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Election 2016: What does it mean for tax policy?

The Dbriefs Federal Tax series

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Agenda

- About the night before last night
- A big picture view of the federal budget
- Setting the stage for 2017: Summarizing the Trump tax plan
- Note that Congress will want to be heard on tax policy... And it won't be with one voice
- Bottom line question: Is tax reform "more likely than not" in 2017?

About the night before last night

Election 2016 — a few initial observations

- **Despite a clear win Trump does not appear to have a strong electoral mandate, since the campaign was “light” on policy**
- **The new President will confront a Congress with its own agenda(s) and political dynamics**

Election 2016 — a few initial observations

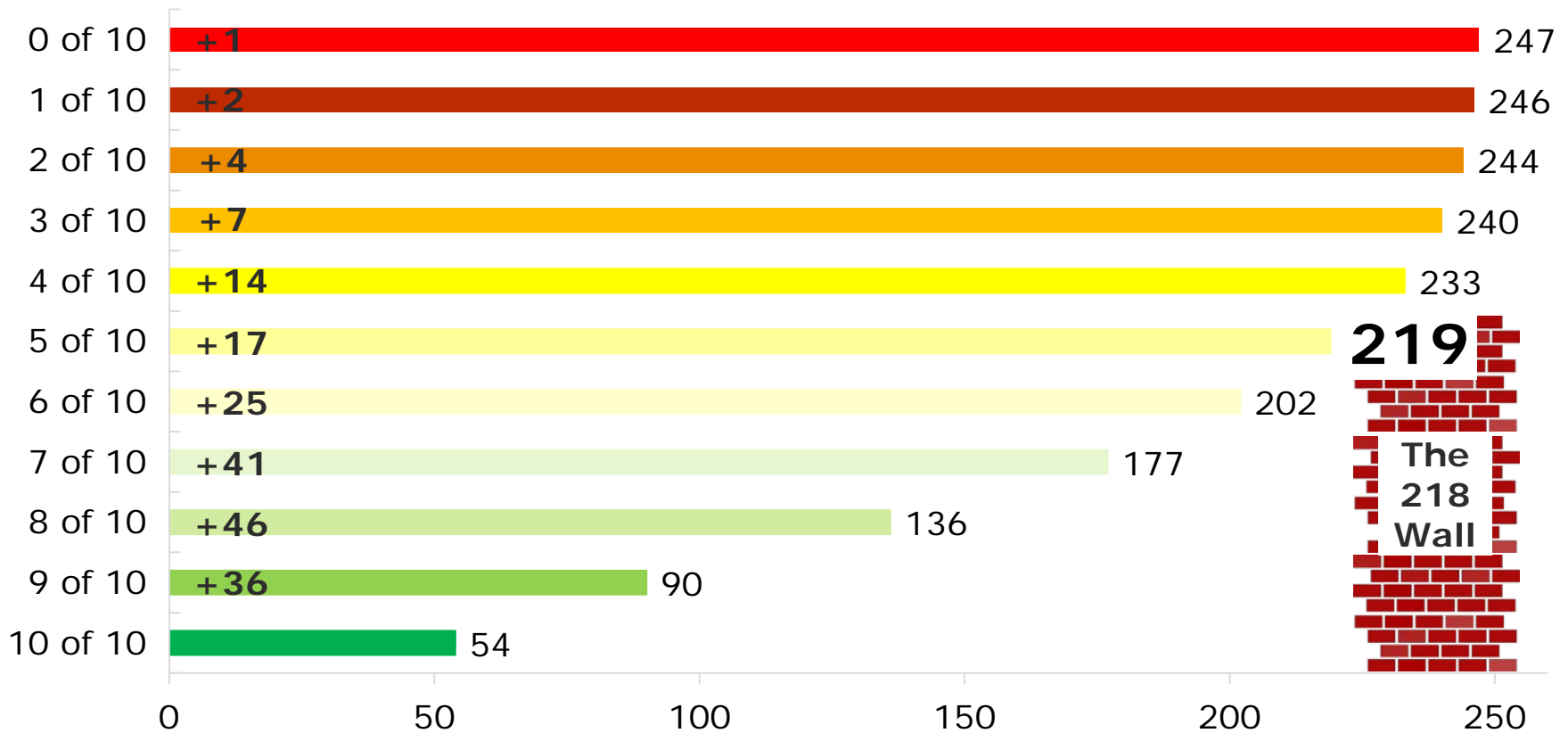
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- **Expected incoming Senate Democratic Leader Chuck Schumer is more open to tax reform than outgoing Democratic leader Harry Reid**
- **However, he faces a daunting map for 2018 and a potentially expanding rift between the progressive and more moderate members of his caucus**

Election 2016 – a few initial observations

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- The new President will confront a Congress with its own agenda(s) and political dynamics
- Expected incoming Senate Democratic Leader Chuck Schumer is more open to tax reform than outgoing leader Harry Reid
- However, he faces a daunting map for 2018 and a potentially expanding rift between the progressive and more moderate members of his caucus
- **In the House, Republicans saw the size of their majority reduced slightly, from 246-186 to 238-193 (with 4 races outstanding)**
 - **This presents further governing challenges even under the best of circumstances**
 - **Those challenges will be made greater because few of the members leaving Congress at the end of this session are from the cohort typically reluctant to follow leadership’s chosen strategy**

