



## ML Strategies Legislative Update

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## MLS 2017 Outlook: Tax Reform

This year marks the 30<sup>th</sup> anniversary of the *Tax Reform Act of 1986*, a landmark bill that is recognized as the single largest reform of the U.S. tax code in the nation's history. There seems to be broad consensus, across the political spectrum, that the time has once again come for a new overhaul of the tax code, and the election of a new Republican president who will work alongside a House and Senate with Republican majorities seems to have created the perfect scenario for comprehensive tax reform in 2017.

One of the initial items taken up by the new congress was a first-step in the repeal of Obamacare via the Fiscal Year 2017 budget resolution. The resolution includes tools to allow repeal legislation to move through a fast-track process and pass with a simple majority in the Senate, as in the House; reconciliation instructions to four authorizing committees – Ways and Means in the House, Finance, and Health, Education, Labor, and Pensions (HELP) in the Senate – to achieve at least \$1 billion each in deficit reduction over 10 years (fiscal years 2017 through 2026); suggested deadlines for the authorizing committees to report legislation to the Senate and House Budget Committees by January 27, 2017 (the legislation will be combined for consideration in both the House and Senate); and reserve funds necessary to accommodate legislation to repeal and replace Obamacare, and accommodate patient-centered health care reform legislation in the future.

Senate Majority Leader McConnell said last month that he plans to also move tax reform this year through a second use of the reconciliation process for Fiscal Year 2018 that will include instructions to reduce the deficit through the tax code. While that second budget resolution has been expected sometime in the spring, it now appears to be slipping to later in the year. As with the just-passed budget reconciliation measure for Fiscal Year 2017, it would allow for tax reform to pass with a simple majority as in the House, thereby limiting the likelihood of a Democratic filibuster.

There has been some discussion about addressing tax reform in separate tranches for business and individual tax reform. However, House Ways and Means Chairman Kevin Brady (R-TX) and Senate Finance Chairman Orrin Hatch (R-UT) have both expressed their desire to focus on comprehensive reform.

## **Timeline of Recent Actions on Tax Reform**

Tax reform is a huge undertaking, and the new congress and administration will rely on groundwork that has been done over the past several years as they make decisions about how an overhaul of the tax system may look.

- February 2014 – Tax Reform Act of 2014: A comprehensive draft proposal for tax reform which was released by then-House Ways and Means Committee Chairman Dave Camp (R-MI); the bill would have lowered corporate and individual tax rates and simplified the tax code, but faced wide opposition and was only ceremonially put to the floor at the end of 2014.
- September 2014 – Treasury Actions on Inversion: Treasury Secretary Jack Lew put forward a series of measures designed to reduce benefits of tax inversions, including blocking inverted companies from transferring assets to parent companies and accessing foreign earnings.
- January 2015 – Senate finance Committee Tax Working Groups: The Senate Finance Committee created five tax reform “working groups” on different issues to create proposals for tax reform in the 114<sup>th</sup> Congress. These reports were presented in July 2015; however, there was no consensus or clear plan for reforms.
- July 2015 – Portman/Schumer Plan: Sens. Portman (R-OH) and Schumer (D-NY) proposed a framework to tax all U.S. corporate profits abroad regardless of repatriation, but at a significantly lower rate. The plan was supported by Rep. Paul Ryan (R-WI), but opposed by Senate Majority Leader Mitch McConnell (R-KY), who prefers comprehensive tax reform.
- December 2015 – Consolidated Appropriations Act: Congress dealt with a package of expiring tax credits known as “tax extenders” by making some provisions permanent and extending others. The deal was attached to a must-pass spending bill, ensuring passage.
- February 2016 – President’s FY2016 Budget Request: The request proposed international tax reform in exchange for increased infrastructure spending.
- June 2016 – House Republican’s Tax Blueprint: Ways and Means Chairman Kevin Brady (R-TX) released the House GOP’s tax reform platform, part of Speaker Ryan’s “A Better Way” plan.
- September 2016 – Donald Trump tax plan: Then-candidate Donald Trump released his tax reform plan.

## **Executive Branch Agenda**

According to the non-profit Tax Foundation, the President-elect’s tax plan would make the following changes to the tax code for business and individual tax payers.

