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November 10th Tax Reform Update

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PRACTICE AREAS

Tax

The House of Representatives unveiled their original version of the Tax Cuts and Jobs Act on November 2. The House Ways & Means Committee has spent four days considering the Act and finished its markup, sending the bill to the House floor for debate on Thursday, November 9. The Ways & Means Committee made some minor changes to the bill. Additionally, the Senate Finance Committee released policy highlights of their version of the Act on Thursday afternoon. Updates to our previous summary of the Act are set forth below, along with an overview of the Senate's proposal.

Summary of Changes for Individuals in House Bill

The original version of the Act included four brackets, retaining the highest rate under current law. The rates are: 12%, 25%, 35%, and 39.6%. No changes were made by the Ways & Means Committee. Additionally, the original version of the Act nearly doubled standard deductions and repealed personal exemptions. The Ways & Means Committee did not make any changes during markup affecting the standard deduction or personal exemptions. The Act also increased the Child Tax Credit to $1,600 while increasing phase out limitations, and allowed a credit of $300 for the taxpayer, spouse, and non-child dependents until 2023. No changes were made to these credits during the markup.

The original version of the Act repealed most itemized deductions except for the home mortgage interest and charitable contribution deductions, making changes to both. The mortgage interest deduction cap on debt was lowered, and the charitable contribution deduction for cash contributions was changed to be more friendly to taxpayers.

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The Act also repealed deductions for state and local taxes paid except for state and local property taxes paid. Other deductions and credits were eliminated. During the markup, the Ways & Means Committee decided to keep the adoption expenses credit, as well as the exclusion from income of moving expense reimbursements for military families moving on orders. Furthermore, the income exclusion for employer-provided dependent-care assistance is retained until 2023. Lastly, the Ways & Means Committee has decided to add a provision that has been in limbo for several years which allows excess funds in qualified savings plans to be rolled over into ABLE programs.

The original version of the Act set a termination date of December 31, 2023 for the "death taxes," after which the death taxes would be completely repealed. The current credit amount of $5.49 million[1] was doubled. Additionally, gift taxes would remain almost unchanged and the stepped-up income tax basis regime for inherited property would be unchanged. No changes were made during the markup

Summary of Changes for Businesses in House Bill

The original version of the Act capped income from pass-through entities at a maximum rate of 25%. The Act also included a limiting definition of qualified income to prevent abuse, and requirements for recognizing pass-through income. During the markup, the Ways & Means Committee added a special provision for small business owners which includes a new 9% tax bracket (below the general bracket at 12%). This bracket is available to active owners and shareholders of non-publicly traded entities on the first $75,000 of business income who earn less than $150,000. This lower rate is phased-out starting at $150,000 up to a complete phase-out at $225,000. The cut-offs and phase-out limitations are modified for non-married and single parent taxpayers.

The original version of the Act reduced the corporate tax rate to a flat 20% but did not include any provisions to prevent double taxation. In addition, the Act allowed businesses (until 2023) to immediately and completely expense the cost of new investments and partially limited the interest expense. The Act repealed most business credits and deductions with the exception of the research and development deduction and low-income housing credit. Net operating losses were also restructured under the Act. During markup, the Ways & Means committee included a provision which requires capitalization of research and experimental costs associated with the taxpayer's trade or business over 5 years (15 years if conducted outside of the United States).

Lastly, the Act subjected repatriated foreign profits to lower tax rates: 12% on liquid assets and 5% on non-liquid assets. The Act also included an exemption for dividends received from foreign subsidiaries. During markup, the Ways & Means Committee changed the rates on repatriated funds to 7% on liquid assets and 14% on non-liquid assets.

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Senate Finance Committee Policy Highlights Overview

The Senate will be releasing its own version of the Tax Cuts and Jobs Act either Friday afternoon or early next week. On Thursday it released highlights of its policies, and there are key differences between it and the House version of the Act. Notably, seven tax brackets will be included in the Senate bill, with the lowest rate staying 10% and the highest rate dropping to 38.5%. The Senate version will also nearly double the standard deduction and increase the Child Tax Credit, as well as retain the adoption expenses credit, medical expenses deduction, education relief for graduate students, and enhanced standard deductions for the elderly and blind. Another significant change from the House version is that the Senate version would keep the mortgage interest deduction limitation at $1,000,000 of debt. Furthermore, the Senate version does not repeal the death taxes, but does double the current exemption.

Two important diversions from the House bill show up in the treatment of business income. The Senate bill would lower the corporate rate to 20%, as the House bill does, but it is rumored that the rate cut would not start immediately in 2018, instead delaying the cut to 2019. Pass-through income is not rate-capped, but a deduction is proposed of 17.4% on such income.

As more details become available on the Senate version of the bill, including the text of the bill itself, we will make further updates.

Where Tax Reform is Headed

The House's version of the Act has passed the Ways & Means Committee and was introduced to the House floor for debate on Thursday, November 9. Republicans in the House have a 45 member advantage and the House is expected to pass the Act next week. However the Senate Finance Committee is working through its markup of their version of the Act, and we have already seen significant differences. Furthermore, the Republicans hold a slim 52-48 advantage in the Senate, and the recent elections have worried some on the Hill, including Republican Senators who could see their advantage dwindle to 51-49. The changes included in these bills would go into effect for tax years starting January 1, 2018 and after, and both the Senate and the House still hope to be holding votes on their bills by Thanksgiving, with the goal that President Trump will sign a bill before Christmas.

The Tax attorneys at Koley Jessen are keeping a close watch on Tax Reform. Please contact us with any questions.

[1] Under current law, the applicable exclusion amount for decedents dying in 2017 is $5.49 million and is set to increase to $5.6 million for decedents dying in 2018.