959(b) applies to any portion of a distribution from a controlled foreign corporation to another controlled foreign corporation, such controlled foreign corporation shall be deemed to have paid so much of such other controlled foreign corporation's foreign income taxes as—

“(A) are properly attributable to such portion, and

“(B) have not been deemed to have been paid by a domestic corporation under this section for the taxable year or any prior taxable year.”

(2) and by adding after subsection (d) (as added by section 14201) the following new subsections:

“(e) FOREIGN INCOME TAXES.—The term ‘foreign income taxes’ means any income, war profits, or excess profits taxes paid or accrued to any foreign country or possession of the United States.

“(f) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section.”

(c) CONFORMING AMENDMENTS.—

(1) Section 78 is amended to read as follows:

“SEC. 78. GROSS UP FOR DEEMED PAID FOREIGN TAX CREDIT.

“If a domestic corporation chooses to have the benefits of subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year, an amount equal to the taxes deemed to be paid by such corporation under subsections (a), (b), and (d) of section 960 (determined without regard to the phrase ‘80 percent of’ in subsection (d)(1) thereof) for such taxable year shall be treated for purposes of this title (other than sections 245 and 245A) as a dividend received by such domestic corporation from the foreign corporation.”

(2) Paragraph (4) of section 245(a) is amended to read as follows:

“(4) POST-1986 UNDISTRIBUTED EARNINGS.—The term ‘post-1986 undistributed earnings’ means the amount of the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986) accumulated in taxable years beginning after December 31, 1986—

“(A) as of the close of the taxable year of the foreign corporation in which the dividend is distributed, and

“(B) without diminution by reason of dividends distributed during such taxable year.”

(3) Section 245(a)(10)(C) is amended by striking “902, 907, and 960” and inserting “907 and 960”.

(4) Sections 535(b)(1) and 545(b)(1) are each amended by striking “section 902(a) or 960(a)(1)” and inserting “section 960”.

(5) Section 814(f)(1) is amended—

(A) by striking subparagraph (B), and

(B) by striking all that precedes “No income” and inserting the following:

“(1) TREATMENT OF FOREIGN TAXES.—”

(6) Section 865(h)(1)(B) is amended by striking “902, 907,” and inserting “907”.

(7) Section 901(a) is amended by striking “sections 902 and 960” and inserting “section 960”.

(8) Section 901(e)(2) is amended by striking “but is not limited to—” and all that follows through “that portion” and inserting “but is not limited to that portion”.

(9) Section 901(f) is amended by striking “sections 902 and 960” and inserting “section 960”.

(10) Section 901(j)(1)(A) is amended by striking “902 or”.

(11) Section 901(j)(1)(B) is amended by striking “sections 902 and 960” and inserting “section 960”.

(12) Section 901(k)(2) is amended by striking “, 902,”.
(13) Section 901(k)(6) is amended by striking “902 or”.
(14) Section 901(m)(1)(B) is amended to read as follows:
“(B) in the case of a foreign income tax paid by a foreign corporation, shall not be taken into account for purposes of section 960.”

(15) Section 904(d)(2)(E) is amended—

(A) by amending clause (i) to read as follows:

“(i) NONCONTROLLED 10-PERCENT OWNED FOREIGN CORPORATION.—The term ‘noncontrolled 10-percent owned foreign corporation’ means any foreign corporation which is—

“(I) a specified 10-percent owned foreign corporation (as defined in section 245A(b)), or

“(II) a passive foreign investment company (as defined in section 1297(a)) with respect to which the taxpayer meets the stock ownership requirements of section 902(a) (or, for purposes of applying paragraphs (3) and (4), the requirements of section 902(b)).

A controlled foreign corporation shall not be treated as a noncontrolled 10-percent owned foreign corporation with respect to any distribution out of its earnings and profits for periods during which it was a controlled foreign corporation. Any reference to section 902 in this clause shall be treated as a reference to such section as in effect before its repeal.” and

(B) by striking “non-controlled section 902 corporation” in clause (ii) and inserting “noncontrolled 10-percent owned foreign corporation”.

(16) Section 904(d)(4) is amended—

(A) by striking “noncontrolled section 902 corporation” each place it appears and inserting “noncontrolled 10-percent owned foreign corporation”,

(B) by striking “NONCONTROLLED SECTION 902 CORPORATIONS” in the heading thereof and inserting “NONCONTROLLED 10-PERCENT OWNED FOREIGN CORPORATIONS”.

(17) Section 904(d)(6)(A) is amended by striking “902, 907,” and inserting “907”.

(18) Section 904(h)(10)(A) is amended by striking “sections 902, 907, and 960” and inserting “sections 907 and 960”.

(19) Section 904(k) is amended to read as follows:

“(k) CROSS REFERENCES.—For increase of limitation under subsection (a) for taxes paid with respect to amounts received which were included in the gross income of the taxpayer for a prior taxable year as a United States shareholder with respect to a controlled foreign corporation, see section 960(c).”

(20) Section 905(c)(1) is amended by striking the last sentence.

(21) Section 905(c)(2)(B)(i) is amended to read as follows:

“(i) shall be taken into account for the taxable year to which such taxes relate, and”.

(22) Section 906(a) is amended by striking “(or deemed, under section 902, paid or accrued during the taxable year)”.

(23) Section 906(b) is amended by striking paragraphs (4) and (5).

(24) Section 907(b)(2)(B) is amended by striking “902 or”.

- (25) Section 907(c)(3)(A) is amended—
(A) by striking subparagraph (A) and inserting the following:
“(A) interest, to the extent the category of income of such interest is determined under section 904(d)(3),” and
(B) by striking “section 960(a)” in subparagraph (B) and inserting “section 960”.
- (26) Section 907(c)(5) is amended by striking “902 or”.
- (27) Section 907(f)(2)(B)(i) is amended by striking “902 or”.
- (28) Section 908(a) is amended by striking “902 or”.
- (29) Section 909(b) is amended—
(A) by striking “section 902 corporation” in the matter preceding paragraph (1) and inserting “specified 10-percent owned foreign corporation (as defined in section 245A(b) without regard to paragraph (2) thereof)”,
(B) by striking “902 or” in paragraph (1),
(C) by striking “by such section 902 corporation” and all that follows in the matter following paragraph (2) and inserting “by such specified 10-percent owned foreign corporation or a domestic corporation which is a United States shareholder with respect to such specified 10-percent owned foreign corporation.”, and
(D) by striking “SECTION 902 CORPORATIONS” in the heading thereof and inserting “SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS”.
- (30) Section 909(d) is amended by striking paragraph (5).
- (31) Section 958(a)(1) is amended by striking “960(a)(1)” and inserting “960”.
- (32) Section 959(d) is amended by striking “Except as provided in section 960(a)(3), any” and inserting “Any”.
- (33) Section 959(e) is amended by striking “section 960(b)” and inserting “section 960(c)”.
- (34) Section 1291(g)(2)(A) is amended by striking “any distribution—” and all that follows through “but only if” and inserting “any distribution, any withholding tax imposed with respect to such distribution, but only if”.
- (35) Section 1293(f) is amended by striking “and” at the end of paragraph (1), by striking the period at the end of paragraph (2) and inserting “, and”, and by adding at the end the following new paragraph:
“(3) a domestic corporation which owns (or is treated under section 1298(a) as owning) stock of a qualified electing fund shall be treated in the same manner as a United States shareholder of a controlled foreign corporation (and such qualified electing fund shall be treated in the same manner as such controlled foreign corporation) if such domestic corporation meets the stock ownership requirements of subsection (a) or (b) of section 902 (as in effect before its repeal) with respect to such qualified electing fund.”
- (36) Section 6038(c)(1)(B) is amended by striking “sections 902 (relating to foreign tax credit for corporate stockholder in foreign corporation) and 960 (relating to special rules for foreign tax credit)” and inserting “section 960”.
- (37) Section 6038(c)(4) is amended by striking subparagraph (C).

