Trump Administration FY 2018 budget highlights tax reform effort

May 23, 2017

In brief

The Trump Administration today released a $4.1 trillion FY 2018 budget proposal to Congress that proposes to balance the federal budget over 10 years by promoting economic growth through tax reform, regulatory relief, and infrastructure investments, and by significantly reducing federal spending. The President's budget assumes that tax reform and other policy changes will help to increase US economic growth to 3 percent annually, up from the 1.9-percent annual growth projected by the Congressional Budget Office (CBO) and the 2.0-percent Blue Chip projection. The budget proposes to reduce federal spending by $3.6 trillion over 10 years.

The President's FY 2018 budget assumes "deficit neutral tax reform, which the Administration will work closely with Congress to enact." The budget does not provide additional details on the tax reform principles announced on April 27, 2017 by Administration officials. The Administration's tax reform principles call for lowering business tax rates to 15 percent, moving to a territorial tax system from the current worldwide US tax system, enacting a one-time repatriation tax on the accumulated foreign earnings of US companies, and repealing "most special interest tax breaks." The Administration's reform principles also call for moving from seven to three individual tax brackets, with rates set at 10 percent, 25 percent, and 35 percent; lowering the top investment tax rate to 20 percent, after repeal of the 3.8-percent net investment tax; and increasing the standard deduction. The principles also call for repeal of the estate tax and the corporate and individual alternative minimum tax, and for protecting home ownership, charitable giving, and retirement saving.

The President's budget assumes repeal of the 3.8-percent net investment tax, budget savings from Medicaid spending reductions, and other tax and health care policy changes proposed in the House-passed "American Health Care Act." The Congressional Budget Office on May 24 is scheduled to release an official cost estimate for the House bill. Senate Republican have been meeting to discuss potential changes to the House-passed health care bill in an effort to reach agreement on a version of the legislation that can pass the Senate. The House and Senate would still need to agree on a final version of legislation to repeal and replace the 2010 Affordable Care Act (ACA).

A series of Congressional hearings will be held on the President's FY 2018 budget. The House Ways and Means Committee today held a tax reform hearing that focused primarily on the border adjustment tax proposal of the House Republican tax reform Blueprint released in June 2016. The Ways and Means Committee on May 18 held a hearing on tax reform and economic growth and is expected to hold a series of tax reform hearings in advance of releasing tax reform legislation. Senate Finance Committee members also met recently with Administration officials to discuss tax reform.

In detail

President Trump's FY 2018 budget proposal seeks to balance the federal budget in 10 years through a combination of policies that would increase economic growth and reduce federal spending. The President's budget assumes that increases to the federal deficit will be limited to $3.1 trillion over the next 10 years, and a small budget surplus will be achieved by 2027.

By contrast, the CBO currently projects that federal deficits will increase by $9.4 trillion over the next 10 years under a current-law budget baseline. CBO has projected that deficits could increase by $11.4 trillion over the same period under alternative assumptions that include permanent extension of expiring tax provisions, elimination of Budget Control Act spending caps, and the repeal of postponed health taxes.

In a statement, White House Office of Management and Budget (OMB) Director Mick Mulvaney noted that the President's budget does not propose changes to Social Security or Medicare. The budget instead calls for achieving budget savings through changes to Medicaid, regulatory reforms, welfare reforms, and changes to various mandatory and discretionary spending programs.

For example, the budget assumes $193 billion in savings over 10 years from changes to federal food assistance programs that include new work requirements and other changes to eligibility standards. The budget also assumes $40 billion over 10 years in savings from reforms of the earned income tax credit and the child tax credit.

At the same time, the President's budget proposes to increase defense spending and calls on Congress to provide an additional $2.6 billion for border security and immigration enforcement in FY 2018, with $1.6 billion to be spent on a border wall.

Overall, President Trump's FY 2018 budget would reduce federal spending significantly below the historical average of the past 50 years. As shown in the chart below, federal outlays have averaged 20.3 percent of GDP over the past 50 years, while revenues have averaged 17.4 percent of GDP over the same period. President Trump's budget would reduce federal outlays to 18.4-percent of GDP by 2027, at a time when CBO currently is projecting outlays to increase to 23.4-percent of GDP, primarily due to increases in health care outlays and Social Security spending for an aging population.

