

HERE WE GO AGAIN!

WILL TAX REFORM FINALLY HAPPEN?

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AGENDA

- The Context
- The Proposals
- The Difficulties

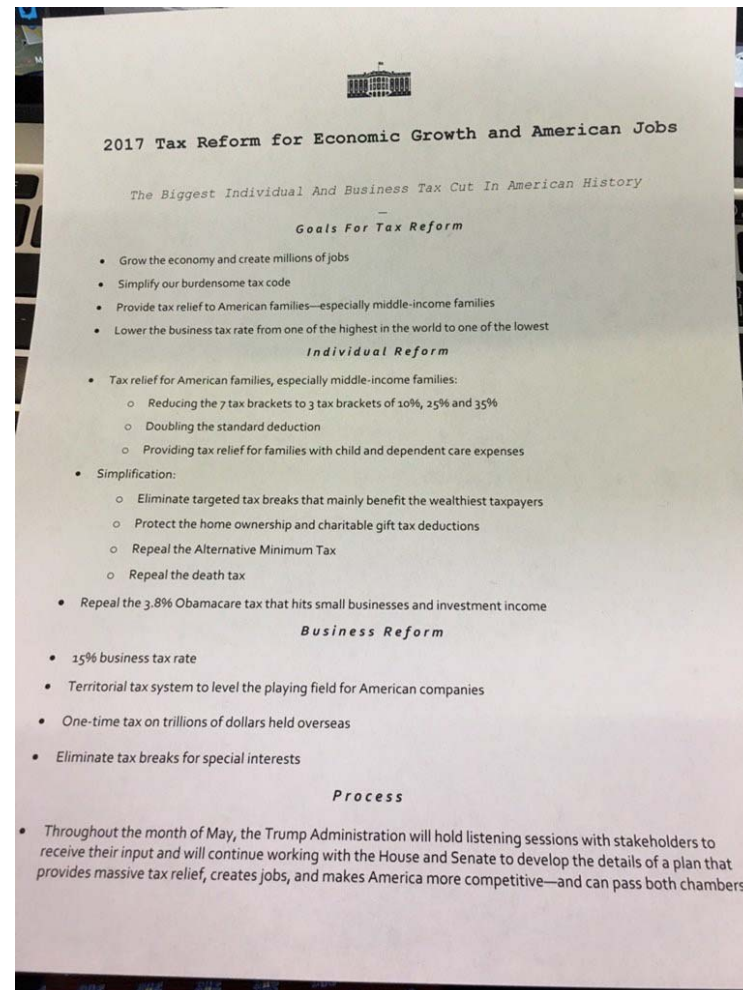
THE CONTEXT

- Republican control of White House, Senate and House of Representatives
 - Republicans have only 52 votes in Senate, creating potentially difficult procedural issues
- Professed desire to enact reform
- Fiscal constraints
 - CBO projects increasing annual deficits through 2017
 - Cumulative deficit - \$9.5 b.
 - Public debt - \$25.b (88.9% of GDP)

THE MAJOR PROPOSALS

- House Republican Blueprint, “A Better Way”
 - The current starting point for the process
- President Trump 9/26 “Principles”
 - “The biggest tax cut in history”
- Senator Hatch Integration Proposal
 - Not yet released, but broad outlines reported
- Dave Camp 2014 Proposal
 - Conventional approach-repeal preferences/lower rates

THE PRESIDENT'S PLAN



REPUBLICAN BLUEPRINT AND TRUMP OUTLINE- INDIVIDUAL AND ESTATE TAX PROPOSALS

Republican Blueprint

- Taxation of pass-through business income, after reduction for reasonable compensation, at 25%
- Individual income tax rates of 12, 25 and 33%
- Deduction of 50% of capital gains, dividends and interest
- Increase standard deduction
- Repeal AMT
- Repeal all itemized deductions except for home mortgage interest and charitable contributions
- Retain retirement savings incentives
- Repeal estate and generation-skipping tax
 - Gift tax omitted

Trump

- Tax pass-through income at 15%
- Individual income tax rates of 10, 25 and 35%
- Maximum 20 rate on capital gain
- 3.8% net investment tax repealed
- Double the standard deduction
- Repeal AMT
- [Cap itemized deductions at \$100,000, \$200,000 for marrieds]
- Repeal unspecified deductions but retain home mortgage and charitable contribution deductions
- New deductions, credits and other incentives for child and dependent care expenses care
- Carried interests taxed as ordinary income
- Repeal estate tax
 - No mention of gift and GST
 - [Tax capital gains on property held at death with an exemption of \$5 million (\$10 million for married couples)]

REPUBLICAN BLUEPRINT AND TRUMP CAMPAIGN BUSINESS TAX PROPOSALS

Republican Blueprint

- Corporate Rate—20%
- Repeal Corporate Minimum Tax
- Replace corporate tax with a “Cash Flow” tax
 - Full expensing of the costs of investments other than land
 - No current deduction for net interest expense
 - Border adjustment
- Eliminate section 199 and other unspecified deduction and credits
- Retain enhanced R&E credit
- Indefinite carryover of 90% of NOL's with interest
- Retain LIFO

Trump

- Corporate Rate—15%
- [Repeal Corporate Minimum Tax
- Domestic manufacturers may elect full expensing of capital improvements with denial of net interest expense
- Eliminate section 199 and other unspecified deductions and credits
- Retain R&E credit]
- No provision
- No provision

REPUBLICAN BLUEPRINT AND TRUMP BUSINESS TAX PROPOSALS

Republican Blueprint

- Creation of territorial tax system with 100% deduction of dividends from foreign subs
 - Repeal of Subpart F, except for PFIC rules
- Deemed repatriation tax on currently deferred accumulated earnings payable over 8 years
 - 8.75% on cash or cash equivalents
 - 3.5% on other earnings

Trump

- Territorial tax
- Deemed repatriation tax on all currently deferred accumulated earnings
 - No repayment time specified
 - No rate specified

REPUBLICAN BLUEPRINT AND TRUMP TAX PLAN COSTS

Republican Blueprint

- Tax Foundation—(\$191 b.)
- Tax Policy Center—(\$3 tr.)

