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House Passes and Senate Considers GOP Tax Proposals, Leadership Target End of Year for Passage

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On November 16, House Republicans approved H.R. 1, the Tax Cuts and Jobs Act, on a party-line vote of 227 to 205, with 13 Republicans and all Democrats voting against passage. Senate Republicans are also moving toward passing a similar measure and are poised to consider the Senate Finance Committee's proposal, approved on November 16 with a party-line vote of 14 to 12. Republican congressional leadership is hoping to have a compromise bill on the President's desk before the end of the year.

The House bill is weighted towards tax cuts for corporations, which would benefit from roughly $1 trillion of the $1.456 trillion in tax cuts between 2018 – 2027 because of a 15 percent cut in the corporate income tax, from 35 percent to 20 percent. The legislation simplifies personal income taxes, reducing federal tax brackets from seven to four. The measure also eliminates or reduces a number of existing tax deductions, capping the mortgage interest deduction at $500,000, eliminating most state and local tax deductions, tightening rules for the child tax credit, and doubling the estate tax exemption from $5.49 million to $11.2 million before eliminating it in 2025.

Senate Republicans' latest tax proposal contains some key differences from the House-passed measure. Primarily, the Senate proposal would maintain the existing seven personal income tax brackets, lower the rates, and sunset those rates after 2025. In addition, it would eliminate all state and local tax deductions; maintain the existing mortgage interest deduction cap at $1 million; delay the proposed 15 percent cut in the corporate income tax to 2019, but make those changes permanent; and increase the estate tax exemption to $11.2 million rather than fully repealing it.

	Current	**House**	**Senate**
Personal Rates	Seven brackets with rates of 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%	Four brackets with rates of 12%, 25%, 35%, and 39.6%	Seven brackets with rates of 10%, 12%, 22%, 24%, 32%, 35%, and 38.5%, sunset after 2025
Standard Deduction	$6,350	$12,200	$12,000, sunset after 2025
Corporate Income Tax	35%	20%	20% starting 2019 and made permanent

			thereafter
"Pass-Through" Income	Taxed at individual income rates	Owners would pay up to 25% on "Business Income" and those "actively involved" would pay individual rates on 70% of income and 25% on the remaining income (exceptions apply)	Allow owners to deduct up to 17.4% for certain pass-through income (exceptions apply)
Depreciation of Business Assets	Allows for depreciation of capital expenditures over varying time rime frames	Immediate expensing of capital expenditures over five years; except buildings	Same as House with some differences in which assets as eligible for depreciation
Mortgage Interest Deduction	Up to $1 million in mortgage debt	Up to $500,000 in mortgage debt	No change from current law
State and Local Tax Deduction	All taxes paid	Eliminate	Up to $10,000 in local property taxes
Personal Exemption	$4,050	Replace with $300 personal credit and $300 non-child dependent credit (sunset in 2022)	Same as House and adds an $18,000 standard deduction for single parents
Estate Tax Threshold	$5.49 million	$11.2 million before full repeal in 2025	$11.2 million permanently
Child Tax Credit	$1,000	$1,600	$2,000 with sunset after 2025
ACA Health Insurance Mandate	Requires all Americans to purchase insurance for pay a penalty of $695 or 2.5% of household income (whichever is	No change from current law	Reduce penalty to $0 starting 2019

	higher)		
Medical Expense Deduction	Allows deductions of medical expenses if totaling more than 10% of income	Eliminate deduction	No change from current law
College Endowment Capital Gains	Not taxed	1.4% tax on gains for institutions with 500 or more students and endowments larger than $250,000 per student	Same as house
"Private Activity" Bonds	Issued tax free	Eliminate tax free benefit	Same as House
International Taxation	Existing global tax regime	Domestic tax regime with repatriation of existing offshore profits at a rate of 14% for liquid assets and 7% for other assets	Domestic tax regime with repatriation of existing offshore profits at a rate of 10% for liquid assets and 5% for other assets

Notably, the Senate Finance Committee's proposal would effectively repeal the Affordable Care Act's (ACA) individual mandate (achieved by setting its penalty to $0) starting in 2019, generating an estimated $338 billion in savings between 2018 – 2027. Republicans consider repeal of the individual mandate a step towards undoing the ACA and as a source of revenue for providing steeper tax cuts. The House-passed bill did not include this language.

While the House bill passed with a comfortable margin, the Senate, as usual, is another story. Senate Republicans have a very narrow margin of error to pass the proposal, as all 48 of the chamber's Democrats are expected to vote against the bill. Some Senate Republicans, such as Senators Bob Corker (R-TN), Jeff Flake (R-AZ), Lisa Murkowski (R-AK), and Susan Collins (R-ME) have already expressed reservations about the proposals. Furthermore, on November 15, Senator Ron Johnson (R-WI) stated he will vote against the package unless more is done to help so-called "pass through" entities. Finally, including repeal of the ACA's individual mandate would likely have significant implications for the individual insurance market and the uninsured rate, which could add further political complications. It remains unclear whether Senate Republicans will be able to attract enough support to push the proposal forward.

