2017 Tax Cut and Jobs Act

The House Ways and Means Committee released draft tax reform legislation on Thursday. The Tax Cuts and Jobs Act, H.R. 1, incorporates many of the provisions listed in the Republicans' September tax reform framework while providing new details. Budget legislation passed in October would allow for the tax reform bill to cut federal government revenue by up to $1.5 trillion over the next 10 years and still be enacted under the Senate's budget reconciliation rules, which would require only 51 votes in the Senate for passage. The Joint Committee on Taxation issued an estimate of the revenue effects of the bill on Thursday showing a net total revenue loss of $1.487 trillion over 10 years.

The bill features new tax rates, a lower limit on the deductibility of home mortgage interest, the repeal of most deductions for individuals, and full expensing of depreciable assets by businesses, among its many provisions.

Lawmakers had reportedly been discussing lowering the contribution limits for Sec. 401(k) plans, but the bill does not include any changes to those limits.

The Senate Finance Committee is reportedly working on its own version of tax reform legislation, which is expected to be unveiled next week. It is unclear how much that bill will differ from the House bill released on Thursday.

Individuals

Tax rates: The bill would impose four tax rates on individuals: 12%, 25%, 35%, and 39.6%, effective for tax years after 2017. The current rates are 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. The 25% bracket would start at $45,000 of taxable income for single taxpayers and at $90,000 for married taxpayers filing jointly.

The 35% bracket would start at $200,000 of taxable income for single taxpayers and at $260,000 for married taxpayers filing jointly. And the 39.6% bracket would apply to taxable income over $500,000 for single taxpayers and $1 million for joint filers.

Standard deduction and personal exemption: The standard deduction would increase from $6,350 to $12,200 for single taxpayers and from $12,700 to $24,400 for married couples filing jointly, effective for tax years after 2017. Single filers with at least one qualifying child would get an $18,300 standard deduction. These amounts will be adjusted for inflation after 2019. However, the personal exemption would be eliminated.

Deductions: Most deductions would be repealed, including the medical expense deduction, the alimony deduction, and the casualty loss deduction (except for personal casualty losses associated with special disaster relief legislation). The deduction for tax preparation fees would also be eliminated.

However, the deductions for charitable contributions and for mortgage interest would be retained. The mortgage interest deduction on existing mortgages would remain the same; for newly purchased residences (that is, for debt incurred after Nov. 2, 2017), the limit on deductibility would be reduced to $500,000 of acquisition indebtedness from the current $1.1 million. The overall limitation of itemized deductions would also be repealed.

Some rules for charitable contributions would change for tax years beginning after 2017. Among those changes, the current 50% limitation would be increased to 60%.

The deduction for state and local income or sales taxes would be eliminated, except that income or sales taxes paid in carrying out a trade or business or producing income would still be deductible. State and local real property taxes would continue to be deductible, but only up to $10,000. These provisions would be effective for tax years beginning after Dec. 31, 2017.

Credits: Various credits would also be repealed by the bill, including the adoption tax credit, the credit for the elderly and the totally and permanently disabled, the credit associated with mortgage credit certificates, and the credit for plug-in electric vehicles.

The child tax credit would be increased from $1,000 to $1,600, and a $300 credit would be allowed for nonchild dependents. A new “family flexibility” credit of $300 would be allowed for other dependents. The $300 credit for nonchild dependents and the family flexibility credit would expire after 2022.

The American opportunity tax credit, the Hope scholarship credit, and the lifetime learning credit would be combined into one credit, providing a 100% tax credit on the first $2,000 of eligible higher education expenses and a 25% credit on the next $2,000, effective for tax years after 2017. Contributions to Coverdell education savings accounts (except rollover contributions) would be prohibited after 2017, but taxpayers would be allowed to roll over money in their Coverdell ESAs into a Sec. 529 plan.

The bill would also repeal the deduction for interest on education loans and the deduction for qualified tuition and related expenses, as well as the exclusion for interest on U.S. savings bonds used to pay qualified higher education expenses, the exclusion for qualified tuition reduction programs, and the exclusion for employer-provided education assistance programs.

Other taxes: The bill would repeal the alternative minimum tax (AMT).

The estate tax would be repealed after 2023 (with the step-up in basis for inherited property retained). In the meantime, the estate tax exclusion amount would double (currently it is $5,490,000, indexed for inflation). The top gift tax rate would be lowered to 35%.

Passthrough income: A portion of net income distributions from passthrough entities would be taxed at a maximum rate of 25%, instead of at ordinary individual income tax rates, effective for tax years after 2017. The bill includes provisions to prevent individuals from converting wage income into passthrough distributions. Passive activity income would always be eligible for the 25% rate.

For income from nonpassive business activities (including wages), owners and shareholders generally could elect to treat 30% of the income as eligible for the 25% rate; the other 70% would be taxed at ordinary income rates. Alternatively, owners and shareholders could apply a facts-and-circumstances formula.

However, for specified service activities, the applicable percentage that would be eligible for the 25% rate would be zero. These activities are those defined in Sec. 1202(e)(3)(A) (any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees), including investing, trading, or dealing in securities, partnership interests, or commodities.