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POLITICS

Republicans Stick With Big Corporate Tax Cuts in House Bill

The Tax Cuts and Jobs Act seeks the biggest transformation of tax code in more than 30 years; leaves top individual tax rate at 39.6%

House Ways and Means Chairman Kevin Brady (R., Texas), who authored the Tax Cuts and Jobs Act, said, 'We are following the Reagan example here.' PHOTO: RON SACHS/CNP/ZUMA PRESS

By Richard Rubin
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WASHINGTON—House Republicans, seeking the biggest transformation of the U.S. tax code in more than 30 years, aim to permanently chop the corporate tax rate from 35% to 20%, compress the number of individual income tax brackets, and repeal the taxes paid by large estates starting in 2024, according to a detailed summary of the plan reviewed by The Wall Street Journal.

The GOP plan repeals the deduction for state and local income and sales taxes. It allows a deduction for property taxes, but caps it at $10,000. That limit applies to married filers and individuals.

To partly offset that lost revenue, Republicans plan to curtail the deductions individuals take for state and local tax payments and the ones businesses get for the interest they pay on debt. But the plan being released Thursday morning stops short of touching other popular tax breaks that were being considered for change, such as the ability of individuals to park up to $18,000 a year in pretax funds into 401(k) savings accounts.

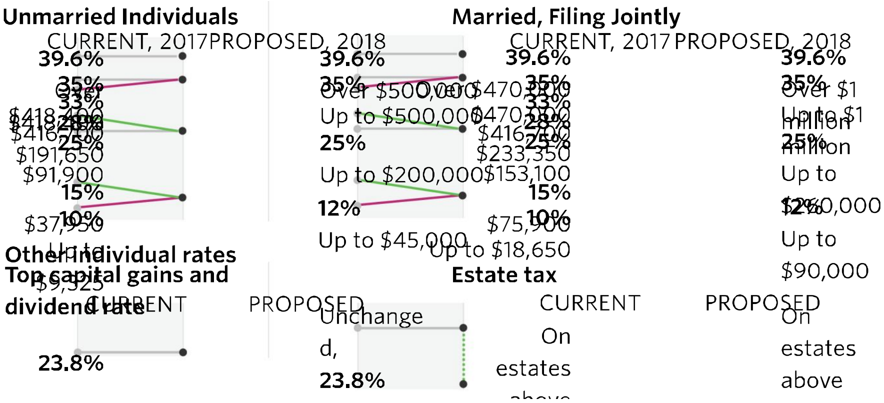
The plan, named the Tax Cuts and Jobs Act, calls for leaving the top individual tax rate at 39.6%, but pushing the income threshold for that rate to $1 million for married couples. The House Ways and Means Committee plans to consider the bill next week with the aim of turning it into law by Christmas and having most of it take effect in 2018.

Republicans view the tax bill as essential to their political futures and their best chance for a legislative victory in President Donald Trump's first year in office. Mr. Trump will likely argue the bill meets many of his goals, but it still faces a challenging path to completion in a Congress contending with many competing interests.

The tax bill, revised repeatedly in the final days before its release, already bears the marks of political compromises large and small, in addition to budgetary contortions needed to avoid creating larger and long-lasting budget deficits. For example, incentives for business investment lapse after five years and so does a new $300 per person credit for filers, their spouses and non-child dependents such as college students. Those

Rates and Brackets

Republicans propose collapsing seven tax brackets into four brackets, with new rates and thresholds for where higher taxes kick in.



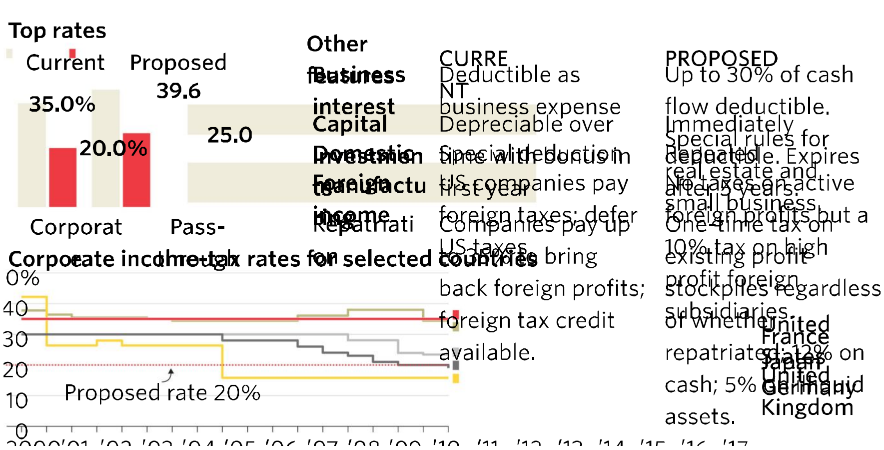
Source: House Ways and Means Committee

expirations mean the tax cuts would shrink in future years unless Congress acts.

