

This document compiles the House and Senate versions of tax reform for individual income taxes and pass-through business income taxes. Text and scores come from JCT, and are organized as follows:

**1. Senate individual income tax provisions**

- a. Source: <https://www.jct.gov/publications.html?func=startdown&id=5032>

**2. JCT score of Senate individual income tax provisions**

- a. <https://www.jct.gov/publications.html?func=startdown&id=5043>

**3. House individual income tax provisions**

- a. <https://www.jct.gov/publications.html?func=startdown&id=5031>

**4. JCT score of House individual income tax provisions**

- a. <https://www.jct.gov/publications.html?func=startdown&id=5026>

**5. Senate pass through tax provisions**

- a. Source: <https://www.jct.gov/publications.html?func=startdown&id=5032>

**6. JCT score of Senate pass through tax provisions**

- a. <https://www.jct.gov/publications.html?func=startdown&id=5043>

**7. House pass through tax provisions**

- a. <https://www.jct.gov/publications.html?func=startdown&id=5031>

**8. JCT score of House individual income tax provisions**

- a. <https://www.jct.gov/publications.html?func=startdown&id=5026>

apply, over the sum of the net short-term capital loss for the taxable year and any long-term capital loss carryover to the taxable year.

#### Unrecaptured section 1250 gain

“Unrecaptured section 1250 gain” means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 (relating to certain property used in a trade or business) applies may not exceed the net section 1231 gain for the year.

### **Description of Proposal**

#### **Modification of rates**

The proposal replaces the individual income tax rate structure with a new rate structure.

**Table 2.—Proposed Federal Individual Income Tax Rates for 2018**

<b>If taxable income is:</b>	<b>Then income tax equals:</b>
<i><b>Single Individuals</b></i>	
Not over \$9,525	10% of the taxable income
Over \$9,525 but not over \$38,700	\$952.50 plus 12% of the excess over \$9,525
Over \$38,700 but not over \$60,000	\$4,453.50 plus 22.5% of the excess over \$38,700
Over \$60,000 but not over \$170,000	\$9,246 plus 25% of the excess over \$60,000
Over \$170,000 but not over \$200,000	\$36,746 plus 32.5% of the excess over \$170,000
Over \$200,000 but not over \$500,000	\$46,496 plus 35% of the excess over \$200,000
Over \$500,000	\$151,496 plus 38.5% of the excess over \$500,000
<i><b>Heads of Households</b></i>	
Not over \$13,600	10% of the taxable income
Over \$13,600 but not over \$51,800	\$1,360 plus 12% of the excess over \$13,600
Over \$51,800 but not over \$60,000	\$5,944 plus 22.5% of the excess over \$51,800
Over \$60,000 but not over \$170,000	\$7,789 plus 25% of the excess over \$60,000
Over \$170,000 but not over \$200,000	\$35,289 plus 32.5% of the excess over \$170,000
Over \$200,000 but not over \$500,000	\$45,039 plus 35% of the excess over \$200,000
Over \$500,000	\$150,039 plus 38.5% of the excess over \$500,000

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<i>Single Individuals</i>	
Not over \$9,525	10% of the taxable income
Over \$9,525 but not over \$38,700	\$952.50 plus 12% of the excess over \$9,525
Over \$38,700 but not over \$60,000	\$4,453.50 plus 22.5% of the excess over \$38,700
Over \$60,000 but not over \$170,000	\$9,246 plus 25% of the excess over \$60,000
Over \$170,000 but not over \$200,000	\$36,746 plus 32.5% of the excess over \$170,000
Over \$200,000 but not over \$500,000	\$46,496 plus 35% of the excess over \$200,000
Over \$500,000	\$151,496 plus 38.5% of the excess over \$500,000
<i>Heads of Households</i>	
Not over \$13,600	10% of the taxable income
Over \$13,600 but not over \$51,800	\$1,360 plus 12% of the excess over \$13,600
Over \$51,800 but not over \$60,000	\$5,944 plus 22.5% of the excess over \$51,800
Over \$60,000 but not over \$170,000	\$7,789 plus 25% of the excess over \$60,000
Over \$170,000 but not over \$200,000	\$35,289 plus 32.5% of the excess over \$170,000
Over \$200,000 but not over \$500,000	\$45,039 plus 35% of the excess over \$200,000
Over \$500,000	\$150,039 plus 38.5% of the excess over \$500,000

## Senate: Individual income tax provisions

<b>If taxable income is:</b>	<b>Then income tax equals:</b>
<b><i>Married Individuals Filing Joint Returns and Surviving Spouses</i></b>	
Not over \$19,050	10% of the taxable income
Over \$19,050 but not over \$77,400	\$1,905 plus 12% of the excess over \$19,050
Over \$77,400 but not over \$120,000	\$8,907 plus 22.5% of the excess over \$77,400
Over \$120,000 but not over \$290,000	\$18,492 plus 25% of the excess over \$120,000
Over \$290,000 but not over \$390,000	\$60,992 plus 32.5% of the excess over \$290,000
Over \$390,000 but not over \$1,000,000	\$93,492 plus 35% of the excess over \$390,000
Over \$1,000,000	\$306,992 plus 38.5% of the excess over \$1,000,000
<b><i>Married Individuals Filing Separate Returns</i></b>	
Not over \$9,525	10% of the taxable income
Over \$9,525 but not over \$38,700	\$952.50 plus 12% of the excess over \$9,525
Over \$38,700 but not over \$60,000	\$4,453.50 plus 22.5% of the excess over \$38,700
Over \$60,000 but not over \$145,000	\$9,246 plus 25% of the excess over \$60,000
Over \$145,000 but not over \$195,000	\$30,496 plus 32.5% of the excess over \$145,000
Over \$195,000 but not over \$500,000	\$46,746 plus 35% of the excess over \$195,000
Over \$500,000	\$153,496 plus 38.5% of the excess over \$500,000
<b><i>Estates and Trusts</i></b>	
Not over \$2,550	10% of the taxable income
Over \$2,550 but not over \$9,150	\$255 plus 25% of the excess over \$2,550
Over \$9,150 but not over \$12,500	\$1,905 plus 35% of the excess over \$9,150
Over \$12,500	\$3,077.50 plus 38.5% of the excess over \$12,500

