FEDERAL TAX REFORM PROPOSALS

H.R. 1 (Brady) Tax Cuts & Jobs Act (aka the Brady plan or House Plan) / U.S. Senate Committee on Finance Framework

This report focuses on many of issues clients have raised regarding recent tax reform proposals. Procedurally, the U.S House version is now headed to the full Floor. The U.S. Senate Finance Committee released its tax reform proposal framework on November 9; the Committee will markup the bill on November13. Both chambers hope to go to conference with the respective versions of the bill and to have the conference report to the President for approval before Christmas. MuniServices previously reported on the "Big Six" Tax Framework prior to the release of detailed bill language. Please see http://www.muniservices.com/wp-content/uploads/MuniServices_Policy_Update_-_Big_Six_Proposed_Tax_Reform_100517.pdf. Please contact your respective Client Services Manager for additional information.

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Selected Provisions

Mortgage Interest Deduction: IRC 163(a) currently states that all interest paid or accrued within the taxable year of indebtedness is allowable. IRC 163(h)(3)(B)(ii) and IRC 163(h)(3)(C)(ii) currently states that mortgage interest deduction caps at $1.1 million in mortgage loans for married filing joint flier. **House Proposal:** Caps new mortgage loans up to $500k. In other words, if a mortgage is higher than $500k, taxpayers could only deduct mortgage interest up to $500k of the home loans. If the proposed mortgage interest cap is passed, any home loan that was purchased prior to the proposed mortgage interest cap is subject to the $1.1 million mortgage loans. This provision would have a disproportionate impact on states like California with high housing costs. This reduction would increase the amount of Federal taxes paid by Californians with mortgage interest from loans in excess of $500,000. The California Association of Realtors estimates that the average California home owner could pay as much as $3,000 more per year in taxes. **Senate Proposal:** Would be preserved for home loans of up to $1 million, the same as under current law and a departure from a House plan that had lowered that amount to $500,000.

Medical and Dental Deductions: IRC 213(a) states that Medical & Dental Expense are disallowed below 10% of Adjusted Gross Income. **House Proposal:** Expenses are completely removed as a deduction on the Schedule A. If taxpayers are subjected to Alternative Minimum Income Tax, under the current law Medical and Dental Deduction are added back. **Senate Proposal:** The medical expense deduction, claimed by approximately 8.8 million mostly middle-income people, over half of whom are over 50, would also stay.

Retirement Savings: IRC 404(a) currently allows deduction for contributions of an employer to an employee's compensation under a deferred-payment plan. IRC 402(g)(1) sets an individual's 401(k) limitation of $18,000 per year and additional $6,000 per year for individuals that are over 50 as a catch-up contribution. The 401(k) contributions are pre-tax from wages and non-taxable. **House Proposal:** President Trump has stated (as of now) this will be left alone because it helps the middle class. **Senate Proposal:** Retirement savings plans like 401(k) and IRAs are also secure under the Senate plan.

Charitable Contributions: **House Proposal:** Would not alter the charitable deduction. However, estimates from the Joint Committee on Taxation (JCT) show the number of itemizers would be substantially reduced under the new plan, which could create a disincentive for giving. Current law IRC 170(a) allows any charitable contributions made by individuals and families who itemize on their tax returns. Current law also states that most charitable contribution is limited to 50% of Adjusted Gross Income. **Senate Proposal:** Would not alter the charitable deduction.

Bonds

Municipal Bond Interest Tax Exclusion

Tax-exempt municipal bonds have also been a fundamental feature of the United States tax code since 1913. Municipal bonds remain the primary method used by states and local governments to finance public capital improvements and public infrastructure projects – including our roads, bridges, schools, hospitals, water infrastructure and much more – which are essential for creating jobs, sustaining economic growth and improving the quality of life for Americans in every corner of this country. Any tax reform bill should not sacrifice – and drive up the costs – of one of our nation's most effective methods of financing for critical infrastructure. States and local governments own and operate the vast majority of our nation's infrastructure systems and invested $3.8 trillion in infrastructure through municipal bonds from 2007 to 2016. The federal tax exemption reduces the cost of issuing municipal bonds, which is vital to taxpayers across the country who pay the interest and principle on municipal bond debt in exchange for investing in public, community assets. While there are many different forms of bonds and they are not always issued directly by cities.

Publicly-Issued Municipal Bonds: These bonds are the primary way state and local governments finance the public infrastructure that supports everyday life. Their tax exemption allows cities to borrow and lower interest rates and save on costs. **House Proposal:** The exemption is not mentioned. **Senate Proposal:** Preserved.

