Tax Cuts and Jobs Act

December 16, 2017

Highlights

- ✔ 37-Percent Top Individual Tax Rate
- ✔ 21-Percent Top Corporate Tax Rate
- ✔ New Tax Regime for Pass-throughs
- ✔ Individual AMT Retained/Modified
- ✔ Federal Estate Tax Retained/Modified
- ✔ Corporate AMT Repealed
- ✔ More Generous Expensing
- ✔ International Provisions

Inside

SPECIAL REPORT

Sweeping Tax Overhaul Heads to House and Senate

The House and Senate Tax Cuts and Jobs Act Conference Committee unveiled its tax reform package on December 15. The Committee, after a week of intense negotiations, blended the House and Senate versions of the Tax Cuts and Jobs Act (H.R. 1) into one legislative package. GOP leaders predict that Congress will pass this final version of H.R. 1 before lawmakers leave for their holiday recess. The Conference agreement generally tracks the overall framework for tax reform released by the GOP earlier this year and the House and Senate versions of H.R. 1. *This final bill carries a January 1, 2018, effective date for most provisions.*

The Conference bill would impact virtually every individual and business on a level not seen in over 30 years. As with any tax bill, however, there will be "winners" and "losers." The bill calls for lowering the individual and corporate tax rates, repealing countless tax credits and deductions, enhancing the child tax credit, boosting business expensing, and more. The bill also impacts the Affordable Care Act (ACA), effectively repealing the individual shared responsibility requirement.

President Trump has signaled his support for tax legislation before year-end. Few possible roadblocks to ultimately getting a bill to the President's desk before year-end remain. Prior Senate hold-outs have now signaled their support of the Conference bill, while support in the House appears to be holding steady Nevertheless, some still-hidden parliamentary hurdle or sudden public concern should not be discounted until all the votes are in.

IMPACT. *Many of the changes to the Internal Revenue Code in the Conference bill are temporary. This is true especially with respect to the provisions of the bill impacting individuals. This decision was made in order to keep the bill within budgetary parameters, but with no guarantees that a future Congress would extend them.*

INDIVIDUALS

Tax Rates

The Conference Committee version of H.R. 1 proposes temporary tax rates of 10, 12, 22, 24, 32, 35, and 37 percent after 2017. Under current law, individual income tax rates are 10, 15, 25, 28, 33, 35, and 39.6 percent.

IMPACT. *The rate changes in the Conference bill would expire after 2025. This is a key difference from earlier versions of the bill. The original House bill would have made these individual income tax rate changes permanent.*

COMMENT. *The IRS has announced that initial withholding guidance (Notice 1036) to reflect the Tax Cuts and Jobs Act, if passed, will be issued in January 2018.*

IMPACT. *The Conference bill includes income ranges for their respective brackets.*

Conference Agreement Brackets

Rate	Joint Return	Individual Return
10%	$0 - $19,050	$0 - $9,525
12%	$19,050 - $77,400	$9,525 - $38,700
22%	$77,400 - $165,000	$38,700 - $82,500
24%	$165,000 - $315,000	$82,500 - $157,500
32%	$315,000 - $400,000	$157,500 - $200,000
35%	$400,000 - $600,000	$200,000 - $500,000
37%	Over $600,000	Over $500,000

IMPACT. *Under the Conference bill, income levels would be indexed for inflation for a "chained CPI" instead of CPI. Both the original House bill and the Senate bill called for a chained CPI. In general, this change would result in a smaller annual rise in rate brackets, which the Joint Committee of Taxation estimates, when combined with using the chained CPI for all other inflation-adjusted tax amount, would bring $128 billion more into the U.S. Treasury over the next ten-year period. The chained CPI is permanently applied to almost all amounts subject to annual inflation adjustment, even the permanent amounts that would apply if provisions are allowed to expire after 2025.*

COMMENT. *H.R. 1 as approved by the Conference Committee does not change the current tax treatment of qualified dividends and capital gains.*

IMPACT. *The Conference 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.*

COMMENT. *Legislation has been introduced in Congress to extend the current suspension of the ACA"s medical device excise tax, the health insurance provider fee, and the excise tax on high-dollar health plans. H.R. 1, as approved by the conference committee, does not address these ACA taxes.*

Standard Deduction

The Conference bill calls for a near doubling of the standard deduction. It increases the standard deduction to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other individuals, indexed for inflation (using chained CPI) for tax years beginning after 2018. All increases are temporary and would end after December 31, 2025. Under current law, the standard deduction for 2018 had been set at $13,000 for joint filers, $9,550 for heads of households, and $6,500 for all other filers. The additional standard deduction for the elderly and the blind ($1,300 for married taxpayers, $1,600 for single taxpayers) is retained.

