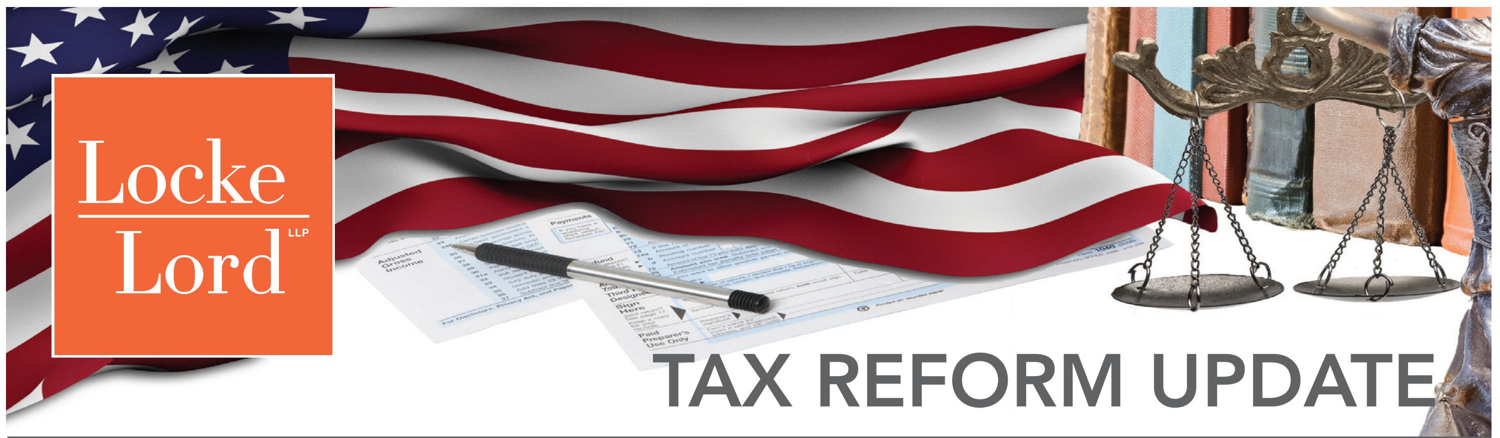

Tracking Tax Reform: Comparison of the Tax Cuts and Jobs Act as Passed by the House and Approved by the Senate Finance Committee

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On November 16, the House passed the Tax Cuts and Jobs Act (the "House Bill") by a 227-205 vote. Also on November 16, members of the Senate Finance Committee voted 14-12 to approve their own tax bill (the "Senate Plan"). The Senate Plan is not yet in legislative form, but so far it differs from the House Bill in some important ways.

More changes to the Senate Plan are likely to occur when it is debated by the full Senate. The Senate will likely bring their plan to the floor for a vote after Thanksgiving. Assuming the Senate Plan is passed, a likely next step would be a conference committee to reconcile the differences between the Senate Plan and the House Bill. We will continue to provide updates when appropriate to help you keep track of the evolution of both plans.

Individual Taxation.

Rates.

- The House Bill sets forth four tax brackets – 12%, 25%, 35%, and 39.6%. The brackets would apply to married taxpayers filing jointly as follows: households with income up to $24,400 would pay no income tax; the 12% bracket would apply to household income up to $90,000; the 25% bracket would apply to household income up to $260,000; the 35% bracket would apply to household income up to $1 million; and the 39.6% bracket would apply to households with income over $1 million. For unmarried taxpayers and married taxpayers filing separately, the bracket income thresholds would be half the thresholds for married taxpayers filing jointly, with the exception that the 35% bracket threshold for unmarried individuals would be $200,000. The House Bill phases out the estate tax over six years, increases the lifetime exemption to $10 million during the transition period, and retains the gift tax and the basis step-up at death.
- The Senate Plan sets forth seven tax brackets – 10%, 12%, 22.5%, 25%, 32.5%, 35%, and 38.5%. The number of brackets in this plan seems inconsistent with the previously reiterated tax reform goal of simplifying tax reporting. The brackets would apply to married taxpayers filing jointly as follows: the 10% bracket would apply to household income up to $19,050; the 12% bracket would apply to household income up to $77,400; the 22.5% bracket would apply to household income up to $120,000; the 25% bracket would apply to household income up to $290,000; the 32.5% bracket would apply to household income up to $390,000; the 35% bracket would apply to household income up to $1 million; and the 38.5% bracket would apply to households with income over $1 million. For unmarried taxpayers and married taxpayers filing separately, the bracket income thresholds would be half the thresholds for married taxpayers filing jointly, with the exception that the 32.5% bracket threshold for unmarried individuals would be $170,000 and the 35% bracket threshold for unmarried individuals would be $200,000. Unlike the new tax rates under the House Bill, these tax rates would expire at the end of 2026. The Senate Plan increases the estate tax lifetime exemption to $10 million, but does not repeal the estate tax. The Affordable Care Act's individual insurance mandate would also be repealed.

