



The Trump tax reform plan – key points

Tax Reform Alert

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As a result of the elections, the chances for the enactment of comprehensive tax reform are perhaps greater than at any time over the past decade. A great deal of work has already been done on tax reform in the Congress. What has been lacking is the political dynamic needed to make reform a reality.

President-elect Donald Trump and Congress may also consider a scenario whereby part of the tax reform could be used to pay for an infrastructure program to create greater domestic economic growth.

What follows are brief summaries of President-elect Trump's tax proposals and the House Republican Tax Blueprint that is expected to be a possible starting point for the consideration of reform early in 2017.

The conventional wisdom among tax policymakers in Washington has been that comprehensive tax reform would be far more likely in the event of a Trump presidency, especially given that a Trump victory would likely leave Republicans in control of both houses of Congress. Although it may take some time for the President-elect and his team to fully set out their agenda, the underlying assumption that tax reform is more likely in a Trump Administration may well be the case.

The tax plan that candidate Trump proposed early in the campaign went through various refinements as some well-known Republican economists and later, some Congressional tax writers and their staffs, became involved in the process of reworking the plan and, in the final analysis, brought it much closer in substance to the House Republican Tax Reform Blueprint that was released just before the Republican convention in late June.

House Ways and Means Committee Republican staff are actively working to turn the blueprint into legislative language in order to have it ready for the incoming Administration in early 2017. House Speaker Paul Ryan (R-WI), who had previously served as Chairman of the Committee on Ways and Means, has made tax reform one of his highest priorities. There are some policy disagreements between the Speaker and the President-elect, but both have repeatedly said that the current tax system is an impediment to economic growth and to the competitiveness of US companies in the global marketplace, and have pledged to reform the tax code across the board.

Because the Trump plan as it has been refined and the House Blueprint have converged to a great extent, the outline below describes the key points in the President-elect tax reform plan with reference to the House Blueprint.

THE TRUMP PLAN – INDIVIDUALS

- The Trump plan follows the same individual rate reductions as the House plan. The current seven brackets would be reduced to three, 12 percent for married joint filers with taxable incomes below \$75,000, 25 percent for incomes between \$75,000 and \$225,000, and 33 percent for income above that (the brackets for single filers would be based on half of these income thresholds).
- Trump would increase the standard deduction for joint filers to \$30,000 (\$15,000 for single filers) and would eliminate the personal exemptions as well as the head of household filing status. Itemized deductions would be capped at \$200,000 for joint filers and \$100,000 for single filers.
- Trump would repeal the estate and generation-skipping taxes but would tax capital gains held until death and valued at over \$10 million (this is intended to exempt small businesses and family farms). Contributions of appreciated assets into a private charity established by the decedent will not be recognized.
- Trump retains the current system for taxing capital gains with a maximum rate of 20 percent. Carried interest would be taxed as ordinary income.
- Trump would establish a Dependent Care Savings Account with allowable annual contributions of up to \$2,000 per year and would create new benefits for families with children with joint incomes under \$500,000 (individuals with children under \$250,000).
- The 3.8 percent tax on net investment income that was enacted as part of the Affordable Care Act would be repealed (along with the ACA in general).

THE TRUMP PLAN – BUSINESS TAXATION

- The business tax rate for all businesses would drop from the current 35 percent to 15 percent, and the AMT would be eliminated.
- Corporate profits held offshore would be subject to a one-time deemed repatriation at a 10 percent rate (otherwise Trump appears to favor territoriality going forward).
- Most corporate tax expenditures would be eliminated (the research credit would be retained), but manufacturers would be allowed to expense capital investments. The corporate deduction for interest would be eliminated.

THE HOUSE REPUBLICAN TAX REFORM BLUEPRINT

What follows are areas not reflected in the Trump plan discussion or that differ from it.

- Active business income from sole proprietorships and pass-through entities would be capped at 25 percent (the middle individual brackets instead of the highest 33 percent bracket). However to the extent that the income is “reasonable compensation for services” it will be taxed up to the 33 percent rate.
- C corporations would be taxed at a flat 20 percent rate and the corporate AMT would be repealed.
- Businesses would be permitted to expense investments in tangible and intangible property (except land). Interest expense would be allowed against interest income with any amount not being currently allowed carried forward indefinitely to use against future interest income.
- NOLs could be carried forward indefinitely and increased by an inflation factor (but the NOL deduction is limited to 90

percent of the net taxable amount for the year without regard to the carryforward) and could not be carried back.

- The House Blueprint states in general that most “special interest deductions and credits” would be eliminated.
- On the international side, the House Blueprint would shift the US from the current system to a destination based system under which the taxing jurisdiction for business income would be based on the location of consumption (where the goods are sold and services are performed) rather than the location of production. This is achieved in two ways, first by moving to a territorial tax system, and through border adjustments. Border adjustments would probably be achieved by denying the seller of a product sold in the US with foreign components any deduction for the cost of component parts purchased from overseas. This is intended to compensate for the impact of VAT rebates for exported goods in foreign tax system that tax using a VAT.

LEGISLATIVE PROCESS

Although Congress has considered a number of comprehensive tax reform plans over the past decade, none have moved much beyond the Committee process; tax reform is inherently complex and to succeed politically, will require ideally some degree of bipartisan support and buy in from stakeholders, and there is some Democratic support for reducing the corporate rate and reforming the international tax system, but most likely as part of a plan that also provides tax relief to the middle class. Presumably the new President and Congressional Republican leaders will make an effort to attract Democratic support and certainly will accelerate their outreach to stakeholders.

However, the new political alignment in Washington potentially opens up a new path forward for tax reform under budget reconciliation, a process designed to reduce federal debt that was used by the George W. Bush Administration to pass the 2001 Bush tax cuts and by the Obama Administration to pass some parts of the Affordable Care Act after Democrats lost their majority in the Senate in the 2010 elections. The advantage to reconciliation is that passage of the legislation only requires a simple majority in the Senate making it impossible for the minority party to filibuster it; the disadvantage is that provisions in budget reconciliation must expire at the end of the budget window, usually a ten-year period (the 2012 Bush tax cuts were temporary and led to the deal with President Barack Obama to make some of the 2001 brackets permanent) and provisions that have no budgetary effect may not be permitted in a reconciliation bill.

It will take some time for the dust to settle in Washington; the President-elect is not well known to most members of Congress. However, tax reform is one his clear objectives and Republican leaders in Congress are likely to see this election as a great opportunity to update a tax code that has not had major updating since 1986.

Find out more by contacting either of the authors.

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