Senate Passes Comprehensive Tax Reform Proposal

Issue: Tax Reform

Date: December 4, 2017

Action Taken: On December 2, at 2 a.m. (!), the Senate approved its version of the Tax Cuts and Jobs Act, a comprehensive tax reform bill similar to the House's bill of the same title.

Background: With the Senate's 51-49 passage along party lines, the effort to enact the most major tax reform since 1986 moves toward the final phase. Sen. Corker (R-TN) was the only Republican to vote against the bill. The House and Senate are scheduled to proceed to a conference committee this week, where the differences between the House and Senate versions will be resolved. It is anticipated that a final bill will be on the President's desk for signature before the end of the year.

NAIFA's strategy of working some issues behind the scenes, activating grassroots support, and our ongoing coalition efforts have gotten us much of what we need. Neither the House nor Senate bills change the tax rules for life insurance and annuity products, funding rules for retirement savings plans, non-qualified deferred compensation arrangements, or workplace benefits. The Senate bill includes the corrections industry sought to the tax provisions specific to life insurance companies, and we are hopeful these corrections will be adopted in the final version negotiated via conference.

NAIFA's side-by-side comparison of the two bills describes some of the provisions impacting NAIFA members and clients, including:

- ***Corporate tax rate***: Both bills cut the corporate tax rate to 20 percent, but the House bill makes the rate cut effective January 1, 2018, while the Senate bill delays the effective date of the tax rate cut until 2019.

- ***Pass-through business income tax***: The House bill offers pass-through businesses (subchapter S corporations, partnerships, limited liability companies, sole proprietorships) a special 25% tax rate for a portion of business income, using a 30/70 rule to determine the amount of income eligible for the special rate. This rate is not available to personal service entities. For passthrough owners with less than $150,000 of taxable income, the House bill also includes a lower individual income tax rate of 9% (to be phased in) for up to $75,000 of their net business income, available to personal service entities. The Senate bill provides a deduction of 23% of qualified business income, up to 50% of W-2 wages. The 50% of W-2 limit does not apply to to taxpayers (married) with less than $500,000 of taxable income, and also includes limitations for personal service businesses. The conference committee is expected to grapple with these very different approaches, so we expect to see changes in the final bill.

- ***Alternative minimum tax:*** The House bill repeals the AMT for both individuals and corporations. The Senate bill retains and modifies the AMT.

- ***Expensing:*** Both bills provide for full expensing—i.e., the full cost of a qualified business acquisition could be deducted in the year of purchase, rather than having to be spread out (capitalized) over the asset's useful life. However, this is one issue that will need to be resolved in conference as the approaches differ.

- ***Business interest:*** Both bills limit the deductibility of interest paid on business loans, but with different calculations, however, both limit the deductible amount to 30 percent of adjusted taxable income.

- ***Retirement savings:*** The bills do make some favorable smaller changes to retirement savings rules. These rule changes include contributions after a hardship withdrawal, more time to repay a plan loan following separation from service, and earlier in-service distributions from defined benefit plan. Both eliminate the ability to recharacterize IRA contributions from ROTH to traditional or vice versa, and both make contribution limits for 401(k), 403(b) and 457(b) plans the same when employers sponsor more than one plan.

- ***FIFO basis calculation rule for stock/investment sales***: The Senate bill contains a provision requiring taxpayers to use the first-in first-out (FIFO) method to determine cost basis of specified securities sold, exchanged, or otherwise disposed of on or after January 1, 2018—i.e., it repeals specific identification method for determining basis when an asset is sold. The House bill does not contain a similar provision.

- ***Estate tax:*** The Senate bill approximately doubles the exemption from the estate tax. The House bill also almost doubles the estate tax exemption, through 2024. But as of 2025, the House bill would repeal the estate tax, while retaining step-up in basis rules.

- ***Medical expense deduction***: The House bill repeals the medical expense deduction, and the Senate bill allows a deduction for unreimbursed medical expenses above 7.5% of AGI, a change from the current 10% of AGI limit. However, the Senate version is effective only for 2017 and 2018.

- ***ACA mandates***: The Senate bill zeroes out the penalty for failure to comply with the ACA's individual mandate. The House bill does not speak to the ACA mandates.

- ***Individual tax rates/other provisions:*** Both bills change individual tax rates and brackets—the Senate drops the top rate to 38.5 percent and includes seven tax brackets; the House bill retains current law's top 39.6 percent rate and includes four tax brackets. Both bills almost double the standard deduction and increase the child tax credit, while eliminating personal exemptions. The House bill also adds a tax credit for non-child dependents. Many deductions are eliminated—including the one for state and local income taxes. Both bills allow a deduction for state/local *property* taxes of up to $10,000, and both eliminate the deduction for home equity loan interest. The House bill also eliminates the mortgage interest deduction for second homes, and limits the mortgage interest deduction to interest on up to $500,000 (up from current law's $1 million) of new mortgage indebtedness.