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

IMPACT. *The doubling of the standard deduction would effectively eliminate most individuals from claiming itemized deductions other than higher-income taxpayers. For example, for the vast majority of married taxpayers filing jointly, only those with allowable mortgage interest, state income and local income/property taxes (up to $10,000), and charitable deductions that exceed $24,000 would claim them as itemized deductions (absent extraordinary medical expenses). With fewer individuals claiming those deductions, this could have broad impact on both real estate prices and charitable organizations despite retaining those two deductions, in modified form.*

IMPACT. *The Conference bill eliminates the deduction for personal exemptions and the personal exemption phase-out through 2025. That repeal, as scored by the Joint Committee on Taxation, would raise $1.22 trillion in revenue over the next 10 years. That repeal would reduce the net benefit of the standard deduction for most taxpayers. An enhanced child and family tax credit is positioned to make up some of the difference for certain families.*

Deductions and Credits

The Conference bill makes significant changes to some popular individual credits and deductions. Many of the changes, however, are temporary, generally ending after 2025, in order to keep overall revenue costs for the bill within budgetary constraints.

Mortgage interest deduction. The Conference bill limits the mortgage interest deduction to interest on $750,000 of acquisition indebtedness ($375,000 in the case of married taxpayers filing separately), in the case of tax years beginning after December 31, 2017, and beginning before January 1, 2026. For acquisition indebtedness incurred before December 15, 2017, the Conference bill allows current homeowners to keep the current limitation of $1 million ($500,000 in the case of married taxpayers filing separately).

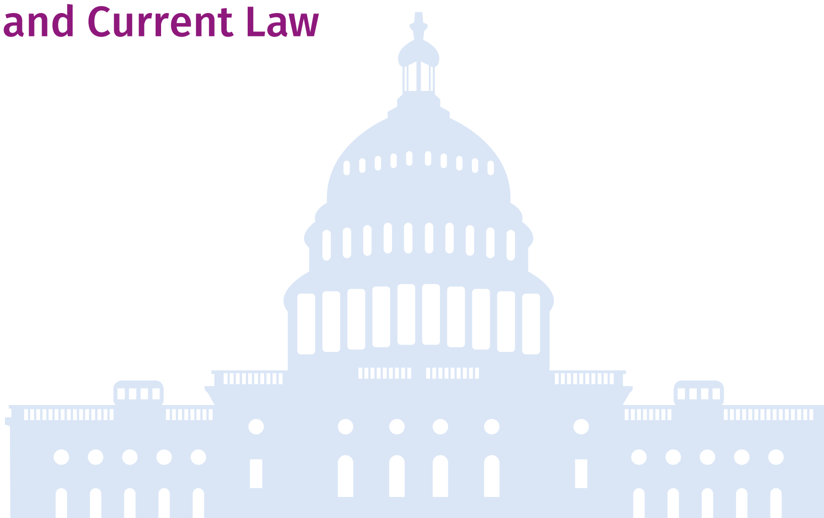
The Conference agreement also allows taxpayers to continue to include mortgage interest on second homes, but within those lower dollar caps. However, no interest deduction will be allowed for interest on home equity indebtedness.

COMMENT. *Some homeowners dodged a bullet when the Conference bill rejected the additional limitation in both the House and Senate bills to increase the holding period for the homeowners' capital gain exclusion to a five-out-of-eight year principal-residence test.*

State and local taxes. The Conference bill limits annual itemized deductions for all nonbusiness state and local taxes deductions, including property taxes, to $10,000 ($5,000 for married taxpayer filing a separate return). Sales taxes may be included as an alternative to claiming state and local income taxes.

COMMENT. *The Conference bill short-circuits any immediate year-end tax planning by adding*

Comparison of Conference Bill and Current Law



	Current Law (2017)	Conference Bill (2018)
Child tax credit	$1,000 (refundable up to $1,000)	▲ $2,000 (refundable up to $1,400)
Individual rates	10, 15, 25, 28, 33, 35, 39.6%	▼ 10, 12, 22, 24, 32, 35, 37%
Standard deduction	MFJ: $12,700 S: $6,350 HH: $9,350	▲ MFJ: $24,000 S: $12,000 HH: $18,000
Top corporate rate	35%	▼ 21%
Pass-through income	Same as individual rates	▼ 20% deduction
Alternative minumum tax	Ind: 26, 28% Corp: 20%	▼ Ind: exemption increased Corp: repealed
Personal exemptions	$4,050	X Repealed
State and local taxes	Deductible	▼ Maximum $10,000 deduction
Mortgage interest	$1 million limit	▼ $750,000 limit

a provision that disallows prepayment in 2017 of state and local taxes imposed for a year after 2017 to avoid the new dollar limitation.

