Tax Briefing

Wolters Kluwer

# ADMINISTRATION'S 2017 TAX REFORM OUTLINE

April 27, 2017

*Special Report*

## HIGHLIGHTS

- Tax Reform Options
- Reduced And Consolidated Individual Tax Rates
- 15% Corporate Tax Rate
- 15% Pass-through Tax Rate
- Elimination Of AMT
- Repeal Of Federal Estate Tax
- Repatriation Tax Break
- Move To Territorial Tax System
- Details To Come

## INSIDE



# White House Calls For Big Individual And Business Tax Cuts, And More

President Trump has unveiled a tax reform outline –the "2017 Tax Reform for Economic Growth and American Jobs." The outline calls for dramatic tax cuts and simplification: lower individual tax rates under a three-bracket structure, doubling the standard deduction, and more than halving the corporate tax rate; along with changing the tax treatment of pass-throughs, expanding child and dependent incentives, and more. Both the alternative minimum tax and the federal estate tax would be eliminated. The White House proposal does not include spending and tax incentives for infrastructure; nor a controversial "border tax." According to White House officials, the President's proposals set out broad principles with specifics to be hammered-out in coming weeks. *This Briefing presents a high-level overview of the President's proposals.*

**IMPACT.** *At this time, the White House proposals are just that, proposals. No legislative language has been revealed. Congressional tax writing committees will need to weigh in. The House Ways and Means Committee and the Senate Finance Committee have been engaged in tax reform discussions both in public and behind the scenes. Regarding a timeline, Administration officials have predicted that tax reform "will not slide into 2018."*

**IMPACT.** *If a tax reform package moves in Congress under the reconciliation rules, which require only a Senate majority, the tax cuts would likely have to sunset after 10 years. Treasury Secretary Steven Mnuchin said that the White House would prefer permanent tax reforms but "if we have it for 10 years, that's better than nothing."*

## INDIVIDUALS

### *Tax Rates*

The President's proposal calls for replacing and lowering the current individual tax rates with a new, three-bracket range: 10, 25, and 35 percent. Under current law, individual income tax rates are 10, 15, 25, 28, 33, 35, and 39.6 percent.

**IMPACT.** *White House officials said that the Administration has not yet developed the income brackets for the new rates. The House GOP Tax Reform Blueprint has called for a rate structure of 12, 25, and 33 percent.*

### *Standard Deduction*

The President's plan calls for doubling the standard deduction. The 2017 standard deduction amounts under current law are $6,350 and $12,700, respectively, as adjusted for inflation.

**IMPACT.** *One goal of a higher standard deduction is to simplify tax filing by cutting more than half those taxpayers who would otherwise do better itemizing deductions.*

**COMMENT.** *During his campaign, Trump had also proposed a cap on the amount of itemized deductions that could be claimed at $100,000 for single filers and $200,000 for married couples filing jointly. Additionally, according to campaign materials, all personal exemptions would be eliminated, as would the head-of-household filing status. These "give-backs" to offset some* *of the costs of the rate cuts and the higher standard deduction may arise during negotiations on Capitol Hill in ironing out the "details."*

## Deductions

The President's plan would eliminate all individual tax deductions except for the mortgage interest deduction and the charitable contribution deduction.

**IMPACT.** *The loss of many itemized deductions would channel an even greater number of taxpayers to the standard deduction. Big losers may include state and local governments that depend upon the federal itemized deductions for state and local income taxes and real estate taxes as an indirect subsidy for those taxes. Losing the medical expense deduction and the miscellaneous itemized deduction will also prove difficult for some taxpayers. "Above-the-line" deductions apparently would also be eliminated, although the administration would carve out deductions for retirement savings.*

**COMMENT.** *The three largest refundable individual credits currently are the earned income tax credit, the additional child tax credit and the American Opportunity Tax Credit. In tax year 2015, these refundable credits totaled $102 billion, according to the Treasury Inspector General for Tax Administration. They may also be targeted for elimination.*

## Elimination Of Targeted Tax Breaks

The President's tax proposal also outlines without elaboration the elimination of "targeted tax breaks that mainly benefit the wealthiest taxpayers." During his campaign, Trump had mentioned elimination of carried interest. Various "preference items" that are now caught in the AMT may also be targeted for change.

> "According to White House officials, the President's proposals set out broad principles with specifics to be hammered-out in coming weeks."

## Net Investment Income Tax

The net investment income (NII) tax imposes a 3.8-percent tax on certain investment income of higher income taxpayers. The President has proposed to repeal the NII tax.

