



# **TAX REFORM**

## ***THE BIG PICTURE***

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# Tax Reform – The Big Picture

*Written by Michael Platner – 3/3/17*

The outlook for comprehensive tax reform legislation has changed dramatically with the Trump Administration and Republican control of the 115th Congress. During the campaign and since the election, both President Trump and Republican Congressional leaders have made it clear that comprehensive tax reform to significantly lower individual and business tax rates is one of their top priorities.

The Republican leadership intends to move very quickly on tax reform: Speaker Ryan and President Trump have said they would like to have tax reform completed before the August 2017 recess. In spite of that goal, it is very likely Congress will not be able to complete the legislation until late 2017 or early 2018, which provides an opportunity for interested businesses to provide input into the design of the new tax system.

House Republican leadership intends to use their tax reform Blueprint as the basis for developing their legislation. In the Senate, Chairman Orrin Hatch (R-UT) spent 2016 developing a corporate integration proposal, which he plans to set aside, for now, while he works with Members of the Senate Finance Committee to develop a proposal based on the Committee's 2015 tax reform working group recommendations. In addition, new Senate Minority Leader Chuck Schumer (D-NY) is much more interested in tax reform than was former Senate Minority Leader Harry Reid (D-NV).

This document provides a summary of the current positions of the forces most likely to shape any final tax reform plan.



## **President Trump's Tax Plan**

During the campaign, the President released an outline of his tax reform plan that would create a 15% business income tax rate and a 15% tax rate on business income from pass-through entities. The plan allows manufacturers to elect to expense all capital investments in the year placed in service combined with a denial of the current interest expense deduction. In addition, most business tax incentives would be eliminated, except for the R&D credit. During his address to a Joint Session of Congress on Tuesday, February 28th, President Trump reiterated his desire to provide a significant tax cut to companies "so they can compete and thrive everywhere and with anyone." He also echoed the complaints of the House Republican leadership that current international tax systems are biased against American products, but did not endorse the House Blueprint.

## **House Tax Reform Blueprint**

On June 24, 2016, the House Republican Task Force on Tax Reform, led by Ways and Means Committee Chairman Kevin Brady (R-TX), released "A Better Way for Tax Reform," the House Republicans Blueprint for pro-growth, comprehensive tax reform. The report proposes to reduce individual, corporate, and pass-through business tax rates while providing full expensing for business costs and moving the United States from a worldwide international tax system to a "territorial" dividend-exemption system. The Blueprint also would repeal both the corporate and individual alternative minimum tax.

For business income, the Blueprint proposes to reduce the top U.S. corporate income tax rate from 35 percent to 20 percent and provides a new, low tax rate of 25 percent for pass-through businesses such as S-corporations, limited liability companies, partnerships, and sole proprietorships. Full expensing of business costs (including tangible and intangible assets, but excluding land) would apply to both corporate and pass-through business income. As a trade-off for lower tax

rates and full expensing of equipment, the deduction for business interest expense would only be allowed to offset business interest income. While excluding future foreign earnings from the U.S. tax system, foreign earnings accumulated under the current international tax system would be subject to tax at 8.75 percent to the extent held in cash or cash equivalents and any remaining income would be subject to tax at 3.5 percent. Companies would be allowed to pay the resulting tax liability over an eight-year period.

One of the most controversial provisions in the Blueprint is the proposal to move the U.S. tax system toward a border adjustable, destination-based cash-flow tax for businesses. The cash-flow based approach would replace the current income-based approach for taxing both corporate and non-corporate businesses and would be applied on a destination basis. This means that income from products, services and intangibles that are exported outside the U.S. would not be subject to U.S. tax, regardless of where they are produced. It also means that products, services and intangibles that are imported into the U.S. would be subject to U.S. tax regardless of where they are produced. Under this approach, the cost of imported goods or services that are either sold to consumers in the U.S. or used to produce a product manufactured and sold in the U.S. could not be used to reduce the business's taxable income. This is equivalent to the imposition of a tariff on the value of that imported product or service at the marginal tax rate for that business.

Companies that import products into the U.S. for further manufacturing or resale and export products for sale in other countries would have to analyze the net impact of these changes on their businesses to determine if the proposed system is better for them than the current tax system.

The Blueprint "envision[s] tax reform that is revenue neutral" by including the positive revenue effects from economic growth and using a "current policy baseline" under which temporary tax provisions are assumed to be extended. The

House Ways and Means Committee has established several work groups to develop draft statutory language to implement these tax reform proposals in preparation for consideration by the Committee before the August recess.

### **Senate Tax Reform Working Groups**

In 2015, the Senate Finance Committee organized five bipartisan working groups on the major building blocks for tax reform: business income tax; international tax; individual tax; savings and investment; and community development and infrastructure. Over several months, these working groups examined their assigned areas to learn about the policy tradeoffs and potential areas for reform, with an eye toward producing recommendations for a bipartisan tax reform bill.

Each of the working groups issued a report on their findings and provided options for tax reform. The business tax workgroup report expressed support for lowering business tax rates but did not specify a target rate and noted the challenge of offsetting rate reduction with base broadening. The international tax workgroup called for moving to dividend exemption system with “robust and appropriate base erosion rules,” including possible consideration of minimum tax proposals; expressed support for development of an incentive to keep intellectual property development in the U.S.; noted work needs to continue on a deemed repatriation toll charge as part of the transition to a reformed system; and called for “appropriate” net interest limitation rules for both outbound and inbound companies.

### **FY 2018 Budget Reconciliation**

Later this spring, the House and Senate Republican leadership intend to adopt an FY 2018 Budget Resolution that includes budget reconciliation instructions for the Senate Finance and House Ways and Means committees to enact tax reform legislation. If necessary, the budget reconciliation process will provide Congress

with the opportunity to enact tax reform without the threat of a filibuster in the Senate.

### **Prognosis for Tax Reform in 2017**

The goal of all those contributing their ideas to comprehensive tax reform is to create a simple and fair tax system that encourages job creation, higher wages, companies to remain in the United States, and growth in the U.S. economy. The simple and fair part of that goal will require Congress to eliminate special interest tax deductions and credits and reduce tax rates for businesses and individuals. However, as outlined above, the prominent players in this arena will need to compromise with one another to enact legislation that can be ready for the President's signature.

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Van Ness Feldman's federal tax policy practice combines substantive, legislative tax policy acumen with focused experience in energy and environmental policy—allowing the firm to effectively promote clients' tax issues with legislators, regulators, and decision-makers across the political spectrum. For more information on tax reform or any other tax issue, please contact Michael Platner at 202-298-1988.

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