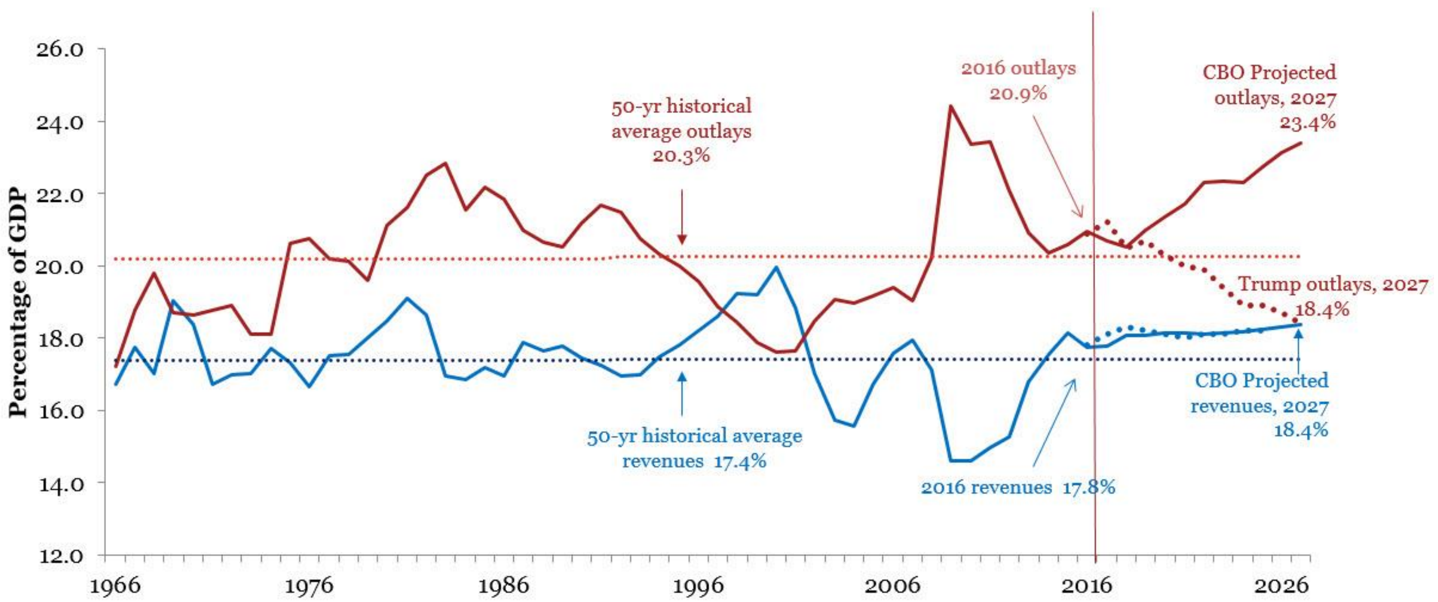
At the same time, President Trump's budget assumes federal revenues will grow roughly in line with the CBO's projections of revenues at 18.4 percent of GDP by 2027.

For official White House details on the President's budget, click here.

Next steps for the budget

Congress will hold a series of hearings on the President's FY 2018 budget before the House and Senate begin to draft their own budget plans.

The House and Senate cannot adopt a new FY 2018 budget resolution until final action is taken on ACA repeal and replacement legislation. The House and Senate are relying on the current FY 2017 budget resolution to advance the House-passed "American Health Care Act." The FY 2017 budget resolution included budget reconciliation procedures that allow the Senate to pass a health care bill



Source: Congressional Budget Office, *The Budget and Economic Outlook: 2017 to 2027* (January 2017); Administration Budget, May 2017; PwC calculations.

with a simple majority, instead of the 60 votes generally required. Senate Republicans currently have a 52-seat majority.

House and Senate Republicans hope to secure the votes for a new FY 2018 budget resolution that will provide budget reconciliation instructions for tax reform.

Tax reform efforts

Treasury Secretary Steven Mnuchin and White House National Economic Council Director Gary Cohn were on Capitol Hill last week for private meetings with Republican leaders and members of the House and Senate tax-writing committees to discuss tax reform. In particular, they held May 17 meetings with Ways and Means Republicans and both Republican and Democratic members of Finance Committee. Administration officials have indicated that they will continue to meet with members of Congress and other tax reform stakeholders.