The bracket thresholds are all adjusted for inflation and then rounded to the next lowest multiple of \$100 in future years. Unlike present law (which uses a measure of the consumer price index for all-urban consumers), the new inflation adjustment uses the chained consumer price index for all-urban consumers.

### **Simplification of tax on unearned income of children**

The proposal simplifies the “kiddie tax” by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. Thus, taxable income attributable to earned income is taxed according to an unmarried taxpayers’ brackets and rates. Taxable income attributable to net unearned income is taxed according to the brackets applicable to trusts and estates, with respect to both ordinary income and income taxed at

preferential rates. The child's tax is no longer affected by the tax situation of the child's parent or the unearned income of any siblings.

### **Replacing CPI-U with chained CPI-U**

The proposal requires the use of the chained CPI-U ("C-CPI-U") to index tax parameters currently indexed by the CPI-U. The C-CPI-U is also developed and published by the Department of Labor, and differs from the CPI-U in that it accounts for the ability of individuals to alter their consumption patterns in response to relative price changes. Values that are reset for 2018, such as the bracket thresholds and standard deduction, are indexed by the C-CPI-U in taxable years beginning after December 31, 2018. Other indexed values in the code switch from CPI-U indexing to C-CPI-U indexing going forward in taxable years beginning after December 31, 2017.

### **Maximum rates on capital gains and qualified dividends**

The proposal generally retains the present-law maximum rates on net capital gain and qualified dividends. The breakpoints between the zero- and 15-percent rates ("15-percent breakpoint") and the 15- and 20-percent rates ("20-percent breakpoint") are the same amounts as the breakpoints under present law, except the breakpoints are indexed using the C-CPI-U in taxable years beginning after 2017. Thus, for 2018, the 15-percent breakpoint is \$77,200 for joint returns and surviving spouses (one-half of this amount for married taxpayers filing separately), \$51,700 for heads of household, \$2,600 for estates and trusts, and \$38,600 for other unmarried individuals. The 20-percent breakpoint is \$479,000 for joint returns and surviving spouses (one-half of this amount for married taxpayers filing separately), \$452,400 for heads of household, \$12,700 for estates and trusts, and \$425,800 for other unmarried individuals.

Therefore, in the case of an individual (including an estate or trust) with adjusted net capital gain, to the extent the gain would not result in taxable income exceeding the 15-percent breakpoint, such gain is not taxed. Any adjusted net capital gain which would result in taxable income exceeding the 15-percent breakpoint but not exceeding the 20-percent breakpoint is taxed at 15 percent. The remaining adjusted net capital gain is taxed at 20 percent.

As under present law, unrecaptured section 1250 gain generally is taxed at a maximum rate of 25 percent, and 28-percent rate gain is taxed at a maximum rate of 28 percent.

### **Paid preparer due diligence requirement for head of household status**

The proposal directs the Secretary of the Treasury to promulgate due diligence requirements for paid preparers in determining eligibility for a taxpayer to file as head of household. A penalty of \$500 is imposed for each failure to meet these requirements.

### **Effective Date**

The proposal is effective for taxable years beginning after December 31, 2017.

Score for Senate mark

JOINT COMMITTEE ON TAXATION  
November 17, 2017  
JCX-59-17

ESTIMATED REVENUE EFFECTS OF  
THE "TAX CUTS AND JOBS ACT,"  
AS ORDERED REPORTED BY THE COMMITTEE ON FINANCE ON NOVEMBER 16, 2017

Fiscal Years 2018 - 2027

[Billions of Dollars]

