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Federal Tax Reform: The Senate Bill – Comparison to the House Bill, and Evaluating the Bigger Picture

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The Senate Finance Committee released a detailed description of the Senate's tax reform bill, titled the Tax Cuts and Jobs Act, on November 9. The Committee has not released the text of the bill, and likely will not do so until after it approves the bill. Earlier on the same day, the House Ways and Means Committee completed its four-day markup of the House bill, H.R. 1—which had been released on November 2, 2017—and approved the amended version.

Although it is important to focus on the details of the two plans, we also note the following broader points that could be helpful in evaluating the bills.

The table below summarizes the key provisions of the Senate bill and compares them to the original House bill and the amended House bill.

- Next steps. The full Senate and the full House will vote on their respective bills. The House is expected to vote on the House bill as early as this Thursday. The Senate is not expected to vote on its bill until closer to Thanksgiving. (Before the Senate bill goes to a floor vote, it must be approved by the Senate Finance Committee, which is in the middle of a multi-day markup of the bill). Once the two bills are approved—because they contain considerable differences—they must be merged in a conference committee. After this merged bill comes out of the conference committee, it must then be passed by the House and the Senate before it can become law. One commentator noted that the conference committee discussion/markup of the bill will "likely resemble the final scene in *Animal House* as leadership insists, 'Remain calm…all is well,' while bedlam ensues."

- To be enacted, the bill must increase revenue, decrease tax cuts, or make them temporary. Much like the House bill, the Senate bill does not meet the rules for it to pass via the budget reconciliation process. As we've earlier noted, in order for tax changes to be eligible to pass under the budget reconciliation process, and thus to be passable with the vote of only 50 senators rather than the 60 senators (i.e., have Democratic buy-in, which seems highly unlikely), the cost of the tax changes cannot exceed $1.5 billion past 10 years. In other words, the cost of the tax legislation has to be zero in 2027. Although both the House and the Senate bills will increase the deficit by nearly $1.5 trillion over the next 10 years, as written, they will continue to increase the deficit the next year as well. Critically, there are not enough measures in the bills to stop the increase in deficit beyond a 10-year period. There are not tax cuts that expire in the 11th year, or tax increases that will go into effect in the 11th year. In other words, the bills do not provide for enough of the tax cuts to be temporary, or provide for additional tax or revenue increases that would ensure that the deficit did not continue to increase after the 10-year period.

- Temporary tax cuts a possibility. It is quite possible that what eventually passes will be temporary tax cuts that are set to expire after 10 years. As we have noted earlier, even if the tax cuts are announced as temporary, once temporary tax cuts are in place, there is a likelihood that they will become permanent. For example, the Bush tax cuts were supposed to be in place for only 10 years. However, they were made permanent upon expiration. This is because once they expire, reverting back to the old rates is often viewed as a "tax increase," and it is hoped by the proponents of the tax cuts that their opponents will not have the political appetite to be viewed as responsible for "tax increases."

- Reductions in income from capital, versus from debt or labor. Income can be viewed as arising from three primary sources: labor/wages, capital-financed investment, and debt-financed investment. Both the Senate bill and the House bill contain several proposals decreasing taxes on income derived from capital. Critics note that the super-wealthy earn a disproportionate amount of their income from capital, as compared with those that earn it through wages.

- Past 2017. Republicans have repeatedly said they would like to enact new tax laws before the end of 2017. Although the political motivation for this is understandable, we note that even if no bill passes this year, we would not be at all surprised to see continued proposals and a push for tax reform well past 2017.

- Individual mandate repeal. Neither of the bills currently repeals the individual mandate (which requires individuals to have health insurance). However, President Trump suggested including the repeal, and several Republicans seem agreeable. Senator Toomey reportedly said it was a “terrific solution” to the dilemma that the tax bills add to the budget deficit outside the permissible 10-year window. The repeal of the individual mandate would increase revenue/decrease costs to the government because if individuals are not required to get health insurance, it would mean fewer individuals would be on Medicaid or enroll in plans on the Affordable Care Act’s marketplaces – both of which would reduce the cost to the government. While the repeal of the individual mandate may solve this problem, it would make the passage of the bills even more difficult.