Miscellaneous itemized deductions. The Conference bill repeals all miscellaneous itemized deductions that are subject to the two-percent floor under current law.

Medical expenses. The Conference bill follows the Senate bill in not only retaining the medical expense deduction, but also temporarily enhancing it. The Conference bill lowers the threshold for the deduction to 7.5 percent of adjusted gross income (AGI) for tax years 2017 and 2018.

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. Limitations on the mortgage interest deduction will also likely hurt the housing industry.*

IMPACT. *Once again, 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.*

Family Incentives

The Conference bill temporarily increases the current child tax credit from $1,000 to $2,000 per qualifying child. Up to $1,400 of that amount would be refundable. The Conference bill also raises the adjusted gross income phaseout thresholds, starting at adjusted gross income of $400,000 for joint filers ($200,000 for all others).

The child tax credit is further modified to provide for a $500 nonrefundable credit for qualifying dependents other than qualifying children.

IMPACT. *As a credit, in contrast to a deduction, the enhanced child credit has been highlighted as one of the provisions that will lower overall tax liability for middle-class families.*

COMMENT. *The House bill proposed measures to curb abuse of the earned income tax credit (EITC). The Conference bill does not include these provisions.*

Education

The Conference agreement retains the student loan interest deduction, as proposed in the Senate bill. It also modifies section 529 plans and ABLE accounts. The Conference bill does not overhaul the American Opportunity Tax Credit, as proposed in the House bill. The Conference bill also does not repeal the exclusion for interest on U.S. savings bonds used for higher education, as proposed in the House bill.

COMMENT. *At the eleventh-hour, the Conference Committee decided to retain the exclusion for graduate student tuition waivers.*

COMMENT. *The Conference bill does not renew the above-the-line deduction for education expenses that expired at the end of 2016 and had earlier been considered for inclusion in a separate "extenders" bill.*

Alimony

The Conference bill repeals the deduction for alimony payments and their inclusion in the income of the recipient.

IMPACT. *To give taxpayers time to adjust to this new balance in assessing benefits and burdens, the new rules will apply only to divorce or separation instruments executed after December 31, 2018.*

Retirement

The Conference Committee version of H.R. 1 generally retains the current rules for 401(k) and other retirement plans. However, the Conference bill would repeal the rule allowing taxpayers to recharacterize Roth IRA contributions as traditional IRA contributions to unwind a Roth conversion. Rules for hardship distributions would be modified, among other changes.

COMMENT. *Initial proposals for more extensive changes to retirement plans to generate revenue resulted in immediate push-back and were not revived by the Conference Committee.*

Federal Estate Tax

The Conference bill follows the Senate bill in not repealing the estate tax, but rather doubling the estate and gift tax exclusion amount for estates of decedents dying and gifts made after

December 31, 2017, and before January 1, 2026. The generation-skipping transfer (GST) tax exemption is also doubled.

COMMENT. *The House bill called for repeal of the federal estate and GST taxes. The Conference Committee, largely to win support in the Senate, retained them in its bill.*

COMMENT. *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 new exclusion amounts will now allow married couples to exempt up to $22 million for 2018 (after adjustment for inflation) from any estate or gift tax. Heirs, however, will continue to receive a "stepped-up, date of death" basis for inherited assets for purposes of any subsequent sale.*

Alternative Minimum Tax

The Conference Committee version of the bill retains the alternative minimum tax (AMT) for individuals with modifications. The Conference bill would temporarily increase (through 2025) the exemption amount to $109,400 for joint filers ($70,300 for others, except trusts and estates). It would also raise the exemption phase-out levels so that the AMT would apply to an income level of $1 million for joint filers ($500,000 for others). These amounts are all subject to annual inflation adjustment.

Affordable Care Act

The Conference bill repeals the Affordable Care Act (ACA) individual shared responsibility requirement, making the payment amount $0. This change would be effective for penalties assessed after 2018.

COMMENT. *The IRS has cautioned that, under current law, for tax year 2017, it will not consider a return complete and accurate if the taxpayer does not report full-year coverage, claim a coverage exemption, or report a shared responsibility payment on the return.*

Carried Interest

Under the Conference bill, the holding period for long-term capital gains is increased to three years with respect to certain partnership interests transferred in connection with the performance of services.

BUSINESSES

Corporate Taxes

The Conference Committee version of H.R. 1 calls for a 21-percent corporate tax rate beginning in 2018. The Conference bill makes the new rate permanent. 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.*

Under the Conference bill, the 80-percent and 70-percent dividends received deductions under current law are reduced to 65-percent and 50-percent, respectively. The Conference bill also repeals the AMT on corporations.