**IMPACT.** *The President's proposal apparently keeps the current framework for capital gains and dividend taxes at the top 20-percent rate. The NII generally impacts individuals with adjusted income of above $200,000 ($250,000 for marrieds, filing jointly).*

## TIMEFRAME


At a news conference in Washington, D.C., Treasury Secretary Mnuchin said that the Trump administration is "going to move as fast as we can" on tax reform. The White House intends to hold listening sessions in May. Mnuchin added that White House and Treasury personnel are working closely with House and Senate GOP leaders on the tax reform package but he gave no specific indication of when details or legislative language will be released. Mnuchin characterized the outline as reflecting the President's "core principles" about tax reform.

**COMMENT.** *The President's proposal does not specifically address carried interest. However, Mnuchin said the President is committed to reforming the tax treatment of carried interest.*

**IMPACT.** *The White House plan apparently does not include repeal of other Affordable Care Act (ACA) taxes, such as the additional Medicare tax and the excise tax on high-dollar health plans. At the time this Briefing was posted, negotiations were continuing in the House over the GOP's ACA repeal and replacement bill, the American Health Care Act (AHCA).*

## Family Incentives

The President's proposal calls for unspecified tax relief for families with child and dependent care expenses. Under current law, taxpayers who incur expenses to care for a qualified child or for an incapacitated dependent or spouse to work or look for work may claim a credit of 20 percent to 35 percent of employment-related expenses, depending upon income level and other factors.

**COMMENT.** *Trump's campaign proposals had included the creation of a new deduction for child and dependent care expenses, as well as increasing the earned income tax credit (EITC) for working parents who would otherwise not qualify for the deduction. A system of "spending rebates" and "above-the-line" deductions was proposed, as well as Dependent CARE Savings Accounts (DCSAs) with matching government contributions and an expanded credit for employer-provided child care.*

## Estate Tax

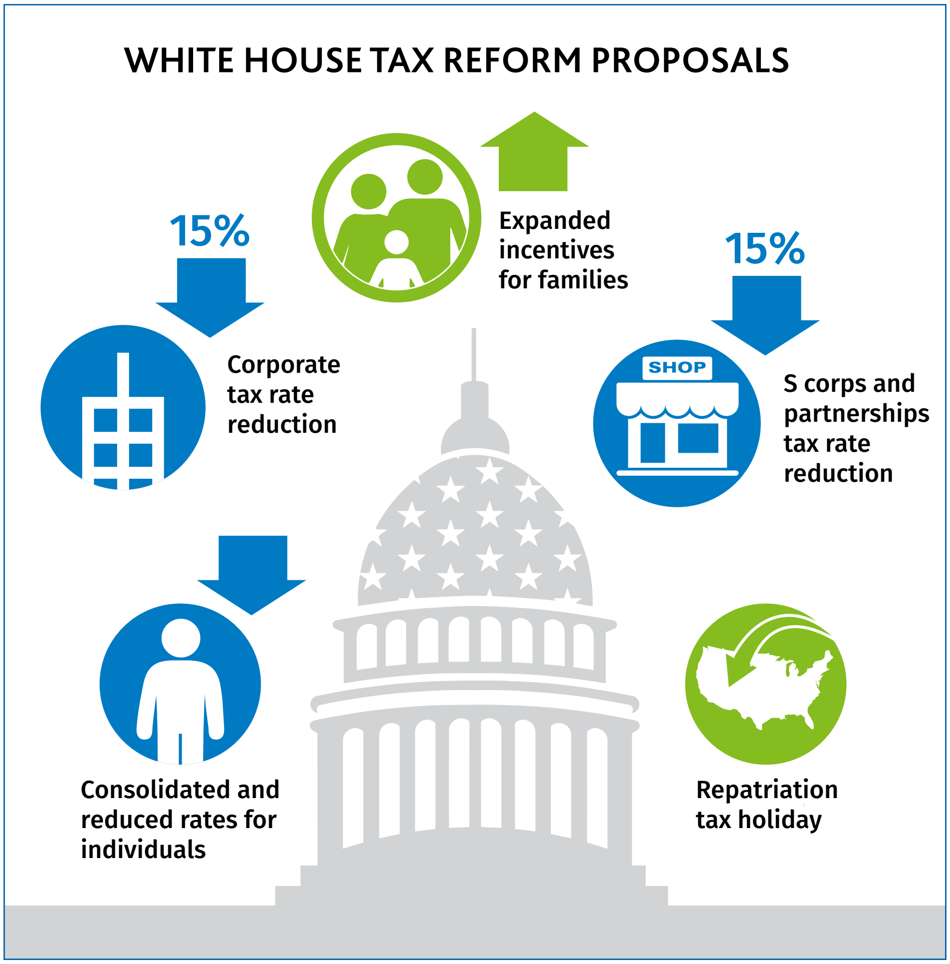
The President's proposal calls for elimination of the federal estate tax. The current maximum federal estate tax rate is 40 percent with an inflation-adjusted $5 million exclusion ($5.49 million in 2017).