Background and Analysis: After months of weekly meetings of the so-called "Bix Six" tax reform leaders from the House, Senate, and White House, congressional Republicans were unable to agree on a joint package and instead released two separate proposals. The House and Senate proposals are both being considered under the budget resolution passed by the House and Senate in September that set the stage for a majority vote for passage in the Senate.

What's in the House Bill?

The House-approved measure cuts taxes for many American taxpayers and corporations. For personal income taxes, the bill would reduce the current seven tax brackets to four, increase the standard deduction, and eliminate the personal exemption. The bill also more than doubles the estate tax threshold before eliminating the tax altogether in 2025.

On the business side of the ledger, the House bill reduces the corporate income tax from 35 percent to 20 percent, eliminates the corporate alternative minimum tax, taxes pass-through income at a maximum rate of 25 percent, and allows for capital investment (except for structures) to be fully and immediately deductible. The bill would also move the U.S. from a global taxation regime to a territorial system.

The legislation seeks to pay for tax cuts by eliminating or curtailing a number of popular deductions. Significantly, the bill limits the mortgage interest deduction to the first $500,000 in mortgage debt, eliminates most of the deduction for state and local taxes, and ends a number of other deductions, including deductions for teachers, graduate students, electric vehicles, medical expenses, moving expenses, and alimony payments. The bill also changes the rules for college endowments, taxing investment profits on endowments with more than $250,000 per student at a rate of 1.4 percent. Colleges with fewer than 500 students are exempt, but it is a significant change from current policy in which college endowment investment profits are not taxed.

The House-passed bill also eliminates a number of tax-exempt bonds used by some institutions and universities to raise funds. If the House-passed language is included in a final package, universities and other select institutions would be stripped of their ability to issue tax-free "private activity bonds." In addition, the bill halts the issuing of tax-free bonds to raise money for the construction of sports stadiums. The bill limits, but does not eliminate, the ability of local and state government to issue tax-free bonds to fund governmental activities.

How Does the Senate Proposal Differ?

The Senate Finance Committee's proposal differs from the House-passed legislation in a number of important ways. First, rather than condensing the personal income tax brackets from seven to four, the Senate proposal maintains the seven tax brackets, but lowers rates and sunsets those rates after 2025 (see table above for more information). While the House bill opts to allow individuals to deduct up to $10,000 in state property taxes, the Senate proposal calls for the full elimination of the state and local tax deduction. Another key difference from the House bill is the mortgage interest deduction. After witnessing the immediate nearly universal condemnation of the House's bill to limit the mortgage interest deduction, the Senate proposal elects to maintain the mortgage interest deduction with only limited changes.

On the business side, the Senate proposal also differs from the House in a number of key ways. First, the Senate proposal would reduce the corporate income tax from 35 percent to 20 percent. This reduction would start in 2019, rather than next year, and would be permanent. The Senate also takes a different approach for taxing pass-through businesses (sole proprietorships, partnerships, and S corporations that currently pay taxes at the individual rate of their owners), creating a new deduction for pass-throughs along with other incentives to promote investment.

The Senate tax proposal would also effectively repeal the ACA's individual mandate by setting its penalty to $0 starting in 2019. The Congressional Budget Office (CBO) and Joint Committee on Taxation (JCT) estimate that repealing the mandate would reduce federal deficits by $338 billion over the 2018 – 2027 period. Senate Finance Chairman Orrin Hatch (R-UT) stated that these savings would allow for steeper tax cuts in individual tax rates and ensure that the corporate tax rate cut is permanent. However, CBO and JCT also estimate that repealing the individual mandate would increase the number of uninsured individuals by 4 million in 2019 and 13 million by 2027. Although President Trump and many conservatives support including repeal of the individual mandate as part of the tax proposal, some moderate Republican senators, such as Senators Collins and Murkowski, have expressed reservations with combining health care issues with tax reform.

What's Next?

Having passed the House, the Senate is expected to vote shortly after Thanksgiving. However, the proposals face a number of obstacles before they potentially reach the President's desk. First, because the proposals are being considered under the budget reconciliation process, they must comply with the budget resolution passed in October. This means that any legislation approved by the Senate cannot increase the deficit by an amount greater than $1.5 trillion over the 2018 – 2027 budget window. Second, the House-approved bill seemingly runs afoul of the Byrd Rule, which requires all legislation passed through reconciliation to not increase the deficit beyond the ten-year budget window (2018 – 2027). According to the Committee for a Responsible Federal Budget, the proposal will increase the deficit by $155 billion in 2028. These issues suggest that both the House and Senate proposals may undergo further changes as the legislative process continues.