TAX FOUNDATION
Since 1937

Federal Tax Reform and Its Impact on the States

www.TaxFoundation.org

Tax Reform 2017

