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Tax Reform Developments and Election Outcomes: A 2017 Tax Policy Preview

Robin G. Matza, Managing Tax Director, Business Tax Services
Deloitte Tax LLP

Election 2016 – A Few Initial Observations

- President-elect Trump seems to have a strong mandate for “change” but not necessarily for his agenda, especially since the campaign was light on policy
- The incoming President will confront a Congress with its own agenda(s) and political dynamics
- Senate Majority Leader Mitch McConnell has expressed interest in acting on tax reform in 2017, matching the long-held position of House Speaker Paul Ryan
- Republicans retained their majority in the Senate (51-48 with one seat undecided), but not every member is necessarily in lock-step with the incoming administration
- Incoming Senate Democratic Leader Chuck Schumer is more open to tax reform than outgoing leader Harry Reid
- In the House, Republicans saw the size of their majority reduced but not significantly (238-193 with four seats undecided)

Setting the Stage for 2017:
Summarizing the Trump Tax Plan

Trump Tax Plan – Business Taxes

Corporate Rate	15%
Pass-through Rate	15%, but unclear to which entities and income it applies/other restrictions
Corporate AMT	Eliminate
Full Expensing	US manufacturers may elect full expensing *or* interest deductibility; election irrevocable after 3 years
Interest Deduction	
International	• No changes currently specified to current regime (2015 plan called for retaining current-law worldwide regime and foreign tax credit but repealing deferral) • Deemed repatriation at 10% tax rate
Financial Products & Institutions	Phase out deferral of inside build-up on life insurance contracts for high earners
Energy	No change specified
Employer-Provided Childcare	• Increase credit cap to $500k • Shorten recapture period to 5 years
Other	• Repeal Affordable Care Act and all related taxes • Eliminate most corporate tax expenditures except R&D credit

Trump Tax Plan – Individual Taxes

Individual Rate	• New brackets: 12% on <$75k; 25% on $75k-225k; 33% top rate on >$225k • Eliminate 3.8% net investment income tax
Capital Gains / Dividends	20% top rate
Carried Interest	Ordinary income
AMT	Eliminate
Deductions	• Standard deduction $15k/$30k • Cap itemized deductions at $200k/$100k • Eliminate personal exemptions and head of household
Estate & Gift Tax	• Eliminate, but capital gains held until death subject to tax, with first $10m tax-free • Disallow “contributions of appreciated assets into a private charity established by the decedent or the decedent’s relatives”
New Tax Benefits	• Deduction for childcare (avg. state cost) and eldercare (inflation-adjusted $5k cap), for those with income <$500k/$250k • Refundable childcare credit for EITC recipients • Dependent Care Savings Accounts with 50% govt match for low-income families

Trump Tax Plan – Revenue Estimates

Tax Policy Center Static estimate	• 10-year revenue effect = **-$6.2 trillion**
Tax Policy Center Dynamic estimate	• 10-year revenue effect = **-$6 trillion** • 10-year GDP impact = -0.4%
Tax Foundation Static estimate*	• 10-year revenue effect = **-$4.4 trillion-$5.9 trillion**
Tax Foundation Dynamic estimate*	• 10-year revenue effect = **-$2.6 trillion-$3.9 trillion** • 10-year GDP impact = +6.9%-8.2%

* Ranges provided because of uncertainty about application of pass-through tax rate

Most impactful provisions:

- Corporate rate reduction
- Individual rate reduction
- Repeal of net investment income tax

Setting the Stage for 2017: Comparing Key Tax Reform Proposals

Tax Reform Debate is Heating Up

- House Republicans released a tax reform “blueprint” on June 24, indicating the direction they want to take the tax reform debate
- Delivers on goal of reducing both corporate and individual tax rates as well as addressing passthroughs
- Unlike prior GOP tax plans, the GOP blueprint pivots toward supporting policies designed to create economic growth
- Tax reform is one of a handful of issues where there is a consistent call for action from House and Senate Republicans

Comparing Key Business Tax Proposals

	Trump Tax Plan	House GOP Tax Reform Blueprint	H.R. 1 (2014 Camp Tax Reform Plan)
Corporate Rate	15%	20%	25% (phased in over 5 years)
Pass-through Rate	15%, but unclear to which entities and income it applies/other restrictions	25%	Taxed at individual rate
Expensing/ Depreciation	US manufacturers may elect full expensing *or* interest deductibility; election irrevocable after 3 years	Full expensing in year one of all assets, tangible and intangible, other than land	Phase in repeal of MACRS
Interest Deduction	Loss of deduction specific to US manufacturers	No current deduction for net interest expense (disallowed deductions may be carried forward indefinitely)	• Modified section 163(j) and implements new thin cap rules • Section 163(j) interest deduction limit for adjusted taxable income reduced from 50% to 40%.