New Congress, same challenges

How often House Republicans voted with Leadership on 10 key votes in 2015



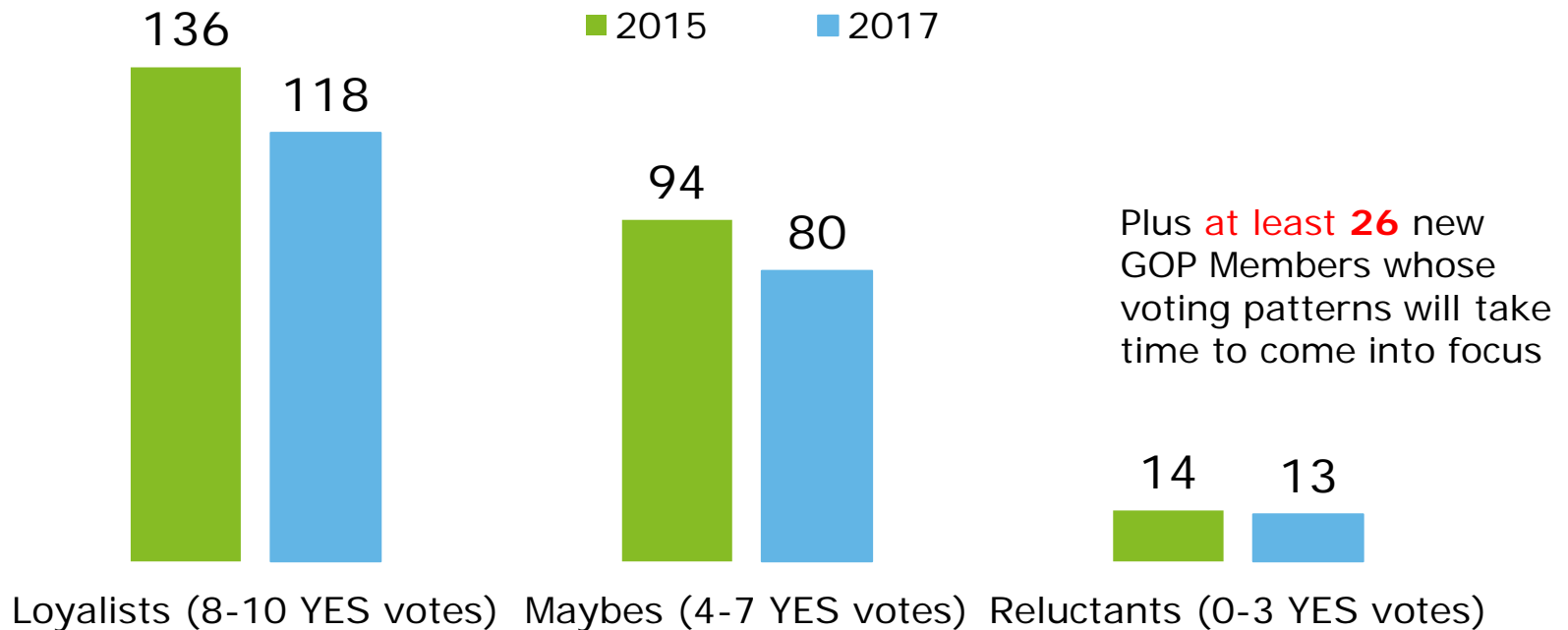
Note: The votes included Omnibus spending, Tax extenders, Long-term highway bill, Ryan for Speaker, Debt ceiling, Continuing Resolution (9/30), Trade Promotion Authority, Budget Resolution, Doc Fix, Short-term DHS funding

Source: Voting data compiled by Bruce Mehlman, Mehlman Castagnetti, and Deloitte Tax LLP

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The math won't get easier

Who is returning to the House GOP next year?



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A big picture view of the federal budget

