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Trump’s Tax Reform Plan – When the Dessert Pays for Dinner

Doubling down on his promise to achieve monumental tax reform, President Trump on April 26 issued a tax reform plan outlining his Administration’s broad aims. Once again, he has made it clear that large-scale tax reform is a high priority, and the Republican majority in Congress appears poised to assume the mantle.

Lacking much specificity, the plan reads like an opening bid. For individuals, the plan proposes the following (including certain points left out of the text but clarified in statements by White House and Treasury officials):

- Reduce the current seven brackets with a top rate of 39.6% to three brackets with a top rate of 35% (10%, 25%, and 35%).
- Double the standard deduction.
- Provide (unspecified) relief for families with child and dependent care expenses.
- Eliminate (unspecified) “target tax breaks that mainly benefit the wealthiest taxpayers,” but protect the home mortgage interest and charitable gift deductions and preserve tax benefits for retirement accounts:
  - State and local tax deductions eliminated.
  - Carried interest still being considered.
- Repeal the alternative minimum tax (AMT).
- Repeal the estate tax (but silent on whether the date of death basis step up will be preserved).
- Repeal the 3.8% Medicare tax on “net investment income,” retaining a top capital gains and qualified dividends rate of 20% (already underway in legislative efforts to repeal and replace the Affordable Care Act).

For businesses, the plan proposes to:

- Lower the business tax rate to 15% (applies to corporations and also, presumably, to pass-throughs).
- Shift from a worldwide to a territorial system of taxation.
- Impose a one-time tax on overseas deferred profits (rate unspecified, but as an indication, Trump's campaign proposal suggested a 10% rate and the 2016 House Blueprint offered an 8.75% rate on cash and cash equivalents and a 3.5% rate on other earnings).
- Eliminate (unspecified) "tax breaks for special interests."

Disallowing interest expense deductions and, in exchange, offering immediate expensing for capital investment—proposed in the 2016 House Blueprint and during Trump's campaign—is absent from the April tax plan. It also leaves out any reference to a border tax, though in the days since its release Trump has reaffirmed his interest in a "reciprocal tax," which would in general impose taxes on imports to match rates that foreign countries charge on U.S. exports (whether such a tax would run afoul of world trade rules remains to be seen). Both proposals, and especially border taxes, are expected to generate significant revenue and (at least partially) offset the cost of tax cuts. As concrete tax reform proposals coalesce in Congress, a reciprocal tax (or a destination-based cash-flow/border adjustment tax akin to that proposed in the 2016 House Blueprint), new deductibility/expensing rules, and any number of other changes could make their way into a tax overhaul package.

Tax reform of this magnitude has two paths through the Senate: Republicans can work across the aisle to secure votes from Democrats or push it through with a filibuster-proof, simple-majority vote using the reconciliation process (as with the Bush tax cuts). Democrats remain staunchly opposed to the Republican proposals, so the latter is the more viable option. However, under the Senate's existing budget rules, to qualify for reconciliation, tax legislation cannot increase deficits beyond 10 years. Due to tax credit carryforwards, even a modest cut to corporate tax rates could increase deficits beyond this budget window. To move ahead on reconciliation, Republicans would likely need to alter the budget rules or methods for scoring, scale back tax cuts, and/or employ additional revenue-raisers, such as border taxes.

The plan's lack of detail suggests that much could change as legislation is crafted, but the ball is rolling on tax reform. Trump Administration officials have already begun to have meetings with members of Congress and other stakeholders. Parts of the April tax plan and other recent tax proposals (such as reciprocal or border adjustment taxes) that are currently being considered in earnest would, if adopted, almost certainly create winners and losers and far-reaching economic impacts.

For more information, please contact Edward Tanenbaum at 212.210.9425 or Danny Reach at 704.444.1272.

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