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Senate Passes GOP Tax Cuts Package; House and Senate Bills Now Move to Conference Committee

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After a week of frenzied debate and last minute deal making, the Senate approved a sweeping package of tax cuts by a vote of 51 to 49 with Senator Bob Corker (R-TN) and all Democrats voting in opposition. It remained unclear throughout most of the week what would be included in the bill and whether it would have support necessary for passage. Much like the earlier Senate debate over repealing the Affordable Care Act (ACA), Senate Republican leadership was forced to tread a fine line to attract support from both the moderate and conservative wings of the caucus without alienating either.

House Republicans approved their version of the bill earlier this fall, also on a partisan vote. The House and Senate will now appoint conferees that will work to close the gaps between the House and Senate measures, before sending a compromise package back to the chambers for final approval. Republican leadership aims to have a final bill on the President's desk before Christmas. Of course, there is a slim chance that the House will simply accept the Senate bill and send it to the President.

Background and Analysis: The action in the Senate this week closely mirrored the ACA debate in late July when the wheeling and dealing that typically occurs behind closed doors reached the floor of the Senate chamber. However, unlike in July, Senate Republicans were able to put together a bill that finally passed the Senate very late into Friday night. The prospects for passage of the final bill, which was released Friday afternoon, remained unclear right up until the actual vote. However, Senate Republicans had picked up momentum earlier in the week as they slowly gathered support from Republican holdouts by modifying various sections of the bill.

A number of the changes made last week aimed to appease Senator Susan Collins (R-ME), a moderate member of the caucus who was part of the team of three Republican Senators that brought down the ACA repeal effort earlier this year. Senator Collins was particularly concerned that the Senate bill, which – unlike the House bill – repeals the ACA's individual mandate, would have a particularly pronounced impact on low-income Mainers. In order to win her support, Senate leadership agreed to include two provisions to 1) allow taxpayers to deduct up to $10,000 in state and local property taxes and 2) to lower the threshold of income that Americans must spend on medical expenses before claiming a deduction from ten percent to 7.5 percent for the next two years. Senator Collins was also able to extract a promise from Senate Majority Leader Mitch McConnell (R-KY) to support two bipartisan bills meant to help stabilize individual insurance markets by reinstating cost-sharing reduction payments to insurance companies (Alexander-Murray) and setting up reinsurance programs for older and sicker individuals (Collins-Nelson).

Another challenge facing Senate Republican leadership was the insistence by Senators Ron Johnson (R-WI) and Steve Daines (R-MT) that the bill include more generous deductions for companies organized as pass-through entities. Their support for the package was gained when Leader McConnell agreed to increase the amount of business income eligible to be deducted from the 17.4 percent mark in the original proposal to 23 percent.

Leader McConnell was also able to bring Senators Jeff Flake (R-AZ) and Lisa Murkowski (R-AK) on board by promising to work on providing "fair and permanent protections" for beneficiaries of the Obama-era Deferred Action for Child Arrivals (DACA) program and by including a measure to open the Arctic National Wildlife Refuge in Alaska to oil and gas drilling, respectively.

In the end, Senator Corker was the only Republican to vote against the bill, citing estimates from the Congressional Budget Office and the Joint Committee on Taxation that the legislation would increase the federal deficit by between $1 trillion and $1.5 trillion over the next ten years. However, Senate Republican leadership did make some changes to the legislation in order to pay for amendments included to attract crucial support in the final days. Among others, the final measure scaled back some planned tax cuts and increased a new tax on assets held overseas by American multinational companies. Most notably, they decided to maintain the alternative minimum tax on corporations and to trim the effects of the alternative minimum tax for high-earning individuals. Originally, the bill would have eliminated both those taxes entirely.

Republican Congressional leadership will seek to reconcile the House and Senate bills through a Conference Committee, before sending the bill back to both chambers for final approval. While there are differences between the House and Senate approved bills (see table below), the two sides generally agree on the scope and focus of the legislation. Republican leaders are racing to complete action before the end of the year.

That said, there are certain key differences that will need to be resolved. The House, for example, wants to cut the mortgage interest deduction in half, and eliminate it entirely for second homes. The Senate would only end it for home equity loans. Senate Republicans decided at the last-minute to abandon plans to repeal the Alternative Minimum Tax – a key part of House legislation. The House cuts roughly $65 billion out of education-related tax breaks, while the Senate leaves them mostly untouched. Senate Republicans have seven individual income tax brackets in their plan, while the House has four. House Republicans want to end the estate tax while the Senate would only temporarily ease it.

The political pressure on the Republicans to reach an agreement and approve the tax cut package – giving them a long sought after legislative win – is substantial.

For more information on tax reform or other matters, please contact Sheila P. Burke, chair of Baker Donelson's Government Relations and Public Policy Group.

	Current	**House-passed measure**	**Senate-passed measure**
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% with sunset after 2025
Standard Deduction	$6,350	$12,200	$12,000, sunset after 2025

Corporate Income Tax	35%	20% starting in 2018	20% starting 2019
"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 23% 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	Immediate full expensing for five years followed by five year phase out
Mortgage Interest Deduction	Up to $1 million in mortgage debt	Up to $500,000 in mortgage debt, only primary residences eligible	Up to $1 million in mortgage debt, home equity loans no longer eligible
State and Local Tax Deduction	All taxes paid	Up to $10,000 in local property taxes	Same as House
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 elimination in 2025	$11.2 million with no elimination
Child Tax Credit	$1,000	$1,600	$2,000 with phase out for joint filers beginning at $500,000 with sunset after 2025

ACA Health Insurance Mandate	Requires all Americans to purchase insurance or pay a penalty of $695 or 2.5% of household income (whichever is higher)	No change	Reduce penalty to $0 starting 2019
Medical Expense Deduction	Allows deductions of medical expenses if totaling more than 10% of income	Eliminate	Allows deductions of medical expenses if totaling more than 7.5% of income for 2018 and 2019 before reverting to 10%
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	Eliminate
International Taxation	Existing global tax regime	Moves to a territorial system with base-erosion rules including the inclusion of 50% of excess returns by controlled foreign corporations in U.S. shareholders' income, and an excise tax on payments made to foreign firms unless claimed as effectively connected income	Moves to a territorial system with anti-abuse rules and a base erosion minimum tax of the excess of 10% of modified taxable income more than an amount equal to regular tax liability
Deemed Repatriation	N/A	Enacts deemed repatriation of	Enacts deemed repatriation of

		currently deferred foreign profits at a rate of 14% for liquid assets and 7% for illiquid assets	currently deferred foreign profits at a rate of 14.49% for liquid assets and 7.49% for illiquid assets
Arctic National Wildlife Refuge	Oil and gas extraction not allowed	No Change	Oil and gas extraction allowed