Proposal	**Senate Bill**	**Amendment to House Bill**[1]	**House Bil**

Individual Marginal Tax Rates	10% 12% 22.5% 25% 32.5% 35% 38.5%	-	12% 25% 35% 39.6%

Observations: The Senate bill would retain the seven existing brackets instead of consolidating them into as the House bill did. The effect on individuals of the rate changes is only meaningfully understood once th which they apply are examined. See footnote for tables summarizing brackets to which rates would apply u law, the House bill and the Senate bill.[3] Generally, there would be significantly fewer individuals in the high as the higher brackets would shift to start to apply to higher levels of income.

One important detail is that under the Senate bill and the House bill, the brackets will be adjusted annually the "chained CPI," rather than the normal or plain CPI, which is currently used. The effect of this is that gra and more people would be pushed into higher tax brackets.

Proposal	**Senate Bill**	**House Amended Bill**	**House Bil**
Standard Deduction and Personal Exemption **(Single Filers/ Joint Filers)**	$12,000/ $24,000 -No personal exemptions	-	$12,000/ $24,000 -No persor exemption

Observations: Similarly to the House bill, the Senate bill nearly doubles the current standard deduction of single individuals and married individuals filing separately and $12,700 for married individuals filing a joint r under the House bill, the personal exemption (currently $4,050 each for the taxpayer, the taxpayer's spous dependents) would be eliminated. This will lead fewer individuals to choose to itemize deductions, since fo people the standard deduction would exceed itemized deductions.

Proposal	**Senate Bill**	**Amendment to House Bill**	**House Bil**
Individual Capital Gains Rates	15% 20% -The 3.8% net investment income tax (NIIT) imposed under Affordable Care Act. (ACA) retained	-	15% 20% -The 3.8% imposed u retained.

Observations: The House and Senate bills both preserve the existing capital gains tax rates, but again, th appears to apply to higher tax brackets as compared with existing tax brackets. In contrast to the House Bl the Trump Plan[4], the 3.8% NIIT is not proposed to be repealed by the House bill (likely because it would i deficit too much).

Proposal	Senate Bill	Amendment to House Bill	House Bil
Individual Deductions	-Full elimination of state and local tax deduction (but state and local taxes paid or accrued in carrying on a trade or business may be deducted). -Maintains the interest deduction for up to $1 million of mortgage interest (but not for home-equity loans or second homes). -Preserves the charitable deduction, and expands it, allowing people to deduct up to 60% of their income in contributions (as compared, generally, with 50% under current law).	-	-State and or sales ta eliminated -Real prop deduction: $10,000. -Mortgage deduction: only for firs of loans fo purchased (reduced fr million limi for second would be e would dedu interest pa equity loan -Extends h required fo sale of per residence exclusion, out exclusi certain adj income lev

Observations: We expect the difference between the House and Senate proposals on the deductibility of s local taxes to be a big point of contention. Commentators have noted that the difference on this point does along party lines, but rather on geographic lines, with those with constituents from high-tax states desiring t deduction as little as possible. Chairman Brady (of the House Ways and Means Committee) has already sta would not accept a complete repeal of the state and local tax deduction in the final bill. Interestingly, there a Senators from high-tax states up for reelection in 2018.

Proposal	Senate Bill	Amended House Bill	House Bil
Estate Tax	Does not repeal the estate tax; instead doubles the current exemption (currently approximately $5.5 million for single and $11 million for married individuals).	Repeal delayed until 2025.	Repeals es effective 20

		Until repeal, exemption doubled.	Until repea doubled.

Proposal	Senate Bill	Amendment to House Bill	House Bil
Corporate Tax Rate	20% (phased in starting 2019)		20%

Observations: There was considerable debate about whether this would be proposed as a permanent rate a temporary one leading up to the release of the House bill. The House bill reflected this as a permanent re no phase-in, and the Senate bill delays it only by a year. There is a very strong desire on the part of the Re have this tax cut be permanent. This may not be practical.

The Senate bill's delayed effective date reduces the bill's cost. The delayed effective date has also been no commentators as being helpful for tax planning (ex: plan to ensure deductions are taken in 2018, when rate result in maximum benefit). President Trump has noted he was hoping for a lower rate as his plan originally 15% corporate tax rate.

