

The 2017 Tax Act

How We Got There, What Does It Mean, and What Happens Next

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A Prescient Comment on the U.S. Legislative Process

- “You can always count on Americans to do the right thing, **after they’ve tried everything else.**”
Winston Churchill (emphasis added)

Agenda

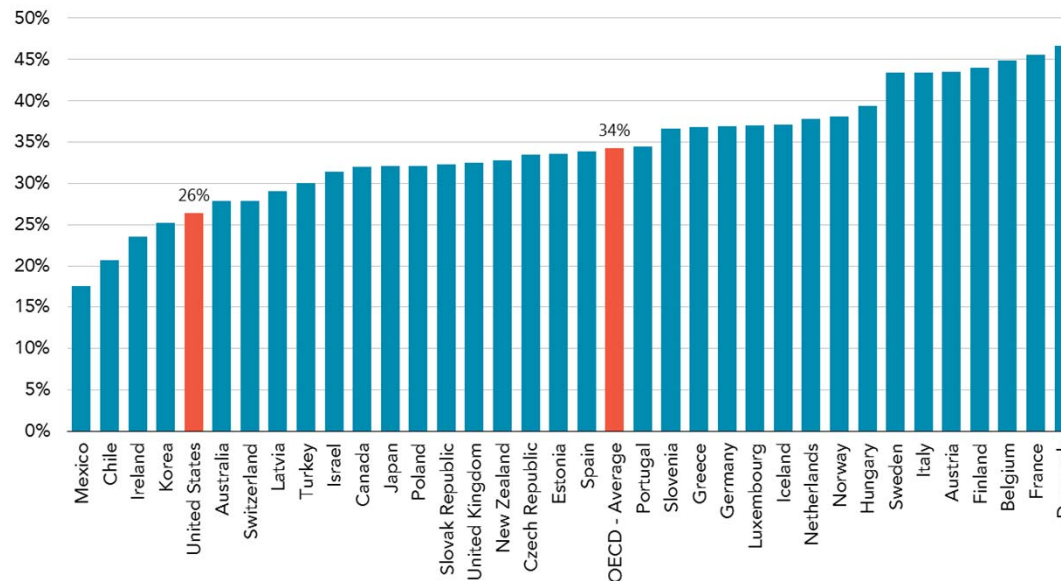
- The need for tax reform
 - Fiscal situation prior to enactment
 - Need for tax reform
 - Legislative objectives
- Legislative process/effect on substantive outcome
- Expiration dates of various provisions
- Did TCJA comport with stated objectives?
- Consequences/overall assessment
- What next?
 - Administrative guidance
 - Additional legislation (“technical corrections,” tax reform 2.0, expired provisions, retirement savings, etc.)
 - Sustainability of the new law (global challenges, 2018 elections)

U.S. Fiscal Situation Prior To Enactment

- **CBO projected increasing annual deficits through 2027**
 - Cumulative 10 year deficit - \$9.5 tr.
 - Total outstanding debt at end of period- \$25 tr. (88.9% of GDP)
- **Effect of increased deficit**
 - Substantial interest expense increase
 - Borrowing reduces total saving in the economy, reducing the nation's capital stock, resulting in lower productivity and total wages
 - Less flexibility to use tax and spending policies to respond to unexpected challenges
 - Likelihood of a fiscal crisis increases
 - Investors could demand higher interest rates to purchase government debt

WAS TAX RELIEF NECESSARY? CONTRARY TO SOME CLAIMS US IS A LOW-TAX COUNTRY

Taxes as a Share of Gross Domestic Product
OECD, 2015



Source: OECD Stat Extract. These are provisional estimates. 2014 data are used for Australia, Japan, and Poland. The OECD average is over the most recent available data.