Trump Campaign

- Tax Foundation
 - Conventional scoring—(\$4.4-\$5.9 tr.)
 - “Dynamic” scoring—(\$2.6-\$3.9 tr.)
- Tax Policy Center
 - Conventional scoring—(\$6.2 tr.)
 - “Dynamic” scoring—(\$7 tr.)
- “Dynamic” scoring takes into account increased Federal interest expense and macroeconomic effects

THE DIFFICULTIES

- On tax reform, see *Showdown at Gucci Gulch*, the story of the 1986 tax act.
- The Substance
 - The Republican Blueprint and Trump proposals have elements in common but differ significantly on how to tax both domestic and foreign income
 - The individual tax sides are similar, but the devil is in the details
 - Does Trump propose “gains at death”?
 - The Republican Blueprint replaces the existing corporate tax with a “border adjustable” business cash flow tax (essentially a subtraction method VAT with a deduction for wages), and excludes foreign income through a territorial tax system with a full deduction for dividends from foreign corporations. The Trump plan appears to retain the existing corporate tax structure with modifications to the base.
 - “Border adjustability” raises considerable revenue
 - “Border adjustability raises serious WTO compliance concerns
 - Importers are not be happy
 - The scope of the territorial tax, including anti-abuse provisions, needs to be determined
 - Transition rules will be critical

THE DIFFICULTIES

- The Legislative Process
 - Both the Republican Blueprint and Trump plan lose revenue during the ten year budget window
 - Will fiscal conservatives buy in?
 - Procedural rules in the Senate will pose problems
 - Legislation “in the regular order” is subject to a filibuster and a Budget Act point of order if it loses revenue over the ten year budget window. Each requires 60 votes to overcome.
 - Republican efforts to peel off 8 Democratic votes is not likely to be successful
 - The “reconciliation” process is an alternative but it raises its own issues
 - Need for budget resolution
 - “Byrd” rule point of order if bill loss revenue outside the ten year budget window
 - Sunset tax cuts

THE DIFFICULTIES

- **Winners v. Losers**
 - Blueprint—Exporters v. Importers
 - Domestic v. Multi-national
 - Manufacturing v. Service
- **Trade agreements and tax treaties**
- **Politics of business only reform as a fall back**

WHAT HAPPENS NEXT

- Extremely difficult to predict at the moment
- Things to watch for
 - Release of Republican draft
 - Executive Branch personnel decisions and confirmations
 - Effect of ACA failure
 - Congressional hearings announcements
 - Budget resolution relating to taxes
 - Reaction of the Senate

A BUSINESS TAX ALTERNATIVE

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

A VAT

- “A tax imposed and collected on the ‘value added’ at every stage in the production and distribution process of a good or service. Joint Committee on Taxation, *Background on Cash-Flow and Consumption-Based Approaches to Taxation*, (JCX-14-16), March 18, 2016.”
- Administered through a credit-invoice system.
 - Each seller in the supply chain charges VAT on a sale and gives the purchaser (other than a final consumer) an invoice that shows how much tax has been charged. A credit may subsequently be claimed for the amount of tax shown on the invoice.
- It is a **tax on transactions**.
- It is **not a tax on business**. Business acts as a collection agent.
- Is “**destination-based**”. Exports are not subject to VAT, imports are.

A COMPARISON OF A BACFT AND A VAT

- How have countries typically financed corporate rate reduction?
- How many countries have a BACFT? A VAT?
- Are they both consumption taxes? Why?
- What is the economic incidence of a BACFT? A VAT?
- What is the price effect of introducing a BACFT? A VAT?
- What is the projected effect on inflation of a BACFT? A VAT?
- What is the projected effect on economic growth of a BACFT? A VAT?
- What is the effect on trade of a BACFT? A VAT?
- What are the WTO consequences of a BACFT? A VAT?
- What are the constitutional implications of a BACFT? A VAT?
- Does a BACFT affect existing bilateral tax treaties? A VAT?
- Which is more administrable/less likely to be abused?
- Which is more transparent—a BACFT or a VAT?
- Which raises more issues with respect to form of business organization (e.g., corporate v. non-corporate)?

THE ANSWER?

- Retention of the corporate tax, but at a rate of 15%
- Worldwide taxation of all income currently
 - Eliminates transfer pricing as a **US tax issue**
 - A territorial system would require either a minimum tax (of 15%) on foreign income or complex base erosion rules
- Assuming a cost of \$2 trillion over ten years, a 4-5% VAT would make this revenue neutral. Administrative and transition costs would indicate a rate of at least 7%.
 - A higher rate could finance income tax changes. See, See, Progressive Consumption Tax of 2016, introduced by Sen. Ben Cardin

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