

# GOP's 2017 Tax Reform Framework

September 29, 2017

## Highlights

- ✓ Reduced and Consolidated Individual Tax Rates
- ✓ Elimination of Personal Exemptions
- ✓ 20% Corporate Tax Rate
- ✓ 25% Pass-through tax rate
- ✓ Elimination of AMT
- ✓ Possible Elimination of State and Local Tax Deduction
- ✓ Repeal of Federal Estate Tax
- ✓ Repatriation Tax Break
- ✓ Move to Territorial Tax System

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### SPECIAL REPORT

## Proposal Calls for Big Individual and Business Tax Cuts, and More

The Trump administration and Congressional GOP leadership have unveiled a tax reform outline, the “Unified Framework for Fixing Our Broken Tax Code.” The framework calls for dramatic tax cuts and simplification: lower individual tax rates under a three-bracket structure, nearly doubling the standard deduction, and a significant reduction in the corporate tax rate; along with changing the tax treatment of pass-throughs, expanding child and dependent incentives, and more. Both the alternative minimum tax and the federal estate tax would be eliminated. According to the proposal, the framework is designed to serve as a template for Congress to develop legislation through the committee process. This Briefing presents a high-level overview of the GOP’s proposals.

**IMPACT.** *At this time, the framework is just a proposal. No legislative language has been revealed. The framework builds on a broader “outline” the Trump administration released in April, 2017. Both the April outline and the new framework bear similarities to the House GOP “blueprint” released in July, 2016. Regarding a timeline, Administration officials predicted at the time of the release of the first proposal that tax reform “will not slide into 2018,” and many members of Congress have echoed that sentiment in the intervening months.*

**IMPACT.** *If a tax reform package moves in Congress under the reconciliation rules, which require only a Senate majority, the tax cuts would likely have to sunset after 10 years. Treasury Secretary Steven Mnuchin said that the White House would prefer permanent tax reforms but “if we have it for 10 years, that’s better than nothing.”*

## INDIVIDUALS

### Tax Rates

The framework calls for replacing and lowering the current individual tax rates with a new, three-bracket structure: 12, 25, and 35 percent. Under current law, individual income tax rates are 10, 15, 25, 28, 33, 35, and 39.6 percent.

**COMMENT.** *The House GOP Tax Reform Blueprint contained a similar three-bracket structure of 12, 25, and 33 percent. The new framework does*



*leave open the possibility of an additional fourth income tax rate meant to “ensure that the reformed tax code is at least as progressive as the existing tax code and does not shift the tax burden from high-income to lower- and middle- income taxpayers.”*

**“The framework calls for dramatic tax cuts and simplification.”**

 **IMPACT.** *The framework does not include proposed income ranges for the new brackets. This makes it difficult to determine whether taxpayers would see an increase or decrease in their effective rate even taking into account the effect of a higher standard deduction (discussed below). Only taxpayers currently in the 39.5 percent bracket can be assured that their applicable rate will decrease.*

The framework also calls for the use of a new, more accurate measure of inflation to be used for determining annual increases in bracket ranges, in addition to other tax code amounts.

### Standard Deduction

The President's plan calls for a near doubling of the standard deduction to \$24,000 for married filing jointly and \$12,000 for single filers. The 2017 standard deduction amounts under current law are \$12,700 and \$6,350, respectively, as adjusted for inflation.

 **IMPACT.** *One goal of a higher standard deduction is to simplify tax filing by cutting more than half those taxpayers who would otherwise do better itemizing deductions. Of course, that group would realize less of a tax benefit than those taxpayers who do not now itemize. Additionally, as the framework points out, it effectively creates a more broadly applicable “zero tax bracket” for taxpayers earning less than the standard deduction amount.*

### Deductions

The framework would appear to eliminate all individual itemized tax deductions except for the mortgage interest deduction and the charitable contribution deduction. The framework would also eliminate “numerous other exemptions, deductions and credits,” including the deduction for

personal and dependency exemptions (discussed below) with an eye towards using the repeal of these tax breaks to make a simpler system and lowering rates overall.