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
<b>I. Tax Reform for Individuals</b>													
A. Simplification and Reform of Rates, Standard Deductions, and Exemptions													
1. 10%, 12%, 22%, 24%, 32%, 35%, and 38.5% income tax rate brackets (sunset 12/31/25) [1][2].....	tyba 12/31/17	-89.8	-130.9	-136.3	-141.7	-147.1	-153.1	-159.0	-165.5	-50.3	[3]	-645.8	-1,173.8
2. Modify standard deduction (\$12,000 for singles, \$24,000 for married filing jointly, \$18,000 for HoH) (sunset 12/31/25) [2].....	tyba 12/31/17	-58.3	-84.1	-86.6	-89.7	-92.6	-95.1	-98.1	-101.6	-30.8	[3]	-411.2	-736.9
3. Repeal of deduction for personal exemptions (sunset 12/31/25) [2].....	tyba 12/31/17	93.9	138.1	142.5	147.4	153	158.8	164.6	170.5	51.7	---	675.0	1,220.6
4. Alternative inflation measure.....	tyba 12/31/17	0.8	2.2	5.5	8.3	10.4	12.9	16.7	20.1	25.6	31.5	27.2	134.0
B. Treatment of Business Income of Individuals													
1. Allow 17.4% deduction of certain domestic non-service passthrough income of individuals, capped at 50 percent of taxpayer's share of total wages paid by the business. Exceptions (1) allow the deduction for service passthrough income for individuals below taxable income threshold, and (2) provide the wage cap does not apply for individuals below taxable income threshold. Threshold is taxable income below \$500,000 for joint filers, \$250,000 for all other individuals, phased out over next \$100,000 for joint filers and \$50,000 for all others (sunset 12/31/25) [4].....	tyba 12/31/17	-24.5	-41.6	-43.9	-45.3	-46.1	-45.1	-46.1	-44.5	-22.0	-3.1	-201.3	-362.2
2. Disallow active pass-through losses in excess of \$500,000 for joint filers, \$250,000 for all others (sunset 12/31/25).....	tyba 12/31/17	10.2	16.5	16.6	17.2	17.8	18.2	18.8	19.5	5.9	-3.5	78.4	137.4
C. Reform of the Child Tax Credit													
1. Modification of child tax credit: \$2,000 not indexed; refundable up to \$1,000 indexed up to nearest \$100 base year 2017; \$2,500 refundability threshold not indexed; \$500 other dependents not indexed; phase outs \$500K/\$500K not indexed; increase to less than 18 years old (sunset 12/31/25) [2].....	tyba 12/31/17	-31.9	-68.0	-69.7	-71.0	-72.3	-75.6	-77.0	-78.1	-40.6	---	-313.0	-584.3

## House: Individual income tax provisions

(relating to certain property used in a trade or business) applies may not exceed the net section 1231 gain for the year.

### **Description of Proposal**

#### **Modification of rates**

The proposal replaces the individual income tax rate structure with a new rate structure. The new rate structure generally has four rates: 12 percent, 25 percent, 35 percent, and 39.6 percent.<sup>14</sup> The 25-percent rate bracket begins at taxable income of \$90,000 for joint returns, \$67,500 for heads of household, \$2,550 for estates and trusts, and \$45,000 for other individuals. The 35-percent rate bracket begins at taxable income of \$260,000 for joint returns, \$9,150 for estates and trusts, and \$200,000 for other individuals. The 39.6-percent rate bracket begins at taxable income of \$1,000,000 for joint returns, \$12,500 for estates and trusts, and \$500,000 for other individuals.

The bracket thresholds are all adjusted for inflation and then rounded to the next lowest multiple of \$100 in future years. Unlike present law (which uses a measure of the consumer price index for all-urban consumers), the new inflation adjustment uses the chained consumer price index for all-urban consumers.

#### **Phaseout of benefit of the 12-percent bracket**

For taxpayers with adjusted gross income in excess of \$1,000,000 (\$1,200,000 in the case of married taxpayers filing jointly), the benefit of the 12-percent bracket, as measured against the 39.6-percent bracket, is phased out at a rate of 6-percent for taxpayers whose AGI is in excess of these amounts. Thus, in the case of a married taxpayer filing a joint return, if AGI is in excess of \$1,200,000, regardless of the character of that income, the taxpayer's marginal rate increases by 6-percent while the benefit of \$24,840 (27.6-percent of \$90,000) phases out over a range of \$414,000. The phaseout thresholds are indexed for inflation.

#### **Simplification of tax on unearned income of children**

The proposal simplifies the "kiddie tax" by effectively applying the rates applicable to trusts, without the 12-percent rate applicable to trusts, to the net unearned income of a child to whom the proposal applies. Specifically, the amount of taxable income taxed at a 12-percent rate may not exceed the amount of taxable income in excess of the net unearned income of the child. The amount of taxable income taxed at rates below 35 percent may not exceed sum of (1) the taxable income in excess of the net unearned income of the child plus (2) the amount of taxable income not in excess of the 35-percent bracket threshold applicable to a trust. The amount of taxable income taxed at rates below 39.6 percent may not exceed sum of (1) the taxable income in excess of the net unearned income of the child plus (2) the amount of taxable income not in excess of the 39.6-percent bracket threshold applicable to a trust.

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<sup>14</sup> In all cases the bracket breakpoints for married taxpayers filing a separate return are one-half of the breakpoints for married taxpayers filing jointly.

The following examples illustrate the application of the proposal:

**Example 1.**—Assume a child to whom the “kiddie tax” applies has \$60,000 taxable income of which \$50,000 is net unearned income, which would otherwise be treated as ordinary income, such as interest. Assume the 25-percent bracket threshold amount for the taxable year is \$45,000 for an unmarried taxpayer, and the 35-percent and 39.6-percent bracket thresholds for a trust are \$9,150 and \$12,500 respectively.

The child’s 25-percent bracket threshold is \$10,000 (\$60,000 less \$50,000), 35-percent bracket threshold is \$19,150 (\$10,000 plus \$9,150), and 39.6-percent bracket threshold is \$22,500 (\$10,000 plus \$12,500). Thus, \$10,000 is taxed at a 12-percent rate, \$9,150 at a 25-percent rate, \$3,350 at a 35-percent rate, and \$37,500 at a 39.6-percent rate.

