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Trump Tax Reform Proposal

April 27, 2017

Tax

On April 26, 2017, U.S. Treasury Secretary Steven Mnuchin and National Economic Council Director Gary Cohn introduced the Trump Administration's tax reform proposal (the "Trump Proposal") in a briefing. The proposal appears to borrow heavily from the tax reform plan put out by Mr. Trump during his presidential campaign with the significant exception that this reform proposal advocates adoption of a territorial tax system.

The proposal, set forth in a bulleted one-page document, was notably short on details, and Secretary Mnuchin stated that many details will be finalized in subsequent discussions with Congress. Below, we highlight the major components in the Trump Proposal that we anticipate will be of the greatest interest to our clients.

Major Proposals

Reduce the Number of Individual Tax Rate Brackets

Under the Trump Proposal, the top rate for individual income tax would go down to 35 percent from its current rate of 39.6 percent (which is above the top rate of 33 percent proposed by Mr. Trump during his presidential campaign). The number of tax brackets would also be reduced from seven to three (10 percent, 25 percent, and 35 percent). Effectively, these changes would reduce income tax rates for most individual taxpayers, though no determination has been made on the income levels where these brackets would be set.

Expanded Standard Deduction

The standard deduction for individuals would be doubled under the Trump Proposal, which would effectively create a zero rate for many lower income taxpayers. Additionally, a higher standard deduction would reduce the number of taxpayers who would use itemized deductions, thus simplifying the return filing process for many taxpayers.

Eliminate Most Individual Deductions

Secretary Mnuchin noted that most individual deductions will be eliminated, with the exception of the mortgage interest deduction and the charitable contribution deduction. This change may prove controversial because it repeals the deduction for state and local income taxes.

Other Individual Provisions

Consistent with the Trump campaign's position, the proposal also would repeal the alternative minimum tax, the estate tax, and the Affordable Care Act's 3.8 percent tax on net investment income.

Adoption of a Territorial System

The Administration would also shift the United States to a territorial tax system, a proposal that was also advocated in the House Republican Tax Reform Blueprint (the "House Blueprint")[1] released last year, as a way to "level the playing field" for U.S. companies. A territorial tax system generally would exempt from taxation the foreign earnings of U.S. headquartered companies. This is a significant change from an early Trump campaign position that advocated a worldwide tax system without deferral.

One-time Repatriation Tax

The Trump Proposal includes a one-time repatriation tax on the foreign earnings of U.S. companies, which is consistent with the Trump campaign position. However, in his remarks, Secretary Mnuchin did not give a specific repatriation rate even though the Trump Administration in prior comments has advocated for a 10 percent repatriation rate. This may suggest that the Administration is moving to the House Blueprint's suggested bifurcated rates of 3.5 percent for foreign earnings and profits invested in "hard" assets and 8.75 percent for earnings and profits held as cash equivalents.

15 Percent Business Income Rate and Treatment of Pass-through Entities

The Trump Proposal would impose a 15 percent rate on all business income, including corporations and individuals receiving business income from S corporations, partnerships and other pass-throughs. It is uncertain whether this 15 percent rate will apply to all pass-through income. Secretary Mnuchin has previously stated that the 15 percent business rate would apply to small business income but would not be "a loophole for people that should be paying a higher rate."

No Mention of a Cash-basis Tax System or the Border Adjustability Tax

The Trump Proposal did not contain any discussion of a cash-basis tax system or the border adjustability approach under the House Blueprint. Under the tax reform proposals of the Trump campaign, U.S. manufacturers would have been allowed to elect full and immediate expensing (subject to loss of the interest deduction) or retain current law depreciation and interest deductions. The Trump Proposal did not contain this earlier campaign proposal. On the issue of the border adjustable tax, Secretary Mnuchin noted that the Administration was continuing discussions with the House. Because the Trump Proposal briefing only provided a general overview of the Administration's proposals, it is possible that President Trump could endorse either of these ideas at a later date.

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At this point, it remains unclear how the Trump Proposal will affect the current tax policy debate or the ongoing tax reform process. Given the fast pace of tax reform efforts, we anticipate that we will issue alerts regularly with new developments.

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[1] The House Republican tax reform proposal is formally titled "A Better Way: A Pro-Growth Tax Code for All Americans." The full document is available at https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf.

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

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