How the Proposed Tax Bill Would Affect Nearly All U.S. Companies and Individuals

By Kate Russell, CPA

November 2017

The House GOP recently made a splash with their long-awaited tax bill proposal, seeking the biggest transformation of the code in more than 30 years. While there were no proposed changes on 401(k) pretax contribution limits, the favorable rates for qualified dividends and long-term capital gains, gift tax exclusion, and the ability to take certain Schedule A deductions (mortgage interest and charitable contributions) many other items would be changed. If passed, this bill would affect nearly all U.S. companies and individuals.

Republicans hope to have a House vote on the bill later this month. They would then reconcile it with a Senate proposal for President Trump to sign into law by the end of the year. The changes would be effective on January 1, 2018.

Below are some key highlights should you not want to read the 429-page bill:

Individuals

1. Seven individual tax brackets are to be reduced to four at 12%, 25%, 35%, and 39.6%, eliminating the 10%, 15%, 28%, and 33% brackets. The highest bracket threshold would be $500,000 for single filers (up from $418,400) and $1 million for married filing jointly (up from $470,700).
2. The standard deduction would increase from $6,350 to $12,000 for single and from $12,700 to $24,000 for married filing jointly.
3. The personal exemption of $4,050 per person would be eliminated.
4. Most itemized deductions would eliminated, including:
    a. State and local income and sales tax
    b. Medical expenses
    c. Employee business expenses
    d. Tax preparation expenses
    e. Personal casualty loss
5. Property tax deduction would be capped at $10,000.
6. The cap on mortgage interest deduction for new home loans would drop from $1 million to $500,000 for debt incurred after 11/2/17. Interest deduction on home equity loans would be eliminated. Deduction for mortgage interest on second homes would be eliminated.

7. Alternative minimum tax (AMT) would be repealed.
8. Child tax credit would increase from $1,000 to $1,600. A new nonrefundable "family" credit of $300 would be allowed to each taxpayer.
9. Many income exclusions and deductions would be eliminated, including:
    a. Exclusion for $5,000 employer dependent care assistance
    b. Exclusion for employer provided education assistance
    c. Deductions for interest on education loans and tuition expense
    d. Alimony payments would not be deductible by the payer and would not be included in income by the recipient
    e. No new contributions to Coverdell Education Savings Account

Pass Throughs (S Corporations, LLCs, and Partnerships)

1. Business income from Pass-Through entities would be taxed at 25% maximum rate.
2. 100% of passive activity income would be subject to the maximum 25% rate.
3. For nonpassive activity income (including wages), 30% of the income would be subject to the 25% rate, and the remaining 70% would be taxed at the ordinary income rate.
4. For certain service professionals (doctor, lawyer, accountant, consultant, financial advisor, and engineer) all income would be taxed at the ordinary income rate.
5. Self-employment tax would be imposed on the labor percentage of the distributive share of the profits for limited partners and S Corp shareholders.

Businesses

1. A flat 20% rate would replace the current four tier schedule of corporate rates.
2. Section 179 expense is increased to $5 million for years 2018 through 2022.
3. Replace 50% bonus depreciation with 100% expensing of the cost of depreciable assets acquired after September 27, 2017 and before January 1, 2023.
4. NOL deduction would be limited to 90% of taxable income. NOL carrybacks would not be allowed and carryforward would have an indefinite period.
5. Deduction for entertainment, amusement, or recreation activities expenses would be eliminated; however, the current deduction for business meals (subject to the 50% limitation) will be retained.
6. The domestic production activities deduction would be eliminated.
7. Like-kind exchange provisions would apply only to real property and would no longer apply to tangible personal property for exchanges.
8. Interest expense deduction would be limited to 30% of adjusted taxable income for businesses with average gross receipts in excess of $25 million.
9. Businesses with average gross receipts of $25 million or less would be permitted to use the cash method of accounting, even if the business keeps inventory.
10. Businesses with average gross receipts of $25 million or less would be exempt from the uniform capitalization rules (UNICAP).
11. Businesses with average gross receipts of $25 million or less would be allowed to use the completed contract method of accounting for long-term contracts.

Estates

1. Estate tax exclusion amount would double ($11.2 million in 2018, indexed for inflation). Estate tax would be fully repealed after 2023.
2. Top gift tax rate would be lowered to 35%.

International

1. Foreign sourced dividends received by 10% U.S. corporate owners would be exempt from U.S. tax.
2. No foreign tax credit or deduction would be allowed with respect to any exempt dividend.
3. Foreign tax credit usage is modified and the carry over period for unused credits would be extended.
4. A new non-deductible 20% excise tax would be applied to certain payments made after 2017 by U.S. corporations to related foreign companies. This tax would apply to payments that are deductible by the U.S. payor, or includable in the cost of inventory or fixed assets. The tax would not apply if the foreign recipient elects to consider such payments as subject to U.S. income tax.
5. A foreign subsidiary's undistributed earnings that are reinvested in U.S. property would not be subject to U.S. tax.
6. U.S. shareholders owning at least 10% of a foreign subsidiary would include in income the shareholder's share of the earnings and profits (E&P) of the foreign subsidiary to the extent that E&P have not been previously subject to U.S. tax. The portion of E&P attributable to cash or cash equivalents would be taxed at a 12% rate, and the remainder would be taxed at a 5% rate.

The Bill is currently being reviewed by Ways and Means Committee Chairman, Kevin Brady, who promises "additional amendments and substantive improvements" to come. Though this Bill is far from being passed, there is the potential of big changes. Tax planning has never been so relevant.

Michael Silver & Company will continue to keep you updated as important changes occur and the Bill moves its way through Congress. Look to these communications for additional information. If you have any questions in the interim, the tax experts at Michael Silver & Company are ready to assist you. Please contact us at 847-982-0333.

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