Anchin Alert

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Accountants and Advisors

November 14, 2017

Compare and Contrast the House and Senate Tax Bills

November 9 was a busy day in Washington for lawmakers in their race to hammer out a tax reform package. The House Ways and Means Committee made amendments to, and approved, the Tax Cuts and Jobs Act. And the Senate Finance Committee released "policy highlights" for its proposed version of a tax plan.

Many of the House and Senate provisions are similar. For example, both plans would repeal the alternative minimum tax and retain the charitable contribution deduction. However, there are a number of key differences. Here's a look at some of the most significant.

Individual taxes

The following changes would generally be effective beginning in 2018:

Individual tax rates. The House bill would consolidate the seven current federal income tax brackets into four: 12%, 25%, 35% and 39.6%. The Senate plan would still have seven tax brackets, but they would be 10%, 12%, 22.5%, 25%, 32.5%, 35% and 38.5%. (Currently, the brackets are 10%, 15%, 25%, 28%, 33%, 35% and 39.6%.)

Personal exemptions and standard deduction. The House bill would eliminate the current personal exemptions for taxpayers and their dependents. It would nearly double the standard deduction to $12,000 for single filers and $24,000 for married couples (adjusted for inflation), which, for many taxpayers, would remove the incentive to itemize deductions.

The Senate plan would do the same but includes an $18,000 standard deduction for single parents (head of household filers).

Child tax credit. The House bill would increase the child tax credit from $1,000 to $1,600 for each qualifying child. The credit wouldn't be adjusted for inflation, so its value would drop over time, and some tax professionals predict that the increased credit wouldn't offset the loss of personal exemptions for many higher-income families.

The House also includes a $300 credit for nonchild dependents, as well as a $300 "family flexibility credit" for the taxpayer (or both spouses, for a joint return). The nonchild dependent credit and the family flexibility credit would be effective for tax years ending before January 1, 2023.

The House plan would also increase the income levels at which these credits phase out. Under current law, the child tax credit is phased out beginning at income levels of $75,000 for single filers and $110,000 for joint filers. The House plan would raise these amounts to $115,000 and $230,000, respectively.

The Senate plan would increase the child tax credit to $1,650. It also would significantly increase the annual income threshold at which the credit begins to phase out to $1 million for married joint filers and $500,000 for single taxpayers. In addition, the Senate plan would provide a $500 credit for dependents other than qualifying children.

Mortgage interest deduction. The House bill would cap the mortgage interest deduction limit at $500,000 of debt for homes purchased after November 2, 2017. The Senate bill would keep the current mortgage interest deduction limit at $1 million of debt.

State and local taxes. The House bill would generally eliminate state and local tax write-offs but preserve a deduction for property taxes limited to $10,000. The Senate bill would fully repeal deductions for state and local taxes, including property taxes. So the deduction of state and local income taxes would be repealed under both bills.

Medical expense deduction. The House bill would get rid of the medical expense deduction while the Senate bill would retain it. The deduction generally allows taxpayers to deduct unreimbursed medical expenses that exceed certain amounts.

Adoption tax credit. The credit for adoption expenses would have been repealed under the original House bill but a November 9 amendment eliminated the repeal. The Senate bill would also retain the credit for qualified expenses. So it appears that the adoption tax credit is no longer a tax reform target.

Enhanced standard deduction for blind and elderly taxpayers. The House bill would eliminate this deduction while the Senate plan would retain it.

Estate tax. The House bill would essentially double the gift, estate and generation-skipping transfer (GST) tax exemptions to $10 million (adjusted for inflation) and eliminate the estate and GST taxes entirely after 2023. That same year, it would reduce the gift tax rate to 35%. The Senate bill would double the exemptions, similar to the House provision. But unlike the House, the Senate doesn't propose repealing the estate tax or GST tax or reducing the gift tax rate at any point.

Business taxes

These changes also would generally be effective beginning in 2018, but be sure to note the exceptions:

Corporate tax rate. The House bill would slash the corporate tax rate from 35% to 20% beginning in 2018 — the largest one-time reduction of the corporate rate in history. The Senate plan also would cut the rate from 35% to 20%, but it would delay the change until 2019.