Comparing International Tax Proposals

	Trump Tax Plan	House GOP Tax Reform Blueprint	H.R. 1 (2014 Camp Tax Reform Plan)
International Regime	• No changes currently specified to current regime (2015 plan called for retaining current worldwide regime and foreign tax credits but repealing deferral)	• Territorial (via 100% dividend exemption) • Eliminate most subpart F rules; retain foreign personal holding company rules	• Provides US corp shareholders 95% DRD for foreign source dividends received from 10%+ owned foreign corporation • 15% minimum worldwide effective rate on foreign base company intangible income • 12.5% minimum worldwide effective rate on foreign base company sales income
Deemed Repatriation	10% tax rate	Differential rates for cash (8.75%) and noncash (3.5%) assets, payable over 8 years at taxpayer's election	Differential rates for cash (8.75%) and noncash (3.5%) assets, payable over 8 years (no interest charge; FTCs and NOLs may offset tax)
Border-Adjusted Tax Base	No proposal	Tax imposed on imports, but not exports (similar concept to other countries' credit-invoice VATs)	No proposal

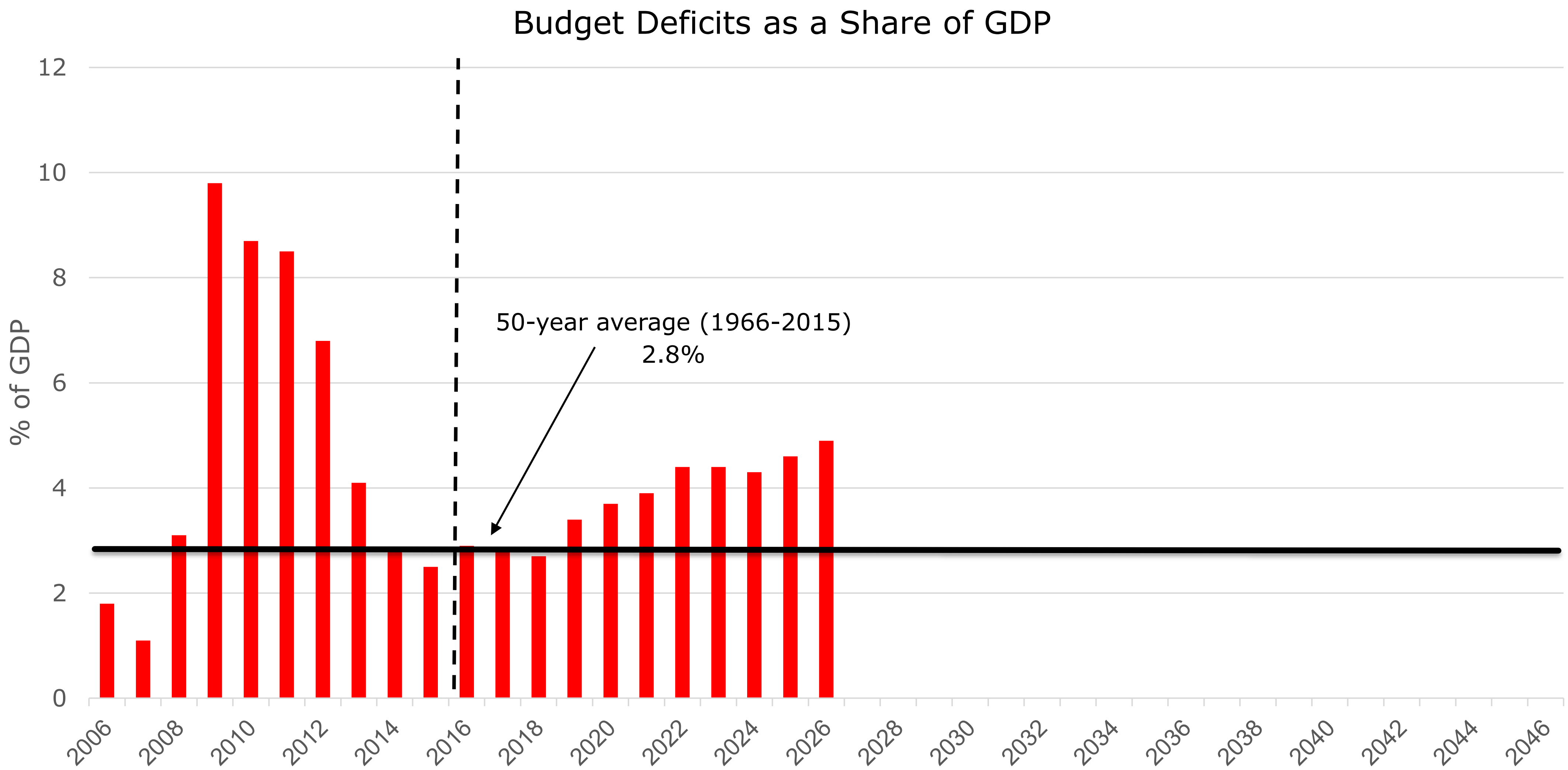
Senate Republicans - Looking at an Alternative Way of Doing Tax Reform