(38) The table of sections for subpart A of part III of subchapter N of chapter 1 is amended by striking the item relating to section 902.

(39) The table of sections for subpart F of part III of subchapter N of chapter 1 is amended by striking the item relating to section 960 and inserting the following:

“Sec. 960. Deemed paid credit for subpart F inclusions.”.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SEC. 14302. SEPARATE FOREIGN TAX CREDIT LIMITATION BASKET FOR FOREIGN BRANCH INCOME.

(a) IN GENERAL.—Section 904(d)(1), as amended by section 14201, is amended by redesignating subparagraphs (B) and (C) as subparagraphs (C) and (D), respectively, and by inserting after subparagraph (A) the following new subparagraph:

“(B) foreign branch income.”.

(b) FOREIGN BRANCH INCOME.—

(1) IN GENERAL.—Section 904(d)(2) is amended by inserting after subparagraph (I) the following new subparagraph:

“(J) FOREIGN BRANCH INCOME.—

“(i) IN GENERAL.—The term ‘foreign branch income’ means the business profits of such United States person which are attributable to 1 or more qualified business units (as defined in section 989(a)) in 1 or more foreign countries. For purposes of the preceding sentence, the amount of business profits attributable to a qualified business unit shall be determined under rules established by the Secretary.

“(ii) EXCEPTION.—Such term shall not include any income which is passive category income.”.

(2) CONFORMING AMENDMENT.—Section 904(d)(2)(A)(ii), as amended by section 14201, is amended by striking “income described in paragraph (1)(A) and” and inserting “income described in paragraph (1)(A), foreign branch income, and”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 14303. SOURCE OF INCOME FROM SALES OF INVENTORY DETERMINED SOLELY ON BASIS OF PRODUCTION ACTIVITIES.

(a) IN GENERAL.—Section 863(b) is amended by adding at the end the following: “Gains, profits, and income from the sale or exchange of inventory property described in paragraph (2) shall be allocated and apportioned between sources within and without the United States solely on the basis of the production activities with respect to the property.”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 14304. ELECTION TO INCREASE PERCENTAGE OF DOMESTIC TAXABLE INCOME OFFSET BY OVERALL DOMESTIC LOSS TREATED AS FOREIGN SOURCE.

(a) IN GENERAL.—Section 904(g) is amended by adding at the end the following new paragraph:

“(5) ELECTION TO INCREASE PERCENTAGE OF TAXABLE INCOME TREATED AS FOREIGN SOURCE.—

“(A) IN GENERAL.—If any pre-2018 unused overall domestic loss is taken into account under paragraph (1) for any applicable taxable year, the taxpayer may elect to have such paragraph applied to such loss by substituting a percentage greater than 50 percent (but not greater than 100 percent) for 50 percent in subparagraph (B) thereof.

“(B) PRE-2018 UNUSED OVERALL DOMESTIC LOSS.—For purposes of this paragraph, the term ‘pre-2018 unused overall domestic loss’ means any overall domestic loss which—

“(i) arises in a qualified taxable year beginning before January 1, 2018, and

“(ii) has not been used under paragraph (1) for any taxable year beginning before such date.

“(C) APPLICABLE TAXABLE YEAR.—For purposes of this paragraph, the term ‘applicable taxable year’ means any taxable year of the taxpayer beginning after December 31, 2017, and before January 1, 2028.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

PART II—INBOUND TRANSACTIONS

SEC. 14401. BASE EROSION AND ANTI-ABUSE TAX.

(a) IMPOSITION OF TAX.—Subchapter A of chapter 1 is amended by adding at the end the following new part:

“PART VII—BASE EROSION AND ANTI-ABUSE TAX

“Sec. 59A. Tax on base erosion payments of taxpayers with substantial gross receipts.

“SEC. 59A. TAX ON BASE EROSION PAYMENTS OF TAXPAYERS WITH SUBSTANTIAL GROSS RECEIPTS.

“(a) IMPOSITION OF TAX.—There is hereby imposed on each applicable taxpayer for any taxable year a tax equal to the base erosion minimum tax amount for the taxable year. Such tax shall be in addition to any other tax imposed by this subtitle.

“(b) BASE EROSION MINIMUM TAX AMOUNT.—For purposes of this section—

“(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the term ‘base erosion minimum tax amount’ means, with respect to any applicable taxpayer for any taxable year, the excess (if any) of—

“(A) an amount equal to 10 percent (5 percent in the case of taxable years beginning in calendar year 2018) of the modified taxable income of such taxpayer for the taxable year, over

“(B) an amount equal to the regular tax liability (as defined in section 26(b)) of the taxpayer for the taxable year, reduced (but not below zero) by the excess (if any) of—

“(i) the credits allowed under this chapter against such regular tax liability, over

“(ii) the sum of—

“(I) the credit allowed under section 38 for the taxable year which is properly allocable to the research credit determined under section 41(a), plus

“(II) the portion of the applicable section 38 credits not in excess of 80 percent of the lesser of the amount of such credits or the base erosion minimum tax amount (determined without regard to this subclause).

“(2) MODIFICATIONS FOR TAXABLE YEARS BEGINNING AFTER 2025.—In the case of any taxable year beginning after December 31, 2025, paragraph (1) shall be applied—

“(A) by substituting ‘12.5 percent’ for ‘10 percent’ in subparagraph (A) thereof, and

“(B) by reducing (but not below zero) the regular tax liability (as defined in section 26(b)) for purposes of subparagraph (B) thereof by the aggregate amount of the credits allowed under this chapter against such regular tax liability rather than the excess described in such subparagraph.