Pass-through business tax rate. The original House bill called for substantial changes to the taxation of owners of pass-through entities (sole proprietorships, partnerships and S corporations), and the Ways and Means Committee passed amendments to its bill on November 9 that would complicate matters further. The House bill would tax pass-through owners on their "business income" at a maximum rate of 25%, rather than at their individual income tax rate. Those "actively involved" in their businesses would pay their individual rate on 70% of their income (which would be deemed wages) and the 25% rate on the remaining income.

Alternatively, until 2023, these business owners would be able to apply a "facts-and-circumstances" formula that calculates the amount of their wage income based on their capital investment in their businesses. This option might be especially appealing for capital-intensive businesses. Personal services businesses (for example, law, accounting, consulting, engineering and financial services firms) wouldn't be eligible for the 25% rate at all.

The Senate bill would provide tax relief to owners of pass-through entities by establishing a "simple and easy-to-administer deduction for pass-through businesses of all sizes." The deduction would amount to 17.4% for certain pass-through income. The deduction would be phased out for specified service businesses whose taxable income exceeded $150,000 for married joint filers and $75,000 for other taxpayers.

These provisions introduce more complexity into the income tax process. In addition, the National Federation of Independent Business expressed concern that the pass-through provisions wouldn't help most small businesses, because their income is low enough that they already pay less than 25% in taxes.

In response to such criticism, the House on November 9 added an amendment to its bill that would provide relief to some small business owners. The amendment eventually would provide a 9% tax rate, in lieu of the ordinary 12% tax rate, for the first $75,000 in net business taxable income of an active owner or shareholder earning less than $150,000 in taxable income through a pass-through business and married filing jointly. (For single taxpayers, the $75,000 and $150,000 amounts would be $37,500 and $75,000, and, for heads of households, they'd be $56,250 and $112,500.)

As taxable income exceeds $150,000 for married joint filers, the benefit of the 9% rate relative to the 12% rate is reduced, and it's fully phased out at $225,000 for such filers. Businesses of all types would be eligible for the preferential 9% rate. The proposed 9% rate would be phased in over five tax years. The rate for 2018 and 2019 would be 11%. For 2020 and 2021, it would be 10%, and for 2022 and thereafter, it would be 9%.

Depreciation of business assets. The House bill would allow companies to immediately expense capital investments — except buildings — acquired and placed in service after September 27, 2017, and before January 1, 2023 (with an additional year for certain property with a longer production period).

In addition, under the House bill, the limit on Section 179 expensing for pass-through entities would rise to $5 million from $500,000, with the phaseout threshold increasing to $20 million from $2 million. These higher amounts would be adjusted for inflation, and the definition of "qualifying property" would be expanded but wouldn't include property used in a real estate business. But the limits would be boosted for only five years, which some economists say isn't long enough to encourage much capital investment.

The Senate plan would also allow for full and immediate expensing of qualifying assets acquired and placed in service before January 1, 2023, though there would be some differences in which assets would qualify. The Senate bill also would increase the Sec. 179 expensing limit, but only to $1 million, and would increase the phaseout threshold, but only to $2.5 million. The higher limits would, however, be permanent (and continue to be indexed for inflation).

Nonqualified deferred compensation amendment

When it was released, the House bill contained a provision that would tax an employee on nonqualified deferred compensation differently than it does now. It would essentially eliminate the ability to defer taxes beyond the vesting period. Business groups complained that the provision would mark the end of many nonqualified deferred compensation plans.

A House amendment, which was approved on November 9, would preserve the current tax treatment of nonqualified deferred compensation. But the Senate bill does propose significant changes to the tax treatment of nonqualified deferred compensation. The changes are too complex to go into here, so contact us for details.

What happens now?

Keep in mind that we've covered only some of the proposed changes here. Many additional changes have been proposed that might affect you or your business.

Despite all the tax reform action that occurred on November 9, there's still a long way to go before a law is passed. The full House of Representatives plans to vote on its bill as early as the week of November 13, according to Republican leaders. Senate Finance Committee members said they'll make revisions to their plan in coming weeks before crafting a formal bill and having the full Senate vote on it.

Then, the House and Senate must reconcile their differences into a single bill that Republican lawmakers hope to vote on before Christmas so that President Trump can sign it by December 31. Meanwhile, lobbyists and special interest groups, as well as taxpayers, will continue to weigh in, and some Republican lawmakers have already expressed opposition to parts of the proposals.

With the significant differences between the House and Senate plans, it remains to be seen whether they can craft a unified bill that can be passed by both chambers by the end of the year. For more information, please contact your Anchin Relationship Partner.

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