Wolters Kluwer

Tax Briefing

House GOP "Tax Cuts and Jobs Act"

November 3, 2017

Highlights

- ✔ Top Tax Rate of 39.6 Percent
- ✔ Repeal of AMT
- ✔ Repeal of Federal Estate Tax After 2023
- ✔ Elimination of State and Local Income Tax Deduction
- ✔ Limited Property Tax Deduction
- ✔ Modified Mortgage Interest Deduction
- ✔ Higher Child Tax Credit
- ✔ 20 Percent Tax Corporate Tax Rate
- ✔ 25 Percent Top Pass-Through Tax Rate
- ✔ Research Tax Credit Retained
- ✔ Many Business Incentives Repealed
- ✔ International Reforms

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SPECIAL REPORT

House GOP Proposes Sweeping Tax Code Overhaul

House Republicans unveiled a major overhaul of the Internal Revenue Code on November 2, 2017. The proposed "Tax Cuts and Jobs Act" would impact virtually every individual and business on a level not seen in over 30 years. As with any tax bill, however, there would be "winners" and "losers." The House GOP plan, at over 400 pages, calls for lowering the individual and corporate tax rates, repealing countless tax credits and deductions, eliminating the alternative minimum tax (AMT), abolishing the federal estate tax after 2023, enhancing the child tax credit, boosting business expensing, and more. The White House has signaled its support for the House GOP bill. Possible roadblocks to ultimately getting a bill to the President's desk before year end are unified opposition from House Democrats, as well as intense lobbying efforts to preserve tax breaks slated for elimination. There is also uncertainty over how the Senate will proceed. The Senate Finance Committee (SFC) is reportedly developing its own tax reform bill, which may or may not mirror the House GOP bill.

IMPACT. *Unveiling of the bill impacts year-end planning. Taxpayers need to plan for several possible contingencies: passage of a final tax reform bill before year end, passage of the bill in early 2018, or the bill failing to move forward. Except for a few changes, including business expensing, most provisions in the House bill would not be effective until 2018. There had been some speculation that tax cuts would extend retroactively to January 1, 2017, but the House GOP bill is mostly forward looking to 2018 and beyond.*

IMPACT. *House Republicans appear to envision moving their bill quickly to a floor vote. The Ways and Means Committee has scheduled a mark-up of the legislation for November 6. A vote by the entire House could come before Thanksgiving. The timeline in the Senate, at least for now, is less clear. Resolution of House and Senate differences within a December timeframe remains even more speculative.*

INDIVIDUALS

Tax Rates

The House GOP bill proposes four tax rates: 12, 25, 35, and 39.6 percent after 2017. Under current law, individual income tax rates are 10, 15, 25, 28, 33, 35, and 39.6 percent.

COMMENT. *The Trump/GOP Tax Reform Framework released in September contained a three-bracket structure of 12, 25, and 35 percent. The House GOP bill would keep the current top rate of 39.6 percent.*

IMPACT. *The House GOP bill includes proposed income ranges for the new brackets.*

Rate	Joint Return	Individual Return
12%	$0-$90,000	$0 - $45,000
25%	$90,000-$260,000	$45,000 - $200,000
35%	$260,000-$1 million	$200,000-$500,000
39.6%	over $1 million	over $500,000

IMPACT. *The income levels would be indexed for inflation for a "chained CPI" instead of CPI. In addition, the benefit of the 12-percent rate would be phased out for taxpayers in the 39.6 percent bracket.*

COMMENT. *The House GOP bill does not change the current tax treatment of qualified dividends and capital gains.*

IMPACT. *The House GOP bill does not repeal the Affordable Care Act's taxes. Left untouched are the net investment income (NII) tax, the additional Medicare tax, the medical device excise tax, and more. On November 1, the GOP leaders of the House Ways and Means Committee and the SFC unveiled a joint proposal to repeal the ACA's individual and employer shared responsibility provisions.*

Standard Deduction

The House GOP bill calls for a near doubling of the standard deduction to $24,400 for married filing jointly and $12,200 for single filers, as adjusted for inflation using a chained CPI for 2018. Heads-of-households could claim a standard deduction of $18,300. Under current law, the standard deduction absent any changes will be $13,000 for joint filers, $9,550 for heads of households, and $6,500 for single filers.