**Example 2.**—Assume the same facts as Example 1 except that the amount of the child’s net unearned income is \$20,000 (rather than \$50,000).

The child’s 25-percent bracket threshold is \$40,000 (\$60,000 less \$20,000), 35-percent bracket threshold is \$49,150 (\$40,000 plus \$9,150), and the 39.6-percent bracket threshold is \$52,500 (\$40,000 plus \$12,500). Thus, \$40,000 is taxed at a 10-percent rate, \$9,150 at a 25-percent rate, \$3,350 at a 35-percent rate, and \$7,500 at a 39.6-percent rate.

### **Replacing CPI-U with chained CPI-U**

The proposal requires the use of the chained CPI-U (“C-CPI-U”) to index tax parameters currently indexed by the CPI-U. The C-CPI-U is also developed and published by the Department of Labor, and differs from the CPI-U in that it accounts for the ability of individuals to alter their consumption patterns in response to relative price changes. Values that are reset for 2018, such as the bracket thresholds and standard deduction, are indexed by the C-CPI-U in taxable years beginning after December 31, 2018. Other indexed values in the code switch from CPI indexing to C-CPI-U indexing going forward in taxable years beginning after December 31, 2017.

However, the proposal contains an overriding provision to require that all indexing throughout the bill uses the CPI, instead of the C-CPI-U, with respect to periods before January 1, 2023. In effect, all cost-of-living adjustments use the CPI through 2022. In 2023, cost-of-living adjustments use the C-CPI-U going forward.

### **Maximum rates on capital gains and qualified dividends**

The proposal generally retains the present-law maximum rates on net capital gain and qualified dividends. The breakpoints between the zero- and 15-percent rates (“15-percent breakpoint”) and the 15- and 20-percent rates (“20-percent breakpoint”) are the same amounts as the breakpoints under present law, except the breakpoints are indexed using the C-CPI-U in taxable years beginning after 2017. Thus, for 2018, the 15-percent breakpoint is \$77,200 for joint returns and surviving spouses (one-half of this amount for married taxpayers filing separately), \$51,700 for heads of household, \$2,600 for estates and trusts, and \$38,600 for other unmarried individuals. The 20-percent breakpoint is \$479,000 for joint returns and surviving



## House: Individual income tax provisions

spouses (one-half of this amount for married taxpayers filing separately), \$452,400 for heads of household, \$12,700 for estates and trusts, and \$425,800 for other unmarried individuals.

Therefore, in the case of an individual (including an estate or trust) with adjusted net capital gain, to the extent the gain would not result in taxable income exceeding the 15-percent breakpoint is not taxed. Any adjusted net capital gain which would result in taxable income exceeding the 15-percent breakpoint but not exceeding the 20-percent breakpoint is taxed at 15 percent. The remaining adjusted net capital gain is taxed at 20 percent.

As under present law, unrecaptured section 1250 gain generally is taxed at a maximum rate of 25 percent, and 28-percent rate gain is taxed at a maximum rate of 28 percent.

### **Effective Date**

The proposal is effective for taxable years beginning after December 31, 2017.

## **2. Enhancement of standard deduction**

### **Present Law**

Under present law, an individual who does not elect to itemize deductions may reduce his adjusted gross income (“AGI”) by the amount of the applicable standard deduction in arriving at his taxable income. The standard deduction is the sum of the basic standard deduction and, if applicable, the additional standard deduction. The basic standard deduction varies depending upon a taxpayer’s filing status. For 2017, the amount of the basic standard deduction is \$6,350 for single individuals and married individuals filing separate returns, \$9,350 for heads of households, and \$12,700 for married individuals filing a joint return and surviving spouses. An additional standard deduction is allowed with respect to any individual who is elderly or blind.<sup>15</sup> The amount of the standard deduction is indexed annually for inflation.

In the case of a dependent for whom a deduction for a personal exemption is allowed to another taxpayer, the standard deduction may not exceed the greater of (i) \$1,050 (in 2017) or (ii) the sum of \$350 (in 2017) plus the individual’s earned income.

### **Description of Proposal**

The proposal increases the standard deduction for individuals across all filing statuses. Under the proposal, the amount of the standard deduction is \$24,400 for married individuals filing a joint return, \$18,300 for head-of-household filers, and \$12,200 for all other taxpayers.

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<sup>15</sup> For 2017, the additional amount is \$1,250 for married taxpayers (for each spouse meeting the applicable criterion) and surviving spouses. The additional amount for single individuals and heads of households is \$1,550. An individual who qualifies as both blind and elderly is entitled to two additional standard deductions, for a total additional amount (for 2017) of \$2,500 or \$3,100, as applicable.

**JOINT COMMITTEE ON TAXATION**  
**November 2, 2017**  
**JCX-46-17**

**Fiscal Years 2018 - 2027**[illegible]

purposes.<sup>31</sup> Rather, the business owner is taxed directly on business income, and files Schedule C (sole proprietorships generally), Schedule E (rental real estate and royalties), or Schedule F (farms) with his or her individual tax return. Furthermore, transfer of a sole proprietorship is treated as a transfer of each individual asset of the business. Nonetheless, a sole proprietorship is treated as an entity separate from its owner for employment tax purposes,<sup>32</sup> for certain excise taxes,<sup>33</sup> and certain information reporting requirements.<sup>34</sup>

### **Description of Proposal**

An individual taxpayer generally may deduct 17.4 percent of domestic qualified business income from a partnership, S corporation, or sole proprietorship.