The Need for Tax Reform

- **Politics, Politics, Politics**
- Multinational corporation competitiveness
- High corporate tax rate
- Tax base erosion
 - IP transfers
 - Earnings stripping
 - Aggressive transfer pricing
- Inversions
- BEPS and state aid investigations

POLLING QUESTION 1

- Do you believe tax reform was necessary in 2018?
 - Yes
 - No

Objectives of the legislation

- Lower corporate rate
- Lower business pass-through rate
- Territorial system for active business income earned outside the U.S.
- Base erosion prevention (section 163(j), GILTI, BEAT)
- Encourage investment in the U.S. (FDII, deemed repatriation)
- Middle class tax relief
- Wealth transfer tax repeal

POLLING QUESTION 2

- Which aspect of tax reform was most important?
 - Lower corporate rate
 - Reform of taxation of business income earned outside the United States
 - Limit base erosion
 - Lower pass-through rate
 - Individual income tax reform

The Legislative Process

- “Regular order” not available because Republicans lacked 60 votes to overcome a filibuster.
- The legislation was considered in the Senate under the “reconciliation” process, which eliminates the filibuster obstacle, but has its own hurdles, each which would require 60 votes to overcome.
 - The legislation could not lose more than \$1.5 trillion over the ten year budget window
 - Members committed to use JCT “scoring” to determine these effects for reconciliation purposes
 - “Gimmicks” used include phase-in and phase outs and front and back load provisions
 - Senators that initially said they would not vote for legislation that increases the deficit even though the budget resolution authorizes a deficit increase got comfortable due to use of a “policy” baseline and factoring in economic growth projected by “dynamic” scoring models
 - No deficit effect outside the 10 year budget window
 - Original Senate bill lost increasing amounts of money every year through 2027 with projections that revenue losses would increase outside the 10 year window
 - Manager’s Amendment overcame this obstacle by sun setting most of Title I (the individual provisions) and repealing the individual mandate of the ACA
 - Non-revenue provisions were out of order

Expiration dates of various tax provisions

Provision	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Individual rate cuts											
21% corporate rate											
20% pass-through deduction											
100% expensing – effective 9/27/17											
Individual AMT exemption amount											
Corporate AMT repeal											
Interest deduction 30% of EBITDA							(EBIT after 2021)				
Amortization of R&D expense											
Estate tax doubled exemption											
\$10,000 State and local deduction											
Alcohol tax modernization											
Medical deduction 7.5%/AGI floor											
More than two dozen extenders											
Other extenders: CFC look-through, NMTC, WOTC											

ACA taxes	2018	2019	2020	2021	2022
Cadillac tax					
Device tax					
HIT					

How well did the Act comport with stated substantive objectives?

- Structural changes
 - Measurement and taxation of domestic business income
 - Taxation of income earned outside the United States
 - Individual taxation
- Revenue effects
- Distributional effects
- Economic growth consequences

Competitive Effects

Where will manufacturing be located?

- **Plus:** Rate cut 14% (really 12.5% w/state and 199 repeal)
 - **Plus:** Expensing (qualified property, esp. with marginal returns)
 - **Minus:** Interest Limitations (esp. for private equity)
 - **Plus:** FDII (for high-return exports)
 - **Plus:** GILTI (considered a plus on theory that it discourages low-tax, high-return outbound capex, but actual results so far are a **minus**)
 - **Minus:** BEAT (discourages large inbound investment)
 - **Minus:** Other rev raisers (NOLs limits, financial co. tax hikes)
 - **Minus:** Tax competition lowers foreign rates
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- **Net Positive** (average, with significant variation) for shifting capex to U.S. except for (large) inbound *compared to prior law*

