House Passes Tax Reform Bill; Senate Finance Committee Considers Bill of its Own

Summary

On November 9, 2017, the Senate Finance Committee released its version of proposed tax reform legislation, the "Tax Cuts and Jobs Act," which the Committee is marking up this week. The House of Representatives passed its tax bill on November 16; however, the bill under consideration by the Senate Finance Committee differs in several respects, including individual tax rates, itemized deductions, retaining the estate and GST taxes, the timing of changes to the corporate tax rate, and pass-through tax rates. On November 14, 2017, Finance Chairman Hatch announced some changes to the Chairman's Mark. One modification now would reduce the Patient Protection and Affordable Care Act individual mandate payment to zero. There are also other changes to rates, the child tax credit, the pass-through provisions, and international tax.

Details

Whereas the House bill proposes four individual tax brackets at 12, 25, 35, and 39.6 percent, the modified Senate version would keep the existing number of rates at seven but lower them to 10, 12, 22, 24, 32, 35, and 38.5 percent. Under both proposals the highest rates apply at $1 million for married taxpayers filing jointly and $500,000 for other filers. Both plans would repeal personal exemptions but the Senate's increase in the standard deduction is slightly lower than the House's and proposes to increase the standard deduction to $12,000 for single filers and $24,000 for married taxpayers filing jointly. The House and Senate differ on the child tax credit, which would increase to $1,600 or $2,000, respectively.

Itemized deductions for mortgage interest, property tax, and medical expenses are treated differently by the proposed legislation. Both bills would eliminate any mortgage interest deduction based on home equity indebtedness; the House bill would cap acquisition indebtedness at $500,000 (effective for debt incurred on or after November 2, 2017) whereas the Senate would retain the current $1 million limitation. Individuals could no longer deduct personal state and local income or sales taxes under either proposal. The Senate bill would also eliminate the local property tax deduction while the House bill would permit a deduction of up to $10,000. Unreimbursed medical expenses that exceed 10 percent of a taxpayer's adjusted gross income would remain deductible under the Senate plan, though any deduction for medical expenses would be repealed under the House proposal.

Regarding the estate, gift, and generation-skipping (GST) taxes, the House bill would increase the individual estate and gift tax exclusion to $10 million (as of 2011) and then adjust for inflation annually before repealing the estate and GST tax after 2023. The Senate bill also proposes an inflation-adjusted $10 million exclusion for individuals but otherwise maintains the estate and GST taxes without repeal.

The House and Senate bills also handle business taxes differently. Both plans present the same decrease in the maximum corporate tax rate from 35 to 20 percent, but the Senate proposes the change begin in 2019, one year later than the House's proposal of 2018. Furthermore, the House bill would tax certain "business income" from pass-through entities at 25 percent, while the Senate instead proposes a 17.4 percent deduction. Both plans feature provisions designed to prevent pass-through compensation from being taxed at rates lower than the owners' individual rates, subject to certain thresholds.

The treatment of deferred foreign earnings and profits is yet another area where both bills take a similar approach but with different rates. The House proposal would tax certain accumulated earnings and profits represented by cash and cash equivalents at a 14 percent rate and would tax earnings and profits represented by illiquid assets at a seven percent rate, while the Senate rates would be 10 and five percent, respectively. Additionally, the Senate bill includes proposals to address similar base erosion concerns as the proposals in the House bill but, in some cases, such proposals operate in a different manner to achieve a similar objective. The Senate bill also includes certain other proposals that were not included in the House bill, such as the repeal of the special rules for DISCs and IC-DISCs and the denial of interest or royalty deductions for certain related party amounts paid or accrued pursuant to certain hybrid transactions, or by, or to, a hybrid entity. The modified Senate proposal would repeal of the Patient Protection and Affordable Care Act individual mandate; the House bill does not contain this provision.

Insights

Congress is moving quickly to advance tax reform legislation, although it is unclear when or if an agreed bill will be passed by both houses of Congress. The House passed its version of tax legislation this week, while Senate Finance markup continues. The process may slow, however, as Senate Republicans seek support, budget and expense restrictions are navigated, and differences between the bills are reconciled.