- Senate Finance Committee Chairman Hatch is working on proposal for "corporate integration"
  - Contours still under development, but generally expected that it would give corporations a deduction for dividends paid while requiring all dividend recipients to pay tax on them at ordinary income rates
  - Recipients subject to full tax, i.e., not at preferred rates, would include not just taxable shareholders but also foreign investors and those individuals who hold stocks in retirement accounts, charities, and pension funds
  - Prospects for any action are unclear; Chairman Hatch has so far delayed releasing it in 2016

- In 2017, Senate Republicans are likely to continue to be supportive of tax reform, though they may find themselves pivoting back toward a more "traditional" approach

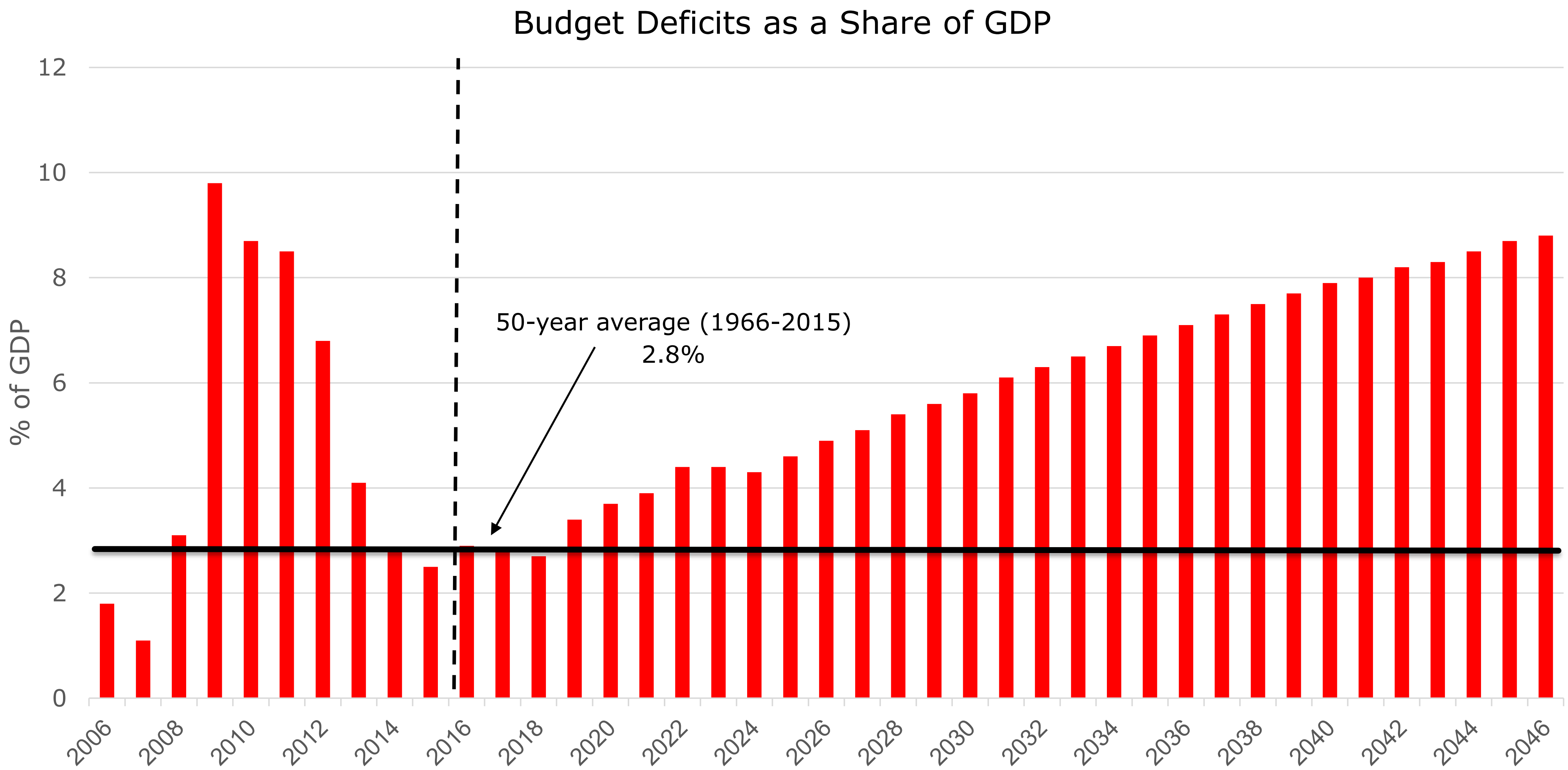
Deficits Becoming Increasingly Important Again

