Tax Insights
from Washington National Tax Services

Trump Administration officials announce tax reform principles

April 26, 2017

In brief

Treasury Secretary Steven Mnuchin and White House National Economic Council (NEC) Director Gary Cohn today unveiled Trump Administration principles (Principles) for tax reform that call for lowering business tax rates to 15 percent. The Principles also call for moving to a territorial tax system from the current worldwide US tax system, and for enacting a one-time repatriation tax on the foreign earnings of US companies. Secretary Mnuchin stated that the specific rate for a repatriation tax would be the subject of negotiations with Congress.

The Principles call for moving from seven to three individual tax brackets, with rates set at 10 percent, 25 percent, and 35 percent. During his campaign, President Trump first proposed lowering the current 39.6-percent top individual rate to 25 percent before proposing a top rate of 33 percent for individuals.

The Principles call for doubling the standard deduction; repeal of the alternative minimum tax; repeal of the estate tax; and expanded tax credits for child and dependent care expenses. The Principles would restore a top investment tax rate of 20 percent for capital gains and qualified dividends by repealing the 3.8-percent net investment income tax that was enacted as part of the Affordable Care Act.

An Administration one-pager states that "targeted tax breaks that mainly benefit the wealthiest taxpayers" would be eliminated, but the deductions for mortgage interest and charitable donations would be protected. For business, "tax breaks for special interests" will be eliminated. Secretary Mnuchin has said that most of the revenue cost associated with President Trump's tax reform proposals would be offset by increased economic growth.

In detail

Treasury Secretary Mnuchin and NEC Director Cohn said that the Administration is in active talks with House and Senate leaders on how best to advance specific tax reform legislation. The Administration outline states that "throughout the month of May, the Trump Administration will hold listening sessions with stakeholders to receive their input" and will continue working with the House and Senate "to develop the details of a tax plan that provides massive tax relief, creates jobs, and makes America more competitive – and can pass both chambers."

Republican Congressional leaders today welcomed the White House tax reform principles as "critical guideposts" for Congress and the Administration as they work together to advance tax reform legislation.

Temporary tax cuts versus permanent tax reform

The Trump Administration provided no estimates for the cost of enacting the level of business and individual rate reductions outlined today.

House and Senate Republican leaders have cautioned that any final tax reform legislation will need to be revenue neutral (against a current policy baseline) after taking into consideration "dynamic" estimates of economic growth if business and individual rate reductions and other structural tax reforms are to be permanent and not temporary.

Senate Majority Leader Mitch McConnell (R-KY) has said he expects tax reform will need to be considered in the Senate using budget reconciliation procedures that allow legislation to be approved with a simple 51-vote majority, instead of the 60 votes generally needed to advance legislation. Republicans currently have a 52-seat majority in the Senate.

Ensuring compliance with Senate budget reconciliation procedures could be critical to the prospects for enacting permanent tax reform legislation. While tax legislation considered under reconciliation can lose revenue within the period covered by a budget resolution (typically ten years), Senate rules require that reconciliation bills not add to the federal deficit in future decades beyond the budget window.

Tax reform legislation that increases federal budget deficits in future decades would need to clear a 60 vote point of order to pass the Senate. Absent 60 votes, measures would have to be taken to prevent the future federal budget deficits. For example, the 2001 and 2003 tax cuts enacted during the Bush Administration included an automatic sunset provision. Alternatively, an offsetting tax increase could be designed to take effect at the end of the budget window in order to offset the future deficits.

Senator McConnell has expressed skepticism that Senate Democrats will agree to the level of tax rate reductions supported by Congressional Republicans, and he has noted the current political environment is very different from 1986 when President Ronald Reagan signed tax reform legislation passed by a Democratic-controlled House and Republican-led Senate.

Senate Minority Leader Charles Schumer (D-NY) has stated that Democrats in Congress want to work with President Trump on pro-growth tax reform and to rebuild US infrastructure, but would oppose reform legislation that increases federal budget deficits. Many Congressional Democrats also have expressed specific concerns about Republican proposals to lower significantly income tax rates for upper-income individuals.

Continuing ACA repeal and replacement effort complicates timeline for tax reform effort

President Trump has continued to call for action on ACA repeal and replacement legislation after a recent House effort failed when a scheduled vote was cancelled due to disagreements among House Republicans. GOP Congressional leaders are relying on an FY 2017 budget resolution that provides budget reconciliation instructions for ACA repeal and replacement legislation.

