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ALERT

Tax

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President Releases Tax Reform Framework

On September 27, 2017, the White House and a group of congressional leaders, commonly referred to as the "Big Six", released a joint framework for proposed tax reform. The framework sets out five goals: middle-class tax relief, simplifying tax returns for most Americans, business tax relief, ending incentives to shift jobs and capital overseas, and broadening the tax base to provide greater fairness. In addition to the specific proposals it sets forth, the framework encourages Congress to consider reforms that "improve the efficiency and effectiveness of tax laws." The key specific proposals of the framework include:

Business Tax Reform

- The maximum corporate tax rate would drop to 20 percent. The current maximum rate is 35 percent.
- The framework would eliminate the corporate alternative minimum tax ("AMT").
- Congress is encouraged to consider "methods to reduce the double taxation of corporate earnings," a likely reference to a plan for corporate integration favored by Senator Orrin Hatch, Chairman of the Senate Finance Committee.
- The maximum rate on business income of pass-through entities (sole proprietorships, partnerships, and S corporations) would drop to 25 percent. The framework leaves it up to Congress define "business income".
- Businesses would be permitted to fully expense the cost of new investments in depreciable assets (other than "structures") for a minimum of five years.
- The corporate tax deduction for net interest expense would be subject to an unspecified cap. The framework leaves it to Congress to determine whether to extend the cap to non-corporate taxpayers.
- The credit for domestic production would end, and Congress is encouraged to eliminate other business credits. However, the research and experimentation and low-income housing tax credits would be retained.
- Congress is encouraged to modernize the rules governing the tax treatment of specific industries and sectors to "better reflect[] economic reality" and curb "tax avoidance". Among other things, this could refer to the tax treatment of carried interest.

International Tax Reform

- The framework proposes a territorial system that would exempt 100% of dividends from foreign subsidiaries in which a U.S. parent owns at least a 10% stake. As a transitional measure, foreign earnings that have been accumulated overseas under the current tax regime would be treated as immediately repatriated and subject to tax. The rate of the repatriation tax is not specified, but the framework does provide that the rate would be lower for foreign earnings held in illiquid assets than for foreign earnings held in cash or cash equivalents. Payment of the transition tax liability would be spread over several years.

- A global minimum tax would be imposed, aimed at curbing use of tax havens and preventing erosion of the tax base. The framework also encourages Congress to pass other rules to "level the playing field" between U.S.- and foreign-based companies.
- Significantly, the framework does not contemplate any form of border-adjustment tax.

Individual Tax Reform

- Largely in line with President Trump's original proposal, the framework contemplates three individual rate brackets: 12, 25 and 35 percent. Congress would have leeway to create a higher fourth rate for the wealthiest individuals. The framework does not include income levels for the proposed brackets.
- Labeled as a "zero tax bracket", the personal exemption and standard deduction would be combined into a new standard deduction of $12,000 for individuals and $24,000 for married taxpayers filing jointly. Currently, the personal exemption and standard deduction together are $10,400 for individuals and $20,800 for married couples filing jointly.
- The framework would eliminate most itemized deductions, except for home mortgage interest and charitable contributions. Among other things, the framework would appear to eliminate the deduction for state and local taxes.
- The individual AMT would be repealed.
- The framework calls for simplifying and improving tax incentives that encourage work, higher education, and retirement security. The framework is silent on the recent debate about shifting to a mandatory Roth-like retirement system, which would tax retirement savings up front while exempting all future earnings and distributions.
- The framework would enhance tax benefits for lower- and middle-income working families, by increasing the child tax credit "significantly" and providing for a non-refundable credit of $500 for non-child dependents. The child tax credit is currently $1,000 per child.
- The estate tax would be repealed. It currently applies to estates valued at more than $5.49 million for individuals or $10.98 million for married couples.

The framework is just that, a high-level plan addressing broad goals. It leaves many decisions and details up to Congress. We expect that the House and the Senate will work together on these decisions, including how (or to what extent) they will pay for the full cost of rate cuts. While at this stage timing remains uncertain, Congressional Republicans have said they want to move swiftly, perhaps even by passing legislation by year-end.

The framework can be viewed in its entirety here. To discuss the implications of the framework, or for more information, please reach out to the Tax Reform Group or your regular contact in the Ropes & Gray Tax Group.