

# Tax Reform 2.0



SEPTEMBER 14, 2018

## Highlights

- ✓ Permanent Extension of Most Provisions of TCJA
- ✓ Significant Changes to Retirement Savings
- ✓ Vast Expansion of Tax Benefits for Organizational Costs
- ✓ Bills Face Uncertain Future

## Inside

### Inside

Individual, Small Business Tax Cuts .....	1
Retirement Savings.....	2
Business Innovation.....	3
Hill Reaction .....	3

## SPECIAL REPORT

# Trio of Bills Propose New Tax Benefits and Permanent Extension of Tax Reform Provisions

On September 13, the House Ways and Means Committee approved the Republican Tax Reform 2.0 package. The measure, consisting of three separate bills, is expected to reach the House floor for a full chamber vote during the week of September 24. The Tax Reform 2.0 package includes the following bills:

- Protecting Family and Small Business Tax Cuts Act of 2018 (H.R. 6760);
- Family Savings Act of 2018 (H.R. 6757); and
- American Innovation Act of 2018 (H.R. 6756).

Tax Reform 2.0 is billed as the follow-up to the Tax Cuts and Jobs Act (TCJA) (P.L. 115-97), which was the largest overhaul of the Internal Revenue Code in more than 30 years. Though due to Senate rules requiring 60 votes for passage, the bills face a doubtful future even if approved by the House.

## INDIVIDUAL, SMALL BUSINESS TAX CUTS

HR 6760, the largest of the three bills, would make permanent nearly all of the provisions of the TCJA that are set to expire after 2025. Many of the individual provisions under the TCJA were made to sunset after 2025 to remain compliant with Senate budget reconciliation rules, which allowed the chamber to pass the measure by a simple GOP majority.

Specifically, the TCJA provisions set to expire after 2025, largely affecting individual taxpayers, include:

- lower individual tax rates
- the elimination of the personal exemption
- the increased standard deduction
- the increased child tax credit
- higher alternative minimum tax (AMT) exemption amounts,
- the elimination and modification of many individual deductions, and
- the increased estate and generation skipping tax exemption.

HR 6760 would also make permanent the new Section 199A passthrough deduction for qualified business income.



 **COMMENT.** Interestingly, HR 6760 would restore the official name of *The Tax Cuts and Jobs Act*. Not long before the bill came to vote in the Senate, several provisions were required to be stricken as they were not in compliance with budget rules, including the provision naming the bill the “Tax Cuts and Jobs Act.” However, the law is still commonly referenced as the TCJA, even among congressional lawmakers and tax policy experts.

*“Tax Reform 2.0 is about changing the culture in Washington and that starts with today’s important update to our Code.”*

— Kevin Brady, R-Tex

Notably, the bill does not increase the hard limitation on the deduction for state and local taxes (“SALT deduction”). That limit was set at an aggregate of \$10,000. Many suggestions from lawmakers and taxpayers that it be increased due to a disproportionately negative impact on taxpayers in states with a high property tax burden went unheeded. The \$10,000 amount is not adjusted for inflation.

 **COMMENT.** *The lack of relief from this hard limit on the SALT deduction may prove to doom the bill. Twelve House GOP members in states with a high property tax burden, such as California, New York, New Jersey, and Connecticut, joined all House Democrats in voting against the Tax Cuts and Jobs Act, which passed by a vote of 224 to 201. While the Tax Reform 2.0 package does not necessarily need those particular lawmakers’ votes for approval in the House, if too many more House GOP members from these or similarly-situated states defect, the slim majority could vanish altogether.*

Also left unaddressed are the so-called tax extenders. The Tax Cuts and Jobs Act did not extend or make permanent a number of taxpayer-friendly provisions of the Code that are typically extended every year or two years, depending on the length of the prior extension. These provisions include:

- the deduction for tuition and fees,
- the deduction for mortgage insurance premiums,
- the exclusion of discharged debt on a principal residence,

- the election to deduct certain expenses relating to the film, television, and theater industries,
- shorter recovery periods for specified industries, and
- many energy credits.

## RETIREMENT SAVINGS

The stated goal of HR 6757 is to encourage retirement savings by younger families by creating more tax benefits for contributions by both employees and employers. While many smaller amendments have been made to retirement provisions in the Code over the years, there have not been large-scale changes made since the Pension Protection Act of 2006.