 **IMPACT.** *The loss of many itemized deductions would channel an even greater number of taxpayers to the standard deduction. Big losers may include state and local governments that depend upon the federal itemized deductions for state and local income taxes and real estate taxes as an indirect subsidy for those taxes. Losing the medical expense deduction and the miscellaneous itemized deduction will also prove difficult for some taxpayers.*

 **IMPACT.** *The doubling of the standard deduction would effectively eliminate most individuals from claiming itemized deductions other than high-income taxpayers. For example, if the standard deduction for married filing jointly is \$24,000, then only individuals with mortgage interest and charitable deductions in excess of \$24,000 would claim them as itemized deductions. With fewer individuals claiming those deductions, this could have broad impact on both real estate prices and charitable organizations.*

 **Comment.** *During his campaign, Trump had also proposed a cap on the amount of itemized deductions that could be claimed at \$100,000 for single filers and \$200,000 for married couples filing jointly. Additionally, according to campaign materials, all personal exemptions would be eliminated, as would the head-of-household filing status. These “give-backs” to offset some of the costs of the rate cuts and the higher standard deduction may arise during negotiations on Capitol Hill in ironing out the “details.”*

Despite this proposal to eliminate many deductions and credits, the framework does indicate that unspecified benefits meant to encourage work, higher education, and retirement would be retained.

 **IMPACT.** *It is unclear from the text of the framework what exactly these unspecified tax benefits are, but it may include the earned income credit, the American Opportunity tax credit, deduction for tuition and fees, student loan interest deduction, and deductions and exclusions applicable to retirement savings contributions. Presumably, these details will be hashed out by tax-writing Committees in Congress.*

## Family Incentives

As noted above, the framework would eliminate the deductions for personal and dependency exemptions. This could lead some taxpayers to have higher taxable income even with the doubled standard deduction.

**COMMENT.** Under the inflation adjusted amounts for 2017, a family of four filing a joint return could claim a standard deduction of \$12,700, plus \$16,200 for four personal exemptions of \$4,050. The result reduces adjusted gross income by \$28,900. Under the GOP framework, the standard deduction for married filing jointly is only \$24,000 with no exemptions. The result would be that the family's taxable income would be increased by \$4,900 as compared to 2017 inflation adjusted amounts.

The framework indicates that the child tax credit would be "significantly" increased to help alleviate the discrepancy, though the amount of that increase is not specified. As under current law, the first \$1,000 of the child

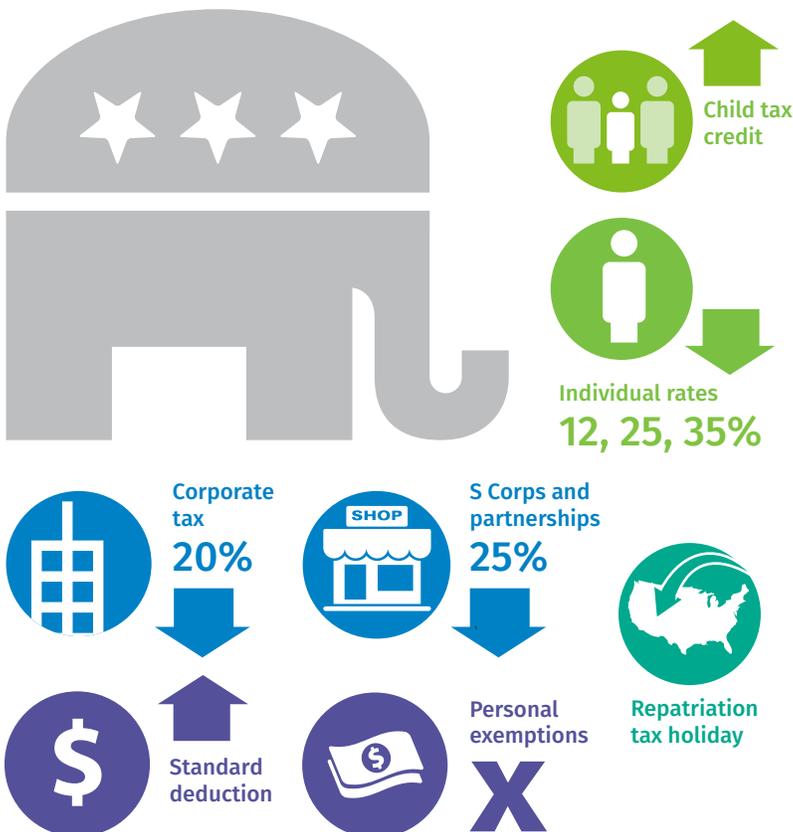
tax credit (the so-called "additional child tax credit") would be a refundable credit. Also, income limitations on the child tax credit (currently \$110,000 married filing jointly, \$75,000 single, and \$55,000 married filing separately) are also proposed to increase.