Source: Tax Notes, January 29, 2018

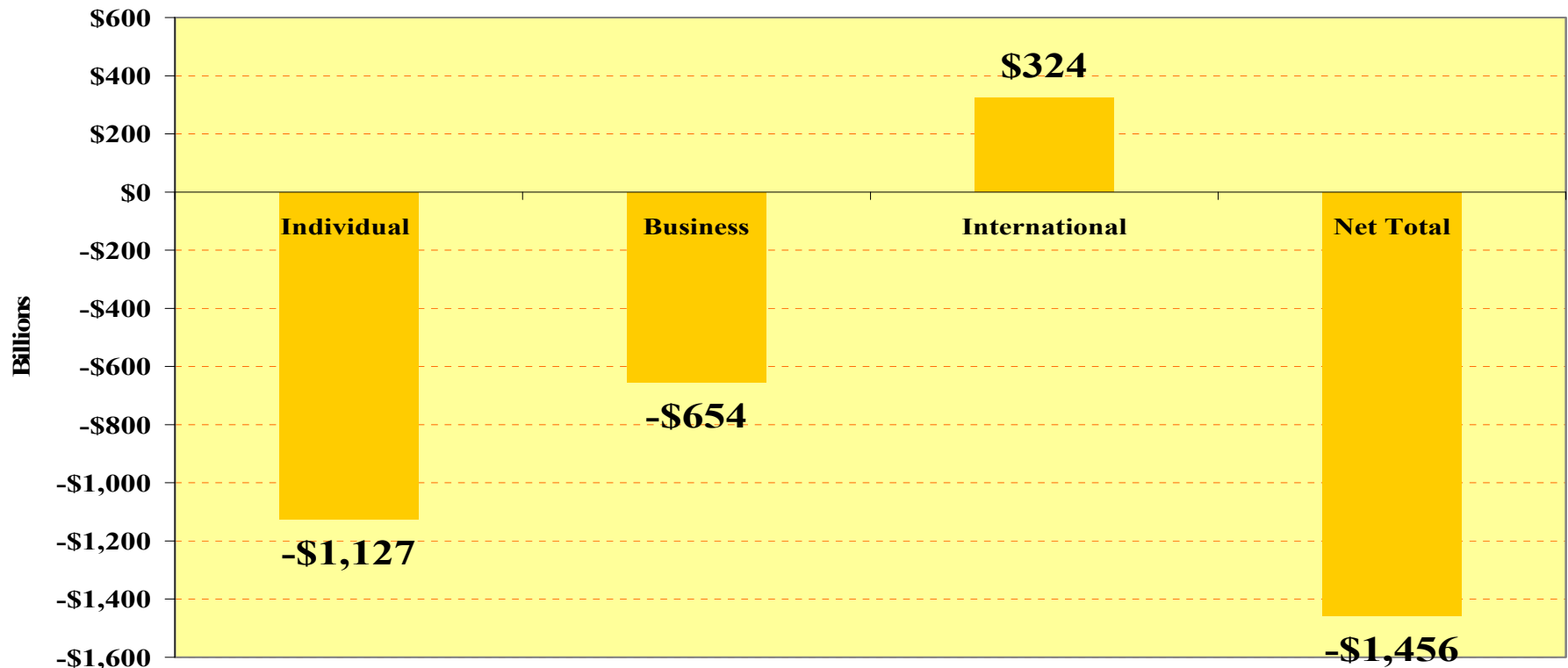
POLLING QUESTION 3

- Do you believe the Act will improve the competitive position of U.S. multinationals?
 - Yes
 - No

Revenue Consequences

- Ten Year Revenue Cost

Ten-Year Estimated Revenue Cost of Major Categories of Tax Provisions in TCJA



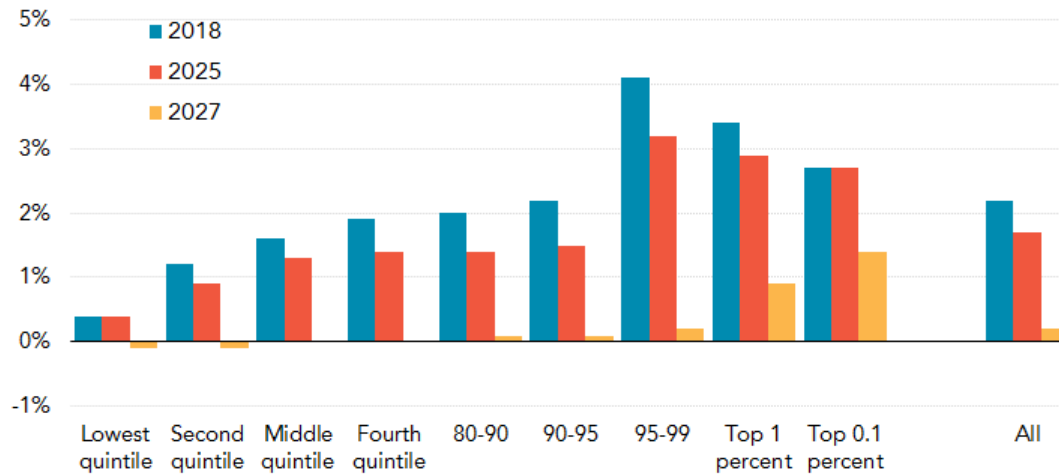
Source: House of Representatives, "Tax Cut and Jobs Act, Conference Report to Accompany H.R. 1," 115 Cong. 1st Sess., Report 115-466, pp. 683-692.

