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Tax Reform 2.0: The Ways and Means Tax Proposals

The Ways and Means Committee, on September 13, 2018, approved three tax bills. H.R. 6760, the Protecting Family and Small Business Tax Cuts Act of 2018, would make the individual tax cuts in the 2017 tax revision (commonly referred to as the Tax Cuts and Jobs Act) permanent. H.R. 6757, the Family Savings Act of 2018, would expand tax benefits for savings and make other modifications to retirement plans. H.R. 6756, the American Innovation Act of 2018, would provide tax benefits for start-up businesses. The last two bills were approved in the House on September 27, 2018, and the first on September 28, 2018.

Making the Individual Tax Cuts Permanent, H.R. 6760

The most significant bill, measured by budgetary impact, would make the expiring provisions relating to individual tax revisions, including the deduction for pass-through businesses taxed under the individual tax, permanent. These provisions are explained in CRS Report R45092, *The 2017 Tax Revision (P.L. 115-97): Comparison to 2017 Tax Law*, coordinated by Molly F. Sherlock and Donald J. Marples.

When the 2017 tax revision was adopted, a number of provisions in the bill were enacted on a temporary basis. If those provisions had been enacted on a permanent basis, the cost would have exceed the $1.5 trillion cost allowed under reconciliation in the Senate. Provisions relating to corporations, the international tax system, and a variety of provisions relating to business deductions were enacted on a permanent basis, whereas most of the provisions relating to individuals are set to expire after 2025.

The Joint Committee on Taxation estimated that making these provisions permanent would cost $631 billion for FY2019-FY2028. Since the costs largely occur in the last three years, the cost would be significantly larger in the future. If the cost grows by 5% a year, over the following 10 years (FY2029-FY2038), it will increase the deficit by $4 trillion, not including interest costs.

There are four major elements of the individual provisions in the 2017 tax revision that are made permanent by H.R. 6760: (1) the rate reductions and other structural changes, (2) the limits on deductions including the $10,000 cap on itemized deductions for state and local taxes (SALT), (3) the deduction for pass-through businesses taxed under the individual tax along with a limitation on their loss deductions, and (4) the increased exemption for the alternative minimum tax. There are also some other provisions including an increase in the exemption for the estate tax.

The revenue estimates for H.R. 6760 discussed below are for FY2019-FY2028, but as they generally reflect extensions after 2025, are estimates for a three-year effect.

Rate Reductions and Structural Changes

These provisions included the new rate structure that featured slightly lower tax rates, the increase in the standard deduction and child and dependent credits, and the repeal of personal exemptions. The new rates were slightly lower with the top rate reduced from 39.6% to 37%. The rate reductions were projected to cost $522 billion. The increased standard deduction generally offset the loss of personal exemptions for taxpayers, and the increased child tax credits generally offset the loss of dependent exemption, for a small combined loss of slightly over $20 billion.

The $10,000 SALT Cap and Other Restrictions on Deductions and Exclusions

The original bill temporarily eliminated some itemized deductions and restricted others. The most significant of these in revenue terms was a $10,000 cap on the amount of state and local taxes that could be deducted. There was also a lower $750,000 cap on mortgage debt eligible for interest deductions and an elimination of interest deductions for certain home equity loans, elimination of most casualty loss deductions and miscellaneous expenses, an increase in the income limit on charitable deductions, and a repeal of the overall limit on itemized deductions. These provisions together would gain $318 billion in revenue if made permanent.

The bill would also make permanent the inclusion of employer provided moving expenses in income ($2 billion) and repeal the deduction for moving expenses ($3 billion), except for members of the Armed Forces. It would permanently repeal the exclusion for employer-provided bicycle commuter fringe benefits and limit the deduction of wagering losses, at a negligible revenue cost.

H.R. 6760 would extend a reduction in the floor for itemized deductions for medical expenses, expiring in 2018, for two years, at a cost of $3.9 billion.

The Deduction for Pass-through Businesses and Limitation on Losses

Businesses taxed under the individual rather than corporate tax, including sole proprietorships, partnerships, and Subchapter S corporations that elect to be taxed on a partnership basis were allowed a deduction of 20% of qualified pass-through income. For high-income individuals, the deduction is limited to the greater of 50% of wages paid, or 25% of wages paid plus 2.5% of depreciable property. Certain service businesses are not eligible for high-income individuals. Making the pass-through deduction permanent is projected to cost $179 billion.