Proposal	Senate Bill	Amendment to House Bill	House Bil
Interest Deductibility	-Cap placed on business interest deductions. However, limit on deductibility is stricter than House bill. While the House bill bases its 30% limitation on business interest income plus earnings before interest, taxes, depreciation, and amortization (EBITDA), the Senate bill limits to business interest income plus 30% of adjustable taxable income. -Disallowed interest can be carried forward indefinitely (as compared with 5 years under the House bill.) -Cap does not apply to some real property businesses, regulated public utilities, and small businesses with average gross receipts below $15 million (compared to $25 million under the House bill).	-Provides a limited exclusion from the limit on deductibility for taxpayers that paid or accrued interest on "floor plan financing indebtedness" (debt used to finance motor vehicles acquired for retail sale and secured by that inventory.) This appears to benefit car dealerships which borrow money to buy inventory.	-Cap place business in deductions sum of bus interest inc 30% of adj taxable inc -Any intere disallowed taxable yea carried forv next five ta -Cap does some real businesses public utilit small busin average gr of $25 milli

Observations: The existing tax deduction for interests lowers the effective cost of obtaining capital and has part of our tax system. For years, U.S. taxpayers have been encouraged by existing tax rules to leverage th investments. If the proposals are enacted, this would change. If enacted, the interaction with and effect on v tax rules would have to be carefully considered, including those distinguishing debt from equity, earnings-st inversion-related rules. Given how much many in the financial, private equity, real estate, and other industri historically relied on—and currently rely on—the interest deduction in their business models and determinat for various purchases, we expect this proposal will likely face significant pushback, as its enactment would raise the cost of borrowing capital.

Proposal	Senate Bill	Amendment to House Bill	House Bil
Earlier taxation of Nonqualified Deferred Compensation:	-Nonqualified deferred compensation is includible in income generally once no longer subject to a requirement to provide future service. Compensation taxable without regard to whether there are other conditions on the right to receive the compensation, such as conditions related to performance metrics. -Options and stock appreciation rights, other than incentive stock options, would also be subject to taxation once no longer subject to service-based vesting conditions.	-Preserved exception to general rule; current law retained	-Eliminate the genera requiring ta nonqualifie compensat as there is substantial forfeiture.

Observations: There was somewhat of an uproar after the House bill originally revealed its proposals rega taxation of nonqualified deferred compensation plan. Ironically, the Senate bill includes significant changes taxation of nonqualified deferred compensation just hours after the House abandoned a similar plan.

Proposal	Senate Bill	Amendment to House Bill	House Bil
Temporary Immediate Expensing **+ Section 179 Expensing**	-Immediate expensing/full deduction of new equipment placed in service – again available for 5 years, until the end of 2022 (with an extra year for certain property). -One important difference: under the Senate bill, bonus depreciation is limited to *original use* property, whereas the House bill would allow it for newly acquired property, including that for which the taxpayer was not the first to use the property.		-Accelerate of certain c expenses, immediate -However, expensing available fo After that, old rules. -For 5-yea Section 17 business e limit increa $510,000 c $5 million.

	-Reduces the depreciation life for specified assets (ex. 39.5 years to 25 years for some real estate, 15 years to 10 years for qualified improvement property, and 7 years to 5 years for farming machinery). -Increases expensing limitation under Section 179 from $510,000 currently to $1 million.		

Observations: While both the House proposal and the Senate proposal would theoretically spur investmen business assets, are aimed at small businesses, and spur buyers to engage in M&A activity, both proposals milder versions of the much more expansive proposals in the House Blueprint and in the Trump Plan. That proposals would only be in effect for five years probably is reflective of the pressures to limit the cost of the

Proposal	**Senate Bill**	**Amendment to House Bill**	**House Bil**
Pass-Through Business Income	-Still lowers rate on certain pass-through income. However, the approach is different from that of the House bill. -The House bill simply has a lower tax rate on certain pass-through business income. The Senate bill lowers the rate by letting individual owners of sole proprietorships, S corporations and partnerships take a deduction of up to 17.4% of their "qualified business income" (generally net domestic business income – other than specified service income – see definition below). -The amount of the deduction is limited to 50% of the "W-2 wages" of the taxpayer allocable to the qualified business income. So, if an owner of a pass-through entity does not have any W-2 wages from a business, that owner will not get any deduction.	The same as the House Bill, except that a lower 9% tax rate is introduced for some pass-through income. The 9% rate would apply to the "first $75,000" in net business taxable income of an active owner or shareholder earning less than $150,000 in taxable income through a pass-through business. The benefit of the 9% rate would phase out for income above $150,000 and would be fully phased out at $225,000. The 9% would also be phased in over 5 years, so that it would not be fully in effect until 2022.	-Maximum business i owners an shareholde through bu sole propri 25%. -However, owners/inv such busin entitled to -"Professio businesses automatica the rate. -Other bus could choo options: 1.