CBO JUNE 2018 ESTIMATE OF BUDGETARY EFFECTS OF 2017 ACT WITH MACROECONOMIC FEEDBACK

- Macroeconomic feedback would subtract \$571 billion from primary deficits over 2018-2028
- Taking into account feedback, primary deficit would increase by \$1.272 trillion through 2028.
- Incorporating the effects of the Act on debt-service costs would push the deficit to an estimated \$1.854 trillion through 2028
 - In other words, the increased debt service costs approximate the benefit of macroeconomic feedback.

TAX BENEFIT/BURDEN FROM 2017 TAX ACT

FIGURE 1
Percent Change in After-tax Income of the
Conference Agreement for the Tax Cuts and Jobs Act
By expanded cash income percentile, 2018, 2025, and 2027

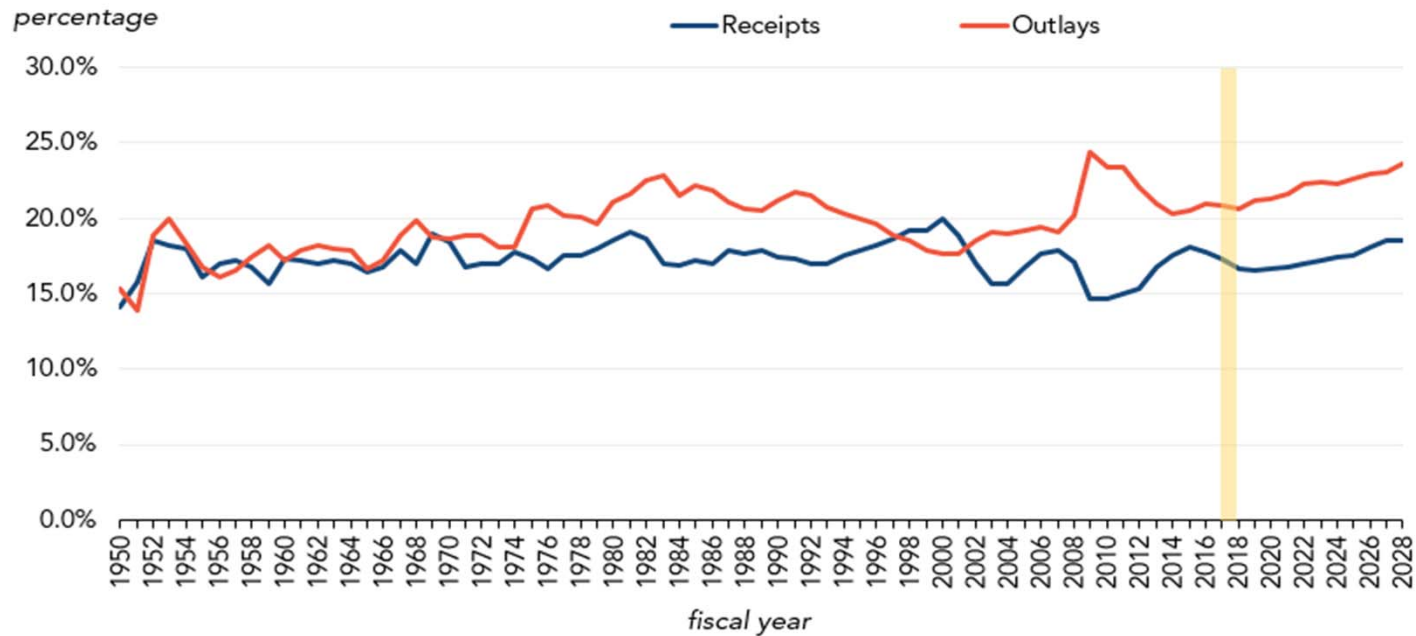


Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0217-1).