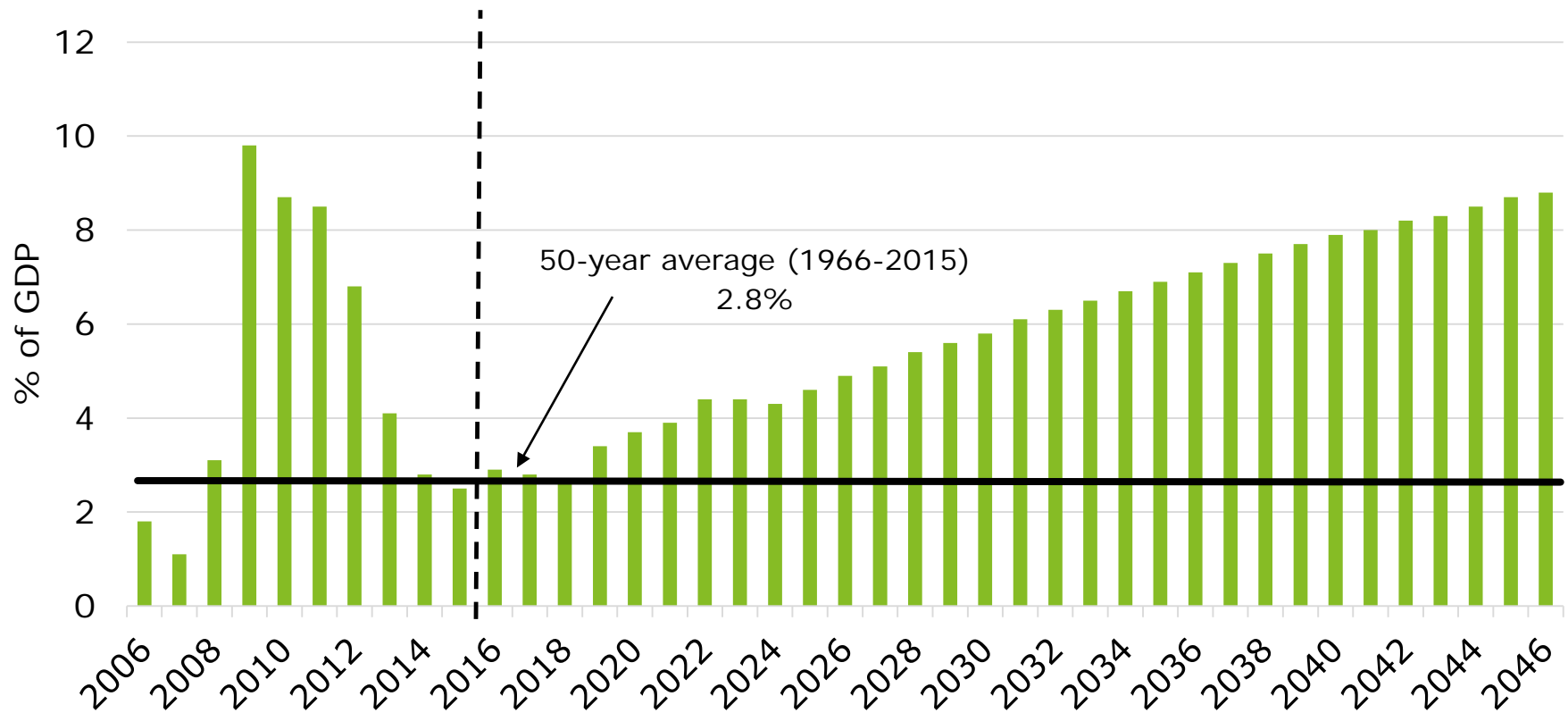
Polling question #1

Which of the following comes closer to describing your views on what should be the priority of US tax reform?

- Focus on international tax reform: Problems with international tax rules that lead to base erosion are serious enough that Congress should act now and leave broader reforms, such as lowering the corporate tax rate, until a later date.
- Focus on corporate tax reform: Tax reform without a cut in the corporate rate is misguided, and Congress should focus on the domestic rate as part of a broader approach to tax reform.
- Focus on comprehensive tax reform: Reform that does not address the taxation of passthroughs is shortsighted and Congress should focus on tax reform benefitting all businesses.
- Don't know / not applicable

Red ink falling but for how long?

Budget Deficits as a Share of GDP



Source: Congressional Budget Office, *Updated Budget Projections: 2016 to 2026* (Mar. 2016), *The 2016 Long-Term Budget Outlook* (Jul. 2016)

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The budget process: Theory and practice

- The President's budget is due by the first Monday in February... but budgets are rarely submitted on time, especially by incoming administrations
 - B. Clinton's first budget submission: April 8, 1993; G.W. Bush's: April 9, 2001; Obama's: May 7, 2009
- A separate debt limit constrains federal borrowing and must be raised or suspended from time to time
 - The current debt limit is suspended until March 15, 2017; "extraordinary measures" by Treasury Dept. may allow Congress to delay acting until sometime in summer 2017
- House and Senate Budget Committees are supposed to report budgets by April 1... but there are no penalties for missing the deadline or even failing to report one
 - Establishes a *spending ceiling* and a *revenue floor* designed to constrain the budget impact of subsequent legislation... but those restraints are often waived or ignored
- Full House and Senate are supposed to agree on a budget resolution by April 15... but delay is common and there are no penalties for failing to do so
 - The budget resolution can be used to make "reconciliation" bills in order – valuable to the majority party, because they are not subject to filibuster in the Senate
- Appropriations Committees use the budget outline to draft 12 bills, which are supposed to be enacted by October 1... but short-term patches and catch-all "omnibus" spending bills are the norm today

