Tax Reform and its Impact on Individuals and Businesses

	Current Law	Tax Cuts and Jobs Act – House Bill	Impact
Tax Brackets	**Seven Rates** Ranges from 10% to 39.6%	**Four Rates (plus a bubble tax)** 12% - up to $90,000 25% - up to $260,000 35% - up to $1 million 39.6% - over $1 million 6% additional tax over between $1.2 million and $1.4 million * amounts are for married filing jointly	The proposed legislation would effectively create 3 tax rates, with a fourth above $1 million. The proposed tax rates benefit taxpayers making less than $260,000 (in that case of married filing jointly), with a rate of 25%, rather than the previous rates The 6% surcharge above $1.2 million is intended to recapture the benefit of the 12% rate for high income earners, effectively reducing the number of brackets from 4 to 3 for couples earning more than $1.4 million annually
Standard Deduction and Itemized Deductions	Standard deduction is $6,350 for single filers and $12,700 for married couples filing jointly Itemized deductions are phased out starting at $313,800 for married couples filing jointly	Standard deduction would be raised for single filers to $12,200 and $24,400 for married couples filing jointly Personal exemptions (currently $4050 per person) are being eliminated, even for dependents The child tax credit would be increased to $1,600 (but would phase out after $230,000). Further, there would be a new $300 credit for each person in a family who isn't a child (it would expire after 2022) Property tax deductions would be capped at $10,000 Mortgage interest deduction only allowed on loans up to $500,000 (with existing loans being grandfathered)	The standard deduction is not really doubled - personal exemptions (currently $4050 per person) are being eliminated to fund the increase Taxpayers who itemize would not be able to: • use the eliminated personal exemption • deduct state income taxes The net effect of the change may be to push more people into using the standard deduction, thereby accomplishing simplification. Based on the proposed rates, these changes would result in many individuals that itemize paying more in taxes than they do currently

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Capital Gains	Current upper limit is 20%	The capital gains rate would remain unchanged	Previous proposals would have treated capital gains, dividends and interest as ordinary income, but at half the effective rate. At this point, any change to reduce such rates appears unlikely.
401(k)	Currently individuals are able to contribute up to $18,000 annually with respect to 401(k) plans	No change	Discussions prior to the release of the legislation had included a drop in 401(k) contributions to $2,400 annually. Not included within the proposed legislation
Small Business/ Partnerships	Income items flow through a pass-through entity and are taxed based on the tax rate applicable to the ultimate non-pass through owners of the entity	Income (other than capital gain) derived from actively operating pass-through businesses (e.g., sole proprietorships, partnerships and S corporations) would be taxed at 25% for passive investors Where the income is from active management (other than professional service companies), the 25% rate would apply to 30% of such income, with the other 70% being treated as compensation income, taxed at the ordinary rates (this is the default rule – other ratios could be used subject to approval from the IRS based on facts and circumstances) Professional services companies (any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees (e.g., law and accounting firms, health services, etc…) would not benefit at all from the 25% tax rate	This provision would provide significant tax savings for passive investors in partnerships as well as active investors in non-professional service companies. Although the default rule is 30/70 for the 25% rate versus ordinary income rates, this ratio could be changed subject to negotiations with the IRS For owners of professional services companies (e.g., law firms and accounting firms), the ordinary individual tax rate would continue to apply as it does today