The framework also provides for a \$500 credit for the care of non-child dependents.

**IMPACT.** Under current law, taxpayers who incur expenses to care for a qualified child or for an incapacitated dependent or spouse to work or look for work may claim a credit of 20 percent to 35 percent of employment-related expenses. Depending upon income level and other factors, this can be as much as \$2,100. It is unclear if the proposed \$500 credit is in addition to the existing child and dependent care credit or a replacement.

**COMMENT.** Trump's campaign proposals had included the creation of a new deduction for child and dependent care expenses, as well as increasing the earned income tax credit (EITC) for working parents who would otherwise not qualify for the deduction. A system of "spending rebates" and "above-the-line" deductions was proposed, as well as Dependent CARE Savings Accounts (DCSAs) with matching government contributions and an expanded credit for employer-provided child care.

## GOP Tax Framework Proposals



## Estate Tax

The President's proposal calls for elimination of the federal estate tax and the generation-skipping transfer tax. The current maximum federal estate tax rate is 40 percent with an inflation-adjusted \$5 million exclusion (\$5.49 million in 2017).

**IMPACT.** During his campaign, Trump also mentioned replacing the estate tax with a carryover basis rule under which beneficiaries must use the decedent's basis in inherited assets rather than their date-of-death values. The framework also does not answer the question of what will become of the gift tax.

## Alternative Minimum Tax

The framework calls for abolishing the AMT, calling it a complicated addition to the tax system that no longer serves its intended purpose. A parallel tax structure, the AMT, has existed for the stated purpose of ensuring that individuals, corporations, estates, and trusts with substantial income do not avoid tax liability. Despite exemptions, it has captured an increasing number of taxpayers to the extent that it forces many individuals “to do their taxes twice to see which is higher,” according to the administration.

 **Comment.** *National Taxpayer Advocate Nina Olson has recommended Congress permanently repeal the AMT. Although it serves as a revenue source, significant tax reform would likely present other options to offset the cost of elimination.*

## BUSINESSES

### Corporate Taxes

The framework calls for a 20-percent corporate tax rate. The maximum corporate tax rate currently tops out at 35 percent. The framework also calls for the elimination of the corporate alternative minimum tax.

### Business Tax Benefits

A number of changes to various business incentives are proposed in the framework. Chief among them is effectively allowing 100 percent bonus depreciation for investments for a five-year period beginning in 2017. Currently, first year “expensing” of capital investments is limited to 50 percent of the cost, gradually stepping down to 30 percent for investments made in 2021.

