Tax Reform: Senate Bill vs House Bill

In the early hours of Saturday morning the Senate passed its version of tax reform. The House bill and the Senate bill will now go to conference committee to iron out the differences. To my surprise the Senate's final bill made some significant moves to the House version of tax reform so I am relatively confident that the conference committee will be able to consolidate these to bills and will result with something to send to the President. Indeed, it looks like we may have tax reform after more than 30 years.

I spent a good part of the weekend drilling down on both bills and have done a side by side on the differences in the two bills. Most of the differences are relatively small but some may take some arm wrestling to resolve.

Provision	House Version	Senate Version
Individual Income Tax Rates and Brackets	Consolidates current seven income tax rates into four, while retaining the top marginal rate of 39.6 percent and including an income recapture provision which phases out the effect of the 12 percent bracket for high earners, sometimes called a "bubble rate" *Single Filer Rate Schedule* 12% > \$0 25% > \$45,000 35% > \$200,000 39.6% > \$500,000	Retains seven brackets while reducing rates, bringing the top marginal rate to 38.5 percent and avoiding a bubble rate; individual income tax rate changes sunset at the end of 2025 *Single Filer Rate Schedule* 10% > \$0 12% > \$9,525 22% > \$38,700 24% > \$70,000 32% > \$160,000 35% > \$200,000 38.5% > \$500,000
Standard Deduction	\$12,200 for single filers, \$18,300 for heads of household, and \$24,400 for joint filers, indexed to chained CPI	\$12,000 for single filers, \$18,000 for heads of household, and \$24,000 for joint filers, indexed to chained CPI
Child and Family Tax Credits	Increases child tax credit value to \$1,600, with the phase-out for joint filers beginning at \$230,000, while creating a new \$300 per-person family tax credit for those not eligible for the child tax credit, to expire after five years	Increases credit value to \$2,000, with the phase-out for joint filers beginning at \$500,000; provision sunsets at the end of 2025
Medical Expense Deduction	Repeals	Retains, and for tax years 2017 and 2018, allows it to be taken if eligible expenses exceed 7.5 percent of AGI rather than 10 percent under current law
Mortgage Interest Deduction	Limits the mortgage interest deduction to the first \$500,000 in principle value	Keeps the mortgage interest deduction for acquisition debt, but eliminates the deduction for equity debt

Graduate Student Income	Treats graduate student tuition waivers as taxable income	Not included in Senate version
Treatment of Pass-Through Income	Caps the pass-through rate at 25 percent, then setting anti-abuse rules that begin with the rebuttable presumption that 70 percent of pass-through income is wage income (subject to the regular rate schedule), while 30 percent is business income (subject to the lower rate cap), while excluding many professional service companies from the preferential rate	Adopts a 23 percent deduction for pass-through income (limited to 50 percent of wage income) for qualifying businesses, including publicly traded partnerships but with a slightly longer list of ineligible service providers; the provision expires at the end of 2025
Corporate Rate Reduction Timing	Cuts rate to 20 percent, effective tax year 2018	Cuts rate to 20 percent, delayed to tax year 2019
Capital Investment	Allows full expensing of short-lived capital investment, such as machinery and equipment, for five years; increases the Section 179 small business expensing cap from $500,000 to $5 million, with the phase-out beginning at $20 million, and maintains current depreciation schedules for real property	Allows full expensing of short-lived capital investment, such as machinery and equipment, for five years, then phases out the provision over the subsequent five; raises Section 179 small business expensing cap to $1 million with a phase-out starting at $2.5 million, and shortens the depreciation of real property to 25 years
Alternative Minimum Tax	Repeals both the individual and corporate alternative minimum taxes (AMTs)	Retains the corporate AMT in its current form, and retains the individual AMT with higher exemption amounts (about 40 percent higher than current law)
Tax Treatment of Interest	Caps net interest deduction at 30 percent of earnings before interest, taxes, depreciation, and amortization (EBITDA)	Caps net interest deduction at 30 percent of earnings before interest and taxes (EBIT)
Net Operating Losses	Eliminates net operating loss (NOL) carrybacks while providing for indefinite net operating loss carryforwards, increased by a factor reflecting inflation and the real return to capital, while restricting the deduction of NOLs to 90 percent of current year taxable income	Eliminates net operating loss carrybacks while limiting NOL carryforwards to 80 percent of taxable income
Cash Accounting	Increases small business eligibility for small businesses, from $5 million to $25 million	Increases small business eligibility for small businesses, from $5 million to $15 million

Business Credits and Deductions	Eliminates credits for orphan drugs, energy, private activity bonds, rehabilitation, and contributions for capital, among others	Modifies, but does not eliminate, the rehabilitation credit and the orphan drug credit, while also limiting the deduction for FDIC premiums and retaining certain other preferences eliminated in the House version
International Income	Moves to a territorial system with base-erosion rules including the inclusion of 50 percent of excess returns by controlled foreign corporations in U.S. shareholders' income, and an excise tax on payments made to foreign firms unless claimed as effectively connected income	Moves to a territorial system with anti-abuse rules and a base erosion minimum tax of the excess of 10 percent of modified taxable income over an amount equal to regular tax liability
Deemed Repatriation	Enacts deemed repatriation of currently deferred foreign profits at a rate of 14 percent for liquid assets and 7 percent for illiquid assets	Enacts deemed repatriation of currently deferred foreign profits at a rate of 14.49 percent for liquid assets and 7.49 percent for illiquid assets
Estate Tax	Increases exemption to $10 million, indexed for inflation, with repeal after six years	Doubles the estate tax exemption
Individual Mandate Penalty	No change	Reduces the individual mandate penalty to $0

As you can see there is a lot here. The next week or so should tell us a lot about whether this will get done by Christmas as the President has promised. Stay tuned.