Comparison of Tax Reform Proposals

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Tax

With the Republican Party now in control of the White House and both houses of Congress, and with both President Trump and GOP Congressional leadership having publicly committed to enacting comprehensive tax reform, Congressional leaders have stated that they intend to take up a tax reform bill later this year. This timing creates an urgent need for clients to understand the key elements of existing tax reform proposals, and how the proposals could affect them.

In this alert, we compare key features of three current GOP tax plans. These include two legislative proposals presented by House Republicans:

- The House Republican Tax Reform Blueprint (the “House Blueprint”);¹ and
- The Tax Reform Act of 2014 (H.R. 1), a tax reform bill drafted and introduced in 2014 by then-Ways and Means Committee Chairman Dave Camp (the “Camp Bill”), many provisions of which are understood to remain under consideration for the upcoming tax reform package.

The third set of proposals we describe are those provided to date by the Trump campaign and the new Administration (the “Trump Proposal”). President Trump stated that he plans to release a comprehensive tax reform plan in the next few weeks.

The Senate continues to develop its approach to tax reform. We will update this alert as new developments occur.

In the charts below we highlight selected elements of the corporate and individual tax proposals that may have the greatest implications for our clients.

## Corporate Tax

<table>
<thead>
<tr>
<th></th>
<th>Trump Proposal</th>
<th>House Blueprint</th>
<th>Camp Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Corporate rate</strong></td>
<td>15%</td>
<td>20%</td>
<td>25%</td>
</tr>
<tr>
<td><strong>International tax system</strong></td>
<td>Worldwide system; no deferral [1]</td>
<td>Territorial system; 100% exclusion [3]</td>
<td>Territorial system; 95% exclusion</td>
</tr>
<tr>
<td><strong>Repatriation tax</strong></td>
<td>10% on previously untaxed foreign earnings</td>
<td>Previously untaxed foreign earnings: 8.75% on cash or cash equivalents; 3.5% on non-cash assets [5]</td>
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</tr>
<tr>
<td><strong>Interest expense</strong></td>
<td>Expense election for manufacturers only [2]</td>
<td>Only to extent of interest income</td>
<td>Limited: 40% ATI under 163(j); worldwide allocation [7]</td>
</tr>
<tr>
<td><strong>Capital expensing</strong></td>
<td>Full capital expensing</td>
<td>n/a</td>
<td></td>
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</tbody>
</table>

### Notes

**Trump Proposal**

1. Under the Trump campaign proposal, profits of foreign subsidiaries of U.S. companies would be taxed each year at the same 15 percent rate applicable to corporate domestic profits. U.S. corporations would no longer be able to defer U.S. taxes by holding profits overseas.

2. Firms engaged in manufacturing may elect to expense capital investment or deduct interest expense but not both. The election is irrevocable after three years.

**House Blueprint**

3. The House plan would enact a territorial tax system, under which dividends from foreign subsidiaries would be exempt from U.S. tax. This territorial system would be coupled with the House’s proposed border-adjusted destination tax (see Note 4, infra).

4. The House plan adopts a cash-flow tax approach for business taxation; it would shift business taxation from an income tax base to a consumption tax base, for example by providing for full expensing of capital expenditures and by eliminating the deduction for net interest expense. The House proposal also would apply border adjustments to imports and exports, principally by denying a U.S. tax deduction for goods and services imported into the U.S., while simultaneously exempting from tax the gross receipts from exports of goods and services. Expenses incurred to generate the export sales would remain deductible (except to the extent attributable to imported goods and services).

The Blueprint states that this border adjustable/destination-based regime is intended to level the playing field with jurisdictions that have value-added taxes. When those countries import U.S.-made goods, those goods are subject to the value-added tax because they are consumed locally. When those countries export goods to the United States, no value-added tax is imposed because the goods are consumed in the United

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States, but the United States does not apply a value-added tax at the federal level. The Blueprint considers this disparate treatment to disadvantage U.S. exports. The Blueprint says that its border adjustments are intended to comply with WTO rules that prohibit export subsidies. Given previous successful WTO challenges to U.S. income tax provisions, such as the foreign sale corporation and extraterritorial income regimes that taxed exports more favorably than domestic sales, we expect significant scrutiny regarding the Blueprint’s WTO compliance.

