U.S. Senate Passes Tax Reform Bill; Next Step, Compromise

On December 2nd, the Senate passed its version of the "Tax Cuts and Jobs Act" with a vote of 51 to 49 – all Democrats, both independents, and one Republican voted against the bill. As approved, the bill includes several last minute amendments and differs considerably from the original bill that was introduced by the Senate Finance Committee. The Senate bill also differs from the version of the bill that was approved by the House of Representatives on November 16th. This result does however substantially increase the likelihood of a unified tax reform bill being finalized before the close of the year.

The rushed process behind the bill has led to a lot of commentary that blurs the difference between the versions, but the differences are significant. The two chambers will now have to reconcile the discrepancies between the bills and then vote on a revised bill – or the House will have to approve the legislation as passed by the Senate. A conference committee with representatives from both the House and the Senate has been tasked with bridging this gap.

Below are some of the highlights of the Senate's legislation along with a comparison to the House's version, where applicable:

- The Senate bill retains the same number of tax brackets for individuals as under current law, seven, although most are lowered through the year 2025, to 10%, 12%, 22.5%, 25%, 32.5%, 35%, and 38.5%. The House bill features only four tax brackets for individuals, instead of seven. There are noteworthy variances between the income thresholds of the two tables; for instance, a married, filing jointly taxpayer would enter the 35% bracket at $260,000 of income under the House bill but would not reach the 35% bracket until $400,000 of income under the Senate version.

- Under the Senate bill, the standard deduction would increase to $12,000 for single taxpayers, $18,000 for heads of household and $24,000 for married, filing jointly. The House bill proposes a similar increase of $12,200, $18,300, and $24,400. Personal exemptions disappear under both versions.

- The revised Senate bill would allow a $10,000 deduction for state and local property taxes. The House bill includes a similar provision. The original Senate bill did not allow any deduction for state and local taxes. Both proposals would eliminate the state and local income tax deduction.

- The Senate bill retains the deduction for medical expenses while the House eliminated it. The legislation sets an adjusted gross income (AGI) threshold of 10%, but an amendment lowered it to 7.5% of AGI for 2017 and 2018.

- Under the Senate bill, the mortgage interest deduction would remain in place for mortgages up to $1,000,000, though the additional deduction for home equity debt would be eliminated. The House bill would cap new mortgages at $500,000 for purposes of the deduction and would only allow it for primary residences.

- For individual taxpayers, the Senate bill would require stocks to be disposed of using a FIFO (first in, first out) basis. This would also apply to gifts of securities.

- Surprisingly, the bill voted on by the Senate included a revised adoption of corporate and individual alternative minimum tax (AMT), rather than repealing it, which the House bill would do.

- In another change, the revised Senate bill would allow individuals to deduct 23% of "domestic qualified business income" passed through from a partnership, S corporation, or sole proprietorship. Thus, owners would be taxed at individual rates less a 23% deduction. Under the House proposal, pass-through income would be taxed at a maximum rate of 25% – though professional service companies would not qualify for the reduced rate. The House bill also presents a further distinction between "wage" income and "business" income.

- The Senate bill lowers the top corporate tax rate from 35% to 20%, the same as the House bill, but it would not be effective until 2019 with the Senate version.

- Both bills would allow for immediate expensing for certain equipment and higher IRC Section 179 deduction limits. The limit would be boosted to $1 million under the Senate bill and $5 million under the House bill.

- The Senate bill retains the estate tax but doubles the current exemption amount (raising it to $11.2 million per individual by 2018). The House bill would eliminate the estate tax starting in 2023, after doubling the exemption amount currently.

- Both bills present opportunities for account owners of 529 plans to use the funds for private elementary and secondary schools (in addition to college).

- The Senate bill would also repeal the individual mandate, Sec. 5000A, which imposes a penalty payment on individual taxpayers who do not have health insurance. The House bill did not repeal the individual mandate.

The above discussion is only a sample of the projected changes to current tax law. As we turn to year-end planning, these two bills present a number of tax saving strategies to consider in anticipation of new tax law for 2018. We will continue to follow the progress of tax reform in Washington and evaluate its impact on our clients. Even though the Senate and the House have presented two distinct bills, there appears to be enough momentum to presume that they will come to a compromise. As always, please feel free to contact us with any questions.

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