2017 Tax Reform: Senate And House Tax Bills Emerge, But There Are Still Significant Issues To Resolve

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Both the Senate and the House have each passed its own version of the Tax Cuts and Jobs Act (the "Bill"). Although the two versions of the Bill contain many similar provisions, a number of key differences still have to be reconciled by the Conference Committee before a final, single piece of legislation emerges.

While there are too many changes to set forth in this Alert, the more significant differences between the two versions of the Bill are as follows.

Provisions Affecting Individuals

Sunset Provision for Tax Breaks in Senate Version

Because the Senate is subject to budgetary restraints as part of the reconciliation process, the Senate Bill provides an expiration date of January 1, 2026, for many of the tax breaks, especially those for individuals. The House Bill makes many of those changes permanent.

Individual Tax Rates and Brackets

The Senate Bill has seven tax brackets for individuals with rates ranging from 10% to 38.5%. The House Bill has four tax brackets ranging from 12% to 39.6%, and retains the top rate (39.6%) under current law.

Deduction for Alimony Payments

The House Bill eliminates the deduction for alimony payments by the payor-spouse and the inclusion of alimony payments in income by the recipient-spouse. The Senate Bill has no similar provision.

Itemized Deductions

1. *State Income Taxes*. Both Bills repeal the deduction for state and local income and sales tax for individual filers, but allow the deduction for state and local taxes on trade or business income. For residents of high tax states like New Jersey and New York, this may have a significant impact on your taxes. You may find that there will be a greater tax savings by utilizing the increased standard deduction (which Congress has proposed to nearly double) rather than itemizing your deductions. However, for many individuals, this will result in an increase in your Federal income taxes.
2. *Real Estate Tax*. Both Bills limit real estate property tax deductions to $10,000.
3. *Home Mortgage Interest Deduction*. The Senate Bill retains the deduction for interest on acquisition indebtedness, but suspends the deduction for interest on home equity indebtedness. The House Bill retains the deduction for interest on acquisition indebtedness, but, for newly purchased homes, reduces the current $1 million limitation to $500,000 ($250,000 for married individuals filing separately), and allows the deduction only for interest on a taxpayer's principal residence. Interest on home equity indebtedness incurred after the effective date of the House Bill would not be deductible.
4. *Medical Expenses*. The House Bill repeals the deduction for medical expenses, while the Senate Bill retains the deduction and lowers the 10% floor to 7.5% for 2017-2018, but reinstates the 10% floor after 2018.

Individual Alternative Minimum Tax (AMT)

The House Bill repeals AMT for individuals, while the Senate Bill retains the individual AMT, but increases the exemption amounts.

Estate Tax

Both Bills significantly increase the estate and gift tax exemption in 2018 by doubling the exemption from $5.6 million to $11.2 million, and index the exemption for inflation. There is also a significant difference in the House and Senate Bills in that the House Bill fully repeals the estate tax after December 31, 2024. The Senate Bill allows the increased exemption to expire after 2025. Both Bills allow a continued step-up in basis for estate property.

Individual Mandate Under The Affordable Care Act

The Senate Bill reduces the amount of the individual shared responsibility payment —i.e., the penalty under Obamacare for not having minimum essential health insurance coverage—to zero. The House Bill has no such provision.

Child Tax Credit

The Senate Bill increases the child tax credit from $1,000 under current law to $2,000, increases the age limit for a qualifying child by one year such that a taxpayer would be able to claim the credit with respect to any qualifying child under 18 (but only for tax years beginning after December 31, 2017 and before January 1, 2025), increases the income level at which the credit phases out ($75,000 for single filers and $110,000 for joint filers under current law) to $500,000, and reduces the earned income threshold for the refundable portion of the credit from $3,000 to $2,500. The House Bill increases the amount of the credit to $1,600 and increases the income levels at which the credit phases out to $115,000 for single filers and $230,000 for joint filers.

Each Bill also provides a non-child dependent credit, which would be $500 under the Senate Bill and $300 under the House Bill. The House Bill also provides a “family flexibility credit”; the Senate Bill has no similar provision.

Provisions Affecting Businesses

Effective Date Of Corporate Tax Reduction

Each Bill reduces the corporate tax rate to 20%, except the House Bill taxes personal service corporations at 25%. The House Bill becomes effective for tax years beginning after December 31, 2017, whereas the Senate Bill becomes effective for tax years beginning after December 31, 2018.