The deduction does not apply to specified service businesses, except in the case of a taxpayer whose taxable income does not exceed \$150,000 (for married individuals filing jointly; \$75,000 for other individuals). The benefit of the deduction for service providers is phased out over a \$50,000 range (for married individuals filing jointly; \$25,000 for other individuals). The phaseout applies for taxable income exceeding \$150,000 (for married individuals filing jointly; \$75,000 for other individuals).

In the case of a taxpayer who has qualified business income from a partnership or S corporation, the amount of the deduction is limited to 50 percent of the W-2 wages of the taxpayer. W-2 wages of a person is the sum of wages subject to wage withholding, elective deferrals, and deferred compensation paid by the person during the calendar year ending during the taxable year. Only those wages that are properly allocable to qualified business income are taken into account.

Qualified business income for a taxable year means the net amount of domestic qualified items of income, gain, deduction, and loss with respect to the taxpayer's qualified businesses (that is, any trade or business other than specified service trades or businesses, defined below). The determination of qualified items of income, gain, deduction, and loss takes into account these items only to the extent included or allowed in the determination of taxable income for the year. For example, if in a taxable year, a qualified business has 100 of ordinary income from inventory sales, and makes an expenditure of 25 that is required to be capitalized and amortized over 5 years under applicable tax rules, the net business income is 100 minus 5 (current-year ordinary amortization deduction), or 95. The qualified business income is not reduced by the

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<sup>31</sup> A single-member unincorporated entity is disregarded for Federal income tax purposes, unless its owner elects to be treated as a C corporation. Treas. Reg. sec. 301.7701-3(b)(1)(ii). Sole proprietorships often are conducted through legal entities for nontax reasons. While sole proprietorships generally may have no more than one owner, a married couple that files a joint return and jointly owns and operates a business may elect to have that business treated as a sole proprietorship under section 761(f).

<sup>32</sup> Treas. Reg. sec. 301.7701-2(c)(2)(iv).

<sup>33</sup> Treas. Reg. sec. 301.7701-2(c)(2)(v).

<sup>34</sup> Treas. Reg. sec. 301.7701-2(c)(2)(vi).

entire amount of the capital expenditure, only by the amount deductible in determining taxable income for the year.

Dividends from a real estate investment trust (other than any portion that is a capital gain dividend) are qualified items of income for this purpose. Similarly, dividends that are includable in gross income from certain cooperative are qualified items of income for this purpose.

If the amount of qualified business income is less than zero for a taxable year, *i.e.*, is a loss, the amount of the loss is treated as a loss from qualified businesses in the next taxable year.

Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer. Similarly, qualified business income does not include any amount allocated or distributed by a partnership to a partner who is acting other than in his or her capacity as a partner for services, and does not include any amount that is a guaranteed payment for services actually rendered to or on behalf of a partnership to the extent that the payment is in the nature of remuneration for those services.

Qualified business income or loss does not include certain investment-related income, gain, deductions, or loss.

A specified service trade or business means any trade or business activity involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.

### **Effective Date**

The proposal is effective for taxable years beginning after December 31, 2017.

## **2. Limitation on losses for taxpayers other than corporations**

### **Present Law**

#### **Loss limitation rules applicable to individuals**

##### **Passive loss rules**

The passive loss rules limit deductions and credits from passive trade or business activities.<sup>35</sup> The passive loss rules apply to individuals, estates and trusts, and closely held corporations. A passive activity for this purpose is a trade or business activity in which the taxpayer owns an interest, but in which the taxpayer does not materially participate. A taxpayer is treated as materially participating in an activity only if the taxpayer is involved in the

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<sup>35</sup> Sec. 469.

ESTIMATED REVENUE EFFECTS OF  
THE "TAX CUTS AND JOBS ACT,"  
AS ORDERED REPORTED BY THE COMMITTEE ON FINANCE ON NOVEMBER 16, 2017

Fiscal Years 2018 - 2027

[Billions of Dollars]

