DONE DEAL: TAX REFORM PASSES CONGRESS

Ed Mills, *Washington Policy Analyst, breaks down the major components of the newly approved tax legislation.*

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The tax reform bill lowering the corporate tax rate and making a number of adjustments to the individual tax code has been approved by Congress and is set to become law. The final tax bill sets a corporate tax rate of 21% starting in 2018, a top individual rate of 37%, the repeal of the corporate AMT, a $1 million phase-out threshold inclusion for the individual AMT, a $750,000 mortgage interest deduction cap through 2025, a 20% deduction on pass-through income, an increase in the estate tax exemption (but not repeal), a $10,000 deduction for state, local, sales or property tax (SALT), 100% deduction of cap-ex for five years, maintaining the deductibility of interest from private activity bonds, and a repeal of the individual mandate of the Affordable Care Act (ACA). In this report, we review the effects of the final provisions and cover next steps for Congress as we head into 2018.

NEXT STEPS FOR CONGRESS

House Ways and Means Committee Chairman Brady (R-TX) anticipates work will continue on tax reform after the bill's passage with corrections to streamline and clarify provisions expected next year. Congressional Republicans may attempt to work with Democrats on fixes that require 60 votes to pass the Senate, but have also signaled that the budget reconciliation measure used to pass tax reform with a 51 majority vote may be used again on issues where bipartisan compromise cannot be reached. This will usher in a new round of debates about which provisions could see further revision (including a potential SALT fix) as well as discussion related to entitlement reform.

DELAY IN BILL SIGNING?

The exact timing of President Trump's signature on the bill is somewhat in flux, but it will not impact the effective date of any provisions in the bill. Under existing law, Congress must vote to waive a budget rule that would require automatic spending cuts to offset the increase to the federal deficit from this tax bill. By delaying signing the bill until January, these cuts get delayed. It is expected that Congress will act to prevent these automatic cuts, but any deal requires a 60-vote threshold in the Senate.

GOVERNMENT SHUTDOWN DEADLINE

With tax reform done, Congress turns its at tention on an agreement for government funding with a Friday deadline looming to avert a shutdown. Congressional Republicans are seeking a short-term budget resolution which would fund the government through January 19. We anticipate that the short-term extension is likely to focus purely on funding for government agencies and funding disaster relief; leaving funding for the Children's Health Insurance Program (CHIP), a fix to the Affordable Care Act (ACA), and immigration issues until January.

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CORPORATE REFORMS

Lowering the corporate tax rate to 21% and moving to territorial taxation are the key parts of the reforms. The corporate alterna tive minimum tax (AMT) is eliminated. Repatriated earnings will be subject to a 15.5% tax on liquid assets and 8% on other earnings and profits with an eight-year repayment window. Net interest deduction is limited to 30% of adjusted taxable income, and net operating loss deductions are capped at 80% of taxable income. Capital expenditures see full depreciation and are 100% deductible for five years. For small businesses, the capital investment deduction limit under Section 179 is increased to $1 million.

INDIVIDUAL REFORMS

Seven tax brackets are retained but lower taxation rates across the board, with a top rate of 37% (starting at $600,000 for joint filers). The standard deduction is nearly doubled to $12,000 for individuals and $24,000 for joint filers. Personal exemptions are eliminated and SALT deductions are capped at $10,000. Mortgage interest deductions are capped at acquisitions of $750,000. The individual AMT is retained, but narrowed with a raised phase-out threshold at $1 million.

See below the changes to the corporate and individual tax code in the final tax bill.