Widening Deficits

Total Federal Receipts and Outlays

Share of National GDP, 1950 - 2028



Source: Office of Management and Budget (OMB), Historical Tables, Table 1.3; Congressional Budget Office (CBO), 10-Year Budget Projections, Table 4.1. Last accessed April 27, 2018.

Note: Estimates from CBO's Baseline Budget Projections for fiscal years 2018 to 2028 (April 2018).

CBO Annual Economic Projections

CBO's Economic Projections, by Calendar Year													
	Actual,												
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	
	Percentage Change From Year to Year												
Gross Domestic Product													
Real ¹	2.3	3.0	2.9	2.0	1.5	1.5	1.6	1.7	1.8	1.7	1.8	1.8	
Nominal	4.1	5.0	4.9	4.1	3.7	3.7	3.8	3.9	3.9	3.8	3.9	3.9	
Inflation													
PCE price index	1.7	1.8	1.9	2.1	2.1	2.1	2.1	2.1	2.0	2.0	2.0	2.0	
Core PCE price index ²	1.5	1.8	2.0	2.2	2.2	2.1	2.1	2.0	2.0	2.0	2.0	2.0	
Consumer price index ³	2.1	2.2	2.2	2.4	2.5	2.5	2.4	2.4	2.4	2.4	2.4	2.4	
Core consumer price index ⁴	1.8	2.1	2.4	2.6	2.6	2.5	2.4	2.4	2.4	2.3	2.3	2.4	
GDP price index	1.8	1.9	2.0	2.1	2.2	2.2	2.2	2.2	2.1	2.1	2.1	2.1	
Employment Cost Index ⁵	2.6	2.9	3.4	3.6	3.6	3.4	3.3	3.2	3.2	3.1	3.1	3.1	
Calendar Year Average													
Unemployment Rate (Percent)	4.4	3.8	3.3	3.6	4.1	4.6	4.7	4.8	4.8	4.9	4.8	4.8	
Payroll Employment													
(Monthly change, in thousands) ⁶	181	211	182	62	21	28	41	53	62	56	65	66	
Interest Rates (Percent)													
Three-month Treasury bills	0.9	1.9	2.9	3.6	3.8	3.6	3.1	2.8	2.7	2.7	2.7	2.8	
Ten-year Treasury notes	2.3	3.0	3.7	4.1	4.2	4.0	3.8	3.7	3.7	3.7	3.7	3.7	
Tax Bases (Percentage of GDP)													
Wages and salaries	43.1	43.2	43.5	43.9	44.0	44.1	44.1	44.2	44.2	44.3	44.3	44.4	
Domestic economic profits	8.9	9.5	9.6	9.0	8.6	8.2	8.1	8.0	8.0	8.0	8.0	8.0	
Tax Bases (Billions of dollars)													
Wages and salaries	8,351	8,795	9,304	9,759	10,160	10,559	10,973	11,408	11,867	12,337	12,837	13,361	
Domestic corporate profits ⁷	1,732	1,931	2,045	2,004	1,975	1,970	2,006	2,078	2,161	2,233	2,325	2,410	
Nominal GDP (Billions of dollars)	19,391	20,362	21,369	22,247	23,079	23,937	24,857	25,832	26,849	27,866	28,957	30,087	
Source: Congressional Budget Office.													

