Provisions addressed in this memo would be effective for the 2018 tax year.

A different bill is expected from the Senate later this week.

H.R. 1 would make extensive changes to the Internal Revenue Code, including collapsing seven individual income tax brackets into four (the top 39.5 percent bracket would start at $1 million for couples, $200,000 for individuals) and a reduction in the C-Corp income tax rate for corporations with taxable income greater than $10 million from 35 percent to 20 percent. The maximum tax rate on pass-through entities (proprietorships, partnerships, LLC, S-Corps and REIT) would be 25 percent.

There are nuances, as well, such as a technique for "phasing out the tax benefit" of the new, lowest rate of 12 percent for high-income taxpayers.

This summary focuses on those items of specific interest to state and local taxing and budget authorities, mostly on items that will directly flow through to state individual and corporate income tax returns, assuming no decoupling from the federal code. For individual taxation, most states will be affected only by changes to Adjusted Gross Income and by changes to Schedule A deductions.

INDIVIDUALS

Exclusions from income and items that would directly affect a taxpayer's Adjusted Gross Income (AGI)

The bill would tax income related to these currently exempt or excluded benefits or activities:

- Interest payments on qualified education loans, qualified tuition expenses, interest on savings bonds used to pay higher education expenses, qualified tuition reduction programs and employer-provided education assistance
- Employer-provided housing valued at more than $50,000 ($25,000 on a joint return), phased out for higher incomes
- Employee achievement awards
- Dependent care assistance provided by employers
- Qualified moving expense reimbursement
- Adoption assistance
- Expenses attributable to the trade or business of being an employee, except for reimbursed expenses and certain expenses of members of the reserve components of the military
- Contributions to Archer Medical Savings Accounts (due to a consolidation with Health Savings Accounts)

- The gain from the sale of a principal residence would be phased out for high-earners (AGI higher than $250,000 for a single filer), the exclusion could be used only once every five years and the home must be used as a principal residence for five out of the previous eight years
- Alimony payments would not be deductible by the payor or includable as income of the payee

Income resulting from the discharge of student debt due to death or disability of the student would be excluded from taxable income.

Items that would affect the return after the AGI calculation, but before Federal Taxable Income is calculated

The standard deduction amounts would almost double. This would reduce the number of Schedule A itemizers to fewer than 10 percent of filers.[1] Limits will be adjusted for inflation.

Filing Status	Standard deduction in 2017	Proposed new standard deduction
Single	$6,350	$12,000
Head of Household	$9,350	$18,000
Joint return	$12,700	$24,000

The personal exemption deduction would be eliminated. This means an additional $4,050 in income would be taxed for each taxpayer and qualifying dependent.[2]

Changes to the Schedule A itemized deductions

The Alternative Minimum Tax would be repealed. AMT credit carryforwards would be claimed as a refund from 2019 through 2022. Also, there would no longer be any limits on itemized deductions available to high-income taxpayers (the Pease limitation)

Schedule A deductions eliminated:

- State and local income or sales tax paid (still available for taxes paid or accrued in carrying on a trade or business or producing income)
- Medical expenses

[1] All non-itemizers would benefit. An individual non-itemizer, for instance, would have $5,650 less income taxed. Itemizers would benefit if they currently list amounts on the Schedule A that are less than the proposed new deduction, for example, an individual with less than $12,000 in Schedule A deductions.
[2] This simplified example does not take into account inflation adjustments or phase-outs that might remain for higher-income taxpayers.

- Contributions to medical savings accounts
- Taxes not paid or accrued in a trade or business
- Moving expenses
- Personal casualty losses (except for hurricane-related losses)
- Tax preparation expenses
- Expenses attributable to a trade or the business of performing services as an employee
- Deductions for gambling losses *and* expenses incurred in gambling would be limited to the amount of gambling income
- An 80 percent charitable deduction of the amount paid for the right to purchase tickets for athletic events

Deductions capped:

- The deduction for property tax paid would be capped at $10,000 per taxpayer.
- Deductions for new mortgages would be capped at $500,000 (down from $1 million); new mortgages are those that close after November 2017
- The charitable contributions cash limitation would be increased from 50 percent to 60 percent

Items that are applied after taxable income is calculated and tax rates have been applied (but note that some states directly link to certain child credit amounts.)

