Client Alert!

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TAX CUTS AND JOBS ACT OF 2017

November 8, 2017

"The less people know about how sausages and tax law are made, the better they'll sleep at night" – Otto von Bismarck

On Thursday, November 2nd, The House Ways and Means Committee released a 429 page "Tax Cuts and Jobs Act of 2017" tax overhaul. The bill proposes to lower business and individual tax rates, modernize US international tax rules, and simplify the tax law, with significant impacts on numerous sectors of the economy.

Provided is a brief summary of some of the major proposed changes to the tax code:

Changes to the Individual Income Tax

- Lowers individual tax rates to 0%, 12%, 25%, and 35% and continues to maintain 39.6% for the top earners but that marginal rate starts at $500,000 a year for single and $1 million for joint filers.
- Almost doubles the standard deduction – from $6,350 to $12,000 for individuals and $12,700 to $24,000 for married couples.
- Eliminates the personal exemption.
- The proposal would limit the state and local income tax deduction to $10,000.
- The deduction for medical expenses would also be repealed. Medical-expense write-offs are currently allowed only if they exceed 10% of annual income.
- Mortgage interest deductibility would be limited to $500,000 principal balance on one residence vs. the current $1 million. However, existing mortgage debt would be grandfathered, including refinancing. But the proposed measure would eliminate the mortgage deduction for second homes. Under the new ceiling, the most expensive house that would get full deductibility would go for $625,000, assuming a 20% down payment and an 80% loan-to-value ratio. Good luck finding that in California!
- Establishes a new Family Credit, which includes expanding the Child Tax Credit from $1,000 to $1,600 to help parents with the cost of raising children, and providing a credit of $300 for each parent and non-child dependent to help all families with their everyday expenses. The phase-out threshold for the Child Tax Credit is also increased: for married households, it rises from $110,000 to

$230,000.

- Repeals the Alternative Minimum Tax.
- Provides immediate relief from the Estate Tax by doubling the exemption ($11.2 million per person) and repealing the Estate Tax after six years.
- Eliminates the deduction for payments of alimony or spousal support.

Changes to Business Income Taxes

- The proposal includes a 20% corporate tax rate from the current 35% top tax rate, which would take effect for 2018 and would be permanent.
- As for repatriation of foreign earnings, unremitted foreign earnings would be subject to a 12% rate on earnings held in cash, and 5% in untaxed earnings that have actually been reinvested in foreign acquisitions, plant, equipment, or other uses. Currently, companies pay up to 35% - the standard corporate tax rate – on overseas profits brought into the U.S.
- One of the more controversial provisions in the proposal is a new 25% rate on personal business income also known as "pass-through income." The proposal would tax passive owners of partnerships, sole proprietorships, and other businesses at 25% if fully "passive". Active business owners would have income continue to be taxed as ordinary income: at a minimum, 70% as ordinary income unless the business owner could prove that a higher share was related to capital income. Income from "personal services businesses" like law, accounting, consulting, etc., would be taxed at ordinary rates by default. Pass-through profits are now taxed at top individual income-tax rates as high as 39.6%.

The current legislation is first and foremost, a tax cut and is not needed reform. How would the proposed changes impact your tax bill? The Tax Policy Center said Americans in the top 1 percent of earners, with annual incomes of more than $730,000 would receive a $37k tax cut, representing 22 percent of the total tax cut available for individuals in 2018. About 12 percent of taxpayers would pay higher taxes in 2018 rising to more than 28 percent of taxpayers by 2027 (none of these taxpayers are in the 1 percent).

For further details and analysis of the "Tax Cuts and Jobs Act of 2017", the Tax Foundation provided a special report: https://taxfoundation.org/2017-tax-cuts-jobs-act-analysis/.

The Ways and Means Committee is scheduled to begin consideration of the bill on November 6th. It seems likely that some of these proposals, especially in regards to the state and local tax limitations, killing the adoption tax credit, abolishing the tax deduction for high individual medical expenses, and limitations on mortgage interest deductibility will change before the bill reaches the House floor for a vote, as these issues more than most others could threaten House passage. We are also not convinced the top corporate tax will fall all the way to 20% in 2018 and also believe that a phase-in of the corporate tax reduction is more likely.

The tax bill may pass late this week in the Ways and Means Committee, with numerous provisions that the Senate will almost certainly reject in December. In the Senate, the bill will need 51 votes and there are only 52 Republican Senators, meaning that the objections of just a few senators over any particular issue could change the substance of the proposal.

Don't lose any sleep as the final bill will likely look much different from the proposal. However, if you see something you don't like, let your Congressman know!