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Corporate Tax	Maximum rate: 35% Combined rate, with dividends: 48% Combined rate, with dividends and the Net Investment Income Tax of 3.8% (the "NII"): 50.5%	Maximum rate would be reduced to 20% (industrialized world average rate is 22.5%) Combined rate, with dividends: 36% Combined rate, with the NII: 39.04%	The corporate tax rate reduction should lead to renewed interest in C corporations: • Combined rate would be equivalent to a partnership investment currently • Eliminates partnership complexity Section 1202 small business corporations may become one of the best bets in entity formation - An investment in qualifying small business stock can be sold tax-free if held for at least five years, effectively dropping the income tax rate to 20%
Business Tax Changes		Immediate deduction for capital expenses (rather than amortization) - 5 year limit The C corporation deduction for interest expense (other than against interest income) would be limited to 30% of EBITDA (with exemptions for certain real estate firms and small businesses) Elimination of the domestic production activities deduction and most other business credits Creation of a territorial tax system - Multinational corporations would not be taxed on their foreign active profits other than high profit foreign subsidiaries Deferred foreign profits would be repatriated at 12% on cash and 5% on illiquid assets Entertainment expenses (other than meals) would no longer be deductible	100% expensing would enable entities to recover their expense on a much quicker basis, however this would only be a five-year run without further changes in legislation or future amendments The limitation on the deduction of interest expenses could create a chilling effect on corporate bond programs The repatriation of foreign profits would be mandatory, rather than optional. This may create short-term cash difficulties for businesses with large amounts of unrecognized profits held overseas

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Carried Interest		Three-year holding period requirement for qualification as long term capital gain with respect to certain partnership interests received in connection with the performance of services where the partnership business activity includes investing in or developing securities, commodities and real estate	Gains to fund managers would be short-term capital gains, unless the underlying investment is held for more than three years
Executive Compensation		New Section 409B would tax all deferred compensation arrangements once they are no longer subject to a substantial risk of forfeiture Per an amendment from Kevin Brady, employees who receive stock options or RSUs as compensation may elect to defer recognition of income for up to 5 years following exercise	409B would eliminate the current deferral benefits under 409A and result in taxation for all deferred compensation, which surprisingly includes stock options. Grandfathering may be available for previously vested deferrals, however The amendment would potentially extend the recognition period on vested options that would not otherwise be exercised, however its applicability would be limited
Business Capital Contributions	Properly structured contributions of cash and assets to corporations and partnerships are currently not subject to tax	Gross income of a corporation would include any contributions to its capital if the amount of money and fair market value of property contributed to the corporation is greater than the fair market value of the stock that is issued in exchange for such money or property Similar rules would apply for partnerships	The scope of this provision beyond local government subsidies is unclear, but it may create unwelcome surprises for investors in the event there is a later determination that stock or equity interests were more or less valuable than the parties believed at the time of purchase. This also calls into question how discounting (e.g., lack of marketability) would play into grants
Affordable Care Act Taxes	3.8% on "net investment income" and an additional 0.9% medicare employment tax	Congress has made several attempts at repealing and replacing the "Affordable Care Act." Most recent attempts would have retained the ACA taxes. It is unlikely at this point that such taxes will be eliminated, and nothing was included in the House legislation.	

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Estate Tax		To be repealed starting in 2024 Prior to its repeal, the estate tax would be 40% on estates over $11.2 million	This may not be a permanent repeal
Alternative Minimum Tax		To be repealed	The AMT elimination has been proposed for some time, and is welcome news
Other Surprising Changes		1031 would only be applicable with respect to real property No long-term capital gain treatment for sales of self-created patents A sale of 50% or more of a partnership interest would no longer be a termination Deductions would not be available for medical expenses Employer contributions to medical savings accounts would be taxable income Sale of a residence would be subject to tax unless held for 5 years (instead of 2 years); subject to phase out	
Prospects Going Forward		The next step for tax reform is passage out of Way and Means in the House as well as the release of the Senate bill. Comments have been made that the Senate version of the bill may delay the corporate rate adjustment by one year and retain the current brackets. The stated goal is to pass this legislation before the end of 2017, however there are some very contentious pieces (e.g., the elimination of the deduction for state and local taxes and the reduced cap on mortgage interest deductions) that may push it to 2018. Further, the cost of the House Bill is currently in excess of $1.5 trillion, and therefore would not be eligible for a majority vote in the Senate, if passed as currently drafted	

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