The Child Tax Credit would be increased from $1,000 to $1,600 for each qualifying child under age 17. The credit is phased out for higher-income taxpayers (a $110,000 phaseout for couples would increase to $230,000). A separate $300 credit would be available for non-child dependents (for five years only). (Nomenclature note: Any portion of the Child Tax Credit that becomes refundable is termed the "additional child tax credit.") Importantly, the bill would require a "work-eligible" Social Security number for every dependent used to claim the refundable portion of the Earned Income Tax Credit.

Other credits would be repealed, including a credit for older taxpayers who retire on disability, an adoption credit, a mortgage credit certificate credit and a plug-in electric drive motor vehicle credit. Three higher education tax credits would be consolidated.

PASSTHROUGHS (PARTNERSHIPS, SOLE PROPRIETORSHIPS, LLCS, S-CORPS)

Passive owners will pay a 25 percent rate on earnings rather than be subject to ordinary individual income tax rates. Each owner or shareholder would separately determine his portion of passive business income. Income from active business activity (specifically targeting wages) would be calculated by looking at the ratio of the “capital percentage” of the net income from such activities. Professional service firms are considered to have 100 percent of earnings due to labor costs, and thus fully classified as active income. For other types of passthroughs, a formula would assign 70 percent of earnings to labor, making them subject to income tax rates. See the section-by-section for more detail on this complex proposal.

ESTATE AND GENERATION-SKIPPING

The current estate value exclusion would be doubled to $10 million and indexed for inflation.

The estate tax would be phased out, beginning in 2024.

The gift tax keeps its basic exclusion amount of $10 million with an annual exclusion of $14,000.

CORPORATIONS

U.S. firms generally would be taxed only on active domestic income.

U.S. multinationals would pay a 5 percent or 12 percent tax on “deemed repatriated” income from overseas earnings and profits; payment could be made over eight years. “Deemed repatriated” is calculated as the proportionate share of qualifying untaxed income from foreign subsidiaries.

BUSINESS EXPENSING

All qualified business property would be eligible for full and immediate expensing from 2017 through 2023. The provision would apply to property acquired and placed in service after Sept. 27, 2017 and before Jan. 1, 2023 (with small exceptions). Property would be eligible if it is the taxpayer’s first use of the property instead of the current requirement for original use of the property. Property used by regulated public utility companies or property used in a real property trade or business would not be qualified.

The small business expensing limitation under section 179 is increased from $500,000 of the cost of property to $5 million. The phase-out amount is increased from $2 million to $20 million. Energy-efficient heating and air-conditioning property is permanently qualified.

OTHER PROVISIONS

There are a few changes to the interest earned on tax-exempt municipal bonds. The bill would repeal the interest exclusion for private-activity bonds and advance refunding bonds, prohibit the use of tax-exempt bonds to finance and build professional sports stadiums and repeal the use of tax credit bonds.

It would no longer be possible to re-characterize a contribution or a conversion of a traditional IRA as a contribution to a Roth IRA (or vice-versa).

All defined benefit plans — including state and local government defined contribution plans — could make in-service distributions beginning at age 59-1/2. It would not be necessary to retire to begin to draw benefits.

There are important changes to accounting rules, including the cash method of accounting, accounting for inventories, capitalization of expenses in inventory costs and accounting for long-term contracts. We refer you to the section-by-section for an overview and to the bill language for details.

Deductions for businesses with $25 million or more in average gross receipts would not be allowed a net interest expense deduction in excess of 30 percent of the business's adjustable taxable income (as determined at the partnership level, not the partner level, in a partnership).

There is a laundry list of similar changes to business accounting rules, including repeal of the credit for employer-provided child care, repeal of a deduction for lobbying expenses that relate to legislation before local government bodies and repeal of a deduction for expenses relating to entertainment or recreation unless the item is "directly related to the active conduct of the taxpayer's trade or business." These changes to business accounting rules are important and wide-ranging, but too detailed to list in this summary. Again, we refer you to the section-by-section.