However, Deficits Set to Climb Again After 2018



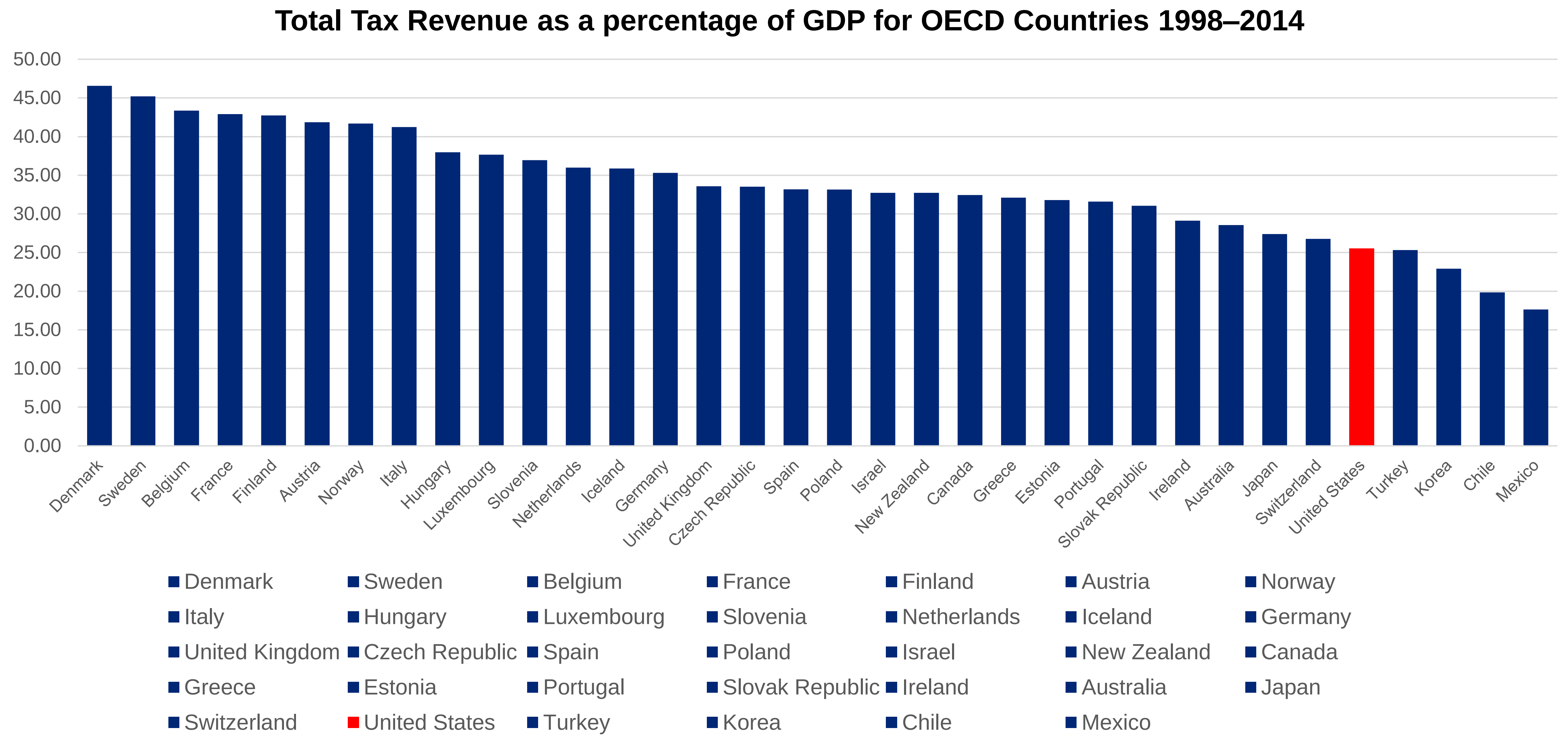
Source: Congressional Budget Office, *Updated Budget Projections: 2016 to 2026* (Mar. 2016), *The 2016 Long-Term Budget Outlook* (Jul. 2016)