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
<b>I. Tax Reform for Individuals</b>													
A. Simplification and Reform of Rates, Standard Deductions, and Exemptions													
1. 10%, 12%, 22%, 24%, 32%, 35%, and 38.5% income tax rate brackets (sunset 12/31/25) [1][2].....	tyba 12/31/17	-89.8	-130.9	-136.3	-141.7	-147.1	-153.1	-159.0	-165.5	-50.3	[3]	-645.8	-1,173.8
2. Modify standard deduction (\$12,000 for singles, \$24,000 for married filing jointly, \$18,000 for HoH) (sunset 12/31/25) [2].....	tyba 12/31/17	-58.3	-84.1	-86.6	-89.7	-92.6	-95.1	-98.1	-101.6	-30.8	[3]	-411.2	-736.9
3. Repeal of deduction for personal exemptions (sunset 12/31/25) [2].....	tyba 12/31/17	93.9	138.1	142.5	147.4	153	158.8	164.6	170.5	51.7	---	675.0	1,220.6
4. Alternative inflation measure.....	tyba 12/31/17	0.8	2.2	5.5	8.3	10.4	12.9	16.7	20.1	25.6	31.5	27.2	134.0
<b>B. Treatment of Business Income of Individuals</b>													
1. Allow 17.4% deduction of certain domestic non-service passthrough income of individuals, capped at 50 percent of taxpayer's share of total wages paid by the business. Exceptions (1) allow the deduction for service passthrough income for individuals below taxable income threshold, and (2) provide the wage cap does not apply for individuals below taxable income threshold. Threshold is taxable income below \$500,000 for joint filers, \$250,000 for all other individuals, phased out over next \$100,000 for joint filers and \$50,000 for all others (sunset 12/31/25) [4].....	tyba 12/31/17	-24.5	-41.6	-43.9	-45.3	-46.1	-45.1	-46.1	-44.5	-22.0	-3.1	-201.3	-362.2
2. Disallow active pass-through losses in excess of \$500,000 for joint filers, \$250,000 for all others (sunset 12/31/25).....	tyba 12/31/17	10.2	16.5	16.6	17.2	17.8	18.2	18.8	19.5	5.9	-3.5	78.4	137.4
<b>C. Reform of the Child Tax Credit</b>													
1. Modification of child tax credit: \$2,000 not indexed; refundable up to \$1,000 indexed up to nearest \$100 base year 2017; \$2,500 refundability threshold not indexed; \$500 other dependents not indexed; phase outs \$500K/\$500K not indexed; increase to less than 18 years old (sunset 12/31/25) [2].....	tyba 12/31/17	-31.9	-68.0	-69.7	-71.0	-72.3	-75.6	-77.0	-78.1	-40.6	---	-313.0	-584.3

An S corporation shareholder's pro rata share of S corporation income is not subject to SECA tax.<sup>43</sup> Nevertheless, courts have held that an S corporation shareholder is subject to FICA tax on the amount of his or her reasonable compensation, even though the amount may have been characterized by the taxpayer as other than wages. This treatment differs from a partner's distributive share of income or loss from the partnership's trade or business, which is generally subject to SECA tax. However, in determining a limited partner's net earnings from self-employment, an exclusion is generally provided for his or her distributive share of partnership income or loss. The exclusion does not apply with respect to guaranteed payments to the limited partner for services actually rendered to or on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration for those services.<sup>44</sup>

Under the Social Security Act, OASDI taxes are directed to Treasury trust funds that provide Social Security benefits, and HI taxes are directed to the Federal Hospital Insurance Trust Fund.

### **Description of Proposal**

Qualified business income of an individual from a partnership, S corporation, or sole proprietorship is subject to Federal income tax at a rate no higher than 25 percent. Qualified business income means, generally, all net business income from a passive business activity plus the capital percentage of net business income from an active business activity, reduced by carryover business losses and by certain net business losses from the current year, as determined under the provision.

### **Determination of rate**

The provision provides that an individual's tax is reduced to reflect a maximum rate of 25 percent on qualified business income.<sup>45</sup>

Taxable income (reduced by net capital gain) that is less than the maximum dollar amount for the 25-percent rate bracket applicable to the taxpayer, is subject to tax at the lower rate brackets applicable to the taxpayer.

Taxable income (reduced by net capital gain) that exceeds the maximum dollar amount for the 25-percent rate bracket applicable to the taxpayer, and that is less than or equal to qualified business income, is subject to tax at a rate of 25 percent. However, taxable income (reduced by net capital gain) that exceeds the maximum dollar amount for the 25-percent rate

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<sup>43</sup> See Rev. Rul. 59-221, 1959-1 C.B. 225, and Rev. Rul. 74-44, 1974-1 C.B. 287. This treatment differs from a partner's distributive share of income or loss from the partnership's trade or business, which is generally subject to SECA tax, as described below. Sec. 1402(a).

<sup>44</sup> Sec. 1402(a).

<sup>45</sup> For taxable years beginning after December 31, 2017, under other provisions of the bill, the regular individual income tax rate schedule provides rates of 12, 25, 35, and 39.6 percent. See section 1001 of the bill (Reduction and simplification of individual income tax rates).

bracket applicable to the taxpayer, and that exceeds qualified business income, is subject to tax in the next higher rate brackets.

The provision provides that a 25-percent tax rate applies generally to dividends received from a real estate investment trust (other than any portion that is a capital gain dividend or a qualified dividend), and applies generally to dividends that are includable in gross income from certain cooperatives.

### **Qualified business income**

Qualified business income is defined as the sum of 100 percent of any net business income derived from any passive business activity plus the capital percentage of net business income derived from any active business activity, reduced by the sum of 100 percent of any net business loss derived from any passive business activity, 30 percent (except as otherwise provided in the case of specified service activities or in the case of a taxpayer election to prove out a different percentage, below) of any net business loss derived from any active business activity, and any carryover business loss determined for the preceding taxable year. Qualified business income does not include income from a business activity that exceeds these percentages.

#### **Passive business activity and active business activity**

A business activity means an activity that involves the conduct of any trade or business. A taxpayer's activities include those conducted through partnerships, S corporations, and sole proprietorships. An activity has the same meaning as under the present-law passive loss rules (section 469). As provided in regulations under those rules, a taxpayer may use any reasonable method of applying the relevant facts and circumstances in grouping activities together or as separate activities (through rental activities generally may not be grouped with other activities unless together they constitute an appropriate economic unit, and grouping real property rentals with personal property rentals is not permitted). It is intended that the activity grouping the taxpayer has selected under the passive loss rules is required to be used for purposes of the passthrough rate rules. For example, an individual taxpayer has an interest in a bakery and a movie theater in Baltimore, and a bakery and a movie theatre in Philadelphia. For purposes of the passive loss rules, the taxpayer has grouped them as two activities, a bakery activity and a movie theatre activity. The taxpayer must group them the same way, that is as two activities, a bakery activity and a movie theatre activity, for purposes of rules of this provision.

