Selected Highlights of Tax Cuts and Jobs Act Provisions Passed by House and Senate

(Summary prepared by Steve Akers)

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H.R. 1 "Tax Cuts and Jobs Act". H.R. 1 was released by the House Ways and Means Committee on November 2, 2017, and various amended substitute versions were subsequently published. The Ways and Means Committee approved the bill on November 9, and the House approved the bill (without considering any additional amendments) on November 16 by a vote of 227-205 (no Democrat voted in favor and thirteen Republicans voted against). The Senate Finance Committee released the Senate plan on November 9, 2017 in a detailed description of the "Chairman's Mark of the Tax Cuts and Jobs Act" without legislative text. A modification to that Chairman's mark was released on November 14, 2017. The Senate version of the Tax Cuts and Jobs Act was approved by the Senate in the early morning hours of December 2 by a vote of 51-49 (no Democrat voted in favor and one Republican voted against). The differences between the separate bills are being resolved by Conference Committee. The compromise approach is expected to be announced later today or within the next several days. A few highlights of the bills passed in the House and Senate are summarized below. (Observations about differences in the Senate version of H.R.1 are noted as relevant.)

Business Tax Matters

- Corporate tax rate of 20% (reduced from 35%). The Senate version delays the top 20% rate until 2019.
- Qualified business income from a partnership, S corporation, or sole proprietorship will be taxed at 25%. Complicated restrictions prevent re-characterizing personal income as business income. (All passive business income qualifies for the 25% rate, but active income is generally treated 70% as wage income and 30% as business income. An alternative is to set the ratio of wage income to business income based on the level of capital investment.) "Specified service activities" (very broadly defined, but including health, law, engineering, architecture and accounting services) do not qualify for the special 25% rate. The provision adopted by the Ways and Means Committee included an amendment creating a 9% rate, instead of a 12% rate, for the first $75,000 of business income. This benefit would be phased out for taxpayers with income between $150,000 - $225,000, and the rate would be dropped from 12% to 9% over a five-year phase-in period. The preferential rate on the first $75,000 of business income would apply to all types of business, with no exception for "specified services activities.
- The Senate version applying favorable treatment for business income from passthrough entities takes a deduction approach rather than a rate reduction approach. The Senate provision allows a 23% deduction (up from 17.4% in the initial release of the Senate version) for qualified business income from a partnership or S corporation, limited to 50% of the taxpayer's pro rata share of the total W-2 wages paid by the business (this provision apparently is intended to encourage companies to hire more workers, but could

have the effect of encouraging businesses to bring more services in-house rather than contracting with outside providers to fulfill certain needs). The 50% of wages limitation would not apply to a "taxpayer with income not exceeding $500,000 for married individuals... [and] phased in for individuals with taxable income exceeding this ... amount over the next $100,000 of taxable income for married individuals..." The deduction would not apply to many types of service businesses, except those whose income falls to below $500,000 for joint filers, $250,000 for others. The general effect, for owners in the top 38.5% bracket is that a 23% deduction results in an effective tax rate of 29.6%. Some Republican Senators (in particular, Senators Johnson and Daines) expressed concern about the wide disparity between the top rate for corporations (20%) vs. the top rate for passthrough entities (the effective 29.6% rate for business income and 38.5% for wage income). As a compromise, the Senate version was revised to increase the deduction from 17.4% in the initial version to 23%.

- The House version of the passthrough entities provision reduces revenue by $596.6 billion over a decade and the Senate version reduces revenues by $476.2 billion over a decade. The Wall Street Journal reports that "]m]ore than half of U.S. business income goes to pass-throughs, and more than half of that goes to the top 1% of households." Rubin & Hughes, *Senate Passes Sweeping Revisions of U.S. Tax Code*, WALL STREET JOURNAL (Dec. 2, 2017).
- Increased expensing of capital investments in depreciable assets for five years.
- Corporate interest deductions for businesses with gross receipts over $25 million ($15 million or less in the Senate version) would be limited to 30% of the corporation's "adjusted taxable income."
- In the House version, but not the Senate version, contributions to a partnership or corporation in excess of the value received as stock or a partnership interest will be taxable to the entity (by the addition of a new §76 of the Code). [This could be significant if the stock or partnership interest received is reduced by applicable minority and marketability discounts; whether that imposition of tax is intended is unclear.]
- The corporate alternative minimum tax is repealed in the House version, but is retained in the Senate version.
- Like kind exchanges would be permitted only for real property.
- Employees who receive stock options or restricted stock for the performance of services may defer recognition of income for up to five years upon exercise of the options. (A provision in the initial version of the Senate version to require that income be recognized upon the vesting of non-qualified deferred compensation, rather than when received, was eliminated in the November 14, 2017 Senate proposal.)

Multinational Treatment of Companies

- Adopt a territorial taxation system for global American companies with a 100% exemption for dividends from foreign subsidiaries if the U.S. parent owns at least a 10% interest.
- Foreign earnings that have accumulated offshore will be treated as repatriated and subject to tax (cash and cash equivalents-14%, illiquid assets-7%); payment of the tax liability may be spread out over eight years. The Senate version includes a 14.5% rate for

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