“(3) INCREASED RATE FOR CERTAIN BANKS AND SECURITIES DEALERS.—

“(A) IN GENERAL.—In the case of a taxpayer described in subparagraph (B) who is an applicable taxpayer for any taxable year, the percentage otherwise in effect under paragraphs (1)(A) and (2)(A) shall each be increased by one percentage point.

“(B) TAXPAYER DESCRIBED.—A taxpayer is described in this subparagraph if such taxpayer is a member of an affiliated group (as defined in section 1504(a)(1)) which includes—

“(i) a bank (as defined in section 581), or

“(ii) a registered securities dealer under section 15(a) of the Securities Exchange Act of 1934.

“(4) APPLICABLE SECTION 38 CREDITS.—For purposes of paragraph (1)(B)(ii)(II), the term ‘applicable section 38 credits’ means the credit allowed under section 38 for the taxable year which is properly allocable to—

“(A) the low-income housing credit determined under section 42(a),

“(B) the renewable electricity production credit determined under section 45(a), and

“(C) the investment credit determined under section 46, but only to the extent properly allocable to the energy credit determined under section 48.

“(c) MODIFIED TAXABLE INCOME.—For purposes of this section—

“(1) IN GENERAL.—The term ‘modified taxable income’ means the taxable income of the taxpayer computed under this chapter for the taxable year, determined without regard to—

“(A) any base erosion tax benefit with respect to any base erosion payment, or

“(B) the base erosion percentage of any net operating loss deduction allowed under section 172 for the taxable year.

“(2) BASE EROSION TAX BENEFIT.—

“(A) IN GENERAL.—The term ‘base erosion tax benefit’ means—

“(i) any deduction described in subsection (d)(1) which is allowed under this chapter for the taxable year with respect to any base erosion payment,

“(ii) in the case of a base erosion payment described in subsection (d)(2), any deduction allowed under this chapter for the taxable year for depreciation (or amortization in lieu of depreciation) with respect to the property acquired with such payment,

“(iii) in the case of a base erosion payment described in subsection (d)(3)—

“(I) any reduction under section 803(a)(1)(B) in the gross amount of premiums and other consideration on insurance and annuity contracts for premiums and other consideration arising out of indemnity insurance, and

“(II) any deduction under section 832(b)(4)(A) from the amount of gross premiums written on insurance contracts during the taxable year for premiums paid for reinsurance, and

“(iv) in the case of a base erosion payment described in subsection (d)(4), any reduction in gross receipts with respect to such payment in computing gross income of the taxpayer for the taxable year for purposes of this chapter.

“(B) TAX BENEFITS DISREGARDED IF TAX WITHHELD ON BASE EROSION PAYMENT.—

“(i) IN GENERAL.—Except as provided in clause (ii), any base erosion tax benefit attributable to any base erosion payment—

“(I) on which tax is imposed by section 871 or 881, and

“(II) with respect to which tax has been deducted and withheld under section 1441 or 1442, shall not be taken into account in computing modified taxable income under paragraph (1)(A) or the base erosion percentage under paragraph (4).

“(ii) EXCEPTION.—The amount not taken into account in computing modified taxable income by reason of clause (i) shall be reduced under rules similar to the rules under section 163(j)(5)(B) (as in effect before the date of the enactment of the Tax Cuts and Jobs Act).

“(3) SPECIAL RULES FOR DETERMINING INTEREST FOR WHICH DEDUCTION ALLOWED.—For purposes of applying paragraph (1), in the case of a taxpayer to which section 163(j) applies for the taxable year, the reduction in the amount of interest for which a deduction is allowed by reason of such subsection shall be treated as allocable first to interest paid or accrued to persons who are not related parties with respect to the taxpayer and then to such related parties.

“(4) BASE EROSION PERCENTAGE.—For purposes of paragraph (1)(B)—

“(A) IN GENERAL.—The term ‘base erosion percentage’ means, for any taxable year, the percentage determined by dividing—

“(i) the aggregate amount of base erosion tax benefits of the taxpayer for the taxable year, by

“(ii) the sum of—

“(I) the aggregate amount of the deductions (including deductions described in clauses (i) and (ii) of paragraph (2)(A)) allowable to the taxpayer under this chapter for the taxable year, plus

“(II) the base erosion tax benefits described in clauses (iii) and (iv) of paragraph (2)(A) allowable to the taxpayer for the taxable year.

“(B) CERTAIN ITEMS NOT TAKEN INTO ACCOUNT.—The amount under subparagraph (A)(ii) shall be determined by not taking into account—

“(i) any deduction allowed under section 172, 245A, or 250 for the taxable year,

“(ii) any deduction for amounts paid or accrued for services to which the exception under subsection (d)(5) applies, and

“(iii) any deduction for qualified derivative payments which are not treated as a base erosion payment by reason of subsection (h).

“(d) BASE EROSION PAYMENT.—For purposes of this section—

“(1) IN GENERAL.—The term ‘base erosion payment’ means any amount paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer and with respect to which a deduction is allowable under this chapter.

“(2) PURCHASE OF DEPRECIABLE PROPERTY.—Such term shall also include any amount paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer in connection with the acquisition by the taxpayer from such person of property of a character subject to the allowance for depreciation (or amortization in lieu of depreciation).

“(3) REINSURANCE PAYMENTS.—Such term shall also include any premium or other consideration paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer for any reinsurance payments which are taken into account under sections 803(a)(1)(B) or 832(b)(4)(A).

“(4) CERTAIN PAYMENTS TO EXPATRIATED ENTITIES.—

“(A) IN GENERAL.—Such term shall also include any amount paid or accrued by the taxpayer with respect to a person described in subparagraph (B) which results in a reduction of the gross receipts of the taxpayer.

“(B) PERSON DESCRIBED.—A person is described in this subparagraph if such person is a—

“(i) surrogate foreign corporation which is a related party of the taxpayer, but only if such person first became a surrogate foreign corporation after November 9, 2017, or

“(ii) foreign person which is a member of the same expanded affiliated group as the surrogate foreign corporation.

“(C) DEFINITIONS.—For purposes of this paragraph—

“(i) SURROGATE FOREIGN CORPORATION.—The term ‘surrogate foreign corporation’ has the meaning given such term by section 7874(a)(2)(B) but does not include a foreign corporation treated as a domestic corporation under section 7874(b).

“(ii) EXPANDED AFFILIATED GROUP.—The term ‘expanded affiliated group’ has the meaning given such term by section 7874(c)(1).