	-The deduction is disallowed for anyone in a service business *except* someone whose taxable income does not exceed $150,000 if married ($75,000 if single). -"Specified service businesses" involve 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.	-These changes were meant to win support of critics that said the bill did not do enough for small business.	30% of inc considered to the capi business (to the 25% other 70% regular ind 2. Establis ratio based and circum -For perso businesses involving p of services of health, l engineerin architectur accounting science, pe arts, consu athletics, fi services, b services, a business w principal as trade or bu reputation or more of employees investing, t dealing in s partnership commoditi default rule apply. The the presum zero perce income sh subject to t

Observations: The approaches taken by the House and the Senate are considerably different. The House more clearly aimed at providing the rate cut to passive investors of capital in pass-through entities. The Sen does not differentiate between passive and non-passive owners. Further, the Senate proposal ties the dedu wages received by the taxpayer (and since partners are generally not W-2 employees, this presumably mea guaranteed payments or payments for services in the case of a partner of a partnership). In addition, given from small business groups over their exclusion from the original House bill, the Senate bill and the amendr House bill provide a limited benefit to some small business owners of pass-through entities.

Both approaches are quite complex. They attempt to provide a benefit to intended targets, while at the sam prevent "abuse" (including the use of the rule by service partnerships). The result is likely to be tax legislati includes "loopholes" that can be taken advantage of, given enough planning.

One wonders how many taxpayers would simply incorporate to take advantage of a simple, uniformly applic rate of 20% when all is said and done.

Proposal	**Senate Bill**	**Amendment to House Bill**	**House Bil**
Carried Interest	Silent	-Would impose a three-year holding period in order to be taxed at long term capital gains rates.	Silent
Observations: No new surprises here. We note that requiring a three-year holding period is likely not view burdensome by most holders of carried interests. It is unclear why the amendment to the House bill went to of adding this.			
Proposal	**Senate Bill**	**Amendment to House Bill**	**House Bil**
Repatriation of Foreign Earnings	-One-time transition tax on currently accumulated foreign earnings that would be deemed repatriated. Rate is 10% for earnings held in form of cash assets, and 5% for other earnings. -Going forward, a dividend exemption for 100% of foreign-source dividends from foreign subsidiaries would apply to 10-percent U.S. shareholders, subject to a 731-day holding period (beginning 365 days before the shares of the foreign corporation become ex-dividend). -However, despite the tax being called "territorial," U.S. shareholders of a controlled foreign corporation (CFC) will include in income its pro rata share of the CFC's global intangible low-taxed income, which is equal to (a) the shareholder's pro rata share of certain foreign profits of the CFC over (b) a deemed return of 10% of the shareholder's pro rata share of the CFC's average aggregate bases of tangible	-The 12% rate is increased to 14%, and the 5% rate is increased to 7%. -This is estimated to raise $70.3 billion. -Amends the proposed excise tax (bill's international base erosion rules) on some payments from domestic corporations to related foreign corporations. Specifically, it eliminates the markup on deemed expenses, and it expands the foreign tax credit to apply to 80% of foreign	-One-time on currentl accumulat earnings th deemed re Rate is 12 earnings h cash or ca equivalent other earni -Going forw dividend ex 100% of fo dividends f subsidiarie apply to 10 U.S. share subject to a holding pe (beginning before the foreign cor become ex

	property used to produce such profits, as of the close of each quarter of the taxable year.	taxes and refines the measurement of foreign taxes paid.	-However, tax being c "territorial," a 10% min imposed o foreign pro certain thre foreign sub U.S. comp

Observations: The mandatory 14% rate under the Amendment to the House Bill on cash-backed foreign a earnings surprised many, as it is much higher than expected and prior Republican proposals. The Senate's more in line with earlier proposals – but still higher than that in the Republican Blueprint.

In addition, given that the House Blueprint and the Unified Framework for Tax Reformsuggested that U.S. r would be taxed on a territorial rather than worldwide basis, the House bill's retention of a 10% worldwide in U.S. multinationals' "foreign high-rate returns" was a contradiction and a surprise. Under the original House multinationals would be subject to the 10% tax on a foreign subsidiary's aggregate net income in excess of return" (7% plus the federal short-term rate) on its depreciable tangible property, adjusted downward for int expense, as well as other exclusions for income effectively connected to a U.S. trade or business, Subpart certain insurance and financing income that meets the requirements for the active finance exemption (AFE) Subpart F income, and certain related-party payments. The fact that the House bill retains vestiges of the o tax regime by imposing a 10% tax on certain offshore profits earned by U.S. multinationals' foreign subsidia that the House GOP plan is not, in fact, fully territorial.