Setting the stage for 2017: Summarizing the Trump tax plan

Trump tax plan

Business taxes

Corporate rate	15%
Pass-through rate	15%, but unclear to which entities and income it applies/other restrictions
Corporate AMT	Eliminate
Full expensing	U.S. manufacturers may elect full expensing <i>or</i> interest deductibility; election irrevocable after three years
Interest deduction	
International	<ul style="list-style-type: none">• No changes currently specified to current regime (2015 plan called for retaining current-law worldwide regime and foreign tax credit but repealing deferral)• Deemed repatriation at 10% tax rate

Trump tax plan

Business taxes

Financial products and institutions	Phase out deferral of inside build-up on life insurance contracts for high earners
Energy	No change specified
Employer-provided childcare	<ul style="list-style-type: none">• Increase credit cap to \$500k• Shorten recapture period to five years
Other	<ul style="list-style-type: none">• Repeal Affordable Care Act and all related taxes• Eliminate most corporate tax expenditures except R&D credit

Trump tax plan

Individual taxes

Individual rate	<ul style="list-style-type: none">• New brackets: 12% on <\$75k; 25% on \$75k-225k; 33% top rate on >\$225k• Eliminate 3.8% net investment income tax
Capital gains/Dividends	20% top rate
Carried interest	Ordinary income
AMT	Eliminate
Deductions	<ul style="list-style-type: none">• Standard deduction \$15k/\$30k• Cap itemized deductions at \$200k/\$100k• Eliminate personal exemptions and head of household

Trump tax plan

Individual taxes

Estate & Gift Tax

- Eliminate, but capital gains held until death subject to tax, with first \$10m tax-free
- Disallow “contributions of appreciated assets into a private charity established by the decedent or the decedent’s relatives”

New Tax Benefits

- Deduction for childcare (avg. state cost) and eldercare (inflation-adjusted \$5k cap), for those with income <\$500k/\$250k
- Refundable childcare credit for EITC recipients
- Dependent care savings accounts with 50% government match for low-income families

Trump tax plan

Revenue estimates

Tax Policy Center Static estimate	• Ten-year revenue effect = -\$6.2 trillion
Tax Policy Center Dynamic estimate	• Ten-year revenue effect = -\$6 trillion • Ten-year GDP impact = -0.4%
Tax Foundation Static estimate*	• Ten-year revenue effect = -\$4.4 trillion-\$5.9 trillion
Tax Foundation Dynamic estimate*	• Ten-year revenue effect = -\$2.6 trillion-\$3.9 trillion • Ten-year GDP impact = +6.9%-8.2%

Most impactful provisions

- Corporate rate reduction
- Individual rate reduction
- Repeal of net investment income tax



* Ranges provided because of uncertainty about application of pass-through tax rate

Polling question #2

If Congress were to enact the tax policy of President-elect Trump, what sort of long-term effect would it have on the economy?

- Helpful – Would promote economic growth
- Harmful – Would likely be a net drag on the economy
- Would not have a meaningful impact on the economy
- Not sure / other



**Note that Congress will want
to be heard on tax policy...
And it won't be with one voice**





**House
Republicans**



**House
Democrats**



**Senate
Republicans**



**Senate
Democrats**

House Republicans

Continued focus on tax reform



- House Republicans released a tax reform “blueprint” on June 24, showing where they want to take the debate
- Unlike prior GOP tax plans, which were designed to be good tax policy, the GOP has pivoted into supporting policies designed to create economic growth
 - At every juncture, when forced to choose between two options, the answer seems to be “whichever the economists believe will boost GDP”
 - Poses interesting trade-offs
- With Republicans also controlling the White House and Senate next year, House Republicans can be expected to press hard for action on tax reform; it is one of the few issues that their members are enthusiastic about doing

House Republicans Blueprint summary

Business Tax

- 20% corporate tax rate; 25% rate on pass-through business income
- 100% expensing (rather than depreciation); repeal deductibility of business interest
- Repeal corporate AMT
- R&D credit and LIFO retained; most other business tax credits and deductions assumed to be repealed

International Tax

- Full territorial system (no tax on repatriation of future foreign profits)
- Transition rule that has a deemed repatriation of past foreign profits (8.75% rate on cash and cash equivalents; 3.5% rate on everything else; payable over eight years)
- Border adjustable, which the blueprint says will obviate the need for most base erosion safeguards

House Republicans

Blueprint summary (cont.)

Individual Tax

- Reduce seven tax brackets down to three — 33%, 25%, and 12%
- 50% exclusion for investment income (capital gains, dividends, interest)
- Combine and expand the standard deduction and personal exemption, allowing fewer taxpayers to go through the complexity of itemizing
- Retain, though possibly in a modified form, the deductions for mortgage interest and charitable contributions as well as incentives for savings and education
- Repeal most other individual income tax preferences, including for state and local taxes
- Repeal AMT
- Repeal estate and gift tax