IMPACT. *One goal of a higher standard deduction is to simplify tax filing by cutting more than half of those taxpayers who would otherwise do better itemizing deductions. Of course, that group would realize less of a tax benefit than those taxpayers who do not now itemize. Supporters argue that it effectively creates a more broadly applicable "zero tax bracket" for taxpayers earning less than the standard deduction amount.*

IMPACT. *The House GOP bill also eliminates the deduction for personal exemptions and the personal exemption phase-out. This loss of personal exemption deductions is assumed to be part of the tradeoff for a higher standard deduction and an enhanced child tax credit.*

Deductions and Credits

The House GOP bill would eliminate countless individual tax deductions. The state and local income tax deduction (as well as the state and local sales tax deduction), teachers' classroom expense deduction, and a limited charitable deduction, in addition to deductions for moving expenses, alimony, student loan interest, personal casualty losses, and medical expenses, are just some of the many individual tax preferences slated for elimination.

IMPACT. *The loss of many itemized deductions would channel an even greater number of taxpayers to the standard deduction. Big losers may include state and local governments that depend upon the federal itemized deductions for state and local income taxes and real estate taxes as an indirect subsidy for those taxes. Losing the medical expense deduction and the miscellaneous itemized deduction will also prove difficult for some taxpayers.*

IMPACT. *The doubling of the standard deduction would effectively eliminate most individuals from claiming itemized deductions other than high-income taxpayers. For example, if the standard deduction for married filing jointly is $24,400, then only individuals with mortgage interest and charitable deductions in excess of $24,400 would claim them as itemized deductions. With fewer individuals claiming those deductions, this could have broad impact on both real estate prices and charitable organizations.*

The House GOP bill would keep a handful of existing individual incentives. The home mortgage interest deduction would be retained, but modified. For most debt incurred after the proposed effective date of November 2, 2017, the current $1 million limitation would be reduced to $500,000.

The state and local *property* tax deduction would be capped at $10,000 after 2017. The deduction for charitable giving also would be retained, but modified after 2017. The deduction for gambling losses would be modified.

> **IMPACT.** *Once again, all the concessions for retaining some deductions are valuable only to those taxpayers who would do better continuing to itemize deductions than taking the higher standard deduction.*

> **IMPACT.** *Supporters of eliminated incentives are likely to try to revive them when the Ways and Means Committee marks up the House GOP bill. Some of the incentives slated for elimination in the House GOP bill could survive in the yet-to-be-unveiled SFC tax reform bill.*

If a tax reform bill goes to a House-Senate conference, some of the eliminated incentives could also be revived there.

Family Incentives

A temporary credit of $300 would be allowed for non-child dependents. A temporary family flexibility credit of $300 would be allowed with respect to the taxpayer (each spouse in the case of a joint return) who is neither a child nor a non-child dependent.

The refundable portion of the child tax credit would remain at $1,000, indexed for inflation based on chained CPI. The House GOP bill would also retain the earned income tax credit (EITC).

