Ways and Means Chairman Camp releases tax reform discussion draft

February 26, 2014

In brief

House Ways and Means Chairman Dave Camp (R-MI) has released a 979-page draft "Tax Reform Act of 2014" that would lower corporate and individual tax rates, reform US international tax rules, and simplify the tax code.

Chairman Camp stated the draft legislation will "fix America's broken tax code by lowering tax rates while making the code simpler and fairer for families and job creators."

Chairman Camp said that he will be working this year to gain support for the first comprehensive overhaul of the US tax code since the Tax Reform Act of 1986. "I am hopeful that lawmakers on both sides of the aisle – and partners at both ends of Pennsylvania Avenue – take a close look at this plan and share their thoughts and ideas, and those of their constituents," adding that "just saying 'no' is not a solution."

While Congress this year faces significant election-year challenges in enacting tax reform legislation, Chairman Camp's tax reform discussion draft is expected to be of great interest to policymakers and stakeholders.

Below are some key aspects of the tax reform discussion draft (the "Draft"), along with links to material released by the House Ways and Means Committee and the Joint Committee on Taxation. We will be providing additional analysis of Chairman Camp's tax reform discussion draft in coming PwC Insights.

In detail

Summary

Under Chairman Camp's discussion draft, the current 35% top corporate rate would be reduced over five years to 25%. The proposed corporate rate reduction would be phased in by two percentage points each year from 2015 through 2019.

Building on an earlier 2011 international tax reform discussion draft, Chairman Camp's new comprehensive tax reform discussion draft would provide a 95% dividends received deduction (DRD) for certain qualified foreign-source dividends received by US corporations from foreign subsidiaries.

Chairman Camp proposes to replace the current seven individual income tax brackets – ranging from 10% to 39.6% -- with two tax brackets of 10% and 25%.

A new 10% surtax is proposed on certain types of income above $450,000 for joint filers and above $400,000 for single filers. The proposed surtax would apply to modified adjusted gross income (MAGI) above the threshold amounts, which would include certain items currently excluded from taxable income, such as employer provided health benefits and the self-employment health deduction, the section 911 income exclusion, tax exempt interest, untaxed Social Security benefits, and 401(k) contributions. In addition, the standard deduction would be phased out for all filers with MAGI income exceeding certain thresholds.

Note: Manufacturing income would be exempt from the proposed 10% surtax.

The standard deduction would be increased but personal exemptions would be repealed.

The Draft would repeal the individual alternative minimum tax (AMT) and the corporate AMT.

Investment income

The Draft would replace the current top rate of 20% percent on long-term capital gains and dividends. Investment income generally would be taxed as ordinary income, but a 40% exclusion would be provided for capital gains and dividends.

Business proposals

The cost of the proposed tax code overhaul would be offset by repealing or significantly limiting a wide range of business and individual tax deductions, credits, and preferences.

The Section 199 deduction for domestic manufacturing income would be phased out and repealed.

The research credit would be modified and made permanent, but amounts paid for supplies or with respect to computer software would no longer qualify as qualified research expenses.

The Draft would eliminate the modified accelerated cost recovery system (MACRS) and lengthen depreciable lives for depreciation of property placed in service after December 31, 2016.

The amortization period for goodwill and certain other intangibles would be increased from 15 years to 20 years.

The Draft would repeal the last-in, first-out (LIFO) method of inventory accounting, and repeal or modify other accounting methods.

In addition, the Draft would require amortization instead of expensing for certain business expenses. Under the draft, 50% of certain advertising expenses would be amortized ratably over a ten-year period. Research and experimental expenditures would be amortized over a five-year period.

The credit for electricity produced from certain renewable resources would be phased out and repealed.

The Draft includes proposals addressed in a January 2012 tax reform discussion draft on financial products, including 'mark-to-market' treatment for certain derivatives.

The Draft would modify tax rules for S corporations and partnerships, building on proposals included in a March 2012 tax reform discussion draft on small businesses and passthrough entities.

The Draft also would limit use of the cash method of accounting.