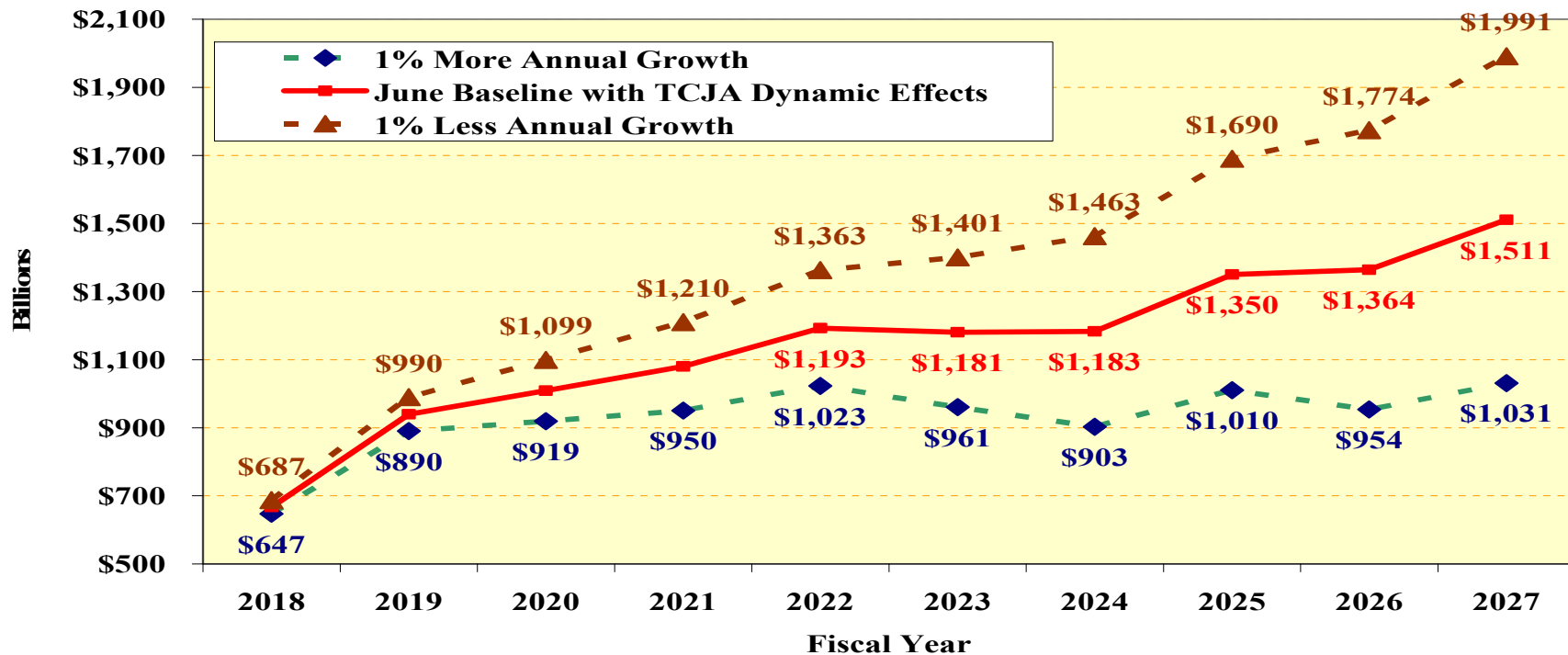
CBO Baseline Budget Projections

														Total	
	Actual													2019-	2019-
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2023	2028	
	In Billions of Dollars														
Revenues	3,316	3,338	3,490	3,678	3,827	4,012	4,228	4,444	4,663	5,002	5,299	5,520	19,234	44,162	
Outlays	3,982	4,142	4,470	4,685	4,949	5,288	5,500	5,688	6,015	6,322	6,615	7,046	24,893	56,580	
Deficit	-665	-804	-981	-1,008	-1,123	-1,276	-1,273	-1,244	-1,352	-1,320	-1,316	-1,526	-5,660	-12,418	
Debt Held by the Public															
at the End of the Year	14,665	15,688	16,762	17,827	18,998	20,319	21,638	22,932	24,338	25,715	27,087	28,671	n.a.	n.a.	
	As a Percentage of Gross Domestic Product														
Revenues	17.3	16.6	16.5	16.7	16.7	16.9	17.2	17.4	17.5	18.1	18.5	18.5	16.8	17.5	
Outlays	20.8	20.6	21.2	21.3	21.6	22.3	22.3	22.2	22.6	22.9	23.1	23.6	21.8	22.4	
Deficit	-3.5	-4.0	-4.6	-4.6	-4.9	-5.4	-5.2	-4.9	-5.1	-4.8	-4.6	-5.1	-4.9	-4.9	
Debt Held by the Public															
at the End of the Year	76.5	78.0	79.3	80.9	83.1	85.7	87.9	89.6	91.5	93.1	94.5	96.2	n.a.	n.a.	
Memorandum:															
Deficit as a Percentage															
of GDP. Adjusted to															
Exclude Timing Shifts'	-3.5	-4.2	-4.6	-4.6	-4.9	-5.1	-5.1	-5.1	-5.1	-4.8	-4.6	-4.8	-4.9	-4.9	