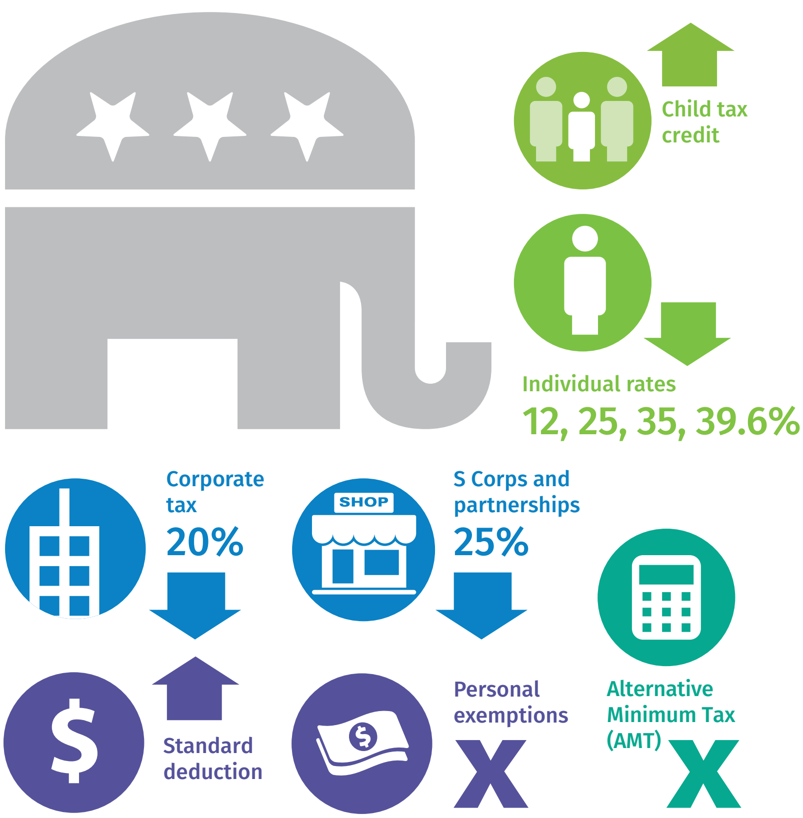
> **IMPACT.** *The phase out for the combined child credit, the non-child dependent credit, and the credit for a non-child or non-child dependent would increase to $230,000 for married couples filing joint returns and $115,000 for single individuals.*

Education

The House GOP bill would consolidate the American Opportunity Tax Credit (AOTC), Hope Scholarship Credit, and Lifetime Learning Credits after 2017. Also after 2017, no new contributions could be made to Coverdell education savings accounts.

> **IMPACT.** *The student loan interest deduction and the higher education tuition and fees deduction, among others, would be repealed.*

House GOP Tax Bill



Retirement

The House GOP bill generally retains the current rules for 401(k) and other retirement plans. However, the House bill would repeal the rule allowing taxpayers to recharacterize Roth IRA contributions as traditional IRA contributions and the rule allowing conversion of a traditional IRA to a Roth IRA. Rules for hardship distributions would be modified, among other changes.

Federal Estate Tax

The House GOP bill calls for doubling the federal estate tax exemption and then eliminating the estate tax after six years. The current maximum federal estate tax rate is 40 percent with an inflation-adjusted $5 million exclusion ($5.49 million in 2017), which married couples can combine for a $10 million exclusion ($10.98 million in 2017). The House GOP bill also modifies the gift tax after 2023 by lowering the rate to 35 percent.

IMPACT. *Repeal of the federal estate tax would not be immediate. After 2023, the estate and generation-skipping taxes would be repealed while maintaining a beneficiary's stepped-up basis in inherited property.*

Alternative Minimum Tax

The House GOP bill calls for abolishing the AMT after 2017. A parallel tax structure, the AMT, has existed for the stated purpose of ensuring that individuals, corporations, estates, and trusts with substantial income do not avoid tax liability.

IMPACT. *The House GOP bill includes special rules for taxpayers with AMT credit carryforwards.*

BUSINESSES

Corporate Taxes

The House GOP bill calls for a 20-percent corporate tax rate beginning in 2018. The maximum corporate tax rate currently tops out at 35 percent.

COMMENT. *Although the current maximum corporate tax rate is 35 percent, many corporations now pay an effective tax rate that is considerably less.*

Business Tax Benefits

A number of proposed changes to various business incentives are included in the House GOP bill. Chief among them is effectively allowing 100 percent immediate expensing of qualified property for a five-year period (qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023, with an additional year for certain longer production period property).

