Trump Administration, Republican Congressional leaders release new tax reform framework

September 27, 2017

In brief

The Trump Administration and Congressional Republican leaders today released a nine-page "unified framework for fixing our broken tax code" (the Framework) that includes specific goals for lower business and individual tax rates. The Framework statement is the latest product of tax reform discussions by a working group known as the "Big 6" – consisting of Treasury Secretary Steven Mnuchin, White House National Economic Council Director Gary Cohn, House Speaker Paul Ryan (R-WI), Senate Majority Leader Mitch McConnell (R-KY), House Ways and Means Committee Chairman Kevin Brady (R-TX), and Senate Finance Committee Chairman Orrin Hatch (R-UT) – and builds off an earlier July 27th joint statement.

The Framework calls for a 20-percent corporate tax rate, a new 25-percent rate for certain passthrough business income, and international reforms that include a territorial tax system and a one-time mandatory repatriation tax. The Framework proposes 100-percent full expensing for five years, effective after September 27, 2017, while partially limiting the deduction for net business interest expense. The plan "aims to eliminate" the corporate alternative minimum tax (AMT). It would repeal the Section 199 domestic manufacturing deduction and "numerous other special exclusions and deductions" but retains the research credit and the low income housing tax credit.

The Framework would replace the current seven individual tax brackets with three brackets with rates set at 12 percent, 25 percent, and 35 percent, while leaving open the possibility of providing a fourth higher tax bracket for upper-income individuals to meet President Trump's goal of ensuring that tax reform "tremendously" benefits the middle class and not "the wealthy." The Framework proposes to roughly double the standard deduction, increase the current $1,000 child tax credit, and repeal the individual AMT and the estate tax. While the plan would repeal "most itemized deductions," tax incentives for mortgage interest and charitable donations generally would be preserved, along with incentives for work, higher education, and retirement security.

The Framework calls for the House and Senate tax committees to provide specific details of tax reform legislation and resolve many open issues. Congress first must pass an FY 2018 budget resolution that is expected to provide reconciliation protections that would allow a tax reform bill to pass the Senate with a simple majority, instead of the 60 votes generally required. The budget resolution also is expected to specify how much of the tax cuts can be deficit-financed over the budget period, with the remainder having to be offset by eliminating or limiting current-law income tax deductions, preferences, and exclusions.

In detail

Business tax reform

Corporate tax rates

The Framework calls for reducing the US corporate income tax rate to 20 percent, and "aims to eliminate" the corporate AMT.

Note: A 20-percent federal corporate income tax rate combined with current average state income tax rates would be 24.8 percent, just above the 23.75-percent average rate for all other OECD countries in 2017. The language on corporate AMT repeal is noticeably less forward leaning than that which is used in other places, a possible indication that this is a place where revenue constraints may limit what can be achieved.

The Framework states that the tax committees may consider "methods to reduce the double taxation of corporate earnings." Senate Finance Chairman Hatch and his staff have been exploring options to reduce the double taxation of corporate dividends by providing a partial corporate dividends paid deduction.

Passthrough tax rates

The Framework proposes a new tax rate structure for small businesses that "limits the maximum tax rate applied to the business income of small and family-owned businesses conducted as sole proprietorships, partnerships and S corporations to 25 percent." The tax committees are expected to "adopt measures to prevent the mischaracterization of personal income into business income to prevent wealthy individuals from avoiding the top personal tax rate."

Note: The use of the words "small and family owned businesses" to identify the intended beneficiaries of this proposal raises the possibility that certain large passthrough businesses may be excluded from this new 25-percent business income rate. Treasury Secretary Mnuchin recently suggested that certain kinds of firms should not be eligible to benefit from this provision. Moreover, the House Republican Conference tax reform website (https://fairandsimple.gop) includes a FAQ section that refers to this provision as being aimed at "local job creators."

Cost recovery

The Framework proposes that businesses will be "allowed to immediately write off (or 'expense') the cost of new investments in depreciable assets other than structures made after September 27, 2017, for at least five years." The Framework also states that the tax committees "may continue to work to enhance unprecedented expensing for business investments, especially to provide relief for small businesses."

Note: While the tax committees generally provide effective dates for tax legislation, the proposed September 27, 2017 effective date for full expensing is clearly intended to encourage businesses to continue making capital investments, and not wait for final action on this proposal by Congress.

Interest expense

The Framework states that the "deduction for net interest expense incurred by C corporations will be partially limited." The tax committees are to consider the appropriate treatment of interest paid by non-corporate taxpayers.

Other provisions

The Framework states that numerous "special exclusions and deductions will be repealed or restricted." The current-law Section 199 domestic production deduction is specifically mentioned as no longer being necessary since "domestic manufacturers will see the lowest marginal rates in almost 80 years."

