

# Are We Going to See Tax Reform in 2014?

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House Ways and Means Committee Chairman Dave Camp (R-Michigan) issued a discussion draft of the "Tax Reform Act of 2014" last week. The proposed legislation spans almost 1,000 pages and contains some interesting provisions, including, without limitation, the following:

## **Individual Taxpayer Provisions**

- Consolidation and simplification of individual income tax brackets. The current seven tax brackets would be consolidated into three brackets-namely, a 10% bracket, a 25% bracket and a 35% bracket. High-income taxpayers would be subject to a phase-out of the tax benefit of the 10% bracket. In addition, the special rate structure for net capital gains would be repealed. In its place, non-corporate taxpayers could claim an above-the-line deduction of 40% of adjusted net capital gain.
- Expand the standard deduction (to \$22,000 for joint filers and \$11,000 for individuals) and modification of available itemized deductions, including:
  - Repeal of the 2% floor on itemized deductions and the overall limitation on itemized deductions.
  - Reduce the itemized deduction for home mortgage interest to \$500,000.
  - Repeal of the deduction for personal casualty losses.
  - Repeal of the deduction for unreimbursed medical expenses.
  - Repeal of the deduction for state and local taxes not paid in connection with business or investment.
  - Simplification of the rules surrounding charitable deductions.
  - Repeal of the exclusion for employee achievement awards.
  - Repeal of the deduction for moving expenses.
  - Reinstating the former provision allowing the cost of over-the-counter medications to be reimbursed through tax-favored health accounts.
- Consolidation and simplification of tax benefits for higher education. A single educational tax credit of up to \$2,500 annually would be made available that could be used for up to 4 years; however, the current deductions for educational expenses and interest on student loans would be repealed.

- Elimination of the income limitations on Roth IRAs and prohibiting new contributions to traditional IRAs and non-deductible traditional IRAs-effectively forcing all new IRA contributions to be Roth contributions.
- Repeal of the exception to the 10% early withdrawal penalty for withdrawals from retirement plans and IRAs used to pay first-time home buyer expenses (capped at \$10,000).
- Elimination of the deduction by the payor for the payment of alimony and elimination of the inclusion in income by the recipient.
- Repeal of the individual AMT.
- IRC Section 1031 would be repealed. Consequently, tax deferral from like-kind exchanges would no longer be permitted.
- Simplification of rules surrounding in-service distributions, hardship withdrawals and required minimum distributions from retirement plans.
- Encouraging Roth contributions in 401(k) plans by requiring all 401(k) plans to offer Roth accounts and requiring larger plans to treat all employee contributions as Roth contributions once an employee had contributed one-half of the annual contribution limit.

### **Business & Corporate Taxpayer Provisions**

- Repeal of the corporate AMT.
- Creation of a flat corporate tax rate of 25% (phased in over 5 years), applicable to business and personal service corporations alike.
- Code Section 351 would be amended so that contributions of capital to a corporation in excess of the fair market value of the stock issued would be taxable to the recipient corporation. This provision would also extend to any non-corporate entity.
- Limitations on the deductibility of NOLs by C corporations would be implemented.
- Code Section 179 expensing would be made permanent at the 2008-2009 levels.
- Code Section 197 amortization of goodwill would be extended from 15 years to 20 years.
- The deductions for meals and entertainment expenses, which are currently limited to 50%, would be eliminated with respect to entertainment. A 50% deduction for meals directly related to the conduct of a trade or business would remain intact.
- Repeal of a significant number of business tax credits.

- Simplify accounting method rules-businesses with average annual gross receipts of \$10 million or less would be allowed to use the cash method of accounting, while businesses with average annual gross receipts over \$10 million would be required to use the accrual method of accounting. The large portion of the current array of exceptions and nuances relative to adopting an accounting method would be eliminated.
- Interest charge rules would attach to all installment sales in excess of \$150,000.
- The LIFO inventory method of accounting would be eliminated.
- Dividends received from a foreign subsidiary would be excluded from the definition of personal holding company income.

### **Pass-Through Entities**

- The S corporation built-in gains tax recognition period would be permanently set at five (5) years.
- The passive income threshold for the application of Code Sections 1362(d)(3) and 1375 would be increased from 25% to 60%.
- Non-resident aliens would be allowed to be beneficiaries of ESBTs.
- The time for making an S election would be extended until the due date of the Form 1120s (with extensions).
- The rules relating to guaranteed payments from a partnership to a partner would be repealed.
- The technical termination of a partnership by the transfer of 50% or more of the interest in the partnership would be repealed.
- "Carried interest" in investment partnerships would be treated as ordinary income.

### **Worker Classification**

- A worker classification safe harbor would be created based upon objective criteria. Limited withholding obligations on the part of the service recipient would be required.

### **Miscellaneous Administrative Changes**

- A C corporation would be required to file its tax return on or before April 15. On the other hand, partnerships and corporations would be required to file their tax returns on or before March 15.
- Most compliance penalties are increased.

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The above summary is not exhaustive. It does, however, illustrate the types of broad-sweeping changes Chairman Camp has in mind. Most lawmakers do not expect a tax overhaul of this nature to become law this year. Rather, the consensus in Washington is that discussions on tax reform will continue into 2015 before any bill is presented for a vote in either the House or the Senate. It is doubtful that we will see any proposed legislation enacted into law until 2016. *Stay tuned!* I expect we will see a great deal of commentary on tax reform in the upcoming months.

For a discussion of Chairman Camp's proposal, [please read here](#).

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## Authored by

[Larry J. Brant](#)

[Principal|Portland](#)

[503.553.3114](tel:503.553.3114) [larry.brant@foster.com](mailto:larry.brant@foster.com)