Policy Points of the Tax Cuts and Jobs Act

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On December 22, 2017, President Trump signed into law significant tax reform legislation, commonly referred to as the Tax Cuts and Jobs Act (TCJA) (P.L. 115-97). While this legislation seems to have come into existence quickly, with legislative language first introduced in the House Ways and Means Committee on November 2, 2017, it had a longer history. That history included discussion of numerous tax policy matters and proposals, some of which are reflected in the TCJA, while others await future legislation. This article covers some of the tax policy changes in the TCJA and offers a rating on whether particular principles were met. An exhibit presents a timeline of key actions that led to the TCJA.

Simplification

Rating: B-

The TCJA increases the standard deduction. It is estimated that this will result in a change from 30 percent of individuals claiming itemized deductions prior to the TCJA to only 13 percent in 2018.¹ The TCJA also removes some itemized deductions such as for interest expense on a home equity debt, miscellaneous deductions subject to the two percent of AGI limitation, and personal casualty and theft loss unless from a federal disaster. The new law limits the personal state and local tax deduction to $10,000 ($5,000 if married filing separately), but this was done more for revenue raising purposes than for simplification.

The TCJA also adds new complexities to the law including:

- IRC section 199A – the qualified business income deduction for owners of qualified trades or businesses. This is intended to provide some rate reduction parity for business owners operating out of the C corporation form, but adds numerous definitions and limitations.
- IRC section 163(j) – a new limitation on business interest of most businesses other than those with under $25 million of gross receipts.
- Various international provisions – the move to a territorial system with various backstops to prevent shifting income to tax havens, includes modifications to existing rules as well as a few new Code sections such as section 59A imposing a tax on base erosion payments, and section 951A on taxation of “global intangible low-taxed income” (GILTI).

Equity

Rating: C

Some new inequities show up in the TCJA. For example, the section 199A qualified business income deduction is not equally available to all types of businesses. For example, at certain high-income levels, some individuals in professional services, such as law and accounting, are denied the deduction although other types of businesses may claim the deduction even with similar income levels.

Cut back on some deductions, such as unreimbursed employee business expenses, treat employees different from independent contractors. Also, limitation on personal casualty losses result in treating differently, the tax treatment from, for example, a loss from a home fire, depending on whether the home is purely personal use (no deduction), rental (deduction allowed) or home office (deduction for the home office portion of the home).

**Economic Growth**

Rating: B-

A key driver of tax reform was to improve international competitiveness. To make the U.S. system more similar to those of other industrialized countries, the corporate rate was lowered to a flat 21 percent. In addition, for corporations, a territorial system was created, moving away from the worldwide system that few countries use today. Supporters of this approach project economic growth due to improved competitiveness for U.S. companies, as well as business expansion by U.S. and foreign businesses in the U.S. Possible changes by other countries, such as rate reductions, may limit the possible benefits.

The TCJA includes 100 percent bonus depreciation for qualified tangible business assets through 2022 (section 168(k)). Such favorable treatment is not allowed for acquired intangible assets although such assets are significant for today’s businesses. In addition, after 2021, the R&D deduction is no longer allowed. Instead, R&D expenditures must be capitalized and amortized over five years (15 years for foreign R&D).

Business models have been changing including a growth in independent contractors, such as gig economy workers where such workers and service recipients and buyers are matched via a web-based platform. This new model warrants tax changes regarding information reporting, possible withholding on payments, retirement benefits and worker classification. None of these topics are part of the TCJA.

The TCJA only addressed income and estate tax changes. No changes were made to other taxes such as Social Security or gasoline excise taxes despite deficiency issues with the funds these taxes support. Should later tax increases be made to these or other taxes, tax savings and distributional effects of the TCJA would change significantly.

**Permanence**

Rating: C-

Due to the budget reconciliation approach to enacting tax reform, which only requires 51 votes in the Senate rather than 60, the bill cannot create deficits in the eleventh year and beyond from enactment date. Thus, almost all of the individual changes are temporary, lasting only from 2018 through 2025. In addition, the partisan approach to enactment of the TCJA might also means that change in the majority party, as well as bipartisan concerns over the deficit and debt, could result in changes to TCJA provisions. This makes long-term planning, including choice of entity considerations, difficult.
Preserving the Income Tax

Rating: B-

The Joint Committee on Taxation states: “the normal structure of the individual income tax includes the following major components: one personal exemption for each taxpayer and one for each dependent, the standard deduction, the existing tax rate schedule, and deductions for investment and employee business expenses. Most other tax benefits for individual taxpayers are classified as exceptions to normal income tax law.”

The TCJA moves our income tax further away from the “normal structure.” Personal and dependency exemptions are eliminated. A $2,000 child credit exists for children under age 17 and a $500 credit for other dependents, though. Also, elimination of all miscellaneous deductions that were subject to the two percent of AGI limitation removes deductions for unreimbursed employee business expenses and investment expenses from the tax base. Thus, the federal income tax does not follow the premise of a net income tax that expenses of generating income should be deductible or that a portion of the base reflecting family size should be exempt from tax.

Summary

The TCJA represents major reforms, particularly for corporations operating internationally. The budget reconciliation process for enactment presented many limitations that prevented the bill from fully addressing changes needed to ensure the tax system reflects today’s ways of living and doing business. We’ll see if additional changes will be made, perhaps after a few years of evaluating how the TCJA changes affect competitiveness of U.S. firms and budget projections.

For a list of changes included in the TCJA, in addition to the bill itself (P.L. 115-97), see the Joint Committee on Taxation list that includes cost estimates (JCX-67-17 (12/18/17)). And watch for an expected stream of much-needed guidance from the Treasury and IRS.

Exhibit – Brief History of the Tax Cuts and Jobs Act

January 2011 – Congressman Camp, chair of the House Ways and Means Committee launches the first in a series of hearings on tax reform.

February 2013 – House Ways and Means Committee forms 11 bipartisan working groups on tax reform.

Summer 2015 – Reports released of the Senate Finance Committee’s five bipartisan working groups on tax reform created in January 2015.

June 2016 – House Republicans release a tax reform blueprint ("A Better Way").

April 2017 – President Trump releases a one-page tax reform plan.

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September 2017 – The group of six (Speaker Paul Ryan, Congressman Brady, Senators Hatch and McConnell, Treasury Secretary Mnuchin, and White House economic adviser Cohn), release that tax reform “unified framework.”

October 2017 – H.Con. Res. 17 enacted to allow up to $1.5 trillion cost for tax reform.

November 2, 2017 – H.R. 1 introduced in the House Ways and Means Committee.

November 9, 2017 – Senate Finance Committee releases proposal consisting of a summary from the Joint Committee on Taxation.

November 13, 2017 – House Ways and Means Committee passes H.R. 1, as amended.

November 14, 2017 – Senator Hatch, Chair of the Senate Finance Committee issues a mark-up to the earlier proposal.

November 16, 2017 – House passes H.R. 1 by vote of 227 to 205. Also, the Senate Finance Committee passes its version.

November 20, 2017 – Senate Finance Committee releases legislative text of what it passed earlier.

December 1, 2017 – Senate passes H.R. 1 as modified.

December 13, 2017 – Conference Committee created.

December 15, 2017 – Conference Committee bill and report released.

December 19, 2017 – House passes H.R. 1 by a vote of 227 to 203.

December 20, 2017 – Senate passes H.R. 1 by a vote of 51 to 48. The House has to revote on the bill due to amendments made to meet budget reconciliation requirements, by a vote of 224 to 201.