Corporate Alternative Minimum Tax (AMT)

The House Bill repeals the corporate AMT, while the Senate Bill retains the corporate AMT at its current 20% rate. The 20% corporate AMT rate equals the 20% corporate tax rate that becomes effective under the Senate Bill for tax years beginning after December 31, 2018, which offsets the value of corporate tax breaks for many businesses.

Interest Expense

Both Bills limit interest expense deductions to business interest income plus 30% of a business's adjusted taxable income (EBITDA), but allow a full deduction for small business having gross receipts of $25 million or less under the House Bill and $15 million or less under the Senate Bill.

Section 179 Expensing

Each Bill increases the expensing limit and phase-out under Code Sec. 179, but the Senate Bill increases the limit to $1 million and begins the phase-out at $2.5 million (up from $520,000 and $2,070,000 for 2018 under current law), while the House Bill increases the limit to $5 million and starts the phase-out at $20 million.

Pass-Through Provision

The Senate Bill allows a non-corporate taxpayer who has qualified business income (QBI) from a partnership, LLC, S corporation, or sole proprietorship to claim a deduction equal to 23% of pass-through income but is subject to complex limitations. Importantly, the Senate's deduction for pass-through income does not apply to businesses held in estates or trusts, which may cause taxpayers to reconsider transferring business interests to trusts and the benefits of transfers out of trusts to individual beneficiaries.

The House Bill takes a different approach to small business relief by providing a new maximum rate of 25% on the "business income" of individuals, with a series of complex anti-abuse rules to prevent treating wages as business income. (Taxpayers in lower income tax brackets would be eligible for a

9% bracket.) Passive owners of a business would be eligible for the 25% rate on all their business income, whereas an active owner would be eligible for the 25% rate on only a portion of their business income (generally 30%, but may be greater if the business is capital intensive). Taxpayers in personal service businesses, e.g., law, accounting, medicine, etc., would not be eligible for the 25% rate.

At this time, the Bills represent similar, but different, versions of tax reform proposed by the Senate and House. It is likely that a single piece of legislation will eventually emerge from the Conference Committee of the House and Senate when it completes its consideration and negotiation of the differences between the two Bills, thus producing a single, final bill to be voted on by both Houses of Congress and signed by the President.

Einhorn Barbarito plans to keep you informed of the key developments of the Bills as they occur. However, there are certain steps you may wish to take before the end of 2017 that could provide benefits that might not be available in future years. Some of those steps are the following:

Individuals:

- Take out a home equity line of credit on your personal residence to take advantage of the interest deduction, which may not be available for home equity loans after 2017.
- Accelerate the payment of medical expenses in 2017, which may not be deductible after 2017.
- Accelerate charitable contributions that you intend to make in future years into 2017. Implementing the use and funding of a donor advised fund is an excellent idea for clients who will be using the standard deduction in future years, as they may lose the tax benefit of these contributions in years after 2017.
- Pay the first quarter of 2018 real estate taxes in 2017.
- If you need to pay a fourth quarter 2017 state estimated tax payment in January, consider making an estimated payment a few weeks earlier than usual, before the end of this year.
- In negotiating any settlement of a divorce or prenuptial agreement, consider carefully the potential change in tax laws regarding alimony on any divorce occurring after 2017.
- If you are considering buying an electric car, act fast as the $7,500 tax credit may disappear after 2017.
- If you are buying a primary or second home, it may pay to accelerate the closing into 2017.

For businesses, there are certain steps to postpone until after 2017 to take advantage of the benefits available in the proposed legislation:

Businesses:

- Postpone the purchase of equipment, machinery or other depreciable items until after 2017, to take advantage of the higher Section 179 expensing limits available in 2018.
- Postpone the recognition of income until 2018 to avoid the current graduated corporate rates, unless there are net operating losses to offset the income.
- Postpone the purchase of qualifying business equipment until after 2017 to take advantage of the 100% depreciation deduction.
- Postpone the purchase of luxury automobiles until after 2017, since the proposed tax legislation sharply increases the depreciation deduction limitations available.

We plan to keep you informed of the changes that will occur once a final Bill becomes law. In the meantime, please feel free to reach out to Einhorn Barbarito with any questions you might have.