“(5) EXCEPTION FOR CERTAIN AMOUNTS WITH RESPECT TO SERVICES.—Paragraph (1) shall not apply to any amount paid or accrued by a taxpayer for services if—

“(A) such services are services which meet the requirements for eligibility for use of the services cost method under section 482 (determined without regard to the requirement that the services not contribute significantly to fundamental risks of business success or failure), and

“(B) such amount constitutes the total services cost with no markup component.

“(e) APPLICABLE TAXPAYER.—For purposes of this section—

“(1) IN GENERAL.—The term ‘applicable taxpayer’ means, with respect to any taxable year, a taxpayer—

“(A) which is a corporation other than a regulated investment company, a real estate investment trust, or an S corporation,

“(B) the average annual gross receipts of which for the 3-taxable-year period ending with the preceding taxable year are at least \$500,000,000, and

“(C) the base erosion percentage (as determined under subsection (c)(4)) of which for the taxable year is 3 percent (2 percent in the case of a taxpayer described in subsection (b)(3)(B)) or higher.

“(2) GROSS RECEIPTS.—

“(A) SPECIAL RULE FOR FOREIGN PERSONS.—In the case of a foreign person the gross receipts of which are taken into account for purposes of paragraph (1)(B), only gross receipts which are taken into account in determining income which is effectively connected with the conduct of a trade or business within the United States shall be taken into account. In the case of a taxpayer which is a foreign person, the preceding sentence shall not apply to the gross receipts of any United States person which are aggregated with the taxpayer’s gross receipts by reason of paragraph (3).

“(B) OTHER RULES MADE APPLICABLE.—Rules similar to the rules of subparagraphs (B), (C), and (D) of section 448(c)(3) shall apply in determining gross receipts for purposes of this section.

“(3) AGGREGATION RULES.—All persons treated as a single employer under subsection (a) of section 52 shall be treated as 1 person for purposes of this subsection and subsection (c)(4), except that in applying section 1563 for purposes of section 52, the exception for foreign corporations under section 1563(b)(2)(C) shall be disregarded.

“(f) FOREIGN PERSON.—For purposes of this section, the term ‘foreign person’ has the meaning given such term by section 6038A(c)(3).

“(g) RELATED PARTY.—For purposes of this section—

“(1) IN GENERAL.—The term ‘related party’ means, with respect to any applicable taxpayer—

“(A) any 25-percent owner of the taxpayer,

“(B) any person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer or any 25-percent owner of the taxpayer, and

“(C) any other person who is related (within the meaning of section 482) to the taxpayer.

“(2) 25-PERCENT OWNER.—The term ‘25-percent owner’ means, with respect to any corporation, any person who owns at least 25 percent of—

“(A) the total voting power of all classes of stock of a corporation entitled to vote, or

“(B) the total value of all classes of stock of such corporation.

“(3) SECTION 318 TO APPLY.—Section 318 shall apply for purposes of paragraphs (1) and (2), except that—

“(A) ‘10 percent’ shall be substituted for ‘50 percent’ in section 318(a)(2)(C), and

“(B) subparagraphs (A), (B), and (C) of section 318(a)(3) shall not be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person.

“(h) EXCEPTION FOR CERTAIN PAYMENTS MADE IN THE ORDINARY COURSE OF TRADE OR BUSINESS.—For purposes of this section—

“(1) IN GENERAL.—Except as provided in paragraph (3), any qualified derivative payment shall not be treated as a base erosion payment.

“(2) QUALIFIED DERIVATIVE PAYMENT.—

“(A) IN GENERAL.—The term ‘qualified derivative payment’ means any payment made by a taxpayer pursuant to a derivative with respect to which the taxpayer—

“(i) recognizes gain or loss as if such derivative were sold for its fair market value on the last business day of the taxable year (and such additional times as required by this title or the taxpayer’s method of accounting),

“(ii) treats any gain or loss so recognized as ordinary, and

“(iii) treats the character of all items of income, deduction, gain, or loss with respect to a payment pursuant to the derivative as ordinary.

“(B) REPORTING REQUIREMENT.—No payments shall be treated as qualified derivative payments under subparagraph (A) for any taxable year unless the taxpayer includes in the information required to be reported under section 6038B(b)(2) with respect to such taxable year such information as is necessary to identify the payments to be so treated and such other information as the Secretary determines necessary to carry out the provisions of this subsection.

“(3) EXCEPTIONS FOR PAYMENTS OTHERWISE TREATED AS BASE EROSION PAYMENTS.—This subsection shall not apply to any qualified derivative payment if—

“(A) the payment would be treated as a base erosion payment if it were not made pursuant to a derivative, including any interest, royalty, or service payment, or

“(B) in the case of a contract which has derivative and nonderivative components, the payment is properly allocable to the nonderivative component.

“(4) DERIVATIVE DEFINED.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘derivative’ means any contract (including any option, forward contract, futures contract, short position, swap, or similar contract) the value of which, or any payment or other transfer with respect to which, is (directly or indirectly) determined by reference to one or more of the following:

“(i) Any share of stock in a corporation.

“(ii) Any evidence of indebtedness.

“(iii) Any commodity which is actively traded.

“(iv) Any currency.

“(v) Any rate, price, amount, index, formula, or algorithm.

Such term shall not include any item described in clauses (i) through (v).

“(B) TREATMENT OF AMERICAN DEPOSITORY RECEIPTS AND SIMILAR INSTRUMENTS.—Except as otherwise provided by the Secretary, for purposes of this part, American depository receipts (and similar instruments) with respect to shares of stock in foreign corporations shall be treated as shares of stock in such foreign corporations.

“(C) EXCEPTION FOR CERTAIN CONTRACTS.—Such term shall not include any insurance, annuity, or endowment contract issued by an insurance company to which subchapter L applies (or issued by any foreign corporation to which such subchapter would apply if such foreign corporation were a domestic corporation).

“(i) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section, including regulations—

“(1) providing for such adjustments to the application of this section as are necessary to prevent the avoidance of the purposes of this section, including through—

“(A) the use of unrelated persons, conduit transactions, or other intermediaries, or

“(B) transactions or arrangements designed, in whole or in part—

“(i) to characterize payments otherwise subject to this section as payments not subject to this section, or

“(ii) to substitute payments not subject to this section for payments otherwise subject to this section and

“(2) for the application of subsection (g), including rules to prevent the avoidance of the exceptions under subsection (g)(3).”

(b) REPORTING REQUIREMENTS AND PENALTIES.—

(1) IN GENERAL.—Subsection (b) of section 6038A is amended to read as follows:

“(b) REQUIRED INFORMATION.—

“(1) IN GENERAL.—For purposes of subsection (a), the information described in this subsection is such information as the Secretary prescribes by regulations relating to—

“(A) the name, principal place of business, nature of business, and country or countries in which organized or resident, of each person which—

“(i) is a related party to the reporting corporation,
and

“(ii) had any transaction with the reporting corporation during its taxable year,

“(B) the manner in which the reporting corporation is related to each person referred to in subparagraph (A),
and

“(C) transactions between the reporting corporation and each foreign person which is a related party to the reporting corporation.