Advance Refund Bonds: These bonds allow do a one-time refinance on bonds to achieve lower rates and cost savings for taxpayers. **House Proposal:** Fully eliminated. **Senate Proposal:** Fully eliminated.

Private Activity Bonds (PABs): PABs are a critical source of financing for important qualified projects and programs, including infrastructure, affordable housing, economic development and much more. **House Proposal:** Fully eliminated. **Senate Proposal:** Retains PAB's and maintains the exclusion in the House bill to build professional sports stadiums.

State and Local Tax Deduction

Tax filers under current law can deduct taxes paid to state and local governments from their income to prevent double taxation and preserve local decision making when it comes to local taxes. **House Proposal:** Eliminates key elements of SALT that incentivize cities to diversify sources of revenue and set local tax rates that work for their local communities. **Senate Proposal:** Fully repealed.

Background: The deduction for state and local taxes paid was one of the six deductions allowed under the original tax code when it was enacted in 1913. Eliminating or capping federal deductibility for state and local property, sales and income taxes would represent double taxation, as these taxes are mandatory payments for all taxpayers.

Elimination Impact: States and local governments deploy revenues from state and local property, sales and income taxes to help finance long term infrastructure projects, local law enforcement, emergency services, education costs and many other services. By eliminating the federal deductibility of these taxes, Congress would be shifting the intergovernmental balance of income taxation and could limit state and local control of our tax systems. Abolishing federal deductibility could also greatly constrain policy options available to states and local governments facing economic hardships and increased responsibilities due to the devolution of federal programs. The federal deduction for state and local taxes allowed Californians to reduce their taxable income by $101 billion in 2014. If eliminated this could take discretionary income out of the California economy unless other provisions in the tax plan offset the losses.

The U.S. Conference of Mayors provided MuniServices with the following regarding the implication should a SALT deduction elimination occur: "If our taxpayers lose the deduction for their state and local income, property and sales taxes, they will face double taxation. Instead of allowing working families in every one of our communities to deduct the amount they pay in state and local taxes, the Federal government will basically be forcing taxpayers, who make up the backbone of our economy, to pay taxes a second time on the same income.

The ripple impact gets worse when we realize that a loss in local revenues could result in a cut in critical services—police and fire protection, education, health care, transportation and housing. Facts show that 39% of taxpayers with annual earning between $50,000 to $75,000; and 70% of taxpayers with annual earning between $100,000 and $200,000 use the SALT deduction. "

Local Property Tax Deduction: Property taxes are the largest source of local revenues. **House Proposal:** Reduces the eligibility of this deduction by capping it at $10,000. **Senate Proposal:** Eliminates property tax deduction for individual filers.

Sales and Income Tax Deductions: These deductions allow cities in many states the ability to diversify their sources of revenue, so they are not solely dependent on property taxes, which are subject to rapid changes in housing prices. **House Proposal:** Eliminates deductions for both sales and income taxes. **Senate Proposal:** Eliminates the state and local tax deductions.

Tax Credits for Cities

Historic Tax Credit (HTC): Encourages the redevelopment of historic and abandoned buildings in cities. **House Proposal:** Fully eliminated. **Senate Proposal:** Retains the HTC and reduces the credit from 20 to 10 percent of eligible expenses.

New Markets Tax Credit (NMTC): Increases the flow of capital to businesses and low-income communities by providing a modest tax incentive to private investors. **House Proposal:** Fully eliminated. **Senate Proposal:** Does not include a repeal of the PATH Act authorization of New Markets Tax Credit (NMTC) for 2018 and 2019.

Uninsured and Underinsured Losses: Among the provisions is to stop allowing property owners to deduct uninsured and underinsured wildfire losses from their federal income taxes. **House Proposal:** Would allow the disaster deductions for survivors of hurricanes Harvey, Irma and Maria, but not for California wildfire survivors. **Senate Proposal:** Casualty losses only deductible in presidentially-declared disaster areas.