Deductions.

- The House Bill increases the standard deduction to $12,200 for individual taxpayers and $24,400 for married taxpayers filing jointly, but eliminates the personal exemption. The House Bill allows individuals to deduct the cost of state and local property taxes up to $10,000, but eliminates the deduction for state and local income taxes and sales taxes. The mortgage interest

deduction for existing mortgages is preserved, but the cap is lowered to $500,000 for mortgage debt for newly purchased homes, a 50% reduction from the current law. The charitable contribution deduction is retained, and the adjusted gross income limitation on contributions is raised from 50% to 60%. However, because of the increase to the standard deduction, fewer taxpayers will have a tax incentive to make charitable contributions.

- The Senate Plan increases the standard deduction to $12,000 for individual taxpayers and $24,000 for married taxpayers filing jointly, but eliminates the personal exemption. The itemized deduction for all state and local taxes paid by individuals, including property taxes, is completely eliminated. The Senate Plan retains the current mortgage interest deduction for new mortgages of up to $1 million. The charitable contribution deduction is retained, and similar to the House Bill, the adjusted gross income limitation on contributions is raised to 60%.

Elimination of the Alternative Minimum Tax.

- The House Bill repeals the Alternative Minimum Tax for individuals and corporations.
- The Senate Plan repeals the Alternative Minimum Tax for individuals and corporations.

Taxation of investment income.

- The House Bill left the current capital gains and dividends tax rates unchanged. However, by setting new income tax rates, some investors could end up owing less tax on short-term capital gains and dividends because their ordinary income tax rate will fall (short-term capital gain tax rates are directly tied to ordinary income tax rates).
- The Senate Plan also left the current capital gains and dividends tax rates unchanged.

Business Entity Taxation.

Rates.

- The House Bill sets a permanent corporate tax rate of 20% after 2017.
- The Senate Plan sets a permanent corporate tax rate of 20% after 2018. A proposed amendment to the Senate Plan offers a 12.5% deduction on the dividends that corporations pay for five years, in an effort to eliminate the bias in the tax law for corporations to finance with debt rather than equity (a proposal referred to as corporate integration).

Taxation of pass-through income to entity owners.

- The House Bill reduces the tax rate for income derived from pass-through entities to 25%. Under the House Bill, business owners can choose to either (i) categorize 70% of their income as wages, subject to ordinary rates, and 30% as business income, taxable at the new 25% rate, or (ii) set the ratio of their wage income to business income based on the level of their capital investment. Professional services firms (e.g. law, accounting, consulting) would not qualify for the reduced rate.
- The Senate Plan provides for a deduction for pass-through entities, instead of a tax rate reduction. Under the Senate proposal, taxpayers determine their "qualified business income" and then subtract 17.4% of that amount from their taxable income, thus in effect reducing their tax rate. Most professional services firms would not qualify for this deduction, but smaller professional services firms (where the taxpayer has individual income below $75,000 and married couples below $150,000) still benefit from this provision. The deduction would be limited to 50% of the W-2 wages of a taxpayer who has qualified business income from a pass-through entity. Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer, and does not include any amount allocated or distributed by a partnership to a partner who is acting other than in his or her capacity as a partner for services performed for the partnership or any amount that is a guaranteed payment for services actually rendered to or on behalf of a partnership to the extent that the payment is in the nature of remuneration for those services.