5. Under the House plan, a 10-percent U.S. shareholder of a CFC or other 10-percent owned foreign corporation would be taxed on its pro rata share of undistributed, non-previously taxed foreign earnings of the corporation. Through the mechanism of a dividends received deduction, this tax would be imposed at an 8.75 percent rate on earnings invested in cash or liquid assets, and at a 3.5 percent rate on earnings invested in other assets.

Camp Bill

6. The Camp Bill would add a new category of subpart F income (“foreign base company intangible income”), defined as the excess of the corporation’s adjusted gross income over 10 percent of the aggregate of the corporation’s adjusted bases in tangible property (other than property used in the production of commodities gross income). This income would be reduced by a 40 percent notional deduction, resulting in a 15 percent statutory tax rate.

7. Under the Camp Bill, interest deductions would be limited to 40 percent of a company’s adjusted taxable income (currently 50 percent under section 163(j)). Further, an interest deductibility limitation would apply to U.S. shareholders of foreign subsidiaries based on the affiliated group’s worldwide debt-equity ratio, preventing disproportionate borrowing by U.S. group members.

Individual Tax

<table>
<thead>
<tr>
<th>TAX REFORM PROPOSAL COMPARISON - INDIVIDUAL TAX</th>
<th>Trump Proposal</th>
<th>House Blueprint</th>
<th>Camp Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital gains rate</td>
<td>20% rate</td>
<td>50% exclusion</td>
<td>40% exclusion</td>
</tr>
</tbody>
</table>

Notes

Trump Proposal

1. Top rate for married-joint filers making over $225,000.

2. The Administration’s position on pass through tax rates is uncertain. In a campaign speech in August 2016, then-candidate Trump seemed to endorse a special 15 percent tax rate on pass through income (i.e., the same rate that would apply to corporations under his proposal). However, in later statements Mr. Trump appeared to back away from such a proposal. Treasury Secretary Mnuchin has indicated that the
Tax Administration’s overall goal is to eliminate (to the extent possible) the disparity in taxation between businesses structured as corporations and those structured as pass-throughs. In the absence of a special tax rate, pass through income would likely be taxed at the individual tax rate.

3. The Trump proposal would increase the standard deduction to $30,000 (joint filers) and $15,000 (single filers). Itemized deductions would be capped at $200,000 (joint filers) and $100,000 (single filers).

House Blueprint

4. The proposed top marginal rate is 33 percent, but the House Blueprint does not specify income thresholds. The Blueprint states that the 25 percent pass through rate will apply only to small business income, but does not specify income thresholds. Under this new approach for taxing small businesses, sole proprietorships and pass-through businesses will pay or be treated as having paid reasonable compensation to their owner-operators. Such compensation will be deductible by the business and will be subject to tax at the graduated rates for families and individuals.

5. The House proposal would increase the standard deduction to $24,000 (joint filers) and $12,000 (single filers), indexed to inflation.

Camp Proposal

6. The proposed top rate of 35 percent is composed of a 25 percent rate plus an additional 10 percent surtax on modified adjusted gross income in excess of $450,000 (joint filers) and $400,000 (single filers).

7. Under the Camp proposal, pass-throughs with qualifying manufacturing income could exclude qualifying income from the 10 percent surtax on such income. See Note 6, supra. Therefore, qualifying manufacturing income would face a top rate of 25 percent, and all other types of pass through income would face a top rate of 35 percent.

8. The Camp proposal would increase the standard deduction to $22,000 (joint filers) and $11,000 (single filers), indexed to inflation.

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If you have any questions concerning the material discussed in this client alert, please contact the following members of our Tax Practice Group:

Ed McClellan +1 202 662 5313 emcclellan@cov.com
Rob Culbertson +1 202 662 5004 rculbertson@cov.com
Dirk Suringa +1 202 662 5436 dsuringa@cov.com

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