Congressional leaders would like to complete work on ACA repeal and replace legislation before the House and Senate pass a new FY 2018 budget resolution providing instructions for tax reform legislation. This is because approving a new FY 2018 budget resolution would invalidate the FY 2017 reconciliation protections that Senate Republicans are relying on to pass ACA repeal and replace legislation.

Administration officials have been talking with House Republican members of the conservative "Freedom Caucus" and more moderate House Republicans to see if an agreement can be reached on an ACA repeal and replacement bill that could pass the House. If House Republicans can pass a revised ACA repeal and replacement bill, Senate Republicans could face their own challenge to secure the votes for a Senate version of such legislation. Both the House and Senate ultimately would need to agree on a final version of ACA repeal and replacement legislation and secure the votes in each chamber to clear a final bill to President Trump.

The most recent version of the House ACA repeal and replace bill (the American Health Care Act) included proposals to repeal most ACA tax provisions, including a tax on health insurance providers, a 2.3-percent medical device excise tax, the 3.8-percent net investment income tax, and a 0.9-percent Medicare health insurance surtax affecting upper-income individuals. Details on the proposed repeal of ACA tax provisions, including effective dates, remain under negotiation. For more on the ACA tax repeal provisions as originally approved by the House Ways and Means Committee, see our PwC Insight.

FY 2018 budget resolution needed to clear path for tax reform

Assuming the FY 2017 budget reconciliation instructions are reserved for ACA repeal and replacement legislation, House and Senate Republicans will need to secure the votes for a new FY 2018 budget resolution to provide budget reconciliation instructions for tax reform.

There may be disagreements among Republicans in Congress on spending levels and deficit reduction goals for the federal government. It remains to be seen how Congressional Republicans will fund President Trump's policy agenda while also proposing to balance the federal budget in 10 years, a goal Republicans have included in past budget resolutions.

Congress at some point this year also must address the need for an increase in the federal debt limit. The statutory debt limit was reinstated on March 16, 2017, but the Treasury Department can use "extraordinary measures" to postpone the need to enact an increase in the limit until later in 2017.

Meanwhile, Congress this week must act on legislation to fund federal departments and agencies beyond April 28, when a short-term FY 2017 spending measure is set to expire.

Congressional tax reform efforts

The Trump Administration tax reform principles differ in key aspects from the House Republican "A Better Way" tax reform blueprint (Blueprint) released in June 2016. The House Republican Blueprint proposes to reduce the 35-percent federal corporate tax rate to 20 percent, establish a new 25-percent rate for certain pass-through business income, and provide a 33-percent top rate for individuals. The Blueprint features a proposed border adjustment tax that has been projected to raise more than $1 trillion over 10 years to help offset the revenue cost of rate reductions. The Blueprint also proposes full expensing for business costs (with no deduction for net business interest expense) under a border-adjustable destination-based cash-flow business tax system. In addition, the Blueprint would eliminate nearly all business tax credits, while retaining the research credit.

In addition to proposing different business and individual tax rates, the Administration tax reform principles do not address the issues of a border adjustment tax, full expensing, or elimination of the net business interest expense deduction.

The Blueprint would move the United States from a worldwide international tax system to a "territorial" dividend-exemption system, and proposes a mandatory "deemed" repatriation tax (8.75 percent for cash or cash equivalents and 3.5 percent for other accumulated foreign earnings).

In response to business groups and a number of House and Senate Republicans who have objected to the border adjustment tax, House Speaker Paul Ryan (R-WI) on April 25 said "we all agree that in its present form it needs to be modified" and steps would be taken to avoid "severe disruptions" that might put importers at a disadvantage.

House Ways and Means Chairman Kevin Brady (R-TX) recently announced plans to hold a series of hearings on the House Republican Blueprint. Chairman Brady and his staff are working to draft bill language based on the Blueprint and have been meeting with stakeholders to seek input on key issues. Chairman Brady also has promised to provide design revisions and transition relief to address concerns over specific elements of the Blueprint.

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

Senate Finance Committee Chairman Orrin Hatch (R-UT) has said that the Senate tax committee is working on its own tax reform plan. Senate Finance Ranking Member Ron Wyden (D-OR) has continued to express hope that tax reform legislation can be enacted with bipartisan support. "Tax reform is always totally, completely and absolutely impossible – bipartisan tax reform – until 15 minutes before it comes together," Senator Wyden said today.

The takeaway

The Trump Administration's release of tax reform principles reaffirms that pro-growth tax reform remains a top priority for President Trump and Congressional Republicans. Despite this commitment to tax reform, there are many 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