Those moves were necessary because a budget blueprint agreed upon by the Senate and the House constrains the tax overhaul to a cost of $1.5 trillion over a decade. They need to hit that target and avoid higher budget deficits beyond that to qualify for fast-track rules that could let them pass a bill without Democratic votes. But Republicans are seeking more than $5 trillion in rate cuts over a decade and need to find offsetting provisions, and critics will label some of their decisions as budgetary gimmicks. Republicans have spent months trying to solve that math problem, looking for tax breaks to repeal without disturbing the slim political coalition they need to pass a bill.

The Corporate Code

Republicans propose to chop the corporate tax rate and the rate for unincorporated business owners to keep up with cuts around the world.



Sources: House Ways and Means Committee and Organization for Economic Cooperation and Development (tax changes); Organization for Economic Cooperation and Development (world rates)

Republican leaders will now begin the hard work of selling their plan, starting with a meeting of lawmakers Thursday morning and a White House event in the afternoon. They are soliciting reaction from business groups, particularly on complicated and novel changes to the taxation of corporate foreign income and pass-through businesses such as partnerships. Those areas contain huge potential problems.

They intend to work quickly. The first crucible is in the House Ways and Means Committee, which will begin considering the plan next week. That theoretically shouldn't be too hard, because Ways and Means Republicans have been huddling all week to hammer out the plan.

After that come the tougher challenges of cobbling together a House majority and melding this bill with a separate Senate plan scheduled for release as soon as next week. Democrats are likely to attack the plan as a budget-busting giveaway to the rich, and estimates, projections, and analyses will be debated furiously in the coming weeks.

President Donald Trump will be able to argue that the bill meets many of his tax-cutting goals. PHOTO: ALEX WONG/GETTY IMAGES

"We'll be in listening mode all throughout the code," said the bill's author, Ways and Means Chairman Kevin Brady (R., Texas). "We are following the Reagan example here. Go bold. Listen. Make adjustments, but keep the process going forward."

The plan hits many Republican goals. It nearly doubles the standard deduction, pushes people away from itemizing their deductions, lowers business tax rates, repeals the alternative minimum tax, and eliminates many tax credits, deductions, and exclusions, such as breaks for moving expenses and employee achievement awards.

Republicans used at least a few budgetary maneuvers to squeeze the plan inside its constraints. For instance, different inflation measures limit some costs. They also changed some provisions during negotiations to add revenue. A new one-time tax rate on U.S. companies' stockpiled foreign profits will be significantly higher than in previous Republican plans, generating money to meet the $1.5 trillion target. The bill would apply a 12% tax rate to cash in foreign subsidiaries and a 5% tax rate to illiquid investments.

INCOME-TAX RATES

The bill collapses the current seven individual tax brackets into four: 12%, 25%, 35% and 39.6%. For married couples, the 25% rate starts at $90,000, the 35% rate starts at $260,000 and the top rate starts at $1 million. For individuals, those break points are $45,000, $200,000 and $500,000.

The new bottom tax rate covers more income than the current 10% and 15% brackets do, meaning lower taxes for many middle-income households. But many upper-income households could face a higher marginal tax rate under the House bill, which pushes some from a 33% bracket into 35%. Whether they see actual tax increases would depend on particulars, and full estimates aren't available yet.

POLITICAL LAND MINES

Meantime, there are political land mines scattered in the plan, some easy to see and others that businesses and advocates will likely unearth in the coming days.

For example, the proposal repeals an itemized deduction for medical expenses, a crucial provision to households with extraordinary health-care costs. It also repeals the tax credit for adoption and the deduction for student-loan interest.

The bill also limits the home mortgage-interest deduction. For new home purchases, interest would be deductible only on loans up to $500,000, down from $1 million today; existing loans would be grandfathered.

Because of the larger standard deduction, fewer people would have a tax incentive to make charitable donations. Many charity groups had pushed for a more widely available deduction, but Republicans decided not to expand the charitable deduction to people who don't itemize their deductions.