POTENTIAL DEFICIT EFFECTS

- Deficit under alternative assumptions

Preliminary Estimate of Deficits After Enactment of TCJA and Estimates Assuming Permanently Higher and Lower 1% Growth



Sources : Same as figure 3 and Congressional Budget Office, "The Budget and Economic Outlook: 2017 to 2027," Jan. 24, 2017, Appendix B, Table B-1 [CBO "rules of thumb"].

POLLING QUESTION 4

- Are you concerned about the deficit effects of the Act?
 - Yes
 - No
- If so, would you prefer
 - Spending cuts
 - Tax increases
 - Combination

Assorted Estimates of the Effects of the 2017 Act on the Level of Real GDP

Percent	First Five Years					Tenth	Average		
	2018	2019	2020	2021	2022	Year	2018-2022	2023-2027	2018-2027
Moody's Analytics	0.4	0.6	0.2	0.1	0.0	0.4	0.3	0.3	0.3
Macroeconomic Advisers	0.1	0.3	0.5	0.6	0.6	0.2	0.4	0.5	0.5
Tax Policy Center"	0.8	0.7	0.5	0.5	0.5		0.6	0.3	0.5
International Monetary Fund	0.3	0.9	1.2	1.2	1.0	-0.1	0.9	0.3	0.6
Joint Committee on Taxation						0.1 to 0.2	0.9	0.6	0.7
Congressional Budget Office	0.3	0.6	0.8	0.9	1.0	0.6	0.7	0.8	0.7
Goldman Sachs	0.3	0.6	0.7	0.7	0.7	0.7	0.6	0.7	0.7
Tax Foundation	0.4	0.9	1.3	1.8	2.2	2.9	1.3	2.9	2.1
Penn Wharton Budget Model						0.6 to 1.1			
Barclays'	0.5								

Sources: Congressional Budget Office and the organizations listed above.

POLLING QUESTION 5

- Do you believe the Act will result in increased economic growth?
 - Yes
 - No
- If yes, of what magnitude?
 - Less than 1%
 - Between 1 and 2%
 - Between 2 and 3%
 - Above 3%

Other Consequences

- Permanence
 - What happens to provisions slated to sunset?
- Simplification
 - Generally true on individual side
 - Complicated on business side
 - Pass-through provision (section 199A)
 - Foreign provisions
- Coherence
- Compatibility with WTO and treaties
- Response of other countries

Paths Not Taken

- Destination-Based Cash Flow Tax
- VAT
- World-wide system with current taxation
- Integration
- Taxation of unrealized appreciation in property held at death and transferred by gift

Overall Assessment

- This was tax change, not tax reform (overall efficiency, simplicity, and fairness are not improved).
- Some assert that the construct is unstable and will have to be revisited.
- TCJA combined with the increased spending agreed to in the March budget deal, adds significantly to the deficit, making the U.S. fiscal situation more ominous.

WHAT NEXT

- Technical Corrections
 - Democrats not likely to cooperate.
 - Will need 60 votes in the Senate
- Expiring provisions
- Joint Committee on Taxation Bluebook
- Administration/Compliance/Enforcement
 - Treasury given wide latitude to implement TCJA
 - Enhanced role for OMB
- Tax Reform 2.0—initiative in House, little Senate interest
 - Make individual tax cuts and 199A permanent
 - Enhance savings incentives
 - Expand 529
 - Create “Universal Savings Accounts”
 - Penalty-free account withdrawals after a birth or adoption
 - Ease IRA contribution limitations for over age 70.5
 - “New business” incentives
 - Increased write off of start up costs
 - Remove “barriers to growth
 - Index capital gains
- IRS Restructuring