Under the Senate bill, Subpart F's regime for taxing U.S. shareholders of "controlled foreign corporations" (worldwide basis will be retained, at least in part, with respect to such shareholders' global intangible low-tax which equals the excess (if any) of the shareholder's pro rata share of a CFC's gross income over an amou 10% of the aggregate of the shareholder's pro rata share of the CFC's "qualified business asset investment an average of the CFC's quarterly adjusted bases in business assets during the taxable year). It remains to how exactly this complex rule will be implemented without creating new opportunities for international tax a deferral that are at the heart of most significant policy critiques of Subpart F.

So, like the House Ways and Means Committee, the Senate Finance Committee has proposed a hybrid int system, that, while more territorial than our current system, does not move as far away from worldwide inco of U.S. corporations as the border-adjusted cash-flow tax proposed as part of the House Tax Reform Bluep by Republicans in the House on June, 2016) or other "territorial" international tax systems adopted by our c trading partners (generally, in conjunction with a value-added tax or VAT).

Proposal	**Senate Bill**	**Amendment to House Bill**	**House Bil**
Alternative Minimum Tax	Eliminated for individuals and corporations.	-	Eliminated individuals corporatior

Observations: Generally in line with expectations

Proposal	**Senate Bill**	**Amendment to House Bill**	**House Bil**
R&D Tax Credit, Low Income Housing Tax Credit (LIHTC) and	-R&D credit and LIHTC retained -Section 199 deduction would be eliminated –	-Section 199 deduction would be eliminated – but effective in 2019.	-R&D cred retained.

Section 199 Deduction	but effective in 2019.		-Section 19 eliminated.
Proposal	**Senate Bill**	**Amendment to House Bill**	**House Bil**
Cash Method of Accounting	Increases thresholds for small businesses that can use cash method of accounting to $15 million (currently $5 million).	-	Increases for small b can use ca accounting million (cu million).
Proposal	**Senate Bill**	**Amendment to House Bill**	**House Bil**
Research or experimental expenditures	-	Requires certain research or experimental expenditures (including software expenditures) to be capitalized and amortized over a 5 year period (15 years where expenses are incurred outside the country). Thus the expensing allowed by Section 174 would be replaced with this. -Rule would be phased in after 2023.	-
Observations: This is one of the more significant revenue raisers included in the House Bill.			

[1] We refer to the 2 amendments from Chairman Brady released on November 6 and 9.

[2] This column refers to the original H.R. 1, without amendments.

[3]

Tax Brackets – Single Individual					
Existing Brackets		**House Bill**		**Senate Bill**	
10%	$0 to $9,325	12%	$0 to $45,000	10%	$0 to $9,525
15%	$9,326 to $37,950			12%	$9,526 to $38,700
25%	$37,951 to $91,900	25%	$45,001 to $200,000	22.5%	$38,701 to $60,000
28%	$91,901 to $191,650			25%	$60,001 to $170,000
33%	$191,651 to $416,700	35%	$200,001 to $500,000	32.5%	$170,001 to $200,000
35%	$416,701 to $418,400			35%	$200,000 to $500,000
39.6%	Over $418,400	39.6%	Over $500,000	38.5%	Over $500,000

Tax Brackets – Married Filing Jointly					
Existing Brackets		**House Bill**		**Senate Bill**	
10%	$0 to $18,650	12%	$0 to $90,000	10%	$0 to $19,050
15%	$18,651 to $75,900			12%	$19,051 to $77,400
25%	$75,901 to $153,100	25%	$90,000 to $260,000	22.5%	$77,401 to $120,000
28%	$153,101 to $233,350			25%	$120,001 to $290,000
33%	$233,351 to $416,700	35%	$260,000 to $1 million	32.5%	$290,001 to $390,000
35%	$416,701 to $470,700			35%	$390,001 to $1 million
39.6%	Over $470,700	39.6%	Over $1 million	38.5%	Over $1 million

[4] The Trump Plan refers to the plan released by the White House on April 26 as well as the tax plan then-candidate Trump described in speeches on August 8, September 13, and September 15, 2016, on his campaign's website and in other statements he made, including on Twitter.

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