	Current Law	Conference Bill
Corporate Tax Rate	35%	21%, starting in 2018
Worldwide vs. Territorial	Worldwide	Territorial
Repatriation of Foreign	Foreign earnings are taxed at a 35% minus	Built up foreign earnings deemed repatriated.
Anti-Base Erosion Provisions	U.S. companies are allowed to shift profits to	Establishes a 5% base erosion tax calculation
Net Interest Deduction	Business interest is generally allowed as a deduction, subject to certain limitations.	Limit net interest deduction to 30% of adjusted taxable income. Uses EBITDA for four years, then switches to EBIT.
Changes to NOL Deduction	Companies are allowed to deduct taxes based upon a net operating loss with a 2-year look back and a carryforward for 20 years.	Caps NOL to 80% of taxable income, extends carryforward indefinitely. Repeals lookback. Applies to losses starting in 2018.
Like-kind Exchange of Real Property	Allows for the exchange of certain properties without recognizing a gain or loss. The like-kind exchange establishes a new basis.	Only allows like-kind exchanges for real property, preserving much of the current law.
FDIC Premiums	FDIC premiums paid to the Deposit Insurance Fund (DIF) are an eligible deduction.	Phase out of deduction starting at banks greater than $10 billion in assets, eliminated at $50 billion.
Advance Refunding Bonds	Interest received on advance refunding bonds (more than 90 days before the redemption bond) are exempt from federal taxation.	Repeals tax exempt status on interest received from advance refunding bonds issued after 2017.
New Market Tax Credits	Tax credit allowed for in qualified community development entities.	No provision, status quo maintained.
Carried Interest	Taxation of distributions from partnerships at capital gain rate rather than ordinary income.	To be held for three years to qualify for capital gain rate.
Bond Reform	Interest received from government bonds and private activity bonds (PABs) are tax exempt.	No provision, status quo maintained.
Insurance	Variety of unique provisions to the insurance industry.	Repeal or change to a number of provisions.
Section 179 Expensing	Limits small business expensing to $500,000.	Increases limit to $1,000,000.

	Current Law	Conference Bill
Income Brackets	7 Brackets: 10% - 39.6% (top rate starts at $470,700 for joint filer – for 2017) 10% - <$9,325 (single); <$18,650 (married) 15% - $9,325; $18,650 25% - $37,950; $75,900 28% - $91,900; $153,100 33% - $191,650; $233,350 35% - $416,700; $416,700 39.6% - $418,400; $470,700	7 Brackets: 10% - 37% (top rates starts at $600,000 for joint filer) 10% - <$9,525 (single); <$19,050 (married) 12% - $9,525; $19,050 22% - $38,700; $77,450 24% - $82,500; $165,000 32% - $157,500; $315,000 35% - $200,000; $400,000 37% - $500,000; $600,000
Pass-through Tax Rate	Net income subject to individual marginal rate.	Allows most pass-throughs to deduct 20% of business income. Limits deduction for joint filer above $315,000 for services businesses.
Standard Deduction	$6,350 individual, $9,350 couples.	$12,000 individual, $24,000 couples.
Personal Deductions	$4,050 deduction for each personal exemption.	Repealed.
State and Local Taxes (SALT)	Filers are able to deduct taxes paid to states and local governments (including property taxes).	Caps state, local, property, and sales tax deduction at $10,000.
Mortgage Interest Deduction (MID)	Itemized deduction for mortgage interest paid on principal residence and one other residence up to $1 million. Allows deduction for up to interest paid on $100,000 in come equity indebtedness.	Caps MID to $750,000 from 2018-2025. Retains $1 million for acquisitions made before December 15, 2017. Removes ability to deduct interest on home equity loan.
Phase out of Deductions (Pease Limitation)	Limitations on otherwise allowable deductions based on income. Current threshold is $261,500 for individuals, $313,800 for couples.	Repealed.
Child Tax Credit	$1,000 credit, phase out beginning at $110,000 (joint filers).	$2,000 credit, $1,400 refundable. $500 for qualifying non-children dependents. Phase-out at $400,000 (joint filers).
Alternative Minimum Tax (AMT)	Taxpayers are required to compute tax liability on an alternative tax code; if filer would pay more in the alternative, the filer is subject to the alternative minimum tax. Tax rate is 26% or 28% depending on income.	Retains AMT, but raises exemption amount ($109,400 for joint filers). Raises exemption phase-out threshold to $1 million (joint filers).
Variety of Current Deductions, Including Student Loans, Medical Expenses, Childcare, Alimony	Subject to certain limits, current code provides an above-the-line deduction for a variety of expenses.	Repeals a variety of current deductions, maintains student loan interest and medical expense deductions.
Estate Tax	40% tax on estates above certain threshold, $5 million as base exclusion.	Doubles base exclusion to $11.2 million, indexed for inflation.
Charitable Contributions	Contributions are an allowed itemized deduction.	Increases percentage limit for charitable contributions.
Sale of Principal Residence	Exclusion from gross income up to $500,000 couple, $250,000 individual if residence was principal residence 2 of last 5 years. Can be used once every 2 years.	No provision, status quo maintained.

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