Changes to depreciation and interest deductions.

- Under the House Bill, taxpayers would be able to fully and immediately expense 100% of the cost of qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023. The House Bill would cap interest deductions at 30% of a company's "adjusted taxable income" which is taxable income without regard to interest expense, interest income, NOLs, depreciation, amortization and depletion, but provides an exception for businesses with average annual gross receipts of $25 million or less.
- The Senate Plan allows taxpayers to fully and immediately expense 100% of the cost of qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023. Similar to the House Bill, the Senate Plan would cap interest deductions at 30% of a company's "adjusted taxable income," but the Senate Plan only provides an exception for businesses with average annual gross receipts of $15 million or less.

Business incentives.

- The House Bill retains the R&D credit and the low-income housing credit, but eliminates many other business credits, such as the new markets and rehabilitation tax credits, and limits, repeals, and modifies many credits affecting energy property. The domestic manufacturing deduction would be repealed after 2017.
- The Senate Plan retains the R&D credit and the low-income housing credit, but imposes limitations on the rehabilitation tax credit and does not address the new markets tax credit. The domestic manufacturing deduction would be repealed after 2018.

The Senate Plan limits, repeals, and modifies a variety of other credits, but does not address many of the credits affecting energy property that the House Bill addresses.

Carried Interest.

- The House Bill originally did not contain any provisions addressing the carried interest tax break, but was amended to provide that starting in 2018, a three-year holding period requirement would be imposed on partnership interests received in connection with the performance of certain investment management services (including rental real estate) in order to be eligible for long-term capital gain tax rates. This would triple the current length of time an asset needs to be held in order to qualify for the lower rate. Certain equity interests and interests held by corporations would be exempt.
- Immediately prior to the approval of the Senate Plan by the Senate Finance Committee, a provision addressing the carried interest tax break was added. The provision imposes a three-year holding period requirement for qualification as long-term capital gain with respect to certain partnership interests received in connection with the performance of services. This appears to be similar to the provision in the House Bill.

International Taxation.

Tax on future foreign earnings.

- The House Bill adopts a territorial tax system. Under the House Bill, U.S. companies would generally no longer pay taxes on active foreign income. However, the House Bill does create a new tax applied to 50% of "high foreign returns" of a foreign subsidiary. A high foreign return generally is net income in excess of 7% plus the Federal short-term rate multiplied by the subsidiary's depreciation basis in its tangible assets.
- The Senate Plan also adopts a territorial tax system. The Senate Plan imposes a 20% tax on "global intangible low-tax income" on a current basis, subject to a 37.5% deduction.

Tax on accumulated foreign earnings.

- The House Bill provides for a one-time 14% tax on previously accumulated foreign earnings held as cash and cash equivalents, and a one-time 7% tax on previously accumulated foreign earnings on non-cash assets. This tax would be payable over up to 8 years, if the taxpayer so elects.
- The Senate Plan would impose a one-time 10% tax on accumulated foreign earnings held as cash and cash equivalents, and a one-time 5% tax on accumulated foreign earnings on non-cash assets. This tax would be payable over up to 8 years at the election of the taxpayer.

Base erosion provisions.

- The House Bill imposes a 20% excise tax on certain payments made by U.S. companies to related foreign corporations, with an exception for when the U.S. company elects to treat the payments as effectively connected income. A credit is permitted for 80% of the foreign taxes paid or accrued on such payments.
- The Senate Plan imposes a minimum tax on "base erosion payments" paid or accrued by a taxpayer to a foreign related person. Under this provision, certain large U.S. companies (companies with average annual gross receipts of at least $500 million over the prior three years) making a certain level of deductible, depreciable or amortizable payments to foreign related persons would have to pay a tax equal to the excess of 10% of its taxable income determined without reference to such deductible, depreciable or amortizable payments over its tax liability as determined under the normally applicable rules.

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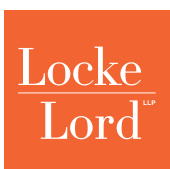

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