**IMPACT.** *During his campaign, Trump also mentioned replacing the estate tax with a carryover basis rule under which beneficiaries must use the decedent's basis in inherited assets rather than their date-of-death values. His proposal also does not answer the question of what will become of the gift tax.*

### *Alternative Minimum Tax*

The President's proposal calls for abolishing the AMT, calling it a complicated, unnecessary addition to the tax system. A parallel tax structure, the AMT, has existed for the stated purpose of ensuring that individuals, corporations, estates, and trusts with substantial income do not avoid tax liability. Despite exemptions, it has captured an increasing number of taxpayers to the extent that it forces many individuals "to do their taxes twice to see which is higher," according to the administration.

**COMMENT.** *National Taxpayer Advocate Nina Olson has recommended Congress permanently repeal the AMT. Although it serves as a revenue source, significant tax reform would likely present other options to offset the cost of elimination.*




## BUSINESSES

### *Corporate Taxes*

The President's proposal calls for a 15-percent corporate tax rate. The maximum corporate tax rate currently tops out at 35 percent.

**IMPACT.** *This proposal is being called one of the most aggressive within the President's plan, projected by some accounts to reduce revenues by $2 trillion over 10 years. Other projections call for economic growth to make up a significant part of the difference.*

**COMMENT.** *Although the current maximum corporate tax rate is 35 percent, many corporations now pay an effective tax rate that is considerably less. The President also proposed to eliminate unspecified tax breaks for "special interests," which would broaden the tax base and largely prevent most businesses from gaining an effective rate much lower than 15 percent.*

### *Small Businesses*

Currently, owners of S corporations and partnerships and sole proprietors pay tax at the individual rates, with the highest rate at 39.6 percent. The President has proposed a 15-percent tax rate for pass-through income.

**IMPACT.** *Small business owners, therefore, would see their top tax rate reduced from 39.6 percent to 15 percent under the President's plan.*

**IMPACT.** *This plan would appear to give a business quasi-corporate status in being able to be taxed at a new 15 percent corporate tax rate, at least until assets are distributed. Upon distribution, Trump's campaign materials had indicated that a second layer of tax would be imposed similar to dividends now taxed to C corporation shareholders.*

**COMMENT.** *Trump's campaign materials also had indicated consideration of rules that would prevent pass-through owners from converting their compensation income taxed at higher rates into profits taxed at the 15-percent level. Mnuchin has stated that provisions would preclude wealthy owners of large companies from gaming availability of the lower rate.*

### *Bonus Depreciation/Small Business Expensing*

The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) extended and modified bonus depreciation and made permanent enhanced Code Sec. 179 expensing. The President's proposal does not specifically address bonus depreciation or small business expensing.

### *Business Credits*

A number of business incentives were made permanent by the PATH Act, including the research credit, 100-percent gain exclusion on qualified small business stock, and the reduced recognition period for S corporation built-in gains tax. The President's proposal does not specifically address these and other business incentives.

### *Energy*

Current law provides for many energy tax incentives for businesses (and individuals). The President's proposal does not specifically address energy tax incentives.

**COMMENT.** *Some popular energy tax breaks have either expired or will soon expire, setting the stage for renewed negotiations in Congress; whether to extend them, make them permanent, or allow them to sunset permanently.*

## INTERNATIONAL

### *Repatriation*

The President's plan calls for a one-time tax on repatriated profits at a yet-unspecified tax rate. The blueprint states that "trillions of dollars" are being held overseas and potential targets for repatriation.

**COMMENT.** *In 2004, Congress provided that U.S. companies could elect, for one tax year, an 85-percent dividends received deduction for eligible dividends from their foreign subsidies.*

**IMPACT.** *The lower corporate tax rate of 15 percent may also provide incentive for businesses not to shift operations overseas going forward.*

### *Territorial Tax Regime*

The President's plan would also move to a territorial tax regime instead of a worldwide tax regime.

**COMMENT.** *"A territorial system means U.S. companies will pay tax on income related to the U.S.," Mnuchin said. "U.S. companies will not be subject to worldwide income," he added.*

## INFRASTRUCTURE

In January, President Trump called for a $1 trillion infrastructure spending bill with unspecified tax incentives. The President's tax reform proposal does not address infrastructure spending.

**COMMENT.** *"The President remains committed to a $1 trillion infrastructure spending initiative," Mnuchin said recently. Mnuchin had appeared to indicate that infrastructure tax incentives could be part of a final tax reform package.*

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