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Trump tax reform plan's silence on border-adjustment tax proposal ratchets up talk of revisions

The tax reform principles that the Trump administration released on April 26 do not discuss where the White House stands on the issue of the destination-based cash flow tax that is included in the tax reform blueprint that House Republicans unveiled last June – and that omission has led to renewed talk of changes to the provision from House GOP leaders. (For a discussion of all the tax reform principles outlined by the White House, see *Tax News & Views*, Vol. 18, No. 13, Apr. 26, 2017.)
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170426_1.html

As currently proposed in the House blueprint, the destination-based cash flow tax, which is estimated to raise over $1 trillion to help offset the cost of a proposed corporate rate cut, provides for "border adjustments" through a not-yet-specified mechanism that would serve to eliminate US tax on products, services, and intangibles exported abroad (regardless of their production location) and impose a 20 percent US tax on products, services, and intangibles imported into the US (also regardless of production location).

The proposal has prompted strong reactions – pro and con – in the business community as well as in Congress. Rival taxpayer advocacy coalitions representing export-heavy and import-heavy interests have been active on Capitol Hill recently in an effort to rally House and Senate members to their side, and there are a number of vocal skeptics of the proposal among Republicans in both chambers.

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White House reservations

President Trump has yet to take a firm position on the proposal. In the past, he has criticized the border adjustment tax as "too complicated," and at other times he has expressed interest in the notion of an as-yet undefined "reciprocal tax" on imports.

Just hours before the White House released its tax reform principles, Treasury Secretary Steven Mnuchin commented at an event sponsored by *The Hill* that the administration likes "some parts" of the proposal, but overall "we don't think it works in its current form."

Brady, Ryan open to changes

In response to Mnuchin's comments, House Ways and Means Committee Chairman Kevin Brady, R-Texas, defended the proposal in an interview on CNBC on April 27, but also appeared amenable to making changes.

"I agree with the Secretary. As we rolled [the blueprint] out last June and started the discussions with stakeholders, it was clear we were going to need to make refinements, we're going to have to have very patient transition rules in it," Brady said. "The reason we're bringing this to the table is this is what our competitors use to beat us – from China, to Europe, to Mexico, and Canada. So just ignoring that it's there won't help us in the 21st century. And so, taxing all products and services equally in the US is a big change from where we're at. But the key here – not only does it create true competition and economic growth – it eliminates the tax incentives to move US companies and their patents and their headquarters overseas."

House Speaker Paul Ryan, R-Wis., likewise indicated that he was willing to revise the proposal when he spoke at an event sponsored by BakerHostetler on the morning of April 26.

"We all agree that in its present form it needs to be modified. What we do not want to do, and we've gotten a lot of good feedback on this, is we don't want to have severe disruptions. If you're an importer or a retailer heavily dependent on importers, we don't want to shock the system so much that it ends up being a huge disruption," Ryan said.

Brady and Ryan both have stated in recent weeks that they were open to including more generous transition rules in the proposal, but that they likely would not offer carve-outs for specific industry sectors.

House Ways and Means Committee member Kenny Marchant, R-Texas, told reporters April 26 that Republicans on the taxwriting panel have discussed a variety of potential options for modifying the proposal.

"We've always planned for a very generous transition period. So I don't know whether it makes it more generous, or there's a huge transition period and/or a lower rate, or reciprocation. There's all kinds of ideas bouncing around there," he said.

For his part, White House Office of Management and Budget Director Mick Mulvaney indicated on April 26 that the fact that the border-adjustment tax was not included among the administration's tax reform principles should not be interpreted as a sign that President Trump has rejected the proposal outright.

"Just because it's not in the first round of 'principles' doesn't mean it won't be in the final version of the bill. The president is interested in trying to figure out a way to tax imports, especially from countries that tax our exports," Mulvaney said in an interview on PBS.

Treasury Secretary Mnuchin told reporters April 26 that administration officials are meeting regularly with House and Senate leaders in an effort to refine proposals and reach an agreement on a tax reform package that can move through both chambers.

No discussion of depreciation and interest expense

Presumably, talks between the White House and congressional leaders will also include issues related to the expensing of business assets and the deduction of interest expense, which were also left out of the administration's initial set of tax reform principles. A Trump campaign proposal from 2016 would give firms engaged in US manufacturing an

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election (revocable within 36 months) to deduct the full cost of capital investments in year one; however, businesses that make the expensing election would lose their ability to deduct interest expense. The Trump campaign was unclear on what activities would qualify as US manufacturing for purposes of full expensing.

The House Republican blueprint provides for full expensing in year one of all assets, tangible and intangible, other than land. Interest expense would be deductible against interest income, but there would be no current deduction for net interest expense; however, net interest expense could be carried forward indefinitely and deducted against net interest income in future years.

JCT: Unfunded, temporary corporate rate cut may not fly under reconciliation

In other tax policy developments, a letter made public this week from the nonpartisan Joint Committee on Taxation (JCT) to House Speaker Ryan cast some doubt on Republicans' ability to move an unpaid-for, temporary reduction in the corporate tax rate. The notion of pursuing a temporary tax *relief* package in place of comprehensive tax *reform* has entered the tax policy discourse in recent weeks as the difficult politics of comprehensive reform have become more apparent. Treasury Secretary Mnuchin, for example, said April 26 that permanent tax reform is the administration's goal but temporary rate cuts would be "better than nothing," as they would help boost economic growth.
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170428_1suppA.pdf

The JCT letter, dated April 25, was sent by Chief of Staff Thomas Barthold in response to Ryan's request for a budgetary analysis of a hypothetical proposal that would lower the top corporate rate from 35 percent to 20 percent (the level specified in the House GOP tax reform blueprint), but only for the three-year period 2018 through 2020. After 2020, the rate would return to 35 percent under the analyzed scenario.