“(2) ADDITIONAL INFORMATION REGARDING BASE EROSION PAYMENTS.—For purposes of subsection (a) and section 6038C, if the reporting corporation or the foreign corporation to whom section 6038C applies is an applicable taxpayer, the information described in this subsection shall include—

“(A) such information as the Secretary determines necessary to determine the base erosion minimum tax amount, base erosion payments, and base erosion tax benefits of the taxpayer for purposes of section 59A for the taxable year, and

“(B) such other information as the Secretary determines necessary to carry out such section.

For purposes of this paragraph, any term used in this paragraph which is also used in section 59A shall have the same meaning as when used in such section.”

(2) INCREASE IN PENALTY.—Paragraphs (1) and (2) of section 6038A(d) are each amended by striking “\$10,000” and inserting “\$25,000”.

(c) DISALLOWANCE OF CREDITS AGAINST BASE EROSION TAX.—Paragraph (2) of section 26(b) is amended by inserting after subparagraph (A) the following new subparagraph:

“(B) section 59A (relating to base erosion and anti-abuse tax).”

(d) CONFORMING AMENDMENTS.—

(1) The table of parts for subchapter A of chapter 1 is amended by adding after the item relating to part VI the following new item:

“PART VII. BASE EROSION AND ANTI-ABUSE TAX”.

(2) Paragraph (1) of section 882(a), as amended by this Act, is amended by inserting “or 59A,” after “section 11.”

(3) Subparagraph (A) of section 6425(c)(1), as amended by section 13001, is amended to read as follows:

“(A) the sum of—

“(i) the tax imposed by section 11, or subchapter L of chapter 1, whichever is applicable, plus

“(ii) the tax imposed by section 59A, over”.

(4)(A) Subparagraph (A) of section 6655(g)(1), as amended by sections 12001 and 13001, is amended by striking “plus” at the end of clause (i), by redesignating clause (ii) as clause (iii), and by inserting after clause (i) the following new clause:

“(ii) the tax imposed by section 59A, plus”.

(B) Subparagraphs (A)(i) and (B)(i) of section 6655(e)(2), as amended by sections 12001 and 13001, are each amended by inserting “and modified taxable income” after “taxable income”.

(C) Subparagraph (B) of section 6655(e)(2) is amended by adding at the end the following new clause:

“(iii) MODIFIED TAXABLE INCOME.—The term ‘modified taxable income’ has the meaning given such term by section 59A(c)(1).”

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to base erosion payments (as defined in section 59A(d) of the Internal Revenue Code of 1986, as added by this section) paid or accrued in taxable years beginning after December 31, 2017.

PART III—OTHER PROVISIONS

SEC. 14501. RESTRICTION ON INSURANCE BUSINESS EXCEPTION TO PASSIVE FOREIGN INVESTMENT COMPANY RULES.

(a) IN GENERAL.—Section 1297(b)(2)(B) is amended to read as follows:

“(B) derived in the active conduct of an insurance business by a qualifying insurance corporation (as defined in subsection (f)),”

(b) QUALIFYING INSURANCE CORPORATION DEFINED.—Section 1297 is amended by adding at the end the following new subsection:

“(f) QUALIFYING INSURANCE CORPORATION.—For purposes of subsection (b)(2)(B)—

“(1) IN GENERAL.—The term ‘qualifying insurance corporation’ means, with respect to any taxable year, a foreign corporation—

“(A) which would be subject to tax under subchapter L if such corporation were a domestic corporation, and

“(B) the applicable insurance liabilities of which constitute more than 25 percent of its total assets, determined on the basis of such liabilities and assets as reported on the corporation’s applicable financial statement for the last year ending with or within the taxable year.

“(2) ALTERNATIVE FACTS AND CIRCUMSTANCES TEST FOR CERTAIN CORPORATIONS.—If a corporation fails to qualify as a qualified insurance corporation under paragraph (1) solely because the percentage determined under paragraph (1)(B) is 25 percent or less, a United States person that owns stock in such corporation may elect to treat such stock as stock of a qualifying insurance corporation if—

“(A) the percentage so determined for the corporation is at least 10 percent, and

“(B) under regulations provided by the Secretary, based on the applicable facts and circumstances—

“(i) the corporation is predominantly engaged in an insurance business, and

“(ii) such failure is due solely to runoff-related or rating-related circumstances involving such insurance business.

“(3) APPLICABLE INSURANCE LIABILITIES.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘applicable insurance liabilities’ means, with respect to any life or property and casualty insurance business—

“(i) loss and loss adjustment expenses, and

“(ii) reserves (other than deficiency, contingency, or unearned premium reserves) for life and health insurance risks and life and health insurance claims with respect to contracts providing coverage for mortality or morbidity risks.

“(B) LIMITATIONS ON AMOUNT OF LIABILITIES.—Any amount determined under clause (i) or (ii) of subparagraph (A) shall not exceed the lesser of such amount—

“(i) as reported to the applicable insurance regulatory body in the applicable financial statement described in paragraph (4)(A) (or, if less, the amount required by applicable law or regulation), or

“(ii) as determined under regulations prescribed by the Secretary.

“(4) OTHER DEFINITIONS AND RULES.—For purposes of this subsection—

“(A) APPLICABLE FINANCIAL STATEMENT.—The term ‘applicable financial statement’ means a statement for financial reporting purposes which—

“(i) is made on the basis of generally accepted accounting principles,

“(ii) is made on the basis of international financial reporting standards, but only if there is no statement that meets the requirement of clause (i), or

“(iii) except as otherwise provided by the Secretary in regulations, is the annual statement which is required to be filed with the applicable insurance regulatory body, but only if there is no statement which meets the requirements of clause (i) or (ii).

“(B) APPLICABLE INSURANCE REGULATORY BODY.—The term ‘applicable insurance regulatory body’ means, with respect to any insurance business, the entity established by law to license, authorize, or regulate such business and to which the statement described in subparagraph (A) is provided.”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 14502. REPEAL OF FAIR MARKET VALUE METHOD OF INTEREST EXPENSE APPORTIONMENT.

(a) IN GENERAL.—Paragraph (2) of section 864(e) is amended to read as follows:

“(2) GROSS INCOME AND FAIR MARKET VALUE METHODS MAY NOT BE USED FOR INTEREST.—All allocations and apportionments of interest expense shall be determined using the adjusted bases of assets rather than on the basis of the fair market value of the assets or gross income.”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

TITLE II

SEC. 20001. OIL AND GAS PROGRAM.