House Democrats

Focused more on “flaws” in the tax code

- Some Ways & Means Democrats seem interested in tax reform and have led the way on discrete parts (e.g., Rep. Richie Neal pairing with GOP Rep. Charles Boustany in 2015 to unveil an innovation box)
- However, the general approach of Ways & Means Committee Democrats is to continue to push for action to address what they say are deep flaws in the tax code
 - Carried interest
 - Inversions and tax benefits available for formerly U.S.-domiciled firms
 - Fossil fuels
 - Etc.
- As the minority party in the House, they have an important role to play in drawing contrasts with the majority but rarely see their ideas enacted into law
- They are unlikely to be supportive of the sort of tax reform that Trump and House Republicans will pursue

Senate Democrats

Have been preparing for 2017

- Like his House counterparts, Senate Finance Committee Ranking Member Ron Wyden has urged Congress to act in the short term on the issue of inversions
- Unlike his House counterparts, he is also working on a broader vision of tax reform, having unveiled one several years ago when he was just a “back-bencher” on the panel
- This year, he has released discussion drafts on three pieces of tax reform as a way to “be in position” in case Clinton won and made tax reform a priority
 - Streamlining depreciation
 - Simplification of financial products taxation
 - Reforming rules for retirement savings accounts
- Incentives for Senate Democrats to push for tax reform are unclear under a Trump presidency

Senate Republicans

Looking at an alternative way of doing tax reform

- Senate Finance Committee Chairman Hatch is working on proposal for “corporate integration”
 - Contours still under development, but generally expected that it would give corporations a deduction for dividends paid while requiring all dividend recipients to pay tax on them at ordinary income rates
 - Recipients subject to full tax, i.e. not at preferred rates, would include not just taxable shareholders but also foreign investors and those individuals who hold stocks in retirement accounts, charities, and pension funds
 - To avoid favoring debt over equity, the proposal is also expected to impose a similar tax regime on recipients of interest payments on corporate bonds
 - Prospects for any action are unclear; Chairman Hatch has so far delayed releasing it in 2016
- In 2017, Senate Republicans are likely to continue to be supportive of tax reform, though they may find themselves pivoting back toward a more “traditional” approach

Bottom line question:
Is tax reform “more likely
than not” in 2017?

Polling question #3

Now that we know who will control the various levers of power in Washington, do you think meaningful tax reform will be enacted in the next four years?

1. Yes
2. No
3. Don't know / not applicable

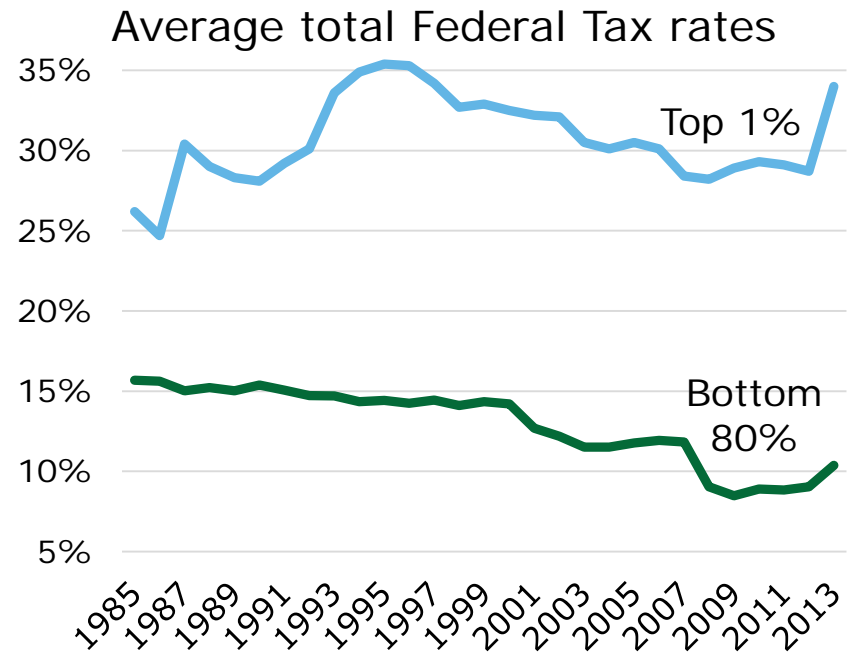
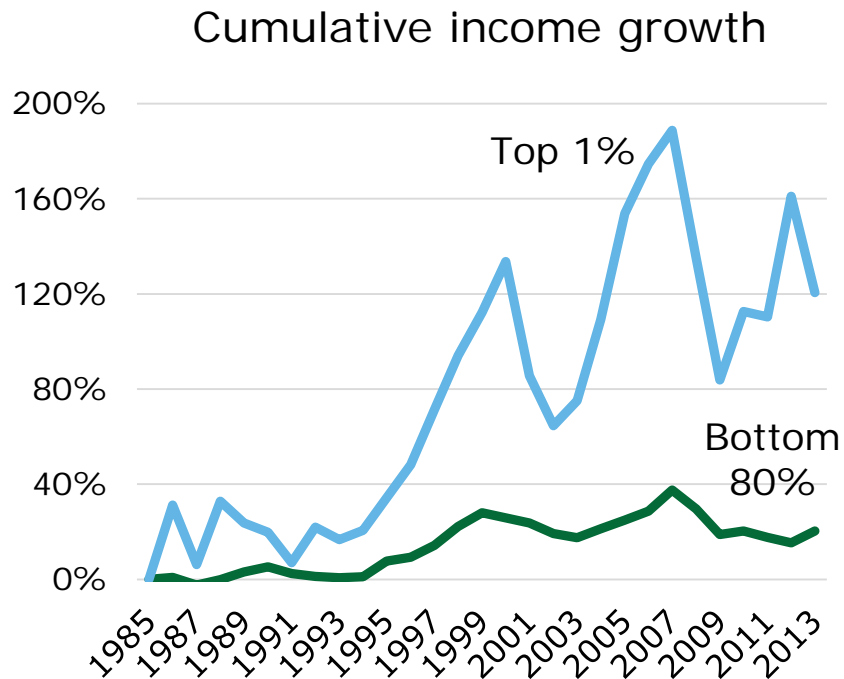
Six reasons to think it could really happen this time

