TAX REFORM LEGISLATION MOVES FORWARD ON TWO FRONTS

Tax reform is moving ahead this year on two fronts.

First, on November 16, 2017, the House passed its tax reform bill, the "Tax Cuts and Jobs Act," (H.R.1"). The Senate followed up on December 2, 2017 with its version of tax version. The two bills are similar, but have a number of differences, and these need to be ironed out by leaders in both the House and Senate.

The two tax proposals involve would result in a major overhaul of many provisions throughout the tax code. While there are numerous similarities in the Senate tax bill with the House tax bill, there are also many differences. The two tax bills were designed to fit within the Tax Framework released on September 27, 2017, which was drafted by Congressional leaders and the Administration.

HIGHLIGHTS FOR BUSINESSES IN HOUSE AND SENATE TAX REFORM PROPOSALS

The tax reform framework offered several major provisions for businesses. One of which was a drop in the corporate tax rate from 35% down to 20%. Another major provision was to establish 100% expensing of capital expenditures. The framework, however, indicated that many other deductions and incentives may be repealed or curtailed. **Selected business provisions** included in House tax bill compared with the Senate version are highlighted in the chart below.

HOUSE VS. SENATE HIGHLIGHTS FOR BUSINESSES		
PROVISION	**HOUSE BILL**	**SENATE BILL**
Corporate Tax Rates	20% for C Corporations beginning in 2018. A Personal Service Corporation (PSC) would be taxed at 25%.	Same tax rate, but **delays the effective date to 2019.** PSC rate at 20%.
Corporate AMT (Alternative Minimum Tax)	Corporate AMT repealed in 2018.	Corporate AMT retained.
Pass-Through Tax Rates	25% tax rate available for "pass-through businesses" (S Corporations and Partnerships/LLC's), however, this rate is subject to a number of complexities. The actual tax rate might end up at 30-35%; not 25%. Effective in 2018.	Adds a new business deduction of 23% for "pass-through businesses" to achieve tax savings. Different format than House version with its own complications. The actual tax rate winds up around 30%. Effective in 2018.

continued...

HOUSE VS. SENATE		
PROVISION	**HOUSE BILL**	**SENATE BILL**
Interest Deduction for Small Business **(Under $25 million or $15 million in revenue).**	Small business not subject to limitations (small business < $25 million in revenue).	Similar provision, but small business defined as < $15 million in revenue.
Interest Deduction for Companies with over $25 million or $15 million in revenue	Limited in their interest deduction based on 30% of adjusted taxable income. Any unused interest expense above 30% threshold would be disallowed, and would carry forward for five years. This limitation would first apply in 2018. Exceptions apply for "real estate businesses" and for "floor plan financing" for auto dealers.	Similar provision for the 30% of adjusted taxable income. Also, unlimited carryforward on excess interest expense. Exception for real estate businesses is elective. Also, no "floor plan" exception.
CapEx Additions	100% bonus depreciation for additions placed in service after September 27, 2017. Applies to property new to the buyer, thus could be "used." Further, the 100% bonus depreciation is not available for "real estate businesses" (see above item for real estate businesses for interest expense limitation).	Similar provision, and effective date. Unsure if "used" property definition applies to Senate bill. Also, enhanced depreciation for property used in farming. Finally, depreciable life of building (commercial or residential) reduced to 25 years.
Section 179 Expensing	• Limitation would be increased from $500,000 to $5,000,000. • Phase-out amount for annual additions would be increased from $2,000,000 up to $20,000,000.	Similar provision, but increases smaller. Expensing would be raised to $1,000,000 and phase-out at $2,500,000.
Accounting Method Reforms for Small Businesses	• Permits use of the cash method (even if the small business had inventories). • Removes the Uniform Cost Capitalization for Inventory (UNICAP) rules for small businesses. • Permits use of the completed contract method or other method for long-term contracts for contractors. • Applies to small businesses up to $25 million of revenue.	Similar small business provisions, however, small business definition is less than $15 million of revenue.

continued...

HOUSE VS. SENATE		
PROVISION	**HOUSE BILL**	**SENATE BILL**
Net Operating Losses (NOLs)	• Allowed, but limited to 90% of a company's income before the NOL deduction. • NOLs can only be carried forward, no carrybacks. • Interest factor applied on NOL carryforwards.	Similar NOL provision with 90% income limitation (80% beginning in 2023). NOLs can only be carried forward indefinitely (except 2 year NOL carryback for farming business). No interest factor listed with NOL carryforwards.
LIFO Inventory	No limitation or changes to LIFO.	No limitation or changes to LIFO.
R&D Credit	Retained.	Retained.
Like-Kind Exchanges (Section 1031 Exchanges)	Limited. Only applies to real property beginning in 2018. Does not apply for personal property.	Similar provision as House bill.