Long-Term Deficits Projected to be Well Above 50-Year Average

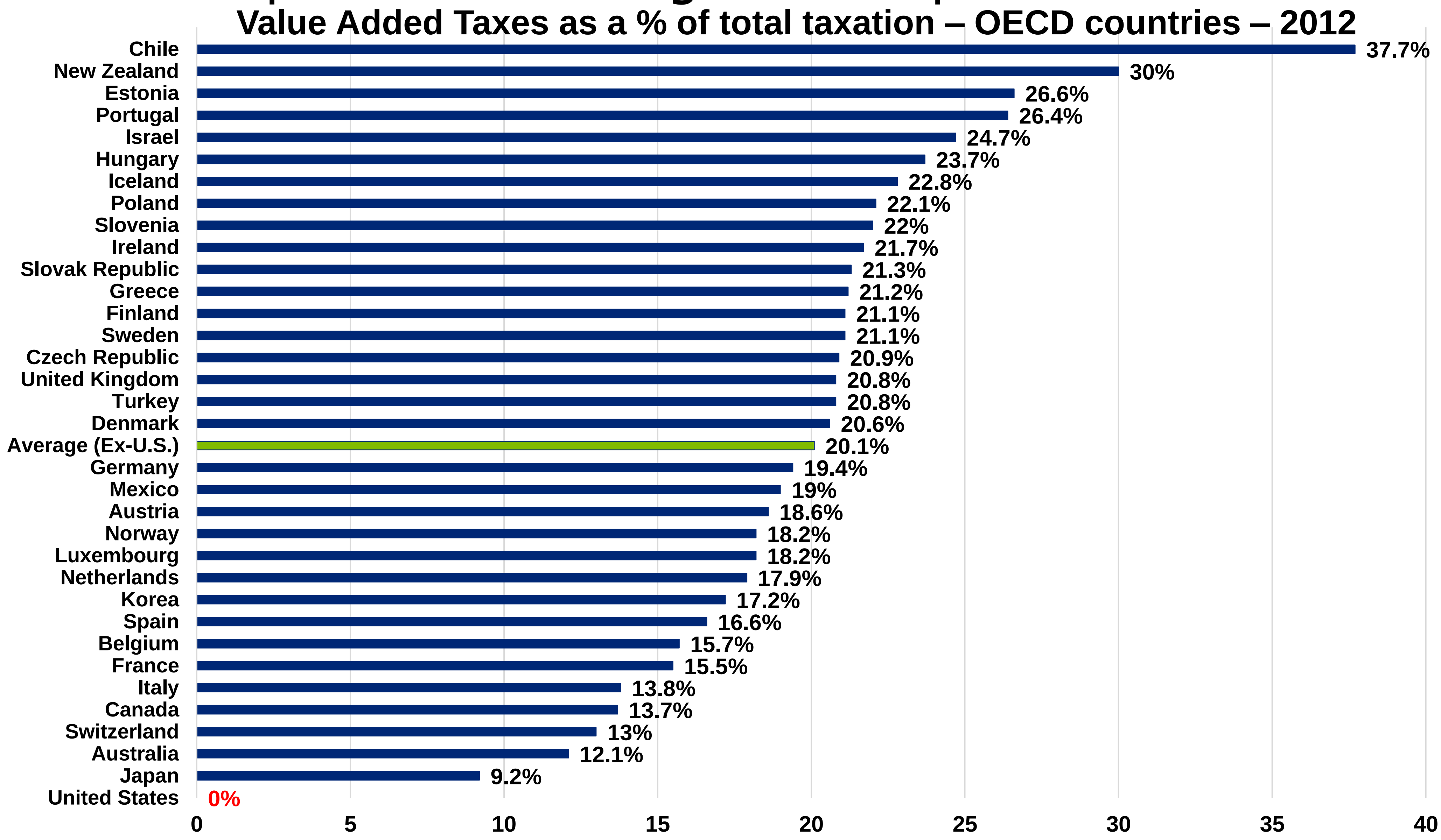


Source: Congressional Budget Office, *Updated Budget Projections: 2016 to 2026* (Mar. 2016), *The 2016 Long-Term Budget Outlook* (Jul. 2016)

Is the U.S. Tax Burden as High as We Think?



U.S. is Unique in not Taxing Consumption at the Federal Level



Source: OECD, *Consumption Tax Trends 2014* (Table 1.A1.7)

Is 2017 the Year for Tax Reform?

Tax Reform in 2017:

- There is general agreement by both political parties on the need to lower the corporate tax rate and reform international tax rules
- The sense of urgency related to BEPS, increased foreign acquisitions of U.S.-based companies, and EU state-aid actions is increasing
- Parties have real and deep differences over whether tax reform should raise more revenue
- Parties remain divided over whether to reduce the top marginal rate for individuals; relatedly, they have very different views as to whether the tax code should be made more progressive or not

Tax Reform in 2017:

- The economy appears to be solid allowing Congress space to work on big but difficult issues
- Significant tax reform work already done with discussion drafts released by Camp, Baucus and Wyden as well as the White House framework and House GOP blueprin
- Tax reform is always easier said than done. The actual task of paring back popular credits and deductions offers ample opportunities for well-organized opposition to arise