1. There is substantial agreement that the current system — with high corporate tax rates, a narrow tax base riddled with credits and deductions, and an antiquated territorial system — is not sustainable
2. External factors (including inversions, foreign acquisitions of US firms, and the state aid cases in the EU) are imposing real costs on US companies and the Treasury, making it harder and harder to stall
3. Lots of groundwork has been laid
4. Reform is a high priority for Sen. Schumer and Rep. Ryan, so this likely won't fall off leadership's radar
5. In a slowing economy, there will be interest in some kind of stimulus, and highway funding has always had strong bipartisan support; but highways aren't free, and one possible source of funding for a roads and bridges package is a "deemed repatriation" tax on unremitted profits held abroad by U.S. companies
6. Republicans are generally united on the idea of tax reform, and with the executive and legislative branches under the control next year, they may try to enact tax reform under reconciliation

On the other hand, there are at least six reasons to keep expectations in check

1. Parties have real and deep differences over whether tax reform should raise more revenue
2. Parties remain badly divided over whether to reduce the top marginal rate for individuals; relatedly, they have very different views as to whether the tax code should be made more progressive or not

The "Fairness" eye test



Source: Deloitte calculations from Congressional Budget Office (CBO), *The Distribution of Household Income and Federal Taxes, 2013* (June 2016), supplemental data.

Note: For a family of four, the *maximum* income in 2013 of the Bottom 80% was \$165,499; the *minimum* income for a similar household in the Top 1% was \$710,400.

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Broadening the base

More than just “closing loopholes”

Largest Business Tax Expenditures – 2015	\$ Billion	Largest Individual Tax Expenditures – 2015	\$ Billion
Deferral of active CFC income	99.3	Tax-preferred retirement plans	157.4
§199 deduction	11.7	Exclusion of employer-provided health benefits	145.5
Deferral on like-kind exchanges	11.0	Reduced rates on LT cap gains/dividends	131.7
Exclusion for muni bond interest	9.7	Earned Income Tax Credit	72.7
Low-income housing tax credit	7.3	Mortgage interest deduction	71.0
Deferral of gain on installment sales	6.9	State and local tax deduction	62.2
§179 expensing	4.8	Child tax credit	57.1
Expensing of R&D expenditures	4.7	Charitable contribution deduction	45.6
Reduced tax on corporate income below \$10M	4.0	Exclusion of Social Security benefits	37.6
Special treatment of life insurance co. reserves	2.9	Property taxes deduction	32.4
Accelerated depreciation	-20.0*	Exclusion of cap gains at death	32.4

*Accelerated depreciation is a negative expenditure (brings in revenue) in the short term but a revenue loss in the longer term.

Source: Joint Committee on Taxation publication [JCX-141R-15](#), “Estimates Of Federal Tax Expenditures For Fiscal Years 2015-2019,” Dec. 7, 2015.

Broadening the base

The benefits of tax expenditures are not spread evenly

Share of benefit of individual income tax expenditures, by income group

Income Group	Share of Tax Benefit	Notes
Bottom 20%	3.6%	
Second 20%	7.9%	
Middle 20%	10.8%	<i>Middle 60% = 34.5%</i>
Fourth 20%	15.8%	
Top 20%	61.6%	<i>Top 1% = 27.5%</i>