COMMENT. *The House bill repealed the corporate AMT. The Senate bill did not. The Conference Committee ultimately decided to follow the House version, effectively allowing some corporations to use certain tax benefits to effectively pay significantly below the new 21-percent rate.*

Bonus Depreciation

The Conference bill increases the 50-percent "bonus depreciation" allowance to 100 percent for property placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft). A 20-percent phase-down schedule would then kick in. It also removes the requirement that the original use of qualified property must commence with the taxpayer, thus allowing bonus depreciation on the purchase of used 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 means to incentivize business growth and job creation.*

Vehicle Depreciation

The Conference bill would raise the cap placed on depreciation write-offs of business-use vehicles. The new caps would be $10,000 for the first year a vehicle is placed in service (up from a current level of $3,160); $16,000 for the second year (up from $5,100); $9,600 for the third year (up from $3,050); and $5,760 for each subsequent year (up from $1,875) until costs are fully recovered. The new, higher limits apply to vehicles placed in service after December 31, 2017, and for which additional first-year depreciation under Code Sec. 168(k) is not claimed.

COMMENT. *The limitations are indexed for inflation for passenger automobiles placed in service after 2018.*

Section 179 Expensing

The Conference bill would also enhance Code Sec. 179 expensing. The Conference bill sets the Code Sec. 179 dollar limitation at $1 million and the investment limitation at $2.5 million.

IMPACT. *Although the differences between bonus depreciation and Code Sec. 179 expensing would now be narrowed if both offer 100-percent write-offs for new or used property, some advantages and disadvantages for each would remain. For example, Code Sec. 179 property is subject to recapture if business use of the property during a tax year falls to 50 percent or less; but Code Sec. 179 is allows a taxpayer to elect to expense only particular qualifying assets within any asset class.*

Deductions and Credits

Numerous business tax preferences would be eliminated under the Conference version of H.R. 1. These include the Code Sec. 199 domestic production activities deduction, non-real property like-kind exchanges, and more. Additionally, the rules for business meals would be revised, as would the rules for the rehabilitation credit.

The Conference bill leaves the research and development credit in place, but requires five-year amortization of research and development expenditures. The Conference bill also creates a temporary credit for employers paying employees who are on family and medical leave.

COMMENT. *The Work Opportunity Tax Credit (WOTC), proposed for elimination under the House bill, is retained by the Conference bill. Under current law, the WOTC is scheduled to expire after 2019.*

Interest Deductions

The Conference bill generally caps the deduction for net interest expenses at 30 percent of adjusted taxable income, among other criteria. Exceptions would exist for small businesses, including an exemption for businesses with average gross receipts of $25 million or less.

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 – as "pass-through" entities – pay tax at the individual rates, with the highest rate at 39.6 percent. The House bill proposed a 25-percent tax rate for certain pass-through income after 2017, with a nine-percent rate for certain small businesses. The Senate bill generally would have allowed a temporary deduction in an amount equal to 23 percent of qualified income of pass-through entities, subject to a number of limitations and qualifications.

The Conference bill generally follows the Senate's approach to the tax treatment of pass-through income, but with some changes, including a reduction in the percentage of the deduction allowable under the provision to 20 percent (not 23 percent), a reduction in the threshold amount above which both the limitation on specified service businesses and the wage limit are phased in, and a modification in the wage limit applicable to taxpayers with taxable income above certain threshold amounts.

IMPACT. *The Conference 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 lower rate.*

Net Operating Losses

The Conference Committee version of H.R. 1 modifies current rules for net operating losses (NOLs). Generally, NOLs would be limited to 80 percent of taxable income for losses arising in tax years beginning after December 31, 2017. The Conference bill also denies the carryback for NOLs in most cases while providing for an indefinite carryforward, subject to the percentage limitation.

ENERGY

The House bill called for repealing many current energy tax incentives, including the credit for plug-in electric vehicles. Other energy tax preferences, such as the residential energy efficient property credit, would have been modified.

The Conference bill retains the credit for plug-in electric vehicles and did not adopt any of the other repeals of or modifications to energy credits from the House bill.

EXEMPT ORGANIZATIONS

The Conference bill does not modify or repeal the so-called "Johnson amendment." This provision generally restricts Code Sec. 501(c)(3) organizations from political campaign activity.

IRS ADMINISTRATION

The Conference bill would extend from nine months to two years the period for bringing a civil action for wrongful levy. The Conference bill does not prohibit increases in IRS user fees, as proposed by the Senate bill.

INTERNATIONAL

The Conference Committee version of H.R. 1 follows the lead of both the House and Senate bills in moving the United States to a territorial system. The Conference 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 15.5 percent for cash assets and 8 percent for illiquid assets. 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 may also provide an incentive for businesses to not shift operations overseas in the future.*

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12/17 2017-2142