

HERE WE GO AGAIN!

WILL BUSINESS INCOME 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
- At least three serious proposals

THE MAJOR PROPOSALS

- House Republican Blueprint, “A Better Way”
- President-Elect Trump Campaign Proposals
- Senator Hatch Integration Proposal (to be released)

REPUBLICAN BLUEPRINT AND TRUMP BUSINESS TAX PROPOSALS

Republican Blueprint

- Corporate Rate—20%
- Repeal Corporate Minimum Tax
- Full expensing of the costs of investments other than land
 - No current deduction for net interest expense
- 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
 - “Destination-based” border adjustments
 - Repeal of Subpart F, except for PFIC rules
- Repatriation tax on currently deferred accumulated earnings payable over 8 years
 - 8.75% on cash or cash equivalents
 - 3.5% on other earnings

Trump

- No specific provision
 - During campaign a 15% worldwide (no deferral) tax was proposed but then apparently withdrawn
- Repatriation tax of 10% on all currently deferred accumulated earnings
 - No repayment time specified

REPUBLICAN BLUEPRINT AND TRUMP BUSINESS 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
- No provision

Trump

- Allow pass-through owners the election to be taxed at 15%, with special rule applicable to distributions to “large” passthroughs
- Individual income tax rates of 12, 25 and 33%
- Maximum 20 rate on capital gain
- Carried interests taxed as ordinary income

REPUBLICAN BLUEPRINT AND TRUMP TAX PLAN COSTS

Republican Blueprint

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

Trump

- 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

HATCH INTEGRATION PLAN

- Deduction for all dividends, limited by the amount that is subject to full taxation
 - Limitation denies a deduction for amounts paid out of preference income or foreign source income
- Withholding tax of 30 % on dividend
- Withholding tax is includible in the income of recipient and is a nonrefundable credit for U. S. taxpayers.
 - Credit is non-refundable for foreign taxpayers and exempt entities
- To equate treatment of interest, a 30 withholding tax is imposed on interest payments
 - Treated the same as dividends, assuring at least one level of tax on interest income
- No indication how foreign income will be treated
 - Question is whether the foreign tax credit will be allowed, thus exempting income tax abroad at a rate equal to or greater than the U.S. rate

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 Republican Blueprint replaces the existing corporate tax with a business cash flow tax (essentially a subtraction method VAT), eliminates foreign source income from the U.S. tax base through “border adjustability” and provides a territorial tax system with a full deduction for dividends from foreign corporations. The Trump plan retains the existing corporate tax structure with modifications to the base.
 - “Border adjustability” raises considerable revenue
 - “Border adjustability raises serious WTO compliance concerns
 - Importers will not be happy
 - The Hatch plan is a totally different approach and does not address individual taxation
 - The scope of the territorial tax, including ant-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
 - Potential conflict with ACA repeal
 - Need for budget resolution(s)
 - “Byrd” rule point of order if bill loss revenue outside the ten year budget window

WHAT HAPPENS NEXT

- Extremely difficult to predict at the moment
- Things to watch for
 - Release of Republican draft
 - Information about new President's Budget
 - Will he submit one? When?
 - Personnel decisions regarding head of OMB, Assistant Secretary for Tax Policy, NEC
 - Action on ACA
 - Congressional hearing announcements
 - Budget resolution relating to taxes
 - Reaction of the Senate
- Not likely that anything will happen soon

PRESENTER

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