(a) DEFINITIONS.—In this section:

(1) COASTAL PLAIN.—The term “Coastal Plain” means the area identified as the 1002 Area on the plates prepared by

the United States Geological Survey entitled "ANWR Map - Plate 1" and "ANWR Map - Plate 2", dated October 24, 2017, and on file with the United States Geological Survey and the Office of the Solicitor of the Department of the Interior.

(2) SECRETARY.—The term "Secretary" means the Secretary of the Interior, acting through the Bureau of Land Management.

(b) OIL AND GAS PROGRAM.—

(1) IN GENERAL.—Section 1003 of the Alaska National Interest Lands Conservation Act (16 U.S.C. 3143) shall not apply to the Coastal Plain.

(2) ESTABLISHMENT.—

(A) IN GENERAL.—The Secretary shall establish and administer a competitive oil and gas program for the leasing, development, production, and transportation of oil and gas in and from the Coastal Plain.

(B) PURPOSES.—Section 303(2)(B) of the Alaska National Interest Lands Conservation Act (Public Law 96-487; 94 Stat. 2390) is amended—

(i) in clause (iii), by striking "and" at the end;

(ii) in clause (iv), by striking the period at the end and inserting "; and"; and

(iii) by adding at the end the following:

"(v) to provide for an oil and gas program on the Coastal Plain."

(3) MANAGEMENT.—Except as otherwise provided in this section, the Secretary shall manage the oil and gas program on the Coastal Plain in a manner similar to the administration of lease sales under the Naval Petroleum Reserves Production Act of 1976 (42 U.S.C. 6501 et seq.) (including regulations).

(4) ROYALTIES.—Notwithstanding the Mineral Leasing Act (30 U.S.C. 181 et seq.), the royalty rate for leases issued pursuant to this section shall be 16.67 percent.

(5) RECEIPTS.—Notwithstanding the Mineral Leasing Act (30 U.S.C. 181 et seq.), of the amount of adjusted bonus, rental, and royalty receipts derived from the oil and gas program and operations on Federal land authorized under this section—

(A) 50 percent shall be paid to the State of Alaska;

and

(B) the balance shall be deposited into the Treasury as miscellaneous receipts.

(c) 2 LEASE SALES WITHIN 10 YEARS.—

(1) REQUIREMENT.—

(A) IN GENERAL.—Subject to subparagraph (B), the Secretary shall conduct not fewer than 2 lease sales area-wide under the oil and gas program under this section by not later than 10 years after the date of enactment of this Act.

(B) SALE ACREAGES; SCHEDULE.—

(i) ACREAGES.—The Secretary shall offer for lease under the oil and gas program under this section—

(I) not fewer than 400,000 acres area-wide in each lease sale; and

(II) those areas that have the highest potential for the discovery of hydrocarbons.

(ii) SCHEDULE.—The Secretary shall offer—

(I) the initial lease sale under the oil and gas program under this section not later than 4 years after the date of enactment of this Act; and

(II) a second lease sale under the oil and gas program under this section not later than 7 years after the date of enactment of this Act.

(2) RIGHTS-OF-WAY.—The Secretary shall issue any rights-of-way or easements across the Coastal Plain for the exploration, development, production, or transportation necessary to carry out this section.

(3) SURFACE DEVELOPMENT.—In administering this section, the Secretary shall authorize up to 2,000 surface acres of Federal land on the Coastal Plain to be covered by production and support facilities (including airstrips and any area covered by gravel berms or piers for support of pipelines) during the term of the leases under the oil and gas program under this section.

SEC. 20002. LIMITATIONS ON AMOUNT OF DISTRIBUTED QUALIFIED OUTER CONTINENTAL SHELF REVENUES.

Section 105(f)(1) of the Gulf of Mexico Energy Security Act of 2006 (43 U.S.C. 1331 note; Public Law 109-432) is amended by striking “exceed \$500,000,000 for each of fiscal years 2016 through 2055.” and inserting the following: “exceed—

“(A) \$500,000,000 for each of fiscal years 2016 through 2019;

“(B) \$650,000,000 for each of fiscal years 2020 and 2021; and

“(C) \$500,000,000 for each of fiscal years 2022 through 2055.”.

SEC. 20003. STRATEGIC PETROLEUM RESERVE DRAWDOWN AND SALE.

(a) DRAWDOWN AND SALE.—

(1) IN GENERAL.—Notwithstanding section 161 of the Energy Policy and Conservation Act (42 U.S.C. 6241), except as provided in subsections (b) and (c), the Secretary of Energy shall draw down and sell from the Strategic Petroleum Reserve 7,000,000 barrels of crude oil during the period of fiscal years 2026 through 2027.

(2) DEPOSIT OF AMOUNTS RECEIVED FROM SALE.—Amounts received from a sale under paragraph (1) shall be deposited in the general fund of the Treasury during the fiscal year in which the sale occurs.

(b) EMERGENCY PROTECTION.—The Secretary of Energy shall not draw down and sell crude oil under subsection (a) in a quantity that would limit the authority to sell petroleum products under subsection (h) of section 161 of the Energy Policy and Conservation Act (42 U.S.C. 6241) in the full quantity authorized by that subsection.

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(c) LIMITATION.—The Secretary of Energy shall not drawdown or conduct sales of crude oil under subsection (a) after the date on which a total of \$600,000,000 has been deposited in the general fund of the Treasury from sales authorized under that subsection.

Speaker of the House of Representatives.

*Vice President of the United States and
President of the Senate.*

Atmos Energy Corporation, Kentucky/Mid-States Division
 Kentucky Jurisdiction Case No. 2017-00349
 Computation of State & Federal Income Tax
 Base Period: Twelve Months Ended December 31, 2017
 Forecasted Test Period: Twelve Months Ended March 31, 2019