Businesses would lose the ability to deduct certain executive compensation above $1 million, which they can now do for performance-based pay. Life insurers would lose some tax breaks. Banks with assets exceeding $50 billion would get no deduction for certain payments to the Federal Deposit Insurance Corporation.

Tax-exempt bonds could no longer be used to build professional sports stadiums. Private universities with assets exceeding $100,000 a student would pay a new 1.4% excise tax on their net investment income. Businesses would no longer be able to deduct entertainment expenses, though today's rules for business meals would remain.

PASS-THROUGH BUSINESSES

One of the most closely watched areas is the taxation of pass-through businesses such as S corporations and partnerships. Republicans promised them a 25% rate, but also said they would create guardrails to prevent people from turning what would otherwise be wage income taxed at up to 39.6% into business income taxed at a lower rate.

Passive owners of pass-through businesses would get the 25% rate, but those actively involved in the business would have a different standard. The bill starts with the presumption that 70% of that pass-through income is attributable to labor and would be taxable at higher individual income-tax rates. For some that would create a blended top tax rate of about 35%, which those businesses and their influential trade groups may argue isn't low enough.

For professional services firms, including lawyers and financial-services professionals, the default rate would be 100% labor income, meaning they would get none of the benefit of the 25% tax rate for pass-through businesses.

That proposal may add new layers of complexity to the tax code. Business aren't bound by those default rates, and they will hire tax lawyers and accountants who will be allowed to argue to the IRS that the firms contain capital investments. That could entitle them to more income at the lower business rates.

MULTINATIONALS

There are big changes in store for multinational companies. U.S. companies would, generally, no longer pay taxes on their active foreign income, a move corporations and Republicans say is important in a competitive international landscape. To prevent companies from shifting profits abroad, the bill creates a new 10% tax on U.S. companies' high-profit foreign subsidiaries, calculated on a global basis.

The plan also imposes new restrictions on foreign companies operating in the U.S. They would face a tax of up to 20% on payments they make abroad from their U.S. operations. That is designed to prevent them from loading up their U.S. operations with deductions and pushing profits to low-tax jurisdictions. Companies could lower those taxes by agreeing to have more of their operations in the U.S. tax system.

Many companies would face a new limit on their interest deductions, which would be capped at 30% of earnings before interest, taxes, depreciation and amortization, which is a measure of cash flow. Real-estate firms and small businesses would be exempt from that limit.

CHILD-TAX CREDIT

For individuals, one potential flashpoint is an expanded child tax credit, which isn't as large or generous to low-income families as a version proposed by Sens. Marco Rubio (R., Fla.) and Mike Lee (R., Utah). The child credit, along with the larger 12% bracket, is crucial to limiting the number of low-income and middle-income families who see tax increases due to the bill. One reason they might see higher bills is because the bill eliminates personal exemptions, which filers can now use to reduce their tax bills.

The House bill takes the child credit from $1,000 to $1,600, below the $1,800 or $2,000 that Messrs. Rubio and Lee want. The House bill also creates a new $300 credit for each person in a filer's family who isn't a child, including the primary taxpayer and non-child dependents such as college students. Those $300 credits expire after 2022.

HOW A FAMILY FARES

Under current law, in 2018, a married couple with two children making $60,000 would get a $13,000 standard deduction and four personal exemptions each worth $4,150. That means they would pay taxes on $30,400 of taxable income. Their base tax bill of $3,608 would be reduced by $2,000 in child tax credits for a total income tax of $1,608.

Under the House plan, the same married couple with two children would get $3,800 in tax credits, $3,200 for the two children and $600 for the two parents. The same family would get a $24,400 standard deduction but no exemptions, for $35,600 of taxable income. Their base tax bill of $4,272 would be reduced by the $3,800 in credits for a total income tax of $472.

The House bill also expands the child credit for the upper-middle class. Currently, the credit starts phasing out for individuals with incomes above $75,000 and married couples with incomes above $110,000. Under the House bill, those thresholds move up to $115,000 and $230,000.

ESTATE TAX

The estate tax provisions also contain wrinkles. The estate-tax exemption, set for $5.6 million per person and $11.2 million per married couple, would double immediately. The tax would get repealed starting in 2024.

Even after repeal, heirs would continue to get something known as a "step-up in basis." That means they would only owe capital-gains taxes on the difference between the sales price of an asset they inherit and the value of the asset at the previous owner's death. Previous versions of estate-tax repeal had limited that benefit.

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