Tax Reform Legislation Takes First Step

The official process to potentially make the biggest changes to the tax code since 1986 has begun. And as the nation's premier tax practitioners, the accounting profession will be very engaged as the proposed legislation winds its way through Congress.

On Nov. 2, the House Ways and Means Committee released draft tax reform legislation. Among other things, The "Tax Cuts and Jobs Act," H.R. 1, 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. It also would result in a net total revenue loss of $1.487 trillion over 10 years, according to the Joint Committee on Taxation. Movement on the bill could happen fairly quickly; under Senate budget reconciliation rules, the measure needs only 51 votes to pass.

AICPA President and CEO Barry C. Melancon, CPA, CGMA, also commented on the arrival of draft tax reform legislation.

"We want to acknowledge the efforts of Chairman Brady and others in developing the tax reform package," Melancon said. "We look forward to continuing to work with lawmakers as they consider tax reform that meets the needs of taxpayers, tax practitioners and others." The AICPA has previously stated that it stands for a tax code that is simple, practical and administrable.

The provisions of the bill affect individuals and businesses alike, changing many familiar mainstays of the current tax code.

The current code's seven individual income tax brackets would be reduced to four: 12%, 25%, 35% and a final bracket that remains at 39.6%. Single taxpayers with income greater than $500,000 and married taxpayers filing jointly with income greater than $1 million would enter the 39.6% rate. The standard deductions would increase to $12,200 for single taxpayers, and $24,400 for married couples filing jointly.

However, the bill repeals most other deductions, including those for alimony, medical expenses and tax preparation fees. It also eliminates the deduction for state and local income or sales taxes, except in the case of taxes paid in carrying out a trade or business or producing income.

The bill also would 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.

Many credits are also repealed in the bill, including those for adoption, plug-in electric vehicles and individuals over age 65 and who are disabled. One notable exception is the child tax credit, which increases to $1,600 and is expanded.

Deductions for mortgage interest, however, would be retained. The mortgage interest deduction on existing mortgages would remain the same; for newly purchased residences (after Nov. 2, 2017), the limit on deductibility would be reduced to $500,000 from the current $1.1 million. The overall limitation of itemized deductions would also be repealed.

Estate taxes would be eliminated by 2023 under the bill (the step-up in basis for inherited property would remain), with the current exclusion amount doubling until that time. The Alternative Minimum Tax (AMT) would be repealed.

Under the bill, a portion of net income (generally 30%) from passthrough entities would be taxed at a maximum rate of 25%, instead of at ordinary individual income tax rates. More restrictive rules are proposed for professional service firms (including taxpayers in the fields of law, accounting, consulting, engineering, financial services or performing arts). The AICPA has previously stated that it is important for lawmakers to recognize that professional service firms, such as accounting firms, are an important sector in our economy.-They heavily contribute to the nation's goals of creating jobs and driving better wages. The AICPA has also stressed that tax reform should recognize the importance of consistent tax rates on business income generated from all of America's passthrough entities.

For businesses, the four current corporate rates would be replaced by a flat 20% rate, with a 25% rate for personal service corporations and a repeal of the corporate AMT. The cash accounting method would be expanded for corporations, with a new limit of $25 million of average gross receipts.

The deduction of net operating losses (NOLs) would be limited to 90% of taxable income, with an indefinite carryforward period. However, for most businesses, carrybacks would no longer be available.

The bill would provide 100% expensing of qualified property acquired and placed in service after Sept. 27, 2017, and before Jan. 1, 2023 (with an additional year for longer-production-period property). It would also increase the Sec. 179 expensing limitation ceiling and phaseout threshold to $5 million and $20 million, respectively. Both would be indexed for inflation.

In an effort to repatriate offshore earnings and profits (E&P), H.R.1 would require U.S. companies with foreign subsidiaries to include previously untaxed offshore E&P in income. The portion of E&P attributable to cash or cash equivalents would be taxed at a 12% rate; the remainder would be taxed at a 5% rate. U.S. shareholders can elect to pay the tax liability over eight years in equal annual installments of 12.5% of the total tax due.

While the full bill weighs in at a heavy 429 pages, a summary is also available in a more manageable 76 pages. The Senate Finance Committee is reportedly also working on tax reform legislation to be unveiled next week. As a separate bill, it could be different from H.R.1.

To stay on top of developments and the profession's advocacy efforts, visit the AICPA's Tax Reform Resource Center at www.aicpa.org/taxreform.