Type of Filing: Original Updated Revised
 FR 16(8)(e)
 Schedule E (Modified)
 Workpaper Reference No(s): _____
 Witness: Waller

| Line No. | Description | Base Period Unadjusted (1) | Adjustments (2) | Test Period Fully Adjusted (3) | Sched. Ref. |
|--|---|----------------------------|---------------------|--------------------------------|-------------|
| 1 | Operating Income before Income Tax & Interest | \$ 40,525,231 | \$ (2,747,478) | \$ 37,777,753 | C-2 |
| 2 | Proposed Increase (C.1, Line 10 + Line 8) | | 3,212,681 | 3,212,681 | C.1 |
| 3 | Interest Deduction | 8,070,215 | 1,784,399 | 9,854,614 | * |
| 4 | Taxable Income | \$ 32,455,016 | \$ (1,319,196) | \$ 31,135,820 | |
| 5 | Composite Tax Rate (state & federal) | 25.740% | | 25.740% | ** |
| 6 | State & Federal Income Tax | \$ 8,353,921 | \$ (339,561) | \$ 8,014,360 | (1) |
| <u>* Interest Expense Calculation:</u> | | | | | |
| 7 | 13 Month Average Rate Base | \$ 358,900,188 | | \$ 427,151,221 | B-1 |
| 8 | Weighted cost of Debt | 2.25% | | 2.31% | J-1 |
| 9 | Interest Expense | <u>\$ 8,070,215</u> | | <u>\$ 9,854,614</u> | |
| 10 | <u>2018 ** Composite Tax Rate Calculation: 6.00% + 21%(100% - 6.00%) = 25.74%</u> | | | | |
| 11 | State Tax Rate | 6.00% | | | |
| 12 | Federal Tax Rate | 21.00% | | | |
| 13 | Change in ADIT, excluding forecasted change in NOLC | | Line 60; B.5 F | (1,282,986) | |
| 14 | Required Change in NOLC | | Line 39/61; B.5 F | (6,731,374) | |
| 15 | | | | | |
| 16 | Total Required Change in Accumulated Deferred Income Taxes¹ | | B.1 F; B.1 B | (8,014,360) | (1) |

(1) This illustration demonstrates that earnings times the statutory income tax rate results in the accrual of all current and deferred income taxes, including the NOLC.
 Story Rebuttal Testimony at Pg. 26, Lines 11-13.

Atmos Energy Corporation, Kentucky/Mid-States Division
 Kentucky Jurisdiction Case No. 2017-00349
 Deferred Credits and Accumulated Deferred Income Taxes
 as of March 31, 2019

Data: Base Period Forecasted Period
 Type of Filing: Original Updated
 Workpaper Reference No(s):

FR 16(8)(b)5
 Sch. B-5 F
 Witness: Waller

| Line No. | Account | Period End | Kentucky- Mid States Division Allocation | Kentucky Jurisdiction Allocation | Jurisdictional Period ending Balance | 13-Month Average | Kentucky- Mid States Division Allocation | Kentucky Jurisdiction Allocation | Allocated Amount |
|--------------------|--|------------------------|--|----------------------------------|--------------------------------------|------------------------|--|----------------------------------|----------------------------|
| DIVISION 09 | | | | | | | | | |
| 1 | Account 190 - Accumulated Deferred Income Taxes | \$ 10,404,258 | 100% | 100% | \$ 10,404,258 | \$ 10,404,258 | 100% | 100% | \$ 10,404,258 |
| 2 | | | | | | | | | |
| 3 | Account 282 - Accumulated Deferred Income Taxes | (69,070,982) | 100% | 100% | (69,070,982) | (68,034,398) | 100% | 100% | (68,034,398) |
| 4 | | | | | | | | | |
| 5 | Account 283 - Accumulated Deferred Income Taxes - Other | (58,142) | 100% | 100% | (58,142) | (58,142) | 100% | 100% | (58,142) |
| 6 | | | | | | | | | |
| 7 | Div 09 Accumulated Deferred Income Taxes | <u>\$ (58,724,866)</u> | | | <u>\$ (58,724,866)</u> | <u>\$ (57,688,282)</u> | | | <u>\$ (57,688,282)</u> |
| 8 | | | | | | | | | |
| 9 | DIVISION 02 | | | | | | | | |
| 10 | Account 190 - Accumulated Deferred Income Taxes | \$ 508,862,755 | 10.35% | 50.25% | \$ 26,466,032 | \$ 508,862,755 | 10.35% | 50.25% | \$ 26,466,032 |
| 11 | | | | | | | | | |
| 12 | Account 282 - Accumulated Deferred Income Taxes | (17,108,074) | 10.35% | 50.25% | (889,794) | (16,654,266) | 10.35% | 50.25% | (866,191) |
| 13 | | | | | | | | | |
| 14 | Account 283 - Accumulated Deferred Income Taxes - Other | 27,259,100 | 10.35% | 50.25% | 1,417,750 | 27,259,100 | 10.35% | 50.25% | 1,417,750 |
| 15 | | | | | | | | | |
| 16 | Div 02 Accumulated Deferred Income Taxes | <u>\$ 519,013,781</u> | | | <u>\$ 26,993,989</u> | <u>\$ 519,467,589</u> | | | <u>\$ 27,017,592</u> |
| 17 | | | | | | | | | |
| 18 | DIVISION 12 | | | | | | | | |
| 19 | Account 190 - Accumulated Deferred Income Taxes | \$ 6,868 | 10.93% | 51.88% | \$ 389 | \$ 6,868 | 10.93% | 51.88% | \$ 389 |
| 20 | | | | | | | | | |
| 21 | Account 282 - Accumulated Deferred Income Taxes | (14,896,582) | 10.93% | 51.88% | (844,771) | (15,622,978) | 10.93% | 51.88% | (885,964) |
| 22 | | | | | | | | | |
| 23 | Account 283 - Accumulated Deferred Income Taxes - Other | (298,010) | 10.93% | 51.88% | (16,900) | (298,010) | 10.93% | 51.88% | (16,900) |
| 24 | | | | | | | | | |
| 25 | Div 012 Accumulated Deferred Income Taxes | <u>\$ (15,187,724)</u> | | | <u>\$ (861,282)</u> | <u>\$ (15,914,120)</u> | | | <u>\$ (902,475)</u> |
| 26 | | | | | | | | | |
| 27 | DIVISION 91 | | | | | | | | |
| 28 | Account 190 - Accumulated Deferred Income Taxes | \$ 970,543 | 100% | 50.25% | \$ 487,711 | \$ 970,543 | 100% | 50.25% | \$ 487,711 |
| 29 | | | | | | | | | |
| 30 | Account 255 - Accumulated Deferred Investment Tax Credits | 0 | 100% | 50.25% | 0 | 0 | 100% | 50.25% | 0 |
| 31 | | | | | | | | | |
| 32 | Account 282 - Accumulated Deferred Income Taxes | (7,295,497) | 100% | 50.25% | (3,666,087) | (7,302,627) | 100% | 50.25% | (3,669,669) |
| 33 | | | | | | | | | |
| 34 | Account 283 - Accumulated Deferred Income Taxes - Other | (835,959) | 100% | 50.25% | (420,081) | (835,959) | 100% | 50.25% | (420,081) |
| 35 | | | | | | | | | |
| 36 | Div 91 Accumulated Deferred Income Taxes | <u>\$ (7,160,913)</u> | | | <u>\$ (3,598,456)</u> | <u>\$ (7,168,043)</u> | | | <u>\$ (3,602,039)</u> |
| 37 | | | | | | | | | |
| 38 | Total Deferred Inc. Taxes and Investment Tax Credits | <u>\$ 437,940,278</u> | | | <u>\$ (36,190,616)</u> | <u>\$ 438,697,144</u> | | | <u>\$ (35,175,205)</u> |
| 39 | <i>(excluding forecasted change in NOLC)</i> | | | | | | | | |
| 40 | Forecasted Change in NOLC | | | | | | | | <u>(6,731,374)</u> |
| 41 | | | | | | | | | |
| 42 | Forecasted 13-month Average ADIT in Rate Base | | | | | | | | <u>(41,906,579)</u> |
| 43 | Calculation of Change in NOLC | | | | | | | | |
| 44 | (from 13-month average Base Period to 13-month average Forecasted Period) | | | | | | | | |
| 45 | | | | | | | | | |
| 46 | Forecasted Test Period | | | | | | | | |
| 47 | | | | | | | | | |
| 48 | 13-month average Rate Base | | | | | 427,151,221 | | | |
| 49 | | | | | | | | | |
| 50 | Required Operating Income | | | | | 32,976,074 | | | |
| 51 | | | | | | | | | |
| 52 | Interest Deduction | | | | | 9,854,614 | | | |
| 53 | | | | | | | | | |