- Question as to whether everyone is currently on the same tax reform page
- The 2018 mid-term elections are only 696 days away, followed closely by the 2020 Presidential election in 1424 days

Final Takeaways

Can History Predict the Future of Tax Reform?

- Newly-elected presidents have moved significant tax changes early in their administration
  - President Clinton signed OBRA 93 on August 10, 1993
  - President Bush signed EGTRRA on June 7, 2001
  - President Obama signed ARRA on February 17, 2009
- Fundamental economic indicators helped drive those efforts
  - Worsening deficit picture helped clear path for tax increases in OBRA 93
  - Increasing budget surpluses eased tax cut efforts in 2001
  - Financial crisis provided impetus for tax/stimulus legislation in 2009
- Do political and economic factors align for action on tax reform early in 2017?

Things to Think About: Tax Reform Landscape

- Divining tax policy in 2017 and beyond is difficult when there are few details and there appear to be different approaches to tax reform within the Republican party
- That said, ignoring the tax reform process could be a mistake
  - Despite strong headwinds facing taxwriters, conceptually everyone still agrees that tax reform is necessary
  - There is a greater sense of urgency among congressional taxwriters given developments in the global tax landscape
  - As an example, last year's PATH Act passed with great speed – approved by the House and Senate and signed into law within a 24-hour period