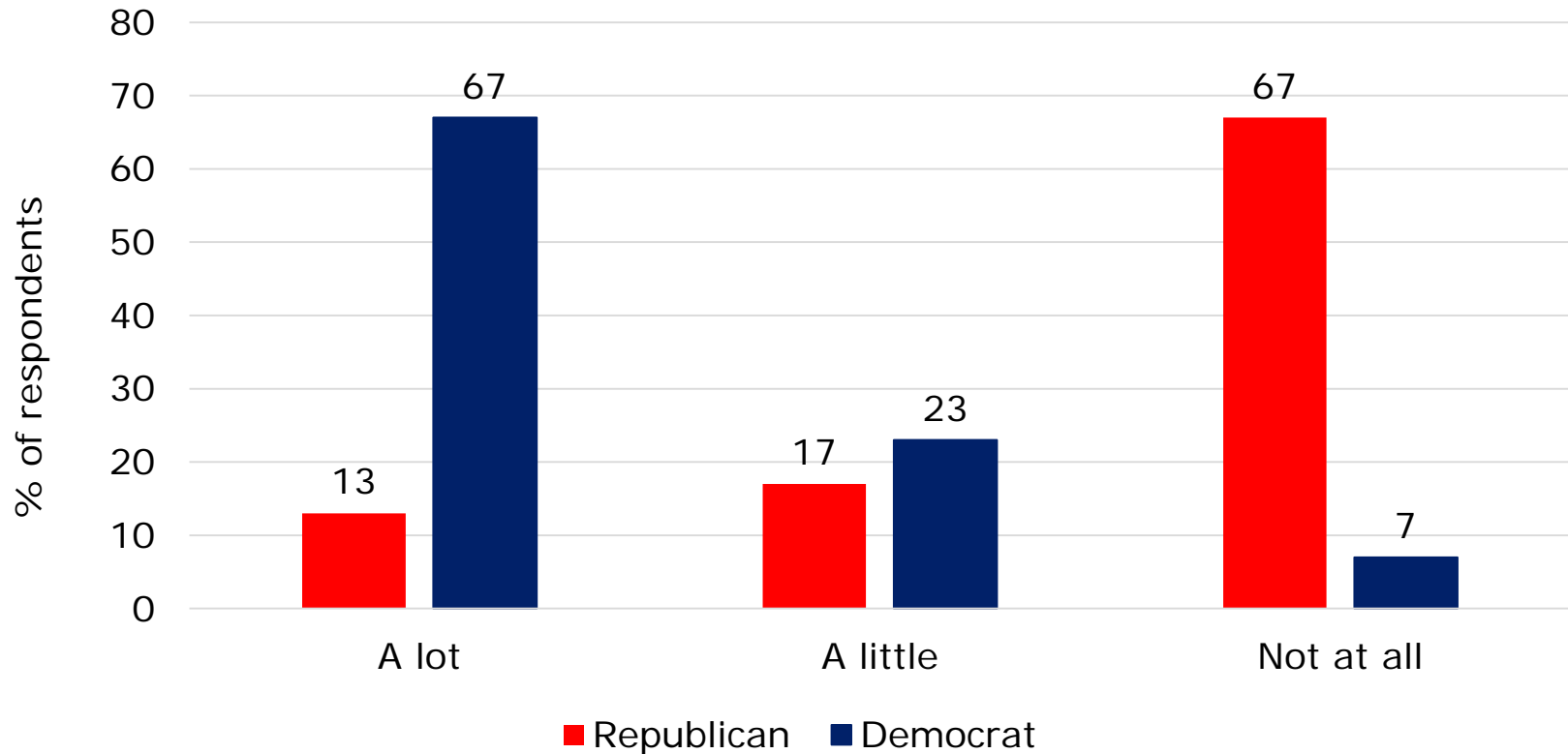
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4. Politics as a whole seems to be broken

The partisan divide

“Plagiarism” is in the eye of the beholder

How much does it bother you that parts of Melania Trump’s speech were taken directly from Michelle Obama’s speech in 2008?

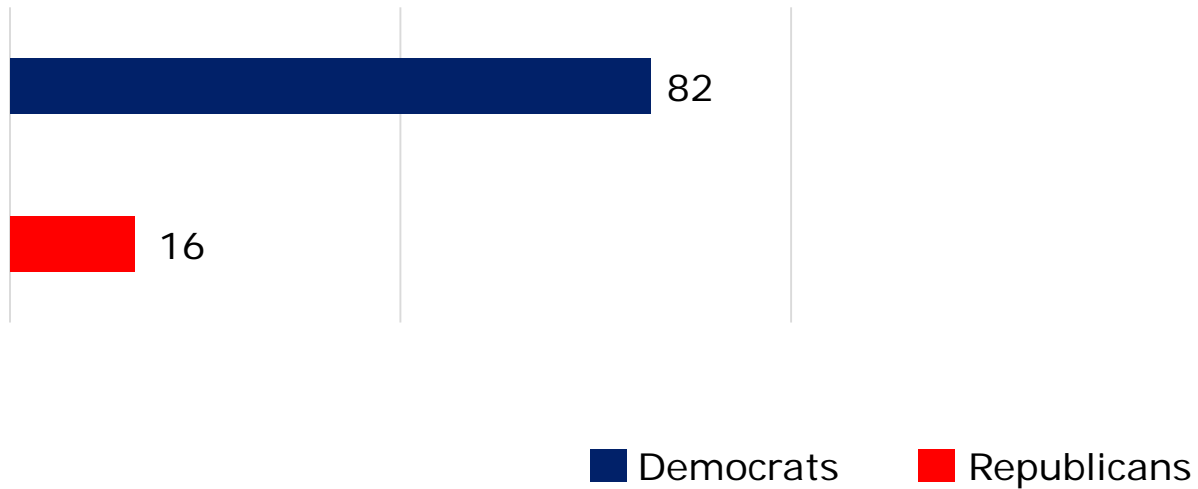


Source: Economist/YouGov poll, July 23-24, 2016; asked of those who watched any part of the Republican National Convention or read or watched news about the convention