HIGHLIGHTS FOR INDIVIDUALS IN HOUSE AND SENATE TAX REFORM PROPOSALS

The tax reform framework also offered several major provisions for individuals. These included a doubling of the standard deduction; repeal of the Alternative Minimum Tax ("AMT"); and elimination of the estate tax. The framework, however, indicated that several deductions and incentives may be eliminated as part of tax reform. **Selected individual provisions** included in House tax bill compared with the Senate version are highlighted in the chart below.

HOUSE VS. SENATE		
HIGHLIGHTS FOR INDIVIDUALS		
PROVISION	**HOUSE**	**SENATE**
Individual Tax Rates	Tax rates of 12%, 25%, 35%, and a top rate of 39.6%. Also, a higher tax rate applies for a portion of the taxable income over $1 million.	Retains current seven tax brackets, but drops the 15% rate to 12%, and reduces the top tax rate from 39.6% to 38.5%. No surtax over $1 million.
Standard Deduction	Doubled to $24,000 for a married couple filing jointly and to $12,000 for a single taxpayer (in both the House and Senate bills).	
Child Credit	Increase from $1,000 to $1,600 (more than doubled for married taxpayers). This would apply beginning in 2018.	Increase from $1,000 to $2,000 in 2018. Also, much higher phase-out range. Credit phased out for married couple with $1,000,000 of income.

continued...

HOUSE VS. SENATE		
PROVISION	**HOUSE**	**SENATE**
Itemized Deduction for State Income Taxes and Property Taxes	Retained a $10,000 deduction limit for property taxes. No deduction, however, for any state income taxes.	Retained a $10,000 deduction limit for property taxes (like the House Bill). Also, no deduction, for any state income taxes.
Mortgage Interest	Limited mortgage interest to home mortgages of $500,000 or less (for loans after November 2, 2017).	No change on acquisition debt, but interest deduction on "home equity" debt would be repealed beginning in 2018.
Charitable Contributions	• An increase in the AGI threshold for charitable contributions from 50% to 60%. • A repeal of the special 80% deduction for the amount paid for the right to purchase tickets for college sporting events.	Both charitable provisions in the House bill are also in the Senate bill.
Casualty Losses	Itemized deduction to be repealed in 2018. Some relief for those in disaster areas from Hurricanes.	Itemized deduction to be repealed in 2018.
Medical Expenses	Repeal medical deductions beginning in 2018 in House bill.	Medical deduction would not be eliminated. Also, the AGI limitation will be 7.5% in 2017 and 2018, and 10% thereafter.
Alimony Deduction	• Repealed as would the income inclusion to the recipient. • Alimony change would apply for divorce decrees executed after 2017.	No provision included in Senate bill for alimony.
AMT	**The individual AMT is repealed in the House bill beginning in 2018, but a softened AMT is retained in the Senate bill.**	
401(k) Contributions	Unchanged (in both the House and Senate bills).	
IRA	The proposal would preclude an individual from re-characterizing a Roth IRA conversion back to a traditional IRA.	
Estate Tax Exemption	Estate tax exemption doubled to $10,000,000 beginning in 2018, and indexed for inflation. The estate tax would be repealed in 2024.	The estate tax exemption would be doubled and indexed for inflation. But, estate tax would not be repealed as in the House bill.

continued...

HIGHLIGHTS FOR INTERNATIONAL

The tax reform framework offered several major provisions for international businesses. The goal was to make the tax rate for U.S. companies more competitive with the rest of the world and offer an incentive to repatriate money back into the U.S. Among the international provisions included in the tax reform proposals are the following **selected** items:

- Senate bill makes several international changes. The bill permanently modernizes our outdated international tax system by eliminating the antiquated "worldwide" system, to eliminate double taxation, enhance the competitiveness of American companies, and bring business and investment back to the United States. It establishes a new "participation exemption system" for taxation of foreign earnings.
- The Senate bill eliminates the "lock-out effect" by making it simpler and less onerous for American multinationals to bring foreign earnings back to America for investment and growth here at home.
- Many of the international tax provisions are significant and complicated.
- See also separate a Sikich Tax Alert on a number of the proposed international changes in the House and Senate tax bills.

For your reference, please review the following resources:

- Summary from Senate Finance Committee on its tax proposal.
- Detailed description of the changes in the Senate tax proposal from the Staff of the Joint Committee on Taxation (JCT) in Congress.

NEXT STEPS AND OUTLOOK

Please keep in mind - tax reform legislation is not final. These two bills have been worked out almost side-by-side in the House and Senate over the past few weeks, but now the differences in the two plans need to be resolved. We will keep you posted as the process picks up speed.

Please consult your local Sikich tax professional with any questions you may have or visit www.sikich.com for more information.

Please consult your local Sikich tax professional with any questions you may have or visit www.sikich.com for more information.