 **COMMENT.** *The bonus depreciation rate has fluctuated wildly over the last fifteen years, from as low to zero percent to as high as 100 percent. It is often seen as a way to incentivize business growth and job creation. However, most economists have found that bonus depreciation does little in the way of motivating businesses to buy new equipment or property that they would not otherwise have bought; instead, bonus depreciation simply creates an incentive to accelerate already planned purchases to tax years when it is available.*

 **COMMENT.** *Unclear under the framework is the fate of “section 179 expensing,” which is available*

*to small businesses on qualifying used as well as new assets. In perhaps a nod to the special needs of small businesses, the framework states that “the committee may continue to work to enhance unprecedented expensing for business investments, especially to provide relief for small businesses.”*

Additionally, the framework calls for the elimination of the domestic production activities deduction, indicating that manufacturers will no longer need the advantage of this deduction due to the substantial reduction in the corporate tax rate. The framework also calls for a partial limitation of the deduction for net interest expense for corporations, as well as consideration of the appropriate treatment of interest paid by non-corporate taxpayers.

 **COMMENT.** *Although the current maximum corporate tax rate is 35 percent, many corporations now pay an effective tax rate that is considerably less. The President has proposed to eliminate unspecified tax breaks for “special interests,” which would broaden the tax base and largely prevent most businesses from gaining an effective rate much lower than 15 percent.*

The framework leaves both the low-income housing credit and the research and development credit untouched, while leaving open the door for tax-writing committees to retain other business credits. The framework also indicates that certain “special tax regimes” that apply to certain industries should be modernized to reflect economic reality and to prevent the use of these regimes to avoid tax.

### Pass-Through Businesses

Currently, owners of partnerships, S corporations, and sole proprietorships pay tax at the individual rates, with the highest rate at 39.6 percent. The framework proposes a 25-percent tax rate for pass-through income.

 **IMPACT.** *Small business owners, therefore, would see their top tax rate reduced from 39.6 percent to 25 percent under the proposal.*

 **COMMENT.** *The framework, as well as Trump’s campaign materials, also had indicated consideration of rules that would prevent pass-through owners from converting their compensation income taxed at higher rates into profits taxed at the 25-percent level, particular service providers such as accountants, doctors, lawyers, etc. Mnuchin has*

stated that provisions would preclude wealthy owners of large companies from gaming availability of the lower rate.

## INTERNATIONAL

### Repatriation

The framework calls for a one-time tax on repatriated profits at a yet-unspecified tax rate. The blueprint stated that “trillions of dollars” are being held overseas and potential targets for repatriation.

 **COMMENT.** *In 2004, Congress provided that U.S. companies could elect, for one tax year, an 85-percent dividends received deduction for eligible dividends repatriated from their foreign subsidiaries. However, most studies have found that the repatriated earnings did little to create new job growth*

as most corporations used the funds to simply buy back outstanding stock from shareholders.

 **IMPACT.** *The lower corporate tax rate of 20 percent may also provide incentive for businesses not to shift operations overseas going forward.*

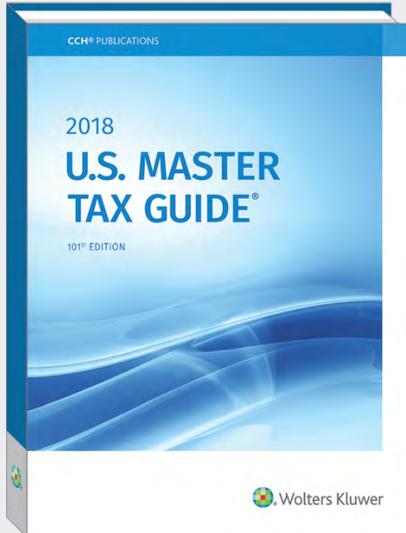
### Territorial Tax Regime

The framework’s repatriation plan is a transitional step to allow movement to a territorial tax regime instead of a worldwide tax regime. Under this territorial tax regime, domestic parent corporations would be entitled to a 100 percent “exemption” of dividends received from 10 percent-owned foreign subsidiaries.

 **COMMENT.** *“A territorial system means U.S. companies will pay tax on income related to the U.S.,” Mnuchin said. “U.S. companies will not be subject to worldwide income,” he added.*



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