Why Any Possible "Tax Reform" Actually Passed will be a BOOM for the Assisted Side of the Tax Preparation Industry.

The House and Senate have now passed different versions of so called tax reform that is going into congressional reconciliation. That reconciliation coming together among these two houses of Congress is no guarantee as there are substantial differences to both of these bills and plenty of special interests and decisiveness still floating around Washington.

That said, some people might think that tax reform could impact the number of people utilizing a paid preparer on the Assisted side of our industry or impede the acceleration of our growth efforts here at Happy Tax. We, on the other hand, disagree and are actually excited for the possibility of any tax reform as it relates to the continued growth of our business.

The first key point is that the Senators in Congress have openly admitted that they do not even know exactly what is in the bill passed last night (nearly 500 pages of new mumbo jumbo). If they aren't sure what's in there, how will taxpayers digest all of these ideas without the help of a tax preparer (or a licensed CPA that Happy Tax provides 100% of the time). There is no "postcard" coming about from either of

these versions passed. In fact, all it seems to do is lower some tax rates, increase other tax rates and make changes to what is and isn't deductible. Some deductions disappear and new deductions appear. And all of these changes create confusion. Confusion actually will drive more people to the assisted side of the business.

The number of people hiring tax preparers has been constant for over 30 years at 60% paying someone to do their return for them and 40% of people self-preparing. Even with the advent of software, the internet and all the technological bells and whistles that exist, the majority of people still choose to trust someone else to prepare their taxes for them. Why is that? Taxes are complex. There are over 70,000 pages of tax code. It takes a long time to prepare them if that isn't your profession. It is a grueling, scary process. Plus, we are a service based economy full of busy people who want to hire others to provide all types of services. Most people could probably wash their own car, change their own oil, do their own nails or do handyman work around their houses. They instead choose to hire someone else to do things that are unpleasant or that takes away from time from other things. Tax preparation is no different. In fact, the difficulty and stress of preparing one's own taxes is what contributes to most people not wanting to do it themselves.

I asked Happy Tax Board of Director Keith Alessi what his thoughts were about the last major tax reform that took place. Mr. Alessi was CEO of Jackson Hewitt at that time. Keith said "In 1997/98, when Congress enacted 'tax simplification', it was a boom for the tax preparation business. You can count on the final regulations and forms being more complicated and confusing to people. Any tax changes send people to preparers in search of guidance. Furthermore, any expansion of the Child Tax Credit or changes to the Earned Income Tax Credit will fuel demand for bank products which are available at Happy Tax."

The bill coming out of reconciliation intact is still no slam dunk. In fact, in addition to the many differences between the two versions of the

bill, Congress's Joint Committee on Taxation estimated that the passage of the "Tax Cuts And Jobs Act, will increase the national deficit by $1,447.8 trillion over the next 10 years. That increase includes any possible growth that is projected to come from the tax cuts in the bill. Over the next few weeks while congress attempts to clean up those differences, that lingering fact will be hanging over this process.

What are the differences in the two bills now?

Among the differences, the House bill brings our current 7 tax brackets down to 4 brackets while the Senate bill keeps the 7 brackets but reduces the top bracket from 39.6 to 38.5%.

Both bills increase the standard deduction (neither of them double it as originally proposed) however they increase it by different amounts. Both bills eliminate the $4,050 personal exemption deductions that are now allowed to be taken.

The house bill eliminates the full mortgage interest deduction for primary residences with mortgages higher than $500,000 (very impactful in higher cost of living states) and eliminates the 2nd home mortgage interest deduction. The senate version leaves the current mortgage interest deduction in place. However it eliminates the deduction completely for any home equity loans not taken to make improvements on your home.

Both bills cap the state and local real estate tax deductions at $10,000 and remove the ability to deduct state and city income taxes paid on your federal return.

All other Itemized Deductions in both bills are eliminated with one exception that would need to be handled in reconciliation. Under the Senate version, the deduction for medical expenses would remain however the House bill eliminates it. In either bill, no longer will any job expenses, home office expenses or even union dues be able to be deductible. I wrote an in depth article about how this part of the initial

proposal back in April impacts union workers. It is not good for those union workers in relation to how this bill impacts them.

Adjustments to income which are above the line deductions that anyone could previously claim are now being eliminated in both versions of the bill. No longer will student loan interest, alimony, moving expenses, military reservist expenses or educator expenses be deductible as a result of this.

The Child Tax Credit of $1,000 per child subject to income limitations is being increased in both bills however they are proposing different rules and amounts so that will have to be taken up in reconciliation.

Self-employed individuals claiming Earned Income Credit (lower income earners receiving a relatively large tax credit to give them some parity with others) will now be required to take every deduction allowable to be taken. This will certainly be used by IRS revenue agents to reduce the amount of Earned Income Credit given by auditing more tax returns and requiring additional expenses to be added to a return which will save money expended on this credit. Much of those savings are being passed on to larger corporations as mentioned later in this writing.

The credit currently given for parents who adopt children will be repealed in both versions of the Bill.

The exclusion of capital gains from the sale of a primary residence is being changed in both bills to now require that you had lived in it for 5 out of the previous 8 years instead of the current 2 out of the previous 5 years. This will require more people to have to pay taxes if they make a profit from selling their home and will effectively negatively impact the real estate market along with the reduced mortgage interest and real estate tax deduction reductions.

The Senate version repeals the Individual Mandate to require everyone to have health insurance that was created by the Affordable Care Act (Obamacare). The House version leaves the Individual Mandate intact.