IMPACT. *The bonus depreciation rate has fluctuated wildly over the last 15 years, from as low as zero percent to as high as 100 percent. It is often seen as a way to incentivize business growth and job creation. However, some economists have found that bonus depreciation does little to motivate businesses to buy new equipment or property that they would not otherwise have bought. Instead, bonus depreciation simply creates an incentive to accelerate already planned purchases to tax years when it is available.*

The House GOP bill also would temporarily increase the Code Sec. 179 expensing limitation to $5 million and the phase-out amount to $20 million for tax years beginning before 2023. Additionally, the House bill would modify the rules for deducting business interest and the rules for net operating losses.

Deductions and Credits

Numerous business tax preferences would be eliminated after 2017. These include the Code Sec. 199 domestic production activities deduction, non-real property like-kind exchanges, the Work Opportunity Tax Credit, and more. Additionally, the rules for business meals would be revised.

The House GOP bill leaves the research and development credit untouched, while leaving open the door for the tax-writing committees to retain other business incentives.

Interest Deductions

The House GOP bill would cap the deduction for net interest expenses at 30 percent of adjusted taxable income. Exceptions would exist for small businesses.

IMPACT. *This provision is an attempt to "level the playing field" between businesses that capitalize through equity and those that borrow.*

Pass-Through Businesses

Currently, owners of partnerships, S corporations, and sole proprietorships pay tax at the individual rates, with the highest rate at 39.6 percent. The House GOP bill proposes a 25-percent tax rate for pass-through income after 2017, aimed at smaller businesses.

IMPACT. *Small business owners, therefore, could see their top tax rate reduced from 39.6 percent to 25-percent under the proposal.*

IMPACT. *The House GOP bill proposes rules that would prevent pass-through owners—particularly service providers such as accountants, doctors, lawyers, etc.—from converting their compensation income taxed at higher rates into profits taxed at the 25 percent level. Generally, 70 percent of pass-through income would be attributed to labor and the percentage would increase to 100 percent for certain service providers. The House GOP bill includes an alternative formula based on facts and circumstances.*

COMMENT. *The House GOP bill would also modify the current rules for nonqualified deferred compensation, among other changes impacting compensation.*

ENERGY

The House GOP bill would repeal many current energy tax incentives, including the marginal well tax credit and the credit for plug-in electric vehicles. Other energy tax preferences, such as the residential energy efficient property credit would be modified.

EXEMPT ORGANIZATIONS

The House GOP bill would modify the so-called "Johnson amendment," which generally restricts Code Sec. 501(c)(3) organizations from political campaign activity. The House GOP bill would also revise reporting requirements for donor advised fund sponsoring organizations and impose an excise tax on the investment income of certain colleges and universities, among other changes.

INTERNATIONAL

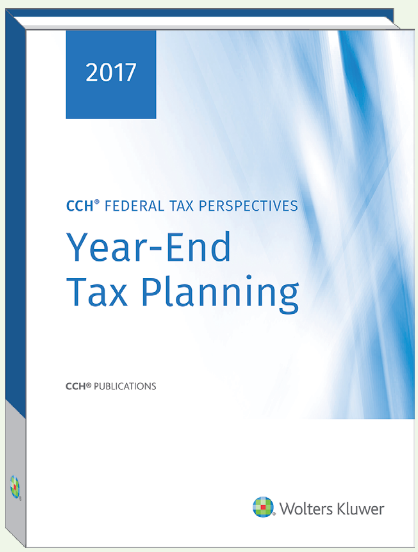
The House GOP bill would create a dividend-exemption system for taxing U.S. corporations on the foreign earnings of their foreign subsidiaries when the earnings are distributed. The foreign tax credit rules would be modified as would the Subpart F rules. The look-through rule for related controlled foreign corporations would be made permanent, among other changes.

Repatriation

A portion of deferred overseas-held earnings and profits (E&P) of subsidiaries would be taxed at a reduced rate of 12 percent (5 percent for illiquid holdings). Foreign tax credit carryforwards would be fully available and foreign tax credits triggered by the deemed repatriation would be partially available to offset the U.S. tax.

IMPACT. *The lower corporate tax rate of 20 percent may also provide an incentive for businesses to not shift operations overseas going forward.*

Year-End Tax Planning



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