The research credit and low income housing credit would be preserved as two provisions that "have been proven to be effective in promoting policy goals important in the American economy." While the Framework assumes repeal of other business credits, it notes that the tax committees may "retain some other business credits to the extent budgetary limitations allow."

The Framework also states that tax committees will "modernize" special tax rules that "govern the tax treatment of certain industries and sectors" to ensure that the tax code "better reflects economic reality and that such rules provide little opportunity for tax avoidance."

International tax reform

The Framework states that tax reform legislation will end the "incentive to keep foreign profits offshore by exempting them when they are repatriated to the United States." The current US worldwide tax system will be replaced "with a 100-percent exemption for dividends from foreign subsidiaries (in which the US parent owns at least a 10-percent stake)."

As part of a transition to this new dividend exemption system, the Framework "treats foreign earnings that have accumulated under the old system as repatriated. Accumulated foreign earnings held in illiquid assets will be subject to a lower rate than foreign earnings held in cash or cash equivalents. Payment of the tax liability will be spread out over several years."

Note: The Framework does not provide specific rates for this one-time deemed repatriation tax. The 2016 House Republican tax reform blueprint and the 2014 tax reform act (H.R. 1) introduced by then-House

Ways and Means Committee Chairman Dave Camp (R-MI) proposed a 3.5-percent rate for illiquid assets and an 8.75-percent rate for cash or cash equivalent assets In addition, H.R. 1 allowed the repatriation tax payments to be spread out over 8 years. The Framework also is silent on proposed measurement or effective dates for this provision.

The Framework states that additional international rules will be provided to stop corporations from "shipping jobs and capital overseas." "To prevent companies from shifting profits to tax havens," tax rules will be provided "to protect the US tax base by taxing at a reduced rate and on a global basis the foreign profits of US multinational corporations." The tax committees also "will incorporate rules to level the playing field between US-headquartered parent companies and foreign-headquartered companies."

Note: The language in this section signals agreement to the need for an anti-base erosion rule. One option clearly appears to be a foreign minimum tax. H.R. 1 in 2014 proposed a 15-percent minimum tax on certain foreign intangible income of US corporations and also proposed rules to limit the level of US interest deductions relative to global indebtedness.

Individual tax reform

The Framework calls for replacing the current seven individual income tax brackets with three brackets with rates set at 12 percent, 25 percent, and 35 percent. The current top rate is 39.6 percent, and the current lowest rate is 10 percent.

Under the Framework, the tax committees may consider an additional top rate that would apply to "the highest-income taxpayers" to maintain the current level of progressivity in the current tax code and ensure that the final legislation "does not shift the tax burden from high-income to lower- and middle-income taxpayers."

The Framework roughly doubles the current standard deduction to:

- $24,000 for married taxpayers filing jointly, and
- $12,000 for single filers.

At the same time, the Framework proposes to repeal the additional standard deduction and the personal exemptions.

The Framework states that typical families in the existing 10-percent bracket "are expected to be better off … due to the larger standard deduction, larger child tax credit and additional tax relief that will be included during the committee process."

The Framework does not specify by how much the current child tax credit will be increased, but does state the first $1,000 of the credit will be refundable, as under current law. The Framework also states that income levels at which the child credit begins to be phased out will be increased and that these modified income limits "will make the credit available to more middle-income families." In addition, a $500 non-refundable credit will be provided for non-child dependents.

The Framework notes the expected use of "a more accurate measure of inflation for purposes of indexing the tax brackets and other tax parameters."

Note: Congress previously has considered changes to inflation indexing rules for both tax provisions and federal entitlement programs as a way to reduce federal deficits.

While not specifically calling for a repeal of the federal deduction for state and local taxes, the Framework "eliminates most itemized deductions, but retains tax incentives for home mortgage interest and charitable contributions."

Note: Both the Trump Administration and House Republican leaders previously have called for repealing the deduction for state and local taxes as a way to help offset the cost of lowering individual tax rates. In addition, the FAQ section of the House Republican tax reform website answers a proposed question about the state and local deduction in part by saying "Americans are sick of the maze of special provisions that benefit some people at the expense of everyone else."

The Framework calls for retaining "tax benefits that encourage work, higher education and retirement security." At the same time, the Framework notes that the tax committees will work to improve the "efficiency and effectiveness" of such provisions and specifically seek to "maintain or raise retirement plan participation of workers and the resources available for retirement."

The Framework calls for repeal of the estate tax and the generation-skipping transfer tax.

Investment income

The Framework is silent on the issue of potential changes to investment tax rates.

