Tax reform proposal clears House; Finance bill headed to Senate floor

Congressional Republican efforts to rewrite the federal tax code took a significant step forward on November 16 as the House of Representatives approved its version of comprehensive tax reform legislation and the Senate Finance Committee reported out a competing measure.

House passage largely drama-free

House Republicans pushed through their proposal – the Tax Cuts and Jobs Act (H.R. 1) – by a largely party-line vote of 227-205.

The bill as approved would, among other things, lower the corporate tax rate to 20 percent and the rate for some income of pass-through entities to 25 percent; compress the individual rate brackets from seven to four (plus a bubble rate that some view as a fifth bracket); provide a more generous business expensing regime; boost the individual standard deduction and the child tax credit; repeal the estate tax and the corporate and individual alternative minimum tax; and shift to a territorial-style system for taxing foreign-source income of US multinationals. (For a detailed summary of the bill as introduced, see Tax News & Views, Vol. 18, No. 40, Nov. 3, 2017; for details on amendments that were incorporated during the Ways and Means Committee mark-up process, see Tax News & Views, Vol. 18, No. 41, Nov. 10, 2017.)

Republicans’ success came with much less drama than many anticipated even a week ago, as all but 13 of their members fell in line behind leadership, signaling how critical a significant legislative win is for the party almost a year after they took control of both the legislative and executive branches. There had been fears of a greater number of defections in recent weeks as some House Republicans – primarily those representing constituents in jurisdictions subject to high state and local taxes – expressed reservations about a provision in H.R. 1 that would eliminate the deduction for state and local income taxes (and for sales taxes in those states that do not have an income tax) as well as limit the deduction for state and local property taxes.

As expected, no Democrats supported the bill.

Passage of tax reform legislation has been a top priority for House Speaker Paul Ryan, R-Wis., for many years and something he’d hoped to lead while he served as chairman of the House Ways and Means Committee in 2015. His plans were upended when turmoil in the Republican leadership led to his installation as speaker only 10 months after he took over the taxwriting panel, and current Ways and Means Chairman Kevin Brady, R-Texas, got to shepherd tax reform through the legislative process instead.

“Here’s nothing short of extraordinary,” said Ryan, at a press conference immediately after the vote. “Getting 227 members to agree on something as complicated as [tax reform]. …The powers of the status quo in this town are so strong, and yet 227 men and women of this Congress broke through that today. That is powerful.”

Finance passage follows contentious mark-up

Just hours after H.R. 1 won passage in the House, the Senate Finance Committee approved its own version of the Tax Cuts and Jobs Act on a strictly party-line vote of 14-12. Final passage came after a days-long mark-up that occasionally erupted into partisan rancor over a series of modifications that Chairman Orrin Hatch, R-Utah, unveiled late November 14 in an effort to ensure that the bill does not increase the federal deficit beyond the 10-year budget window – a requirement for legislation moving under fast-track budget reconciliation protections in the Senate. (Hatch made additional revisions in a separate “wrap up” amendment he offered in the final hours of the mark-up.)

The measure as introduced on November 9 broadly follows the contours of the House-passed legislation. Like the House bill, the Finance Committee proposal would reduce the corporate tax rate to 20 percent; however the Finance proposal would delay implementation of the rate cut until 2019, while the House provision would be effective beginning in 2018. It would reduce marginal tax rates for individuals but does not follow the House in reducing the
number of rate brackets. The Finance bill provides significant relief from the estate tax but stops short of the full repeal included in the House package. It proposes no changes to the current-law deduction for mortgage interest on home purchases (which the House bill would cap at interest paid on loan amounts of up to $500,000); but it would fully repeal the deduction for state and local taxes – something the House bill would retain, although only for property taxes and even then subject to a cap. (For a summary of the proposal as introduced, see Tax News & Views, Vol. 18, No. 41, Nov. 10, 2017.)

URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/171110_1.html

**Individual mandate repeal, sunsets for individual tax cuts:** But the modifications to Hatch’s chairman’s mark include some significant new revenue offsets and proposals to pare back some of the tax relief provisions in the original measure, along with assorted proposals for new tax incentives.

As expected, the amendment would reduce to zero the penalty imposed on individuals who do not have adequate health insurance coverage (the “individual mandate” enacted in the Patient Protection and Affordable Care Act of 2010). This change – which is not part of the House-passed bill – is expected to raise $318 billion over 10 years, according to the Joint Committee on Taxation (JCT) staff, as the foregone penalty income would be more than offset on the spending side by an expected reduction in federal payouts for premium assistance credits. (The estimate assumes that some lower-income individuals who purchased insurance to avoid the penalty will decide to drop their coverage once the penalty is eliminated and therefore will no longer receive the federal subsidy payments.)

