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House Ways and Means Committee Releases Tax Reform Proposal

On Tuesday, February 26, 2014, House Ways and Means Committee chairman Dave Camp released his long-awaited draft legislation on tax reform. The draft is a 979 page report titled "[Tax Reform Act of 2014](#)." If enacted, the draft legislation would usher the single biggest overhaul of the tax code since 1986. The hallmarks of this draft legislation are to reduce the individual and corporate tax rates, reform the international tax rules and at the same time, simplify the overall system.

The draft legislation is the culmination of more than 30 separate congressional hearings that were dedicated to tax reform. In addition, 11 separate bipartisan tax reform working groups were created in conjunction with ranking member Sander Levin, D-Mich., three discussion drafts were issued and more than 14,000 public comments were received at [TaxReform.gov](#).

While it is unlikely that any major tax legislation will be passed by the House and the Senate and signed into law this year, it is very likely that many of the elements of the proposal will become the basis for any future tax reform.

Among the highlights of the Tax Reform Act of 2014 are the following:

Individual Tax Changes

- **New Individual Rate Structure** - The proposal revamps individual tax rates into two brackets of 10 percent and 25 percent for virtually all taxable income.
- **Larger Standard Deduction and Child Tax Credit** - The proposal provides a significantly more generous, inflation-adjusted standard deduction of \$11,000 for individuals and \$22,000 for married couples. Additionally, it increases the child tax credit to \$1,500 per child, adjusts it for inflation going forward and expands the number of families that can claim the credit.
- **Deduction for State and Local Taxes** - The proposal repeals the deduction for income and property taxes.
- **Home Mortgage Interest Deduction** - The proposal limits the deduction to mortgages below \$500,000 with a notable exception for existing mortgages or refinanced mortgages and repeals the deduction for future home equity loans.
- **Medical Expenses** - The deduction for medical expenses would be fully repealed.
- **Alternative Minimum Tax** - The alternative minimum tax, which has applied to more and more taxpayers, would be repealed.
- **Taxation of Investment Income** - Long-term capital gains and dividends would be taxed as ordinary income, with a 40 percent exclusion.

Business Tax Changes

- **Corporate Tax Rate** - The proposal would lower the corporate income tax rate to 25 percent from the current top rate of 35 percent. The rate reduction will be phased in over five years from 2015 to 2019.
- **Changes to Depreciation Tables** - The proposal would eliminate the current modified accelerated cost recovery system (MACRS) and replace it with a system similar to the alternative depreciation system (ADS). This will lengthen asset lives, reduce the present value of capital cost write-offs, and boost taxable business income relative to current law.

- Research and Development (R&D) and Advertisement Costs - Most R&D expenses will have to be amortized and deducted over five years instead of current deduction under the existing law. The proposal would make permanent a revised version of the R&D credit. Additionally, advertising costs will no longer be completely deducted in the year in which the expense was incurred. Certain advertising costs will be 50 percent deductible in the first year and the rest will be amortized over 10 years.
- Last in First Out Method of Accounting (LIFO) - LIFO method of accounting will be repealed.
- Domestic Production Activities Deduction - The deduction for domestic production will be repealed over five years.
- Like Kind Exchanges - Repeal the deferral of gain on like-kind exchanges.
- Alternative Minimum Tax - Repeal the corporate minimum tax.

International Tax Changes

- Gradual Shift Towards a Territorial International Tax System - Currently, the United States taxes corporations on their worldwide income. Corporations are allowed to defer taxes on most foreign income that remains abroad. However, when corporations repatriate their overseas income back to the United States, the United States taxes it at 35 percent with a credit for foreign taxes paid on the income.

The proposal would deem accumulated past foreign earnings currently held abroad in cash as repatriated and retroactively tax it at an 8.75 percent rate. Remaining non-cash accumulated foreign earnings held abroad (income that has already been reinvested in property, plant, and equipment) would be retroactively taxed at a lower 3.5 percent rate. The corporation will have the option to pay this tax over an eight year period. Future taxable income would exclude 95 percent of dividends paid by a foreign corporation to U.S. 10 percent shareholders, resulting in a 1.25 percent tax once the 25 percent new U.S. corporate rate is fully phased in.

We will continue to keep you informed of any developments with respect to this proposal or any other significant tax changes. Should you have any questions, please do not hesitate to contact your Green Hasson Janks tax advisor. &

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