Another provision, a limit on the deduction of losses for noncorporate businesses in excess of $500,000 for a joint return and $250,000 for a single return, would raise $72 billion.

Alternative Minimum Tax Exemption

The exemption for the alternative minimum tax (imposed at a lower rate on a broader base) is increased from $86,200 (for 2018) to $109,400 for a couple and from $55,400 to $70,300 for a single or head of household taxpayer, and is phased out at higher income levels, for a loss of $283 billion.

Estate Tax Exemption

The doubling of the exemption from the estate tax is made permanent at a cost of $29 billion. The exemption is $11,180,000 for 2018 and is indexed for inflation.

Other Provisions

Several provisions have a very small cost. Capital gains tax rates are tied to prior-law rate brackets. The proposal links the 0% bracket to the new 12% and below bracket. The cost is less than $50 million a year. The bill also extends benefits for ABLE accounts, the combat zone exclusion of individuals serving in the Sinai Peninsula, and the treatment of student loans discharged on account of death or disability, all at a negligible cost.

The Family Savings Act of 2018, H.R. 6757

This proposal has three major sections: (1) employer-sponsored pension and retirement plans, (2) administrative provisions, and (3) other savings provisions. Overall, the proposal is estimated to cost $21 billion from FY2019-FY2028.

Rule Changes in Retirement Plans

This section provides a series of rule revisions: simplifications to benefit multi-employer plans, removing a cap on increases in auto-enrollment retirement plans, eliminating certain notification requirements and allowing more plan amendments, treating taxable non-tuition fellowships and stipends as compensation for IRAs (IRA contributions cannot exceed compensation), repealing the prohibition on IRA contributions by those 70½ and older, prohibiting plans from making loans through credit cards and similar arrangements, allowing the transfer of lifetime income investments (annuities) between plans or as a distribution if no longer allowed as an investment option in a plan, allowing custodial accounts on termination of certain plans (Section 403 plans) to be converted into IRAs, clarifying what individuals will be covered by church controlled organization plans, exempting individuals with accounts of $50,000 or less from minimum distribution rules, clarifying the treatment of certain contributions that are picked up by government employers, and allowing elective deferrals by members of the Ready Reserve of the Armed Forces.

These changes would cost $10 billion for FY2019-FY2028, with almost $4 billion associated with the multi-employer plans and slightly over $6 billion with the exemption from minimum distribution rules by those with $50,000 or less in account value.

Administrative Rules

This section has three provisions: (1) it allows due dates for establishment of plans on the tax filing day rather than year end; (2) it modifies the anti-discrimination rules so they are not triggered by participation in the plan of older, longer-service employees; and (3) it commissions a study of premiums for the Pension Benefit Guaranty Corporation (PBGC).

Other Savings Provisions

This section has three proposals. It introduces general universal savings accounts with a $2,500 contribution limit that are separate from other accounts, and whose distributions are not subject to tax. It expands the uses for tax-free distribution from section 529 education savings plans to certain apprenticeship programs, home schooling costs, up to $10,000 in repayment of student loans, and expenses for elementary and secondary education, including parochial schools. It allows penalty-free withdrawals of up to $7,500 from retirement plans in the case of birth or adoption.

These provisions are estimated to cost $11 billion from FY2019-FY2028, with almost $9 billion associated with universal savings accounts and $2 billion with the penalty-free retirement distributions for new births and adoptions.

The American Innovation Act, H.R. 6756http://www.congress.gov/cgi-lis/bdquery/z?d115:H.R.6756:

This proposal would increase the amount of start-up costs that can be deducted immediately from $5,000 to $20,000. The deduction would be phased out dollar for dollar after start-up costs exceed $120,000 (up from $50,000 in current law). The proposal would also allow net operating losses and unused tax credits arising within three years of start up to be carried over to a new owner that continues the business, without regard to the general rules that restrict these carryovers.

The Joint Committee on Taxation has estimated a revenue loss of $5.4 billion over FY2019-FY2028.

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