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“Anchoring” of political views prevalent

Percent of Democrats and Republicans supporting the idea of universal health care when told that *Barack Obama* supports

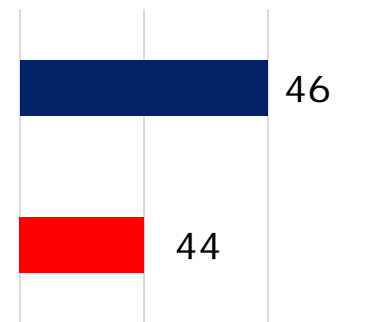


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Percent of Democrats and Republicans supporting the idea of universal health care when told that *Donald Trump* supports



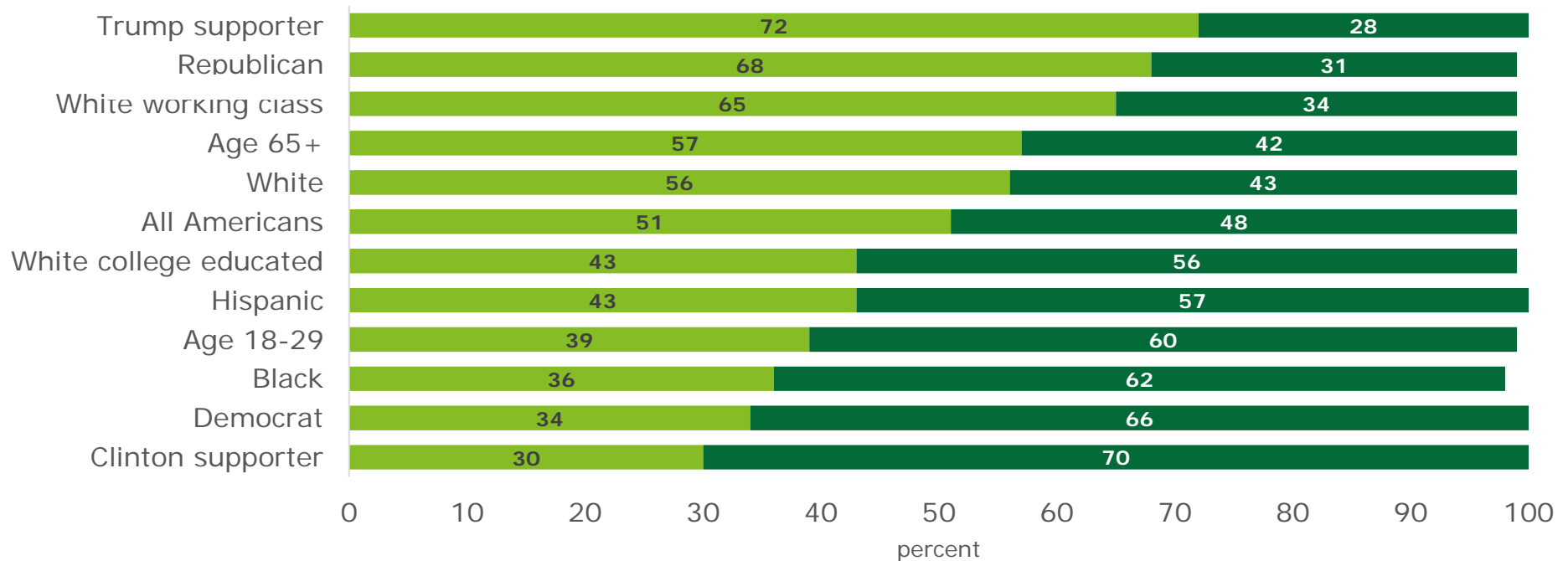
■ Democrats ■ Republicans

The partisan divide

Starkly different views of changes in America

Since the 1950s, do you think American culture and way of life has mostly changed for the better, or has it mostly changed for the worse?

■ Mostly changed for the worse ■ Mostly changed for the better



Source: [PRRI 2016 American Values Survey](#)

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4. Politics as a whole is broken; the system today rewards “purists” not dealmakers
5. You can never rule out the possibility of a “Black Swan” event (natural disaster, financial market turmoil, terrorism, etc.) that could stymie or re-direct the legislative process

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5. You can never rule out the possibility of a “Black Swan” event (natural disaster, financial market turmoil, terrorism, etc.) that could stymie or re-direct the legislative process
6. The House and Senate are more closely divided next year than they are today; that is a recipe for further gridlock in the short-term ...and the 2018 midterm elections are less than 750 days away

Polling question#4

What feature of tax reform do you think will most likely occur in the next Congress?

- Lowering the corporate tax rate
- Expensing of manufacturing equipment
- A simplified code
- International tax reforms
- I don't anticipate any action on tax reform
- Don't know / not applicable

Question and answer

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