### **Business Tax Changes in the President-elect’s proposals:**

- Reduces the corporate income tax rate from the current 35 percent to 15 percent
- Eliminates the corporate alternative minimum tax
- Allows firms engaged in manufacturing in the U.S. to choose between the full expensing of capital investment and the deductibility of interest paid
- Eliminates the domestic production activities deduction (section 199) and all other business credits, except for the research and development credit
- Enacts a deemed repatriation of currently deferred foreign profits, at a tax rate of 10 percent

### **Individual Tax Changes in the President-elect’s proposals:**

- Consolidates the current seven tax brackets into three, with rates on ordinary income of 12 percent, 25 percent, and 33 percent
- Adapts the current rates for qualified capital gains and dividends into the new brackets

- Eliminates the head of household filing status
- Eliminates the Net Investment Income Tax
- Increases the standard deduction from \$6,300 to \$15,000 for singles and from \$12,600 to \$30,000 for married couples filing jointly
- Eliminates the personal exemption and introduces other childcare-related tax provisions
- Taxes carried interest as ordinary income
- Eliminates the individual alternative minimum tax
- Elimination of all itemized deductions except for the mortgage interest deduction and the charitable contribution deduction
- Repeal of the estate and generation-skipping transfer taxes.

### **President-elect Trump's Nominee for Secretary of the Treasury**

The President-elect has named Steve Mnuchin to serve as Secretary of the Treasury. Mr. Mnuchin served as finance chairman of the Trump presidential campaign, and has been heavily involved in the finance sector for many years. For the first 17 years of his finance career, he worked for Goldman Sachs, where he became a partner and eventually served as CIO. After working for Goldman Sachs, he created his own hedge fund, Dune Capital Management LP. Mr. Mnuchin also previously worked as an investment professional at Soros Fund Management, Chairman of CIT Bank, Vice-chairman of ESL Investments, and Director of the Yale Development Board. He has been a major donor to both Republican and Democratic campaigns.

### **Congressional Committee Leadership**

The House Ways and Means Committee will continue to be led by Chairman Kevin Brady (R-TX), with Rep. Richard Neal (D-MA) taking over as Ranking Member for the 115<sup>th</sup> Congress. Rep. Neal was previously the ranking member of the committee's Subcommittee on Tax Policy, which will be chaired by Rep. Roskam (R-IL) this congress, with Rep. Lloyd Doggett (D-TX) taking over as Ranking Member.

Sens. Orrin Hatch (R-UT) and Ron Wyden (D-OR) will continue as Chair and Ranking Member of the Senate Finance Committee.

### **Potential Legislative Activity**

There is some uncertainty as to how tax reform will play out in 2017, but since revenue measures must originate in the House of Representatives, the eventual bill will be based on the tax reform "blueprint" released by the House GOP in June 2016.

Although Senate Republicans have not issued any tax reform proposal of their own, Senate Finance Committee Chairman Orrin Hatch (R-UT) has been meeting with members of the committee to hear their priorities for tax reform.

In June 2016, House Republicans unveiled their "blueprint" for tax reform, which would make significant changes in the tax code for business and individual taxpayers. Titled "A Better Way – Our Vision for a Confident America", the plan will serve as the framework for tax reform in the 115<sup>th</sup> Congress. The plan covers both business and individual taxpayers.

### **Business Tax Provisions in the House GOP Tax Reform Blueprint**

- Reduction of the corporate income tax rate from 35 percent to 20 percent

- Elimination of the Alternative Minimum Tax
- Maximum tax rate of 25 percent for income derived from pass-through businesses
- Full and immediate deductibility of capital investment costs
- Restriction of the deduction for net operating losses to 90 percent of net taxable income
- Creation of a deemed repatriation of corporate profits held offshore at a tax rate of 8.75 percent for cash and cash-equivalent profits and 3.5 percent on other profits
- Modification of all business income taxes to be border-adjustable

#### Individual Tax Provisions in the House GOP Tax Reform Blueprint

- The current seven tax brackets are reduced to four with a maximum rate of 33%
- Repeals the Alternative Minimum Tax
- Reduces tax on investment income, with a 50% deduction of net capital gains, dividends, and interest income, leading to basic rates of 6 percent, 12.5 percent, and 16.5 percent on such investment income depending on the individual's tax bracket
- Continues the earned income tax credit (EITC)
- Simplifies tax benefits for higher education
- Elimination of all itemized deductions except for the mortgage interest deduction and the charitable contribution deduction
- Repeal of the estate and generation-skipping transfer taxes.

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