COMPARISON OF SENATE AND HOUSE TAX REFORM PROPOSALS

Tax Alert
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Practices & Industries

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On November 2, Rep. Kevin Brady (R-TX), Chairman of the House Ways and Means Committee, released a proposed bill, titled the "Tax Cuts and Jobs Act" (the "House bill"), which would make major changes to federal income taxation of individuals and businesses. The House bill has been voted out of Committee and will be voted upon by the entire House in the near future (potentially as early as the week of November 13). A detailed description of the House bill can be found here: http://www.hodgsonruss.com/newsroom-publications-9952.html

The Senate Finance Committee released its tax reform proposal (the "Senate proposal") on November 9. The Senate proposal is in the process of being marked up and amended. Some of the notable differences between the House bill and the Senate proposal are discussed below.

Changes affecting businesses.

- Corporate tax rate. Both the House bill and the Senate proposal would reduce the maximum corporate tax rate to 20% but, under the Senate proposal, this rate would not apply until 2019.
- Deduction for pass-through "Qualified Business Income". Unlike the House bill, the Senate proposal does not provide a special tax rate for certain pass-through income. Instead, the Senate proposal would allow an individual owner to deduct 17.4% of the owner's share of the pass-through entity's "domestic qualified business income," effective January 1, 2018. Additional rules would limit the amount of "domestic qualified business income" and the amount of the deduction. The deduction generally would not apply to individual owners of certain service businesses (*e.g.*, health, law, accounting, engineering, consulting, financial services, or brokerage services), except for individuals whose taxable income would not exceed $150,000 (joint filers) or $75,000 (single filers).
- Carried-interest treatment. The Senate proposal preserves the current treatment of income from carried-interests, although commentary suggests that an amendment to the proposal may change this.
- Tax-exempt private activity bonds. Unlike the House bill, the Senate proposal retains the current treatment of private activity bonds.

Changes affecting international tax.

- Territorial system for U.S. corporate shareholders owning 10% of a foreign subsidiary. Like the House bill, the Senate proposal provides that a 10% or greater U.S. corporate shareholder of a foreign corporation would be entitled to a 100% deduction for foreign-sourced dividends.
- One-time transition tax. Also like the House bill, as part of the transition from our current system to the our new system, U.S. shareholders owning at least 10% of a foreign subsidiary generally will have to include in income the foreign subsidiary's undistributed earnings and profits (E&P). Unlike the House bill, however, such E&P will be taxed at a reduced rate of either 10% or 5%.
- Treatment of intangible property and income therefrom. Similar to the House's "foreign high-return amount", the Senate proposal would require an annual inclusion of a U.S. corporation's "global intangible low-taxed income" ("GILTI"), which is the excess, if any, of (1) certain net items of income of certain foreign subsidiaries, over (2) a deemed return on related tangible property. Unlike the House bill, however, the Senate proposal includes a deduction for "foreign-derived intangible income" ("FDII"), which is the foreign-derived portion of GILTI. Additionally, unlike the House bill, the Senate proposal includes the ability to repatriate intangible property tax-free. These provisions appear aimed at incentivizing U.S. multinationals to keep and/or repatriate their intangible property to the U.S.
- Limitation of deductible amount of interest expense. Like the House bill, in addition to the 30% limitation on the deductibility of interest expense, the Senate proposal includes an additional limitation for U.S. corporations that are members of worldwide affiliated groups (it is a "lesser of" test). Unlike the House bill, however, this limitation would apply to all U.S. corporations (not just those exceeding certain gross receipt thresholds).

Changes affecting individuals.

- Individual income tax rates. While the House bill would consolidate the seven current income tax brackets into four (12%, 25%, 35%, and 39.6%), the Senate proposal would maintain seven brackets but would modify the rates. Neither would repeal the 3.8% net investment income tax.
- Standard deduction. Under both the House bill and the Senate proposal, the standard deduction would increase to $24,000 for joint filers and $12,000 for individual filers (indexed for inflation), and the overall limitation on itemized deductions would be repealed.
- State and local tax deduction. The House bill would allow taxpayers to deduct state and local taxes only to the extent the taxes paid are (1) related to income-producing activities or (2) real property taxes up to $10,000. The Senate proposal would repeal the deduction altogether.
- Mortgage interest deduction. Under the House bill, the home mortgage interest deduction would be limited to $500,000 of principal for new home purchases. The Senate proposal would cap the deduction at $1,000,000 but repeal the deduction for home equity debt interest.
- Other credits/deductions. The House bill would repeal or substantially limit most credits/deductions but the Senate proposal would preserve most of them.
- Personal exemptions. Both would repeal personal exemptions.

- Alternative minimum tax. Like the House bill, the Senate proposal would repeal the alternative minimum tax.

Changes affecting estate tax.

Both the House bill and Senate proposal would immediately double the estate tax exemption amount to $10 million (indexed for inflation) while retaining the step-up in basis of assets received from a decedent. Only the House bill, however, would eventually repeal the estate tax (after 2024). Please see the following link for an alert from Hodgson Russ' Estates and Trusts Practice Group for more information on the proposed changes to the U.S. taxation of wealth transfers: http://www.hodgsonruss.com/newsroom-publications-9959.html

The proposed changes would represent the most comprehensive tax reform in more than 30 years (since 1986). Please contact one of the members of Hodgson Russ' Federal/International Tax Practice Group for more information on the tax reform proposals or to discuss their specific effect on you.