Regulatory authority is provided to require or permit grouping as one or as multiple activities in particular circumstances, in the case of specified services activities that would be treated as a single employer under broad related party rules of present law.

A passive business activity generally has the same meaning as a passive activity under the present-law passive loss rules. However, for this purpose, a passive business activity is not defined to exclude a working interest in any oil or gas property that the taxpayer holds directly or through an entity that does not limit the taxpayer's liability. Rather, whether the taxpayer materially participates in the activity is relevant. Further, for this purpose, a passive business

activity does not include an activity in connection with a trade or business or in connection with the production of income.

An active business activity is an activity that involves the conduct of any trade or business and that is not a passive activity. For example, if an individual has a partnership interest in a manufacturing business and materially participates in the manufacturing business, it is considered an active business activity of the individual.

#### Net business income or loss

To determine qualified business income requires a calculation of net business income or loss from each of an individual's passive business activities and active business activities. Net business income or loss is determined separately for each business activity.

Net business income is determined by appropriately netting items of income, gain, deduction and loss with respect to the business activity. The determination takes into account these amounts only to the extent the amount affects the determination of taxable income for the year. For example, if in a taxable year, a business activity has 100 of ordinary income from inventory sales, and makes an expenditure of 25 that is required to be capitalized and amortized over 5 years under applicable tax rules, the net business income is 100 minus 5 (current-year ordinary amortization deduction), or 95. The net business income is not reduced by the entire amount of the capital expenditure, only by the amount deductible in determining taxable income for the year.

Net business income or loss also includes any amounts received by the individual taxpayer as wages, director's fees, guaranteed payments and amounts received from a partnership other than in the individual's capacity as a partner, that are properly attributable to a business activity. For example, if an individual shareholder of an S corporation engaged in a business activity is paid wages or director's fees by the S corporation, the amount of wages or director's fees is included in net business income or loss with respect to the business activity. This rule is intended to ensure that the amount eligible for the 25-percent tax rate is not erroneously reduced because of compensation for services or other specified amounts that are paid separately (or treated as separate) from the individual's distributive share of passthrough income.

Net business income or loss does not include specified investment-related income, deductions, or loss. Specifically, net business income does not include (1) any item taken into account in determining net long-term capital gain or net long-term capital loss, (2) dividends, income equivalent to a dividend, or payments in lieu of dividends, (3) interest income other than that which is properly allocable to a trade or business, (4) the excess of gain over loss from commodities transactions, other than those entered into in the normal course of the trade or business or with respect to stock in trade or property held primarily for sale to customers in the ordinary course of the trade or business, property used in the trade or business, or supplies regularly used or consumed in the trade or business, (5) the excess of foreign currency gains over foreign currency losses from section 988 transactions, other than transactions directly related to the business needs of the business activity, (6) net income from notional principal contracts, other than clearly identified hedging transactions that are treated as ordinary (i.e., not treated as



capital assets), and (7) any amount received from an annuity that is not used in the trade or business of the business activity. Net business income does not include any item of deduction or loss properly allocable to such income.

### Carryover business loss

Solely for purposes of determining qualified business income eligible for a maximum rate of 25 percent, the carryover business loss from the preceding taxable year reduces qualified business income in the current taxable year.<sup>46</sup> The carryover business loss is the excess of (1) the sum of 100 percent of any net business loss derived from any passive business activity, 30 percent (except as otherwise provided under rules for determining the capital percentage, below) of any net business loss derived from any active business activity, and any carryover business loss determined for the preceding taxable year, over (2) the sum of 100 percent of any net business income derived from any passive business activity plus the capital percentage of net business income derived from any active business activity. There is no time limit on carryover business losses. For example, an individual has two business activities that give rise to a net business loss of 30 and 40, respectively, in year one, giving rise to a carryover business loss of 70 to year two. If the two business activities each give rise to net business income of 20 in year two, a carryover business loss of 30 is carried to year three (that is,  $\langle 70 \rangle - (20 + 20) = \langle 30 \rangle$ ).

### Capital percentage

The capital percentage is the percentage of net business income from an active business activity that is included in qualified business income.

In general, the capital percentage is 30 percent, except as provided in the case of application of an increased percentage for capital-intensive business activities, in the case of specified service activities, and in the case of application of the rule for capital-intensive specified service activities.

The capital percentage is reduced if the portion of net business income represented by the sum of wages, director's fees, guaranteed payments and amounts received from a partnership other than in the individual's capacity as a partner, that are properly attributable to a business activity exceeds the difference between 100 percent and the capital percentage. For example, if net business income from an individual's active business activity conducted through an S corporation is 100, including 75 of wages that the S corporation pays the individual, the otherwise applicable capital percentage is reduced from 30 percent to 25 percent.