The House bill eliminates Alternative Minimum Tax (AMT) however the Senate version leaves it intact.

Small businesses that operate as LLCs or S Corporations (Pass-Through Entities) will have the following changes. Under the House bill, these types of businesses would be taxed at a maximum of 25% instead of whatever their personal tax rate would be. This doesn't help 85% of these types of businesses as their incomes aren't large enough to hit that tax rate. It only helps larger businesses and real estate holding companies (many of which are very large). Plus, only 30% of income can be taxed at this maximum 25% tax rate, the other 70% of income is taxed at regular tax rates. Or they can set the percentage based on their level of capital investment in their business. This reduced maximum rate also does not apply to those classified as professional services business like lawyers, doctors, designers, consultants and accountants who still have to pay up to the maximum personal income tax rate (39.6% in House Bill or 38.5% in Senate bill). The Senate's version of the bill handles Pass-Through Entities the same way except it allows a 17.4% deduction against pass through income.

Businesses that operate as C Corporations (the vast majority of publicly traded and large companies) would see their tax rate lowered from 35% to 20% under the House bill starting in 2018 (hence they will be paying a much lower percentage in taxes than the generally smaller pass through entities). These tax cuts would be made permanent unlike the cuts made for individuals which expire. The Senate version of the bill reduces the tax to the same 20% for C Corporations however it does not take effect until 2019.

Large Multinational Corporations keep much of their assets and cash overseas to avoid US taxation (for example, Apple is holding over 128 billion dollars offshore). They create shell companies that hold their patents, trademarks and other intellectual property in countries with no or little taxation and then pay their profits to those subsidiaries as licensing fees to avoid paying US taxes even though those inventions and assets were effectively created here. Both versions of the bill offer these companies a one-time repatriation to pay taxes on the money allowing them to send the money here to their US based primary companies. The House version of the bill repatriation those funds at 14% for liquid assets and 7% for other assets. The Senate version makes it 10% for liquid assets and 5% for other assets.

Currently, US companies are subject to taxes on their profits they make worldwide (except those that are earned by their overseas subsidiaries mentioned above). Both the Senate and House versions change this to create a territorial system where these companies would no longer pay taxes on profits they earn internationally, only those they earned in the US.

The estate tax is also adjusted in both versions. This tax is required when someone passes on that has an estate over $5.49 million as an individual or just under $11 million for a married couple. The House bill phases this out completely after 2024 and the Senate plan keeps it intact however the exemption for estate and gift taxes are doubled.

Key Proposed Changes Summarized

- Changes to tax brackets (TBD upon reconciliation)
- Increase to Standard Deduction
- Elimination of all personal exemption deductions for taxpayers and dependents
- Reduced mortgage interest deductions
- Capped real estate tax deductions
- No more state and city income tax deductions
- No more medical deductions (in the House version only)

- No more job expense deductions
- No more home office deductions
- No more union dues deductions
- No more student loan interest deductions
- No more alimony deductions
- No more moving expenses deductions
- No more above the line supplies expenses for teachers
- No more above the line military reservist expenses
- Child Tax Credit increases
- Changes to Require Self Employed Earned Income Credit recipients to be required to take all deductions effectively lowering EIC
- No more adoption credit
- Capital gains from sale of primary residence are harder to exclude
- The Individual Mandate of Obamacare could be eliminated (pending reconciliation)
- Alternative Minimum Tax eliminated (in the House version only)
- Small business pass through entity taxes are capped for a small few and further complicated for all
- Large corporations get permanent and large tax reductions
- A one-time repatriation is offered to multinational companies avoiding taxes by keeping their assets overseas
- Multinational corporations will no longer be taxed on international income
- Estate tax is either eliminated or reduced

Summary

I've spent substantial time detailing these items in layman terms, and when it comes time for a final bill to be passed and for taxpayers to have to interpret these changes as it relates to their specific situations, more of them will chose to hire a tax preparer than in any year since 1997 when Mr. Alessi's Jackson Hewitt was the leading gaining stock on the NASDAQ with a 1527% increase to its stock price because of all of the new customers who were confused by the changes.

Remember, this bill was initially proposed as tax simplification and they subsequently changed its name to Tax Cuts. Overall, there does not seem to be very big tax cuts, if at all for many small businesses and middle income people. Large corporations get the bulk of the benefit from this bill and we feel it will create more complexity in filing tax returns. While we take no partisan position on legislation at Happy Tax, we are strongly optimistic that should this law pass, it will be a boom for our business as well as the Assisted Side of our industry as well. Already named as the fastest growing tax business in the US by Entrepreneur Magazine, Happy Tax is in a great position to continue helping Americans to file their taxes, wade through the complexity by creating a better way to file taxes with our concierge, "we come to you" approach and 100% US based licensed CPAs preparing our tax returns. In fact as nearly 70% of all tax preparers have no licensing whatsoever we are strongly positioned to drastically increase our number of clients as a result of this additional complexity causing taxpayers to seek out a credentialed professional from our innovative offering.

Mario Costanz is a lifelong entrepreneur and has had built and sold a number of successful businesses in the internet, restaurant, real estate and income tax preparation industry. He was named to the "One to Watch" section of Accounting Today's 2017 Top 100 Most Influential in Accounting List. More information and contact can be found at https://GetHappyTax.com, https://wefunder.com/happytax, https://facebook.com/mariocostanz or https://linkedin.com/in/mariocostanz.