Additional significant changes and new proposals include:

- A new excise tax that would apply to certain large financial institutions.
- A change in the tax treatment of 'carried interest,' providing for ordinary income treatment in the case of certain partnership interests held in connection with the performance of services.
- Changes in the treatment of life insurance tax reserves and other insurance provisions.
- Changes to real estate investment trust (REIT) tax rules.
- Modifications of rules for tax-exempt organizations, including changes to unrelated business income tax provisions.
- Repeal of the medical device excise tax.
- Modifications of rules governing the IRS, tax administration, and compliance.

International proposals

As noted above, the Draft would provide a 95% dividends received deduction (DRD) for certain qualified foreign-source dividends received by US corporations from foreign subsidiaries.

The Draft also includes a revised version of the 'Option C' anti-base erosion measure that was part of the 2011 international tax reform discussion draft. This proposal would provide for taxation of all intangible income of foreign subsidiaries when the income is earned, with intangible income from foreign markets taxed at a reduced rate of 15% once the proposal is fully phased in. The proposal provides the same reduced rate of tax on foreign intangible income of US parent companies.

Other international reforms include:

- A one-time transition tax, subject to a foreign tax credit, on all previously untaxed earnings and profits of foreign subsidiaries of US corporations.
- Thin capitalization rules that would deny a deduction for the interest expense of US shareholders which are members of worldwide affiliated groups with excess domestic indebtedness.

Individual tax proposals

Significant individual proposals include:

- Reducing the current cap on deductible mortgage interest on new loans to $500,000 of principal, down from $1 million.
- Repealing the deduction for state and local taxes.
- Limiting the availability of deductible retirement savings.
- Simplification of education incentives.
- Repealing various individual tax credits.
- Repealing or modifying other deductions, exclusions, and certain other provisions.

Joint Committee on Taxation estimates

The nonpartisan Joint Committee on Taxation (JCT) has estimated that the cost of lower corporate and individual tax rates would be fully offset during the 10-year period of 2014 to 2023.

JCT staff estimate that the Draft would produce a net revenue gain of $3 billion over 10 years.

Under a 'dynamic' economic model, JCT staff project that the tax reform discussion draft released by Chairman Camp could increase US gross domestic production (GDP) by as much as 1.5 percent to 1.6 percent over the 2014-2023 period. According to a Ways and Means Committee staff summary, the JCT staff economic analysis indicates that increased private-sector employment and greater labor force participation could produce up to 1.8 million more private-sector jobs over the coming decade.

JCT staff also has issued a report on the distributional effects of the proposed tax reforms.

Note: The Congressional Budget Office has offered to provide a separate dynamic analysis of tax reform, so that there could be multiple scores to review. In 2013, CBO provided a dynamic analysis of immigration reform legislation approved by the Senate.

Next steps

Chairman Camp has requested public input and feedback on technical and policy issues raised by the draft released today.

Chairman Camp also has requested comments on the budgetary and economic growth analysis released by the JCT staff.

The takeaway

The release of draft tax reform legislation by Chairman Camp represents a significant step in presenting a possible path for reducing corporate and individual tax rates, reforming US international tax rules, and simplifying the tax code.

Stakeholders should evaluate the proposals and provide the Ways and Means Committee with feedback on Chairman Camp's tax reform draft.

Let's talk

For a discussion of Chairman Camp's draft tax reform bill and the outlook for tax reform, please contact :

Tax Policy Services

Pam Olson
(202) 414-1401
pam.olson@us.pwc.com

Rohit Kumar
(202) 414-1421
rohit.kumar@us.pwc.com

Brian Meighan
(202) 414-1790
brian.meighan@us.pwc.com

Don Longano
(202) 414-1647
don.longano@us.pwc.com

Ed McClellan
(202) 414-4404
ed.mcclellan@us.pwc.com

Lindy Paull
(202) 414-1579
lindy.paull@us.pwc.com

Andrew Prior
(202) 414-4572
andrew.prior@us.pwc.com

National Economics & Statistics

Peter Merrill
(202) 414-1666
peter.merrill@us.pwc.com

Drew Lyon
(202) 414-3865
drew.lyon@us.pwc.com

For additional insights, please join PwC on March 10 at 1:00pm for a webcast covering the discussion draft.

For more information

- House Ways and Means Committee executive summary
- House Ways and Means Committee statutory language
- House Ways and Means section-by-section report
- Joint Committee on Taxation materials