Increased percentage for capital-intensive business activities.—A taxpayer may elect the application of an increased percentage with respect to any active business activity other than a specified service activity (described below). The election applies for the taxable year it is made

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<sup>46</sup> The determination of carryover business loss, for purposes of determining the amount of qualified business income eligible for a maximum rate of 25 percent, does not affect the extent to which items of income, gain, deduction, and loss are included in taxable income. For example, the carryforward of net operating losses and the treatment of passive activity losses continue to affect the determination of taxable income as provided in sections 172 and 469, respectively.

and each of the next four taxable years. The election is to be made no later than the due date (including extensions) of the return for the taxable year made, and is irrevocable. The percentage under the election is the applicable percentage (described below) for the five taxable years of the election.

Calculation of applicable percentage.—The applicable percentage is the percentage applied in lieu of the capital percentage in the case of an election with respect to capital-intensive business activities, or with respect to capital-intensive specified service activities (below). Once an election is made, the applicable percentage (not the capital percentage) determines the portion of the net business income or loss from the activity for the taxable year that is taken into account in determining qualified business income subject to Federal income tax at a rate no higher than 25 percent.

The applicable percentage is determined by dividing (1) the specified return on capital for the activity for the taxable year, by (2) the taxpayer's net business income derived from that activity for that taxable year. The specified return on capital for any active business activity is determined by multiplying a deemed rate of return times the asset balance for the activity for the taxable year, and reducing the product by interest expense deducted by the activity for the taxable year. The deemed rate of return for this purpose is the short-term AFR plus 7 percentage points. The asset balance for this purpose is the adjusted basis of property used in connection with the activity as of the end of the taxable year, determined without taking into account of basis adjustments for bonus depreciation under section 168(k) or expensing under section 179. In the case of an active business activity conducted through a partnership or S corporation, the taxpayer takes into account his distributive share of the asset balance of the partnership's or S corporation's adjusted basis of property used in connection with the activity. Property used in connection with an activity is property described in section 1221(a)(2), which includes property of a character which is subject to the allowance for depreciation provided in section 167 and real property used in the trade or business. For example, if an individual's active business activity has on hand at the end of the taxable year machinery with an adjusted basis of 100 (determined without taking into account basis adjustments for bonus depreciation under section 168(k) or expensing under section 179) and cash of 50, then the asset balance for the activity is 100. Regulatory authority is provided to ensure that in determining asset balance, no amount is taken into account for more than one activity.

Specified service activities.—In the case of an active business activity that is a specified service activity, generally the capital percentage is 0 and the percentage of any net business loss from the specified service activity that is taken into account as qualified business income is 0 percent. Regulatory authority is provided to treat all specified services activities of an individual as a single business activity to the extent the activities would be treated as a single employer for purposes of aggregation rules.

A specified service activity means any trade or business activity involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees, or investing, trading, or dealing in securities, partnership interests, or commodities. For this purpose a security and a commodity have the meanings

provided in the rules for the mark-to-market accounting method for dealers in securities (sections 475(c)(2) and 475(e)(2), respectively).

Capital-intensive specified service activities.—A taxpayer may annually elect the application of an increased percentage with respect to any active business activity that is specified service activity, provided the applicable percentage for the taxable year is at least 10 percent.

### **Self-employment tax**

The proposal provides that only the labor percentage of gross income less deductions from a trade or business carried on by an individual, including an individual who is a partner or S corporation shareholder in a trade or business carried on by a partnership or S corporation, are taken into account in determining net earnings from self-employment. The labor percentage is the excess (expressed as a percentage) of one minus the capital percentage (or applicable percentage, as the case may be).

Thus, the proposal provides that net earnings from self-employment generally include the individual's pro rata share of nonseparately computed income or loss from any trade or business of an S corporation in which the individual is a stockholder. Proper adjustment is made for wages paid in a trade or business carried on by an S corporation to a taxpayer who is a shareholder. For example, an S corporation shareholder is paid wages of 20 with respect to a trade or business conducted by the S corporation, and after the deduction for wages, and has a pro rata share of income from the S corporation of 100. Assume the labor percentage is 70 percent. In determining net earnings from self-employment, the 20 of wages is added to the 100 pro rata share before applying the labor percentage of 70 percent ( $120 \times .7 = 84$ ). The 84 amount is then reduced by the wages of 20, yielding net earnings from self-employment of 64. Present-law rules imposing FICA tax on the wages of 20 are not changed by the provision.

The proposal repeals the present-law exclusion for a limited partner's distributive share of partnership income or loss in determining net earnings from self-employment (including repeal of the exception for partnership guaranteed payments in the nature of remuneration for services). Thus, under the proposal, limited partners are treated the same as other partners for purposes of determining net earnings from self-employment.

The proposal modifies the exceptions that apply in determining net earnings from self-employment by providing that rentals from real estate and personal property leased with the real estate are not among the exceptions. The proposal retains the present-law exceptions for dividends and interest, and gains or loss from the sale or exchange of a capital asset, or gains or losses from other property that is neither inventory nor held primarily for sale to customers.

### **Effective Date**

The provision is effective for taxable years beginning after December 31, 2017. A transition rule provides that for fiscal year taxpayers whose taxable year includes December 31, 2017, a proportional benefit of the reduced rate under the provision is allowed for the period beginning January 1, 2018, and ending on the day before the beginning of the taxable year beginning after December 31, 2017.

**JOINT COMMITTEE ON TAXATION**  
November 2, 2017  
JCX-46-17

**Fiscal Years 2018 - 2027**[illegible]