The Trump Administration and House Republican leaders previously have assumed that the current 3.8-percent net investment income tax and the 0.9-percent additional Medicare tax that apply to higher-income individuals would be repealed along with other tax provisions enacted as part of the 2010 Affordable Care Act

(ACA), but efforts to repeal the ACA have been unsuccessful.

The 2016 House Republican Blueprint also proposed an additional reduction in investment taxes by replacing the current 20-percent top rate on capital gain and qualified dividend income with a 50-percent exclusion of qualified individual capital gain, dividend, and interest income. Under this proposal, the remaining investment income would be subject to ordinary income tax rates.

Key decisions left to House and Senate tax committees

Both tax committee chairmen today issued statements noting that the Framework "serves as a template for the tax-writing committees that will develop legislation through a transparent and inclusive committee process."

House Ways and Means Committee Chairman Brady today said, "Now it's time for the Ways and Means Committee to build on [the Framework's] momentum and deliver legislation that President Trump can ultimately sign into law."

Senate Finance Committee Chairman Hatch today said that the Framework will serve as a "critical roadmap" as the tax committees begin to draft tax reform legislation.

Budget resolution needed before tax committees can act

House Ways and Means Committee Chairman Brady recently announced that he will release a "chairman's mark" with detailed statutory tax reform proposals only after Congress adopts a final FY 2018 budget resolution, hopefully by mid-October. The Ways and Means Committee then will hold markup sessions to review and amend the chairman's mark.

The 2018 budget resolution is expected to include budget reconciliation instructions for tax reform. Budget reconciliation procedures allow the Senate to pass tax reform legislation with a simple majority, instead of the 60 votes generally required.

The House so far has been unable to secure sufficient votes to pass the FY 2018 budget resolution approved by the House Budget Committee in mid-July. That budget resolution provides budget reconciliation instructions that call for deficit-neutral tax reform and $203 billion in savings from mandatory spending programs.

The release of today's "Big 6" tax reform Framework may help to secure the support of House Republicans for a budget resolution. Members of the House Freedom Caucus today expressed support for the Framework plan; they previously have said that they have been unwilling to vote for a budget resolution until more details were provided on specific tax reform issues.

The Senate Budget Committee may meet as early as next week to consider an FY 2018 budget resolution. Senate Budget Committee members Bob Corker (R-TN) and Pat Toomey (R-PA) have expressed support for budget reconciliation instructions that would allow roughly $1.5 trillion in deficit-financed tax reform over 10 years. The remainder of any revenue loss in the budget period (traditionally a 10-year period) would have to be offset by eliminating or limiting current-law income tax deductions, preferences, and exclusions.

Both the House and Senate must agree on a final joint budget resolution to clear the way for tax reform legislation to be considered under budget reconciliation procedures.

With Republicans holding a 52-vote Senate majority, budget reconciliation protections would allow the Senate to pass tax reform legislation with a simple majority, and with the tie-breaking vote of Vice President Mike Pence if necessary. Securing a simple majority in the Senate for tax reform legislation may require the votes of some Senate Democrats if more than two Senate Republicans do not support the legislation, as demonstrated by the recent failure of the Senate to approve ACA repeal legislation.

Reconciliation rules also include a requirement for a 60-vote supermajority to waive a point of order against any reconciliation measure that increases the deficit beyond the 10-year window generally used for budget resolutions. The 2001 and 2003 tax rate reductions initially were enacted using budget reconciliation; as a result, to satisfy this rule the tax cuts were set to "sunset" at the end of the budget period.

Note: The use of budget reconciliation to enact tax reform legislation could require a future President and Congress to address any sunsets of tax relief provisions. The American Taxpayer Relief Act of 2012, which was not a reconciliation measure, repealed various sunset provisions from the 2001 and 2003 Acts. This "fiscal cliff" legislation permanently extended tax relief for most individuals while allowing the scheduled tax increase on some upper-income taxpayers to go forward.

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Click here for a copy of the September 27 "Big 6" unified tax reform Framework.

For more on the earlier July 27 "Big 6" tax reform statement, see our WNTS Insight "Trump Administration, Republican Congressional leaders release statement on tax reform goals."

For more on the House Republican's June 2016 tax reform Blueprint, see our WNTS Insight "House Republican Blueprint: A destination based cash-flow tax."

The takeaway

Today's "Big 6" Framework statement marks a major milestone in efforts by President Trump and Congressional Republicans to enact the first major tax reform legislation since 1986. While offering more specifics on key issues, the Framework leaves many difficult policy issues to be resolved by the House and Senate tax committees. Significant political hurdles also must be overcome if Congress is to enact a sustainable reform of US tax law that will provide a more competitive tax system for business taxpayers.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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