Among the other noteworthy proposals, the amendment also would:

- Sunset, after 2025, the changes to the individual side of the tax code in Hatch’s original chairman’s mark, including marginal rates, changes to credits and deductions, and the proposed doubling of the estate tax exemption. (The individual tax relief proposals in the House bill are all permanent.)
- Tweak some of the seven proposed individual rate brackets (ranging from 10 percent to 38.5 percent) and adjust the income thresholds at which those brackets would apply.
- Sunset the proposed new passthrough regime after 2025 and modify the 17.4 percent deduction for certain passthrough income – for example, by making it available to taxpayers with income from service partnerships whose taxable incomes are under $500,000 (for married-joint filers). (Again, the House proposes permanent passthrough tax relief.)
- Strike proposed changes to the rules affecting the tax treatment of nonqualified deferred compensation.
- Make numerous modifications to the complex international tax provisions in the underlying bill, including the deduction for global intangible low-taxed income, the deduction for foreign-derived intangible income, the base erosion anti-abuse tax, and the transition tax (deemed repatriation).
- Require certain research and experimentation (R&E) costs to be amortized over five years (15 if the research is performed outside the US) and clarify that specified R&E expenditures subject to capitalization and amortization include software development.
- Make several changes to the low income housing tax credit and to the excise tax rules for alcoholic beverages.

Highlights of the most significant modifications are available from Deloitte Tax LLP.


**Partisan split:** The JCT staff estimates that the Hatch’s modified mark would increase the federal deficit by just over $1.4 trillion between 2018 and 2027 – down from its estimate of nearly $1.5 trillion over the same period for the proposal as originally introduced. (The recently approved unified budget resolution for fiscal year 2018 affords fast-track budget reconciliation protections to a tax bill that increases the federal deficit on net by up to $1.5 trillion over 10 years.)

URL: https://www.jct.gov/publications.html?func=startdown&id=5038
URL: https://www.jct.gov/publications.html?func=startdown&id=5033

But during the mark-up, Finance Committee Democrats appeared to be unmoved by the more favorable deficit numbers and contended that Hatch’s modifications – particularly sunsetting tax relief for individuals while providing permanent tax breaks for corporations – only bolstered their position that the bill was skewed to large businesses and wealthy individuals rather than to the middle class.

That argument only intensified with the JCT’s release November 16 of the projected distributional effects of the modified mark. Democrats argued that the tables show households with incomes under $30,000 would on average...
begin seeing an increase in their taxes beginning in 2021, and that households with incomes under $75,000 would see

tax increases by 2027. They also noted that the tables project larger amounts of tax cuts accruing to households at

top of the income scale by the end of the 10-year budget window.

URL: https://www.jct.gov/publications.html?func=startdown&id=5040

Republicans countered that these numbers do not solely reflect direct tax increases but rather in some cases are the

indirect result of reductions in federal spending brought about by certain changes in the chairman’s mark. JCT Chief of

Staff Tom Barthold, who was on hand during the mark-up to explain Hatch’s original proposal and the modifications,

confirmed that reduced outlays were a factor in some of these projections; but he also stated in response to questions

from Ohio Republican Sen. Rob Portman that the increased tax burdens projected for 2027 were attributable to the

proposed sunsetting of individual rate cuts and other benefits under the modified mark.

Democratic amendments rejected: Aside from Hatch’s package of modifications to his original proposal, all the

amendments offered during the mark-up were sponsored by Democrats and were rejected (mostly) along party lines.

One amendment proposed by ranking Democrat Ron Wyden of Oregon to substitute the language of the House version

of H.R. 1 for the measure under consideration in the Finance Committee received zero votes. Wyden offered the

amendment as a way to gauge Senate support for the House measure. Hatch protested, arguing that the Senate was

drafting its own version for a reason.

Next steps: The committee-approved bill is expected to come to the Senate floor the week of November 28, after

lawmakers return from the Thanksgiving recess. Budget reconciliation rules will allow for passage by a simple majority

rather than the three-fifths supermajority – that is, 60 votes – typically required to overcome Senate procedural

hurdles. But Republicans hold only 52 seats in the chamber – which means they can afford to lose only 2 votes if they

hope to secure a victory. (Vice President Mike Pence would step in to cast the deciding vote for Republicans in the

event of a tie.)

Already Republicans have seen one public defection – Sen. Ron Johnson of Wisconsin, who has said he would not vote

for the House or the Senate bill as currently drafted because of what he sees as their inequitable treatment of

passthrough entities. Other GOP senators – such as Susan Collins of Maine and Lisa Murkowski of Alaska – have

expressed reservations about the proposal to repeal the individual mandate, although neither so far has formally

pledged to oppose the underlying bill. Other potential outliers include Tennessee Sen. Bob Corker, who has cited

concerns about the bill’s impact on the federal deficit and recently told reporters that he is undecided, and John

McCain of Arizona, who has been critical of leaders for not moving the bill under regular order (a concern that

contributed to his decision this summer to vote against legislation to repeal the Patient Protection and Affordable Care

Act).

— Michael DeHoff, Jacob Puhl, and Storme Sixeas

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