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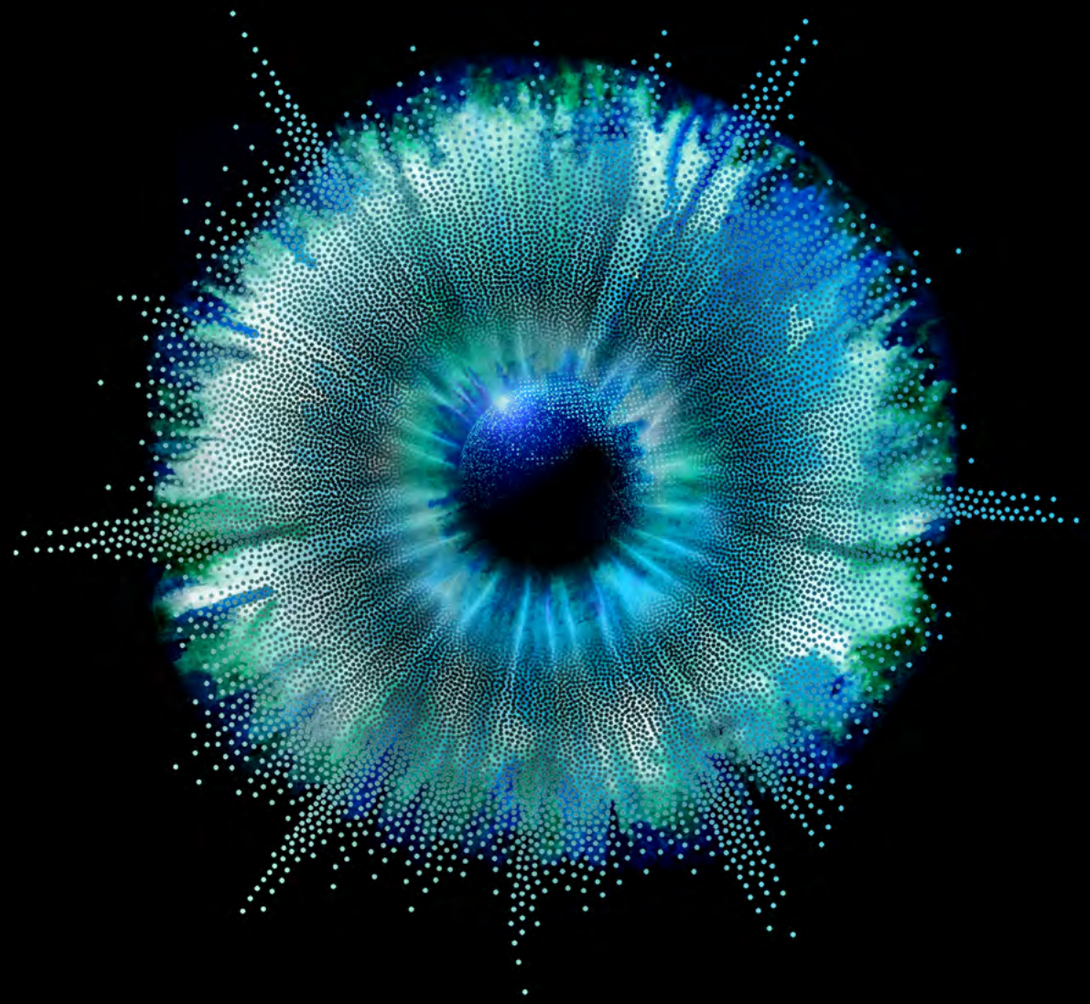

US tax reform year one: Learning from the past to face the future

Get started ▶

Looking back:
A collective sigh

To say that the first full year under the new 2017 Tax Act[1] has been challenging is an understatement.

Trying to understand the new law has been a time-consuming and often difficult process for many organizations that are coping with the sheer volume of tax code changes, as well as the complexity those changes brought about. Some of this complexity is the result of the arcane budget reconciliation process that Republican leaders invoked to move the legislation through Congress. On one hand, the budget reconciliation rules allowed GOP leaders to bypass procedural hurdles that could have stymied the legislation in the Senate; on the other hand, reconciliation restricted lawmakers by requiring them, among other things, to craft a bill that would not increase the federal deficit outside the 10-year budget window.

But much of the complexity is the result of the balancing act that takes place when Congress makes intricate changes to already dense areas of tax law. Thus, the initial elation over the 21 percent corporate tax rate was soon tempered by the reality of some of the offsets: new anti-base erosion protections such as GILTI and BEAT, new limitations on the deduction for business interest expense under section 163(j), new limitations on deductions for employee benefits, and more.

Issues of timing have added to the overall challenge facing taxpayers. The legislation was drafted and moved through Congress in a matter of weeks at the end of last year, and many of its provisions became effective in 2018. That left taxpayers with little time to develop a transition plan and gave the Department of the Treasury no opportunity to have guidance in place that explains how the new provisions operate. The Treasury has rolled out some guidance over the past year, but proposed and final regulations are still pending on many key provisions. As a result, taxpayers

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have, in many cases, been left to work with the information they have in hand and make some high-level assumptions as they attempt to understand and comply with a multitude of changes to the code.