 **COMMENT.** *HR 6757 seems to enjoy bipartisan support in Congress. However, it was approved along party lines by the House Ways and Means Committee in a September 13 markup. While it may not find success coupled with an expansion and extension of the Tax Cuts and Jobs Act, for which not one Democrat voted, it could see passage later in the year as an addition to a possible tax extenders bill.*

One of the most significant proposals allows for multiple employer plans to use a pooled plan provider to meet the requirements of a defined contribution plan. This may allow multiple employers to bargain in larger numbers for more beneficial plan terms for employees.

Several provisions streamline plan administration, including:

- (1) improved 401(k) safe harbor election rules,
- (2) increased timing flexibility for an employer to retroactively establish a qualified plan, and
- (3) nondiscrimination testing relief for grandfathered participants in closed plans.

Child birth or adoption distributions would be permissible for 401(k)s, graduate students would be able to make IRA contributions, taxpayers could fund newly created “Universal Savings Accounts” that can grow tax free, and 529 plans would be expanded to include apprenticeship programs, private primary and secondary education expenses, and student loan repayments.

Not all of the provisions affect only younger employees. The bill also proposes to eliminate the requirement that a contributor to a traditional individual retirement account (IRA) be under the age of 70 ½ in order to claim a deduction. Also proposed is the allowance of portability of savings in a defined contribution plan from one plan to another. Finally, an exception from required minimum

distribution rules is proposed to apply to employees whose aggregate interests in employee plans are not in excess of \$50,000. This \$50,000 amount would be adjusted annually for inflation.

## BUSINESS INNOVATION

HR 6756 is comprised of just two sections meant to encourage business formation. The first provides a large expansion of the election to deduct organizational costs. Organizational costs (i.e. costs incurred in the organization of a new business) are required to be amortized over 15 years, with the exception of a limited amount that can be deducted in the first year. This amount has long been set at \$5,000, with a reduction in the amount on a dollar-for-dollar basis to the extent organizational costs exceed \$50,000.

The proposal would greatly increase these amounts to \$20,000 and \$120,000 respectively. Further, the increased amounts would be annually adjusted for inflation. The proposed bill also applies the deduction for organizational costs to partnerships and S corporations, and eliminates the separate, yet largely identical, rules that had long applied to only those types of passthrough entities.

The second provision allows for losses incurred by a start-up (losses incurred during the three-year period of a new trade or business) to be claimed as a net operating loss by an entity that acquires the start-up. Several qualifications and rules apply to this preservation of start-up losses.

## HILL REACTION

Ways and Means Committee Chairman Kevin Brady, R-Tex., touted Tax Reform 2.0 as an illustration of Republican efforts to consistently modify and update the Code. "Tax Reform 2.0 is our commitment to American workers that our Code will remain the most competitive

in the world," Brady said during opening statements at the September 13 markup of the package. "So, while Tax Reform 1.0 was about changing the trajectory of the economy, Tax Reform 2.0 is about changing the culture in Washington and that starts with today's important update to our Code."

Meanwhile, Democrats are criticizing Tax Reform 2.0 for following in the TCJA's footsteps of primarily benefiting the wealthy. "Republicans are doubling down and moving forward with another round of tax cuts for the well-off and well-connected," Ways and Means Committee ranking member Richard Neal, D-Mass., said during the markup's opening statements. "Republicans are doubling down on their flawed policies with this exercise, with bills guaranteed to be dead-on-arrival in the Senate," Neal added.

Neal called Republicans' Tax Reform 2.0 efforts a "political exercise," because its approval as a whole in the Senate appears highly unlikely. At least nine Democratic votes would be needed on the measure.

Rohit Kumar, former Deputy Chief of Staff for Senate Majority Leader Mitch McConnell, R-Ky., and current Tax Policy Services Leader at PwC, told Wolters Kluwer that Senate Republicans are likely to ignore proposals to make individual and small business tax cuts under the TCJA permanent, knowing Democratic support is unlikely. "Success or failure depends on your perspective. For the vast majority of House Republicans, the vote on permanence is a good vote, albeit perhaps marginally so," Kumar told Wolters Kluwer on September 13. "For a handful of House Republicans, however, it is a more challenging issue by virtue of the SALT cap. Indexing the cap could alleviate some of the burden, but the issue itself is a fundamentally challenging one for blue state House Republicans. Senate Republicans are likely to mostly ignore the permanence bill as there is no hope of getting to 60 votes. The retirement proposals, in contrast, could easily see action in the lame duck as part of a broader package."



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