Postcard Tax Returns

The plan will reduce the number of tax brackets for individuals to four from the current seven. Individuals will no longer be able to take tax credits for adopting a child or take deductions for tax preparation or alimony payments or moving expenses. Proponents of the Brady plan report the proposal will "provide tax relief and allow nine of 10 Americans to file income tax returns on a postcard-sized form." https://www.npr.org/2017/11/03/561712483/gops-dream-postcard-size-tax-return

Version Comparisons to Prior Year

Schedule A - Itemize	Prior Year	House Bill	Senate Bill
Medical & Dental Limitation	10% of AGI	$0.00	
SALT Deduction Limitation	no Limit	$0.00	$10,000.00
Mortgage Interest Limitation	$1,100,000.00	$500,000.00	$1,000,000.00
Charitable Contributions Limitation	50% of AGI		
Casualty and Theft Loss	See IRC 165	$0.00	
Unreimbursed Business Exp	See Treasury Reg 1.67	$0.00	
Misc Personal Exp	See IRC 262	$0.00	
Moving Expense	See IRC 217		

Form 1040 - Deduction & Credits	Prior Year	House Bill	Senate Bill
Standard Deduction - Single	$6,300.00	$12,000.00	$12,000.00
Standard Deduction - MFJ	$12,700.00	$24,000.00	$24,000.00
Personal Exp (per Person)	$4,050.00	$0.00	$0.00
Child Tax Credit (CTC)	$1,000.00	$1,600.00	$1,650.00
CTC phase out of AGI	$110,000.00	$230,000.00	$1,000,000.00
Qualified Child Age	16 and under	16 and under	17 and under
Dependents that are not children	$0.00	$300 Credit	$500 non-refundable

Tax Bracket Single Filing Status	Prior Year	House Bill	Senate Bill
10% Tax Bracket	$0 to $9,275		$0 to $9,525
12% Tax Bracket		$0 to $44,999	$9,525 to $38,700
15% Tax Bracket	$9,275 to $37,650		
22.5% Tax Bracket			$38,700 to $60,000
25% Tax Bracket	$37,650 to $91,150	$45,000 to $199,999	$60,000 to $170,000
28% Tax Bracket	$91,150 to $190,150		
32.5% Tax Bracket			$170,000 to $200,000
33% Tax Bracket	$190,150 to $413,350		
35% Tax Bracket	$413,350 to $ 415,050	$200,000 to $499,999	$200,000 to $500,000
39.6% Tax Bracket	$415,050 and Beyond	$500,000 and Beyond	$500,000 and Beyond

Tax Bracket MFJ Filing Status	Prior Year	House Bill	Senate Bill
10% Tax Bracket	$0 to $18,550		$0 to $19,050
12% Tax Bracket		$0 to $89,999	$19,050 to $77,400
15% Tax Bracket	$18,550 to $75,300		
22.5% Tax Bracket			$77,400 to $120,000
25% Tax Bracket	$75,300 to $151,900	$90,000 to $259,999	$120,000 to $290,000
28% Tax Bracket	$151,900 to $231,450		
32.5% Tax Bracket			$290,000 to $390,000
33% Tax Bracket	$231,450 to $413,350		
35% Tax Bracket	$413,350 to $466,950	$260,000 to $999,999	$390,000 to $1 Mill
39.6% Tax Bracket	$466,950 and Beyond	$1 Mill and Beyond	$1 Mill and Beyond
Estate Tax Exclusion Limitation - Individuals	$5,490,000.00	$11,000,000.00	$11,000,000.00
Estate Tax Exclusion Limitation - MFJ	$10,980,000.00	$22,000,000.00	$22,000,000.00
Corporate Tax:			
15% Tax Bracket	$0 to $50,000		
25% Tax Bracket	$50,000 to $75,000		
34% Tax Bracket	$75,000 to $100,000		
39% Tax Bracket	$100,000 to $335,000		
34% Tax Bracket	$335,000 to $10 Mill		
35% Tax Bracket	$10 Mill to $15 Mill		
38% Tax Bracket	$15 Mill to $18.33 Mill		
35% Tax Bracket	$18.33 and beyond		
Max Corporation Tax Rate	35%	20%	20%

Resources

The House Bill: https://waysandmeansforms.house.gov/uploadedfiles/bill_text.pdf
Senate Committee on Finance Policy Highlights: http://static.c-spanvideo.org/files/pressCenter/USSenateCmteOnFinance_PolicyHighlights_110917.pdf
U.S. House Ways and Means: https://waysandmeans.house.gov/chairman-brady-introduces-tax-cuts-jobs-act/
Proponent Plan Resources: https://fairandsimple.gop/
National League of Cities: http://www.nlc.org/article/tax-reform-bill-an-affront-to-local-control
National Association of Counties: http://www.naco.org/blog/congress-back-session-tax-reform-discussions-heat
US Conference of Mayors: https://www.usmayors.org/category/news/
Advocacy Resources: http://www.nlc.org/SALT
Federal Tax Reform "Big Six": http://www.muniservices.com/wp-content/uploads/MuniServices_Policy_Update_-_Big_Six_Proposed_Tax_Reform_100517.pdf