Client Alert

September 28, 2017

Trump Administration Officials and Congressional Leaders Release "Unified Framework" for Tax Reform

By Nicole Humphrey, Thomas Humphreys, Bernie Pistillo, David Strong, and Brennan Young

On September 27, 2017, a group of top Trump administration officials and key leaders from the House and Senate released an aspirational outline for future tax reform referred to as the "Unified Framework" (the "Framework").[1]

Similar to a one-page plan previously released by the Trump administration back in April,[2] the Framework sets forth a sweeping set of potential tax reform objectives but is lacking in substantive detail. The Framework is also generally consistent with key themes and concepts set forth in the earlier "House blueprint" released by Republicans in June of 2016.[3]

This alert briefly touches on the highlights of the Framework, which Congressional tax-writing committees will be asked to refer to as a template for reform in the coming months as the specific contours of any substantive legislative proposals actually take shape.

INDIVIDUAL REFORM

The Framework proposes a number of changes to the U.S. federal income taxation of individuals, many of which have been present in previous tax plans from the Trump administration and House Republicans.

First, the Framework proposes an increase of the standard deduction to $12,000 for single filers and $24,000 for married taxpayers filing jointly, effectively creating a "zero tax bracket" for taxpayers at or under those thresholds. Second, the Framework would decrease the number of tax brackets from the current seven down to three, consisting of a 12 percent, 25 percent and 35 percent bracket. In an effort to ensure that the reformed Code is at least as progressive as the existing Code, the Framework states that an additional top rate may apply to the highest-income taxpayers. On a related note, the proposal states that it envisions the implementation of a more accurate measure of inflation for indexing tax brackets, but it does not provide further detail of what that might look like.

Third, under the Framework, personal exemptions for dependents will be eliminated, but they will be replaced with increases in the Child Tax Credit and the income levels at which the credit begins to phase out. Fourth, the Framework would eliminate "most itemized deductions," apart from incentives for home mortgage interest and

[1] A copy of the Framework is available online, at https://www.speaker.gov/press-release/unified-framework-fixing-our-broken-tax-code.

[2] A copy of the plan is available online, at http://www.journalofaccountancy.com/content/dam/jofa/news/2017-tax-reform-for-economic-growth.jpg. For a more detailed discussion of the same, please see our Client Alert, available at https://media2.mofo.com/documents/170428-trump-administration-releases-one-page-tax-plan.pdf.

[3] The earlier House plan, entitled "A Better Way: Our Vision for a Confident America," is available at http://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf. For a more detailed discussion of the House Republican plan, see our overview in our quarterly publication, Tax Talk, available at https://www.mofo.com/~/media/Files/Newsletter/2016/08/160805taxtalk.pdf.

charitable contributions.[4] The Framework will also retain tax benefits that encourage work, higher education and retirement.

Fifth, the Framework would repeal the individual alternative minimum tax. Finally, the proposal would repeal the estate tax.

Of note, the Framework does not include the repeal of the 3.8 percent tax on net investment income, which was a feature of earlier plans from the Trump administration and the House Republicans.

BUSINESS REFORM

The Framework also proposes numerous changes that would profoundly reform the U.S. federal income taxation of businesses in the U.S. First, the Framework proposes to reduce the corporate tax rate to 20 percent, down dramatically from the current corporate rate of 35 percent, but higher than the 15 percent listed in the Trump administration's one-page plan from April. In addition, the Framework would aim to repeal the corporate alternative minimum tax. The Framework also includes a new proposed tax rate structure for small businesses, allowing small and family-owned businesses conducted as sole proprietorships, partnerships and S corporations to have a maximum tax rate of 25 percent. Recognizing the potential for abuse, the Framework asks that any legislation for the small business tax rate include measures to prevent the recharacterization of "personal income" to individuals into small business income in order to obtain the lower rate. The details of such measures could be complicated and highly difficult to implement.

Second, the Framework proposes the allowance of a 100 percent immediate deduction by businesses for the cost of new investment in depreciable assets (other than structures) made after September 27, 2017, for a period of at least five years. Third, the Framework proposes that the deduction for net interest expense incurred by C corporations be partially limited. The proposal leaves the treatment of interest paid by non-corporate taxpayers for the committees drafting such legislation to decide.

Fourth, the Framework would eliminate the current deduction for domestic production found in section 199 of the Code on account of the new reduced business tax rates. Further, the Framework explicitly states that tax reform should preserve tax credits for research and development and low-income housing, while repealing other business credits. The proposal also seeks to modernize tax rules affecting specific industries but does not provide details on what industries this statement was intended for.

Finally, the Framework outlines proposals for fundamental changes to the current U.S. international tax regime. In particular, the Framework proposes a change from the current "worldwide" taxation system, which generally taxes all income of U.S. businesses regardless of the country from which the income is earned, to a "territorial tax system," which would generally tax U.S. companies on income earned or sourced in the United States. This would be accomplished by various changes to the existing system, including an allowance for a 100 percent exemption for dividends paid from foreign subsidiaries (in which the U.S. parent owns at least a 10 percent stake). The Framework envisions transitioning to the new territorial tax system by treating foreign earnings accumulated overseas under the old system as repatriated. The tax reform proposal would subject accumulated foreign

[4] The Framework is silent on how these incentives will be maintained with the elimination of itemized deductions. The 2016 plan from House Republicans states that tax reform legislation would look to policies presented by experts and advocates of charitable organizations over the years when developing options to ensure the Code continues to encourage donations, but also does not mention specifics. The House plan did not provide specifics on how to maintain the home mortgage incentive without itemized deductions but states that legislators will attempt to make it more efficient.

earnings held in illiquid assets to a lower tax rate than foreign earnings held in cash or cash equivalents and would allow any repatriation tax liability to be paid over several years. In addition, the Framework seeks to protect the U.S. tax base by imposing a global minimum rate of tax on any foreign profits of U.S. multinational corporations that are earned abroad.

LOOKING AHEAD

President Trump unveiled the Framework at a speech in Indiana. In his speech, he stated that Congress will produce legislation over the next few months, with the goal of passing tax reform legislation before the end of the year. We will continue to provide updates on additional details and developments through further alerts as they arise. In the meantime, if you have questions regarding how the aspirational tax reform concepts set forth in the Framework may potentially affect you or your business operations, please do not hesitate to contact one of the members of the Firm's U.S. federal income tax group.

Contacts:

Nicole Humphrey
(212) 336-4234
nhumphrey@mofo.com

Thomas Humphreys
(415) 268-7041
thumphreys@mofo.com

Bernie Pistillo
(415) 268-7041
bpistillo@mofo.com

David Strong
(303) 592-2241
davidstrong@mofo.com

Brennan Young
(212) 336-4233
byoung@mofo.com

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer*'s A-List for 13 straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.