House Ways and Means Chairman Kevin Brady (R-TX) has begun holding a series of series of hearings on the House Republican Blueprint. The first hearing was held on May 18 and focused on the potential for tax reform to increase economic growth.

The Ways and Means Committee hearing held today focused primarily on the Blueprint's border adjustment tax proposal. At the hearing on increasing US competitiveness and preventing American jobs from moving overseas, Chairman Brady called for tax reform that would lower the corporate tax rate, encourage repatriation of foreign earnings, and end the "made in America" tax by adopting a border adjustment provision that would tax imports and exempt exports in a new destination-based cash flow business tax system.

Chairman Brady acknowledged that there were "legitimate" concerns about how consumers and retailers will be affected by the border adjustment proposal, and committed to move forward with the Blueprint in a thoughtful manner that would provide transition rules and other modifications to address concerns that have been raised.

Ranking Member Richard Neal (D-MA) called the border adjustment tax proposal "interesting" and expressed a willingness to consider "outside the box" ideas. At the same time, Rep. Neal said the border adjustment tax raises a number of important questions, including the impact on consumer prices, concerns about whether currency exchange rates would fully adjust to offset the tax, World Trade Organization (WTO) compliance issues, the potential for creating winners and losers, and the impact on small businesses. Democrats on the committee also repeated their insistence that comprehensive tax reform focus on providing help for middle-class families.

The panel of witnesses expressed their views on US competitiveness and the effect of a border adjustment tax. The CEO of a major US retailer warned that the border adjustment tax would undermine the pro-growth principles in the Blueprint. He said families would face an increase in consumer prices of up to 20 percent on essential items, including groceries and gas. The former CEO of another major US retailer testified that if "properly implemented," border adjustment tax would be in the best interest of the country and would help rebuild American manufacturing. He said that the concerns of the retail industry are real, but could be addressed through transition rules, and that retailers would need to have input on how to transition to the new system. He suggested a long implementation period and a phase-in approach.

While most of the Ways and Means Republicans expressed support for the border adjustment tax provision, a few indicated that they could not support the provision in its current form.

During the hearing, one Ways and Means Committee Democrat cited press reports of Treasury Secretary Mnuchin expressing concerns that the border adjustment proposal does not create a playing field for some businesses.

For more on the House Republican Blueprint, see our WNTS Insight "House Republican Blueprint: A destination based cash-flow tax."

The Senate Finance Committee is expected to produce its own version of tax reform legislation. A number of Senate Republicans have expressed concerns or opposition to the border adjustment tax proposal. In a recent interview, Senate Majority Leader Mitch McConnell (R-KY) said that there probably are not the votes to pass proposal in the Senate.

The takeaway

The Trump Administration's budget reaffirms the central role of tax reform in the Administration's plan for pro-growth policies to help reduce federal budget deficits. Nonetheless, there are difficult policy issues to resolve if Congress is to enact a sustainable reform of the US tax laws and provide a more competitive tax system for business taxpayers.

Additional information

For more details on key tax reform issues, including federal budget issues affecting tax legislation, see PwC's "2017 Tax Policy Outlook – Decision Time for Tax Reform."

Let's talk

For a deeper discussion of how this might affect your business, please contact:

Tax Policy Services

Pam Olson
(202) 414-1401
pam.olson@pwc.com

Rohit Kumar
(202) 414-1421
rohit.kumar@pwc.com

Scott McCandless
(202) 312-7686
scott.mccandless@pwc.com

Todd Metcalf
(202) 346-5119
todd.metcalf@pwc.com

Larry Campbell
(202) 414-1477
larry.campbell@pwc.com

Don Carlson
(202) 414-1385
donald.g.carlson@pwc.com

Janice Mays
(202) 312-7589
janice.a.mays@pwc.com

Andrew Prior
(202) 414-4572
andrew.prior@pwc.com

National Economics & Statistics

Drew Lyon
(202) 414-3865
drew.lyon@pwc.com

Peter Merrill
(202) 414-1666
peter.merrill@pwc.com