Atmos Energy Corporation, Kentucky/Mid-States Division
 Kentucky Jurisdiction Case No. 2017-00349
 Deferred Credits and Accumulated Deferred Income Taxes
 as of March 31, 2019

Data: Base Period Forecasted Period
 Type of Filing: Original Updated
 Workpaper Reference No(s):

FR 16(8)(b)5
 Sch. B-5 F
 Witness: Waller

| Line No. | Account | Period End | Kentucky- Mid States Division Allocation | Kentucky Jurisdiction Allocation | Jurisdictional Period ending Balance | 13-Month Average | Kentucky- Mid States Division Allocation | Kentucky Jurisdiction Allocation | Allocated Amount |
|----------|--|------------|--|----------------------------------|--------------------------------------|----------------------------|--|----------------------------------|------------------|
| 54 | Return on Equity Portion of Rate Base | | | line 50 - line 52 | | 23,121,460 | | | |
| 55 | | | | | | | | | |
| 56 | Return, grossed up for Income Tax | 25.74% | | Line 54 / (1-tax rate) | | 31,135,821 | | | |
| 57 | | | | | | | | | |
| 58 | Tax Expense on Return | 25.74% | | Line 56 x tax rate | | <u>8,014,360</u> | | | |
| 59 | | | | | | | | | |
| 60 | Change In ADIT, excluding forecasted change in NOLC | | | Line 37; B.5 B | | (1,282,986) | | | |
| 61 | Required Change in NOLC | | | | | <u>(6,731,374)</u> | | 0 | |
| 62 | | | | | | | | | |
| 63 | Total Required Change in Accumulated Deferred Income Taxes¹ | | | B.1 F; B.1 B | | <u>(8,014,360)</u> | | | |
| 64 | | | | | | | | | |
| 65 | | | | | | | | | |
| 66 | ADIT Reconciliation | | | | | | | | |
| 67 | Period End ADIT, Base Period | | | B.5 B | | (33,892,218) | | | |
| 68 | | | | | | | | | |
| 69 | 13-Month Average ADIT, Forecasted Period, excl. Change in NOLC | | | Line 37 | | (35,175,205) | | | |
| 70 | Change in NOLC | | | Line 39 | | <u>(6,731,374)</u> | | | |
| 71 | Forecasted 13-month Average ADIT in Rate Base | | | | | <u>(41,906,579)</u> | | | |
| 72 | | | | | | | | | |
| 73 | Total Required Change in Accumulated Deferred Income Taxes | | | Line 71 - Line 67 | | <u>(8,014,360)</u> | | | |
| 74 | | | | | | | | | |
| 75 | | | | | | | | | |
| 76 | ¹ Because the Company is in a NOLC position, the total change in ADIT must equal the tax expenses included in revenue requirement | | | | | | | | |

Atmos Energy Corporation, Kentucky/Mid-States Division
Kentucky Jurisdiction Case No. 2017-00349
Operating Income Summary
Forecasted Test Period: Twelve Months Ended March 31, 2019

Data: Base Period Forecasted Period
Type of Filing: Original Updated Revised
Workpaper Reference No(s): _____

FR 16(8)(c)1
Schedule C-1
Witness: Waller, Martin

| Line No. | Description | Base Return at Current Rates | Forecasted Return at Current Rates | Proposed Increase | Forecasted Return at Proposed Rates |
|----------|------------------------------|------------------------------|------------------------------------|---------------------|-------------------------------------|
| 1 | Operating Revenue | \$ 156,713,247 | \$ 170,729,276 | \$ 3,235,315 | \$ 173,964,591 |
| 2 | Operating Expenses | | | | |
| 3 | Purchased Gas Cost | 65,546,014 | 78,709,117 | | 78,709,117 |
| 4 | Other O & M Expenses | 26,961,891 | 26,164,029 | 16,177 | 26,180,206 |
| 5 | Depreciation Expense | 18,849,735 | 21,511,931 | | 21,511,931 |
| 6 | Taxes Other than Income | 4,830,375 | 6,566,445 | 6,458 | 6,572,903 |
| 7 | | | | | |
| 8 | State & Federal Income Taxes | 8,353,921 | 7,187,416 | 826,944 | 8,014,360 |
| 9 | Total Operating Expenses | <u>\$ 124,541,937</u> | <u>\$ 140,138,939</u> | <u>\$ 849,578</u> | <u>\$ 140,988,517</u> |
| 10 | Operating Income | <u>\$ 32,171,310</u> | <u>\$ 30,590,337</u> | <u>\$ 2,385,737</u> | <u>\$ 32,976,074</u> |
| 11 | Rate Base | 358,900,188 | 427,151,221 | | 427,151,221 |
| 12 | Rate of Return | 8.96% | 7.16% | | 7.72% |

*Honorable John N Hughes
Attorney at Law
124 West Todd Street
Frankfort, KENTUCKY 40601

*Eric Wilen
Project Manager-Rates & Regulatory Affairs
Atmos Energy Corporation
5420 LBJ Freeway, Suite 1629
Dallas, TEXAS 75420

*Justin M. McNeil
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Kent Chandler
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Larry Cook
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204

*Atmos Energy Corporation
3275 Highland Pointe Drive
Owensboro, KY 42303

*Mark R Hutchinson
Wilson, Hutchinson & Littlepage
611 Frederica Street
Owensboro, KENTUCKY 42301

*Rebecca W Goodman
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KENTUCKY 40601-8204