With much of the last year focused on applying the newly deemed repatriation tax on previously untaxed foreign earnings and profits, submitting 2018 quarterly estimates, filing 2017 returns, and preparing for a particularly complicated year-end compliance and reporting process, many tax professionals are exhausted. Although the new law's journey through Congress may have felt like a sprint, navigating the impact of tax reform is clearly turning out to be a marathon.

Heading into the new year, leaders from across Deloitte Tax LLP share their perspectives on the 2017 Tax Act's legacy to date and its potential to further reshape the economic and business landscape. We hope these insights prove useful as you gather your own learnings from the past year and prepare for what likely will be another extended period of change and uncertainty—but also new possibilities.

The 2017 Tax Act and the 7 stages of response

How many of these stages have you experienced?

Shock that the bill passed

Denial of the aggressive timeline

Frustration about the length and complexity of the legislation and the initial lack of administrative guidance

Impatience with release of additional guidance

Confusion as to what the long-term impact will be

Stress over data gathering and calculations

Resolve to manage the uncertainty and find potential opportunities

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Jonathan Traub, Tax Policy group leader, Washington National Tax, Deloitte Tax LLP

A year in, one big question on everyone's mind is: Are the tax cuts working as intended?

It will take years for a clear picture to emerge as the ripple effects of the 2017 tax legislation continue to spread. Both supporters and critics agree it's far too early to say conclusively whether the bill has met its goals of boosting the economy, as many of the changes made by the law will take time to manifest themselves.

And there are many environmental factors and developments that will also affect the economy—trade policy developments, inflation, and interest rate changes chief among them—which will make it difficult to say with certainty what effect the landmark 2017 tax law had on the economy.

With those important caveats in mind, we can look at indicators in key areas—wages, workforce, business investment, and economic growth—to get a broad view of the data to date and perspectives of both bill supporters and its critics.

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Wages

Influenced mainly by the degree of tightness in the labor market, wages—and their growth or stagnation—are what many people see and feel in their wallets directly. Are they earning enough to buy the things they need—and maybe more of the things they want? Or are they feeling squeezed and starting to spend less? While there is some evidence to suggest that wages have been positively impacted by the tax law changes, the disinflationary psychology of the market, as well as declining union power, has helped to restrain wage gains.

The optimist's view

- Average hourly earnings have increased by 81 cents, or 3.1% over the year.[2] In Q3, employees' weekly earnings rose 3.3% from a year ago, up from 2.6% in the same period in 2017.[3]
- More than 4M workers got bonuses this year.[4]
- Some of the largest US firms have raised their minimum wage for employees this year,[5] as have some states.

The skeptic's view

- Wage growth is still below what most economists expect from a strong economy. During the 1990s boom, growth was regularly at 3.5–4% a month.
- Bonuses are a one-time benefit and not as durable as salary or wage increases.
- Consumer goods-focused Chinese imports worth $200B were hit with a 10% tariff in September, set to rise to 25% in January. On furniture and travel goods alone, the higher rate could cost Americans $6B a year.[6]

The long view

The mismatch of job skills to job openings is an issue to watch, as it could have a potential impact on both wages and the workforce. Faster wage growth, if it materializes, could push inflation higher, reminding us that wage growth can be a bit of a goldilocks situation—not enough is bad, but too much can be bad as well.

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Workforce

The unemployment rate is one of the key indicators often cited as evidence of a healthy or stagnating economy. The rise or fall of the unemployment rate and the number of jobless claims are important to watch, but so, too, are labor participation rates.

The optimist's view

- Changes to the tax code boosted disposable income, allowing consumer demand to grow, thereby boosting employment.
- The unemployment rate, at 3.7%, is near its lowest since 1969. The rates for women, blacks, and Hispanics are at or near all-time lows.[7]
- The monthly average of new unemployment claims recently hit a 49-year low.[8]
- About 278K manufacturing jobs were created in the 12 months through September, more than double the same period a year earlier.[9]

The skeptic's view

- Unemployment rates were already falling prior to passage of the tax bill—they've dropped steadily since 2010.[10]
- At about 63%,[11] the labor participation rate continues to fall from its high in 2000, as more people stop seeking work.
- Despite benefits from the new law, a number of big firms announced sizeable US layoffs this year.
- In a recent business environment survey, 81% of respondents said the tax bill has not caused their companies to change hiring or investment plans.[12]

The long view

A key long-term structural indicator of a strong job market is a rising workforce participation rate. Will people who dropped out of the workforce be enticed back? Or will the growing skills gap discourage them from returning and, consequently, place a potential cap on job market growth, further straining employers looking for qualified workers?

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Business investment

One of the objectives of the 2017 Tax Act was to motivate businesses to make capital investments by providing temporary full expensing on business purchases of many categories of assets and equipment, which would potentially drive long-term increases in productivity. The evidence for whether this is happening is mixed as of now. Many companies were already flush with cash and enjoying low borrowing costs before the enactment of the tax legislation, so these new incentives may not have changed investment conditions for them significantly.

The optimist's view

- Q1 S&P 500 capital investment grew 6.8%, up 21% from 2017 and the highest rate in almost seven years.[13]
- The Congressional Budget Office (CBO) forecasts business investment will reach 8.9% in 2018, attributable in part to the bill.[14]
- The Small Business Optimism Index has been near its highest levels in the survey's 45-year history throughout this year and set a new high in August.[15]

The skeptic's view

- CBO also projects that most of the growth effects for business investment will wane between 2019 and 2022.[16]
- Spending on capital improvements is up vs. 2016 and 2017, but growth hasn't been as strong as in previous expansions.[17] In Q3, business investment rose just 0.8%—investment in IP was up, but commercial structure investment slowed significantly,[18] and in its September decision not to raise interest rates the Federal Reserve (the Fed) cited the cooldown in investment.[19]
- Oil & gas sector fixed investment tends to move directionally with oil prices—but in Q3 it fell as prices leveled off,[20] and prices are down sharply in Q4.

The long view

The rate and intensity of future business investment is likely to be determined by businesses' individual and industry fact patterns, and not necessarily driven exclusively by tax law changes. At the same time, the long-term success of the 2017 law hinges in part on this, as more capital spending is hoped to lead to more productive employees and, in turn, faster growth and higher wages.

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Economic growth

The economy was the No. 1 issue for registered voters in the 2016 US presidential election,[21] and the 2017 Tax Act was designed to appeal to voters by spurring faster economic growth. Is that happening, and will the voters be satisfied?

The optimist's view

- CBO has revised upward its estimates for economic output, forecasting that the bill will boost average annual real GDP 0.7% over the 2018-2028 period.[22]
- The US recorded its most robust GDP growth in back-to-back quarters since 2014, with Q2's growth at 4.2% and Q3's at 3.5%,[23] and the Federal Reserve has raised its 2018 estimate to 3.1%.[24]

The skeptic's view

- The deficit rose in FY 2018 to $779B, a 17% increase from FY 2017.[25] The deficit, as well as expectations of higher inflation stemming from the tax stimulus, have already led to higher long-term interest rates and could impinge growth.
- Higher mortgage interest rates, are suppressing activity in the housing market.[26]
- The Fed forecasts growth of 2.5% in 2019 and just 2% in 2020.[27]
- New orders for exports are weakening, not only in the US but also in Europe and elsewhere. The decline in growth of global trade is likely to have a negative impact on economic growth.[28]
- The tariffs imposed by the US this year are causing headwinds: in Q3, trade had its largest negative contribution to GDP growth in 33 years. Had it been a net neutral, GDP growth would have hit 5.3%.[29] Increases in tariffs function like tax increases, and thus partly offset tax-reducing changes to the tax code.

The long view

Looking forward, it's not just about GDP growth. What happens to interest rates and how the Federal Reserve responds could also impact overall economic growth. Protracted trade standoffs with China and other countries also could potentially siphon GDP growth.

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From the policy makers in Washington to the public and private organizations who spent much of the year working to understand the legislation's impact, Deloitte Tax's practice leaders reflect on the 2017 Tax Act—the good, the challenging, and the complex.

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The good

Reducing tax liabilities

The corporate rate reduction to 21 percent and the opportunity to enhance the impact of the rate change between 2017 and 2018, with respect to accelerating deductions and deferring income, has had a positive impact on many companies with respect to reducing their tax liabilities. Although the latter is a one-time opportunity, many companies responded to it and it turned out to have a sizable impact.

Bob Kilinskis
Federal Tax Accounting group leader, Washington National Tax, Deloitte Tax LLP

Advancing technology adoption

The "happy coincidence" of tax reform is that it has helped many tax departments accelerate technology adoption plans that may have been stuck on the back burner. Historically, spreadsheets have been the go-to management tool for many tax professionals, but the complexity of the new rules—especially around data gathering and analysis—has motivated them to switch to more powerful tools that can help them increase speed and quality while mitigating risk. Not many tax departments were doing things this way before tax reform.

Nathan Andrews
Tax Management Consulting practice leader, Deloitte Tax LLP

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The challenging

Compensation and benefits

The areas of compensation and employment tax may be experiencing less overall change than other areas of tax, but there are new challenges. Tax leaders in this space are focused on managing the impact of discrete changes, versus rethinking the whole system as leaders in international or passthrough tax might be facing. Areas such as executive compensation and employee benefits may be under scrutiny and increasing costs for some compensation arrangements, but in general, we're seeing less structural impact than other areas.

Elizabeth Drigotas
Global Employer Services group leader, Washington National Tax, Deloitte Tax LLP

The passthrough deduction

Quantifying the passthrough deduction (199A) has created a significant amount of work for companies. The new rules require companies to analyze their businesses regarding the number of trade or businesses, the structure of their equity, and expense apportionment, as well as payroll and property information. Tax departments need to ensure their teams are anticipating the additional time for compliance and planning required around 199A. For companies that don't expect to pass along the benefit of the passthrough deduction to its owners, entity conversion is a consideration, but one that demands a great deal of added quantitative analysis and planning for many organizations. Compounding the complexity are the new interest limitation rules, which require a significant amount of added analysis, regardless of whether there is an interest limitation.

Fiona Chambers
Passthroughs National Tax Reform leader, Deloitte Tax LLP

The impact on tax planning

Pending regulations from the Treasury—and the resulting uncertainty—appear to be causing many companies to delay or limit tax planning in the short term, with a focus on modeling and remodeling various scenarios. We expect an uptick in implementation of tax planning once additional proposed regulations are issued and once we have final regulations. Taking a wait-and-see approach may help companies avoid significant changes to planning and an adverse impact due to unanticipated clarifications or changes. However, those clients that are not performing scenario analyses but rather holding out for clarity from regulations may be delayed in implementation of favorable tax planning, resulting in lost tax benefits.

Rochelle Kleczynski
National Tax Reform leader, Deloitte Tax LLP

International tax provisions

Understanding the new international tax provisions and their potentially far-reaching effects has been a challenging and often confusing exercise for companies—many of whom were anticipating a territorial system, not a full-inclusion one such as we now have. Many companies are using all the resources they have, and then some, in their efforts to meet near-term compliance requirements and address longer-term planning needs.

Chris Trump
International Tax group leader, Washington National Tax, Deloitte Tax LLP

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The complex

Private company issues

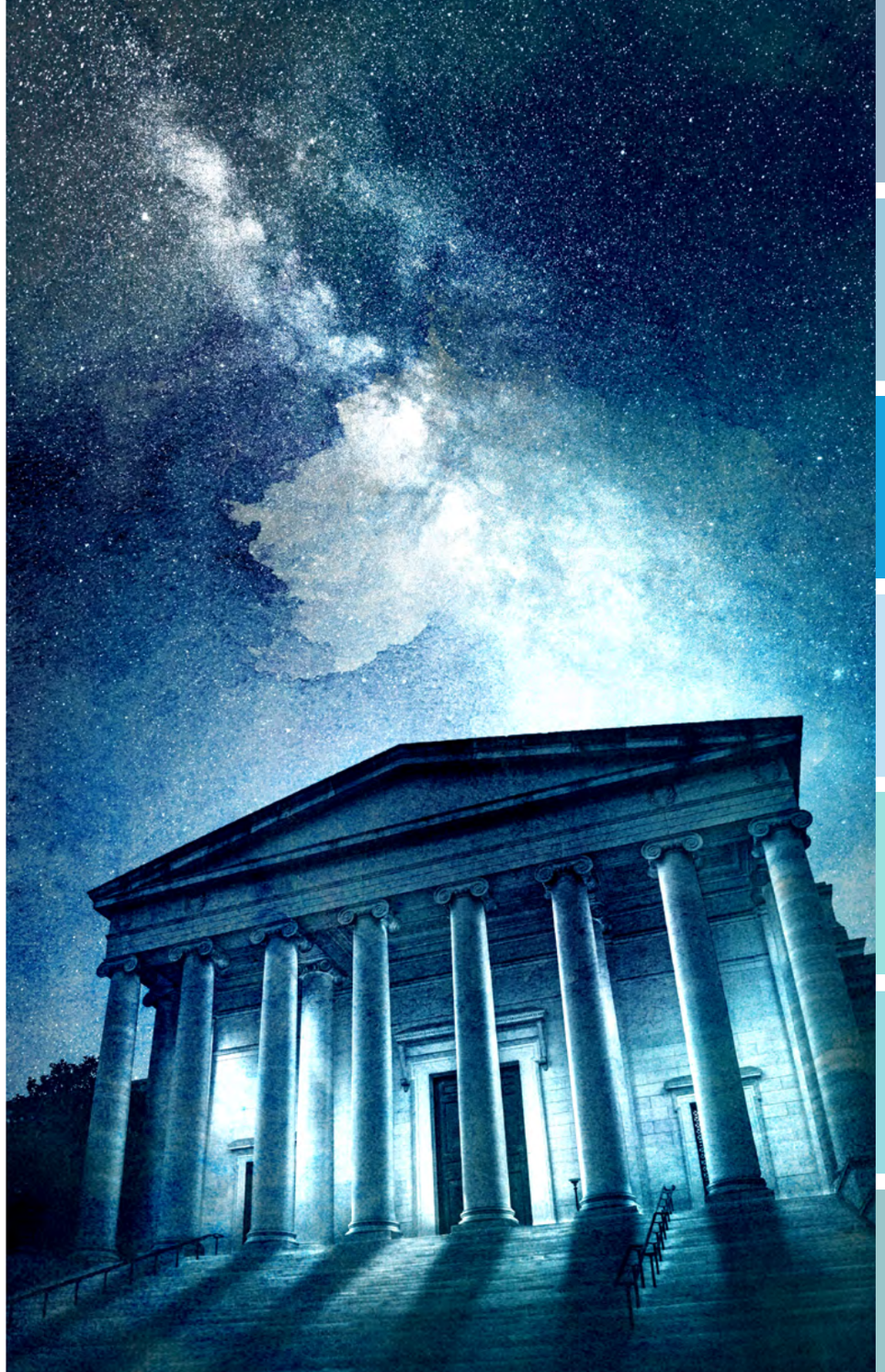
The complexity of the new tax law is proving an incredible burden for some private companies and their owners. Even some of the provisions that should be fairly straightforward, such as the new bonus depreciation rules, are proving more complex as companies digest the new statutes and how to comply. And while some companies are trying to work through the complexity (with or without help), others have been putting off their analysis until they feel they have a better understanding of the provisions that impact their organizations. Unfortunately, many companies are now approaching the critical moment when decisions need to be made.

Wolfe Tone
National Tax managing partner of Deloitte Private, Deloitte Tax LLP

Multistate tax considerations

From a state tax perspective, reconciling conformity gaps between existing state tax codes and the new federal tax laws—such as the deemed repatriation of earnings and profits—will likely take some time to resolve. Tracking, analyzing, and understanding these new state-by-state realities will require tax departments to dig in, work through the analyses, and be prepared to back up their calculations and decisions. IRS regulations will likely have a ripple effect in the states. This, coupled with issuances of state-specific guidance, promises an environment requiring ever-adapting approaches.

Valerie Dickerson
Multistate Tax group leader, Washington National Tax, Deloitte Tax LLP



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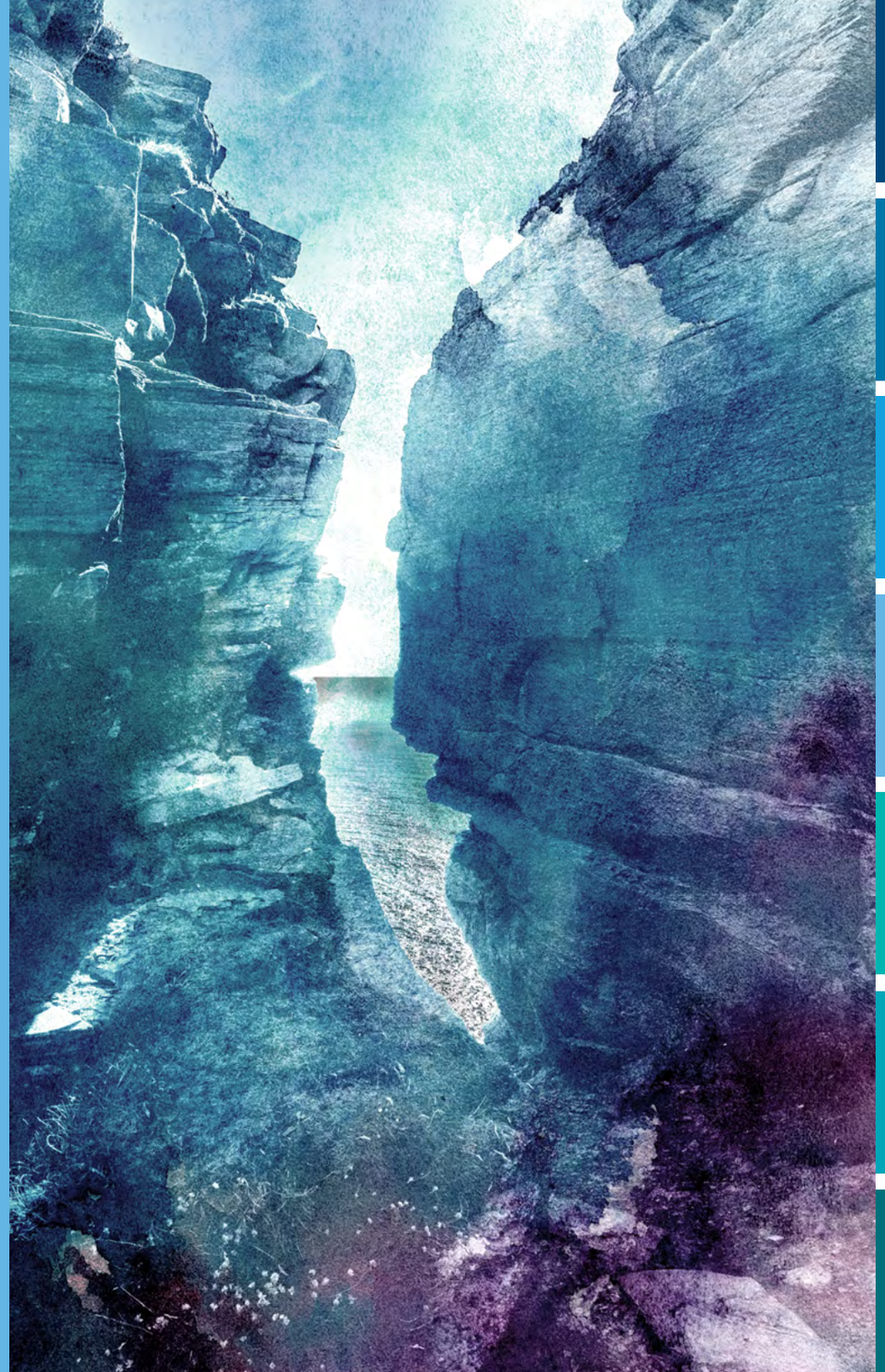
Jonathan Traub, Tax Policy group leader, Washington National Tax, Deloitte Tax LLP

It's no secret that many Americans and their government representatives in Washington hold different views on several key issues. But that doesn't mean there aren't some potential opportunities for compromise.

As we prepare for the incoming 116th US Congress in January—with Democrats controlling the House of Representatives and Republicans still holding the White House and the Senate—many are searching for signs as to whether policy makers will reach across the political aisle to secure some bipartisan achievements. Looking at the platforms of incoming House Democrats and President Trump, there appear to be some areas of overlap, notably on issues tied to trade policy, the taxation of carried interest, prescription drug pricing, tax cuts for "the middle class," and infrastructure investments; however, the likelihood of bipartisan deal-making is an unknown dependent on many factors including the willingness of both Senate Democrats and President Trump to negotiate.



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On the radar screen

Outside of the issues dependent of bipartisan support to move forward, developments in the following three areas have the potential to influence economic, policy, and business developments in the coming months and years and may depend little on whether there is cooperation between the White House and Capitol Hill.

Regulatory policy

The use of executive orders to roll back regulations is likely to continue—potentially in areas such as labor, health, and environmental policy.

Treasury guidance/rulemaking

Treasury is highly motivated to provide certainty needed for implementation of the 2017 Tax Act, President Trump's largest legislative achievement to date. Watch for the agency to use its regulatory authority to the maximum extent.

Trade

While Congress is likely to be called upon to approve (or reject) a renegotiated North American Free Trade Agreement (NAFTA), federal law vests the president with broad powers to regulate trade, and it seems likely that President Trump is prepared to continue to use that authority in ways that may have unknown and far-reaching impacts on US-based businesses and consumers.

After a year of change and uncertainty in tax policy, the combination of a divided US Congress and the start of the 2020 presidential campaign is unlikely to bring much predictability to taxpayers in 2019. Is there anything organizations can do to improve clarity in their own planning and actions? Closely tracking developments in Washington and at the Treasury is essential in a moving-target environment like the current one, as is analyzing the potential options and their impacts. But perhaps what is needed most in the coming months and years is flexibility and patience.

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Without a clear picture of how politics and policy will play out in the coming months and years, how can companies transition from a focus on tax reform to a plan for their new tax reality? Our Deloitte Tax practice leaders share their insights on developments to watch and steps to consider in 2019 and beyond.

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Looking ahead

Bring your tax people into your organization's technology transformation efforts—whether it's cloud, robotic process automation, or analytics. At a time when tax is a front-and-center business concern, this is the time for you to advance the needs and elevate the profiles of the tax department.

Nathan Andrews
Tax Management Consulting practice leader, Deloitte Tax LLP

Qualified opportunity zones could emerge as a promising new investment vehicle for deferring the taxation of capital gains from a variety of sources—not just real estate.

Bob Kilinskis
Federal Tax Accounting group leader, Washington National Tax, Deloitte Tax LLP

Don't lose sight of your planning needs, even as uncertainties remain. It's important to keep your eye on the longer term and prepare your organization for the realities of the new tax environment.

Fiona Chambers
Passthroughs National Tax Reform leader, Deloitte Tax LLP

As they work through the conformity process, state tax policy makers may be willing to pursue potentially transformative tax policy reforms rather than just layering on federal tax provisions. This means tax department capabilities will need a framework for anticipating and addressing change.

Valerie Dickerson
Multistate Tax group leader, Washington National Tax, Deloitte Tax LLP

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Analyzing the effects of changes to meals and entertainment, travel, and mobility rules is likely to remain an area of focus as many companies try to formulate compliance policies that keep the costs of doing business in check, while meeting the key needs and expectations of employees and clients.

Elizabeth Drigotas
Global Employer Services group leader, Washington National Tax, Deloitte Tax LLP

During the first half of 2019 we should get a clearer sense of how challenging data collection and management are likely to be for many companies. Efforts to identify and collect the right data for the new provisions and calculations may prove more effective than originally expected—or companies could find themselves with a larger problem to address.

Rochelle Kleczynski
National Tax Reform leader, Deloitte Tax LLP

The unpredictability of final regulations implementing the 2017 Tax Act and future policy developments are likely to result in continued uncertainty. In the absence of a more prescriptive approach, companies may want to focus on building flexibility in their analysis and planning, honing their proactive and reactive capabilities, and preparing their internal teams and third-party partners for the pace and intensity of work that is still to come.

Chris Trump
International Tax group leader, Washington National Tax, Deloitte Tax LLP

Despite the attention around the impact of certain provisions, try not to view tax as "helping" or "hurting" your organization, but rather as a key consideration in your overall business strategy planning. This perspective may help you see individual tax decisions as part of a larger and more important whole.

Wolfe Tone
National Tax managing partner of Deloitte Private, Deloitte Tax LLP

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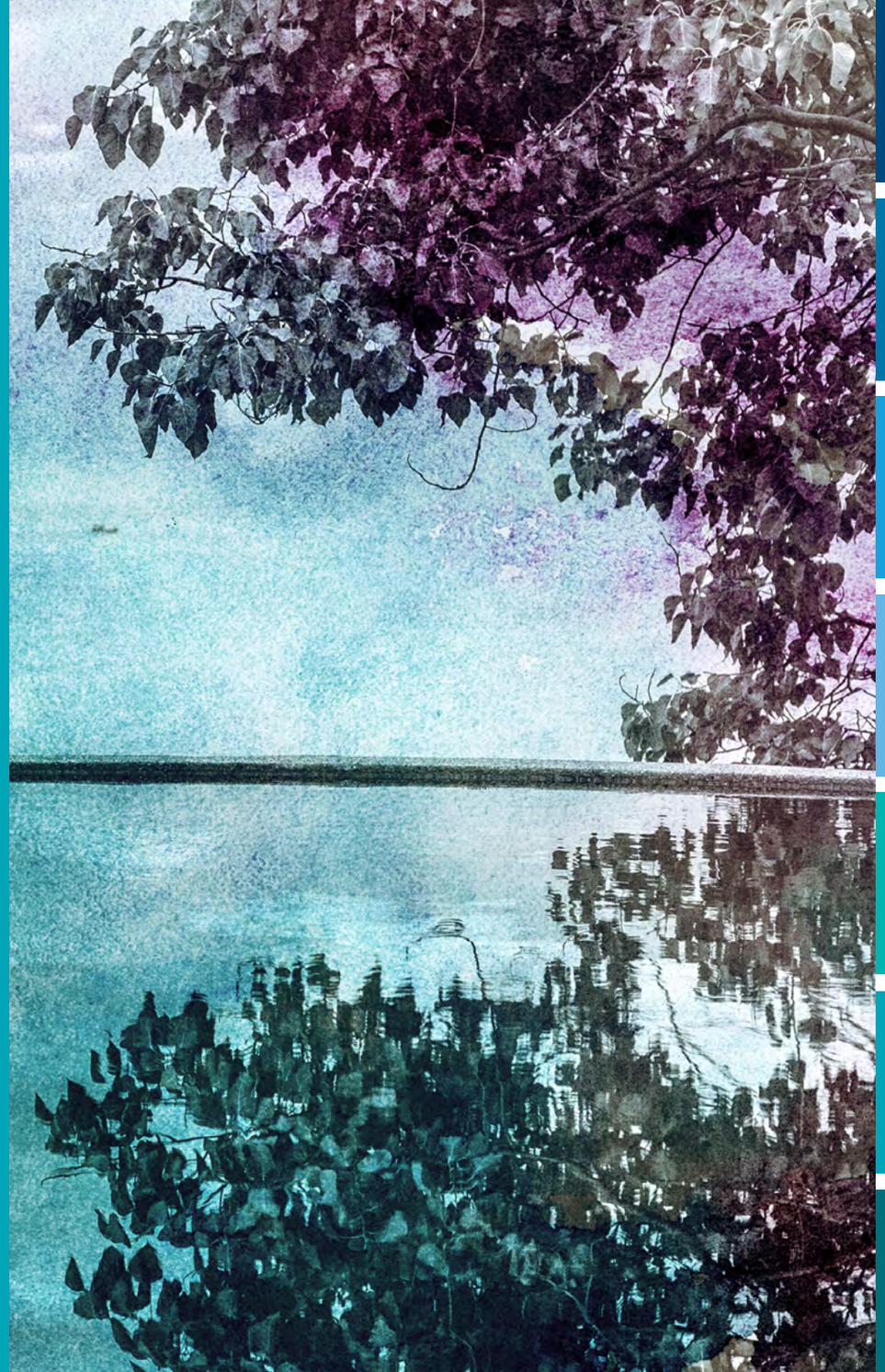
From tax reform to tax reality

Deloitte Tax can help you move forward through continued tax uncertainty. We provide insights, services, and technology tools to help you navigate change today and plan for your eventual tax reality. Explore these resources for more information on perspectives and offering. Or connect with our practice leaders to discuss your tax challenges and goals for 2019 and beyond.



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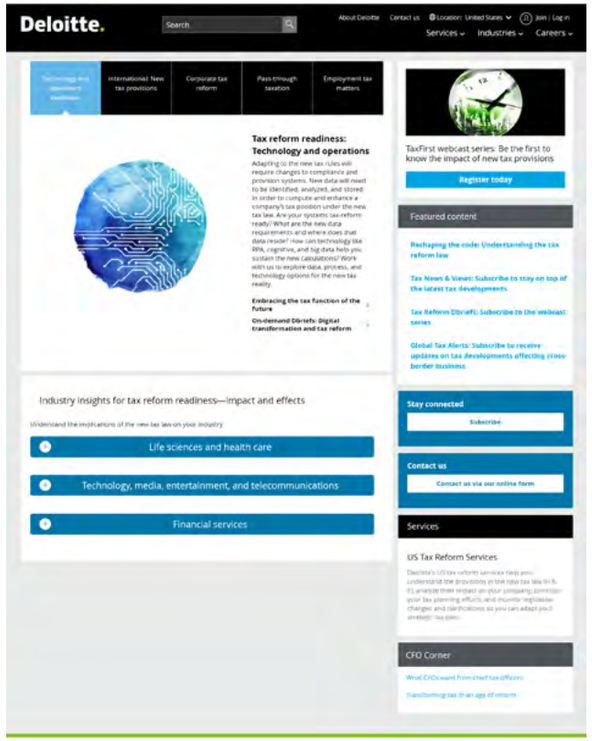
Tax reform hub

Having access to relevant and timely information, insights, and assistance is key to navigating the path ahead. Deloitte Tax has assembled a broad array of resources and perspectives on its new tax reform hub on Deloitte.com. In this one destination, you'll find:

- **The latest tax developments and featured insights—** including updates on IRS and Treasury guidance, Dbriefs webcasts for tax executives, and access to our newsletters and alerts
- **Deep dives on tax law changes and their potential implications—**from international, federal, and state provisions to passthrough taxation to technology and operations
- **Industry-specific perspectives on tax reform readiness—**across life sciences and health care; technology, media, and telecommunications; and financial services



Tax News & Views

Stay ahead of tax reform and other tax policy developments. Our Tax Policy Group publishes a regular newsletter called *Tax News & Views,* which offers clear, concise, and timely coverage of the significant tax developments on Capitol Hill and what they mean for taxpayers.

Visit www.deloitte.com/us/taxnewsviews.html to subscribe to *Tax News & Views* and have the latest tax reform developments sent to your inbox.

TaxFirst webcast series

The impact of the 2017 tax legislation continues with the release of each proposed regulation. Our TaxFirst webcast series provides insights and updates on regulatory guidance within days of release.

Washington National Tax practice

Deloitte Tax's Washington National Tax practice is a select group of tax specialists whose knowledge, skill, and experience bring world-class insights to our tax leader clients. Our teams include former high-ranking Treasury and IRS officials, congressional staff, state officials, and other professionals with considerable private sector and industry experience. This group uniquely positions Deloitte Tax to help you identify opportunities, respond proactively to changes in the tax environment, and develop adaptable positions for sustainable advantage.

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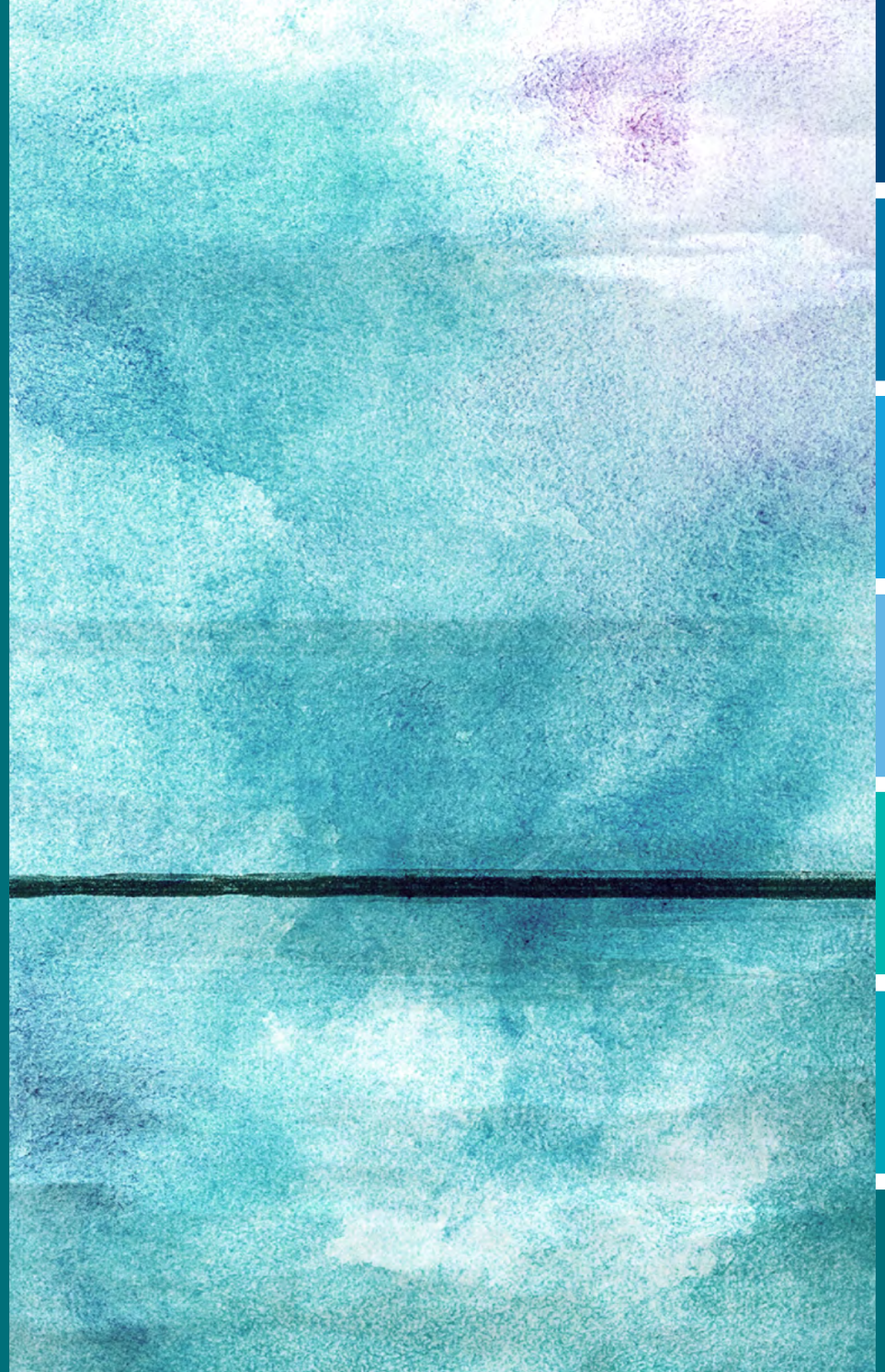

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Contributors and end notes

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