In its analysis, JCT notes that such a plan would reduce federal revenues by about $490 billion over the 10-year budget window – an unsurprising determination. But importantly, the letter also notes JCT's belief that even a temporary corporate rate cut would have a lingering negative effect on federal revenues not only for the duration of the 10-year budget window, *but also in the years beyond the budget window* – in part due to the committee's belief that future repatriations of foreign-source income would be lower than projected under current law as US firms accelerated such repatriations into the lower tax years of 2018 through 2020.

The persisting revenue shortfalls would be "due largely to an increased amount of credits becoming eligible to be carried forward into tax years following 2020 and the lowering of the repatriation baseline resulting from a temporary increase of repatriation of foreign earnings during the period of reduced tax," the letter said.

Relation to budget reconciliation, Byrd Rule: Republican leaders have been fairly open about the likelihood that they will have to move any tax reform (or tax relief) legislation under the so-called "budget reconciliation" process due to a likely lack of support from congressional Democrats. (Indeed, Democrats on the Hill have uniformly been lukewarm at best to the House Republican blueprint and have seemed equally unreceptive to the Trump administration's tax reform principles in the days since their release.)

Under the budget reconciliation process, legislation that meets certain strict budgetary and procedural rules can be passed in both chambers with a simple majority vote, making it a potentially powerful tool for Republicans who control 52 seats in the Senate, 8 shy of the 60 votes normally required to advance legislation in that chamber under regular order.

However, included among the budgetary rules governing the reconciliation process – often collectively referred to as "Byrd Rules," named after the late Sen. Robert Byrd, D-W.Va. – is a prohibition against legislation that would increase the deficit in any year beyond the budget window (unless offset by other budgetary changes within the same legislative title). According to JCT, because the hypothetical temporary corporate rate cut outlined in the scenario Ryan presented would produce a "nonnegligible" revenue loss in the years beyond the budget window, the proposal would seem to run afoul of this particular Byrd Rule. (These "out-year" budget effects presumably would be larger, and thus more difficult to finance through other budgetary changes, if the temporary rate reduction expired at the end of the budget window, rather than after just three years.)

This budgetary restriction – along with the other Byrd Rule limitations – can be waived in the Senate with a three-fifths majority (generally 60 votes); but again, because Democrats are not be expected to lend much, if any, support

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to such a legislative effort, compliance with these rules could well be a prerequisite for passage of any Republican tax bill.

It is not clear why Ryan requested this particular JCT analysis. However, it seems possible he may have made the request at least in part to bolster the case for a style of tax reform that is revenue-neutral over the long-run and which could be enacted on a permanent basis, even under the rules of budget reconciliation. (The House GOP blueprint notes its intent that tax reform would be revenue-neutral after taking into account the revenue effects from enhanced economic growth – so-called "dynamic scoring" – and relative to a "current policy baseline" that assumes temporary tax provisions are extended permanently. Moreover, House Republican leaders have argued that the revenue that would be generated by the blueprint's proposed border-adjustment tax is critical to offsetting the expected cost of the blueprint's proposed reduction in the corporate tax rate.)

Ways and Means Chairman Kevin Brady told CNBC April 27 that "[t]he greatest growth for the greatest years comes about when tax reform is bold, when it balances in the budget, and when it's built to last, it's permanent. Done right, I think permanent tax reform can double the growth that you get from temporary tax cuts." Brady added the House Republican leaders intend to pursue the issue with the Trump administration.

In comments to Bloomberg BNA, Brady said he believes "the White House is eager to have that discussion as well."

"I don't sense they've staked out a position one way or another. They're, like us, just eager to get to the table and begin exchanging ideas," Brady said.

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Trump signs executive order addressing 'tax regulatory burdens'

President Trump on April 21 signed an executive order calling on the Treasury Department to review "all significant tax regulations" issued on or after January 1, 2016, and, in consultation with the Office of Management and Budget, release an interim report that identifies any regulations that impose "an undue financial burden on [US] taxpayers, …add undue complexity to federal tax laws, or…exceed the statutory authority of the Internal Revenue Service." The order further directs Treasury to recommend "specific actions to mitigate the burden imposed by [the] regulations identified in the interim report." Those actions may include delaying or suspending the effective date of the regulations or modifying or rescinding the regulations.
URL: https://www.whitehouse.gov/the-press-office/2017/04/21/presidential-executive-order-identifying-and-reducing-tax-regulatory

The interim report identifying unduly burdensome regulations is due no later than 60 days from the date of the order; recommendations for actions to mitigate the regulatory burdens that Treasury identifies are due no later than 150 days from the date of the order.

The order also broadens the range of regulations that could be subject to review by the Office of Management and Budget by saying an executive order (12866) from 1993 is not controlling. This would end an informal understanding that tax regulations are not "significant" because they interpret law rather than create it; thus, any tax regulation could be reviewed under the current executive order.

Among the rules subject to review under the executive order are final and temporary regulations under section 385 that (1) establish threshold documentation requirements that ordinarily must be satisfied in order for certain related-party interests in a corporation to be treated as indebtedness for US federal income tax purposes; and (2) treat as stock certain related-party interests that otherwise would be treated as indebtedness for US federal income tax purposes. (Details on the provisions in those regulations are available in a tax alert from Deloitte Tax LLP.)
URL: http://newsletters.usdbriefs.com/2016/Tax/TNV/161014_1suppB.pdf

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Also subject to review are final and temporary regulations under section 987 that address the treatment of transactions within qualified business units of select taxpayers. (Details on that guidance are available in an alert from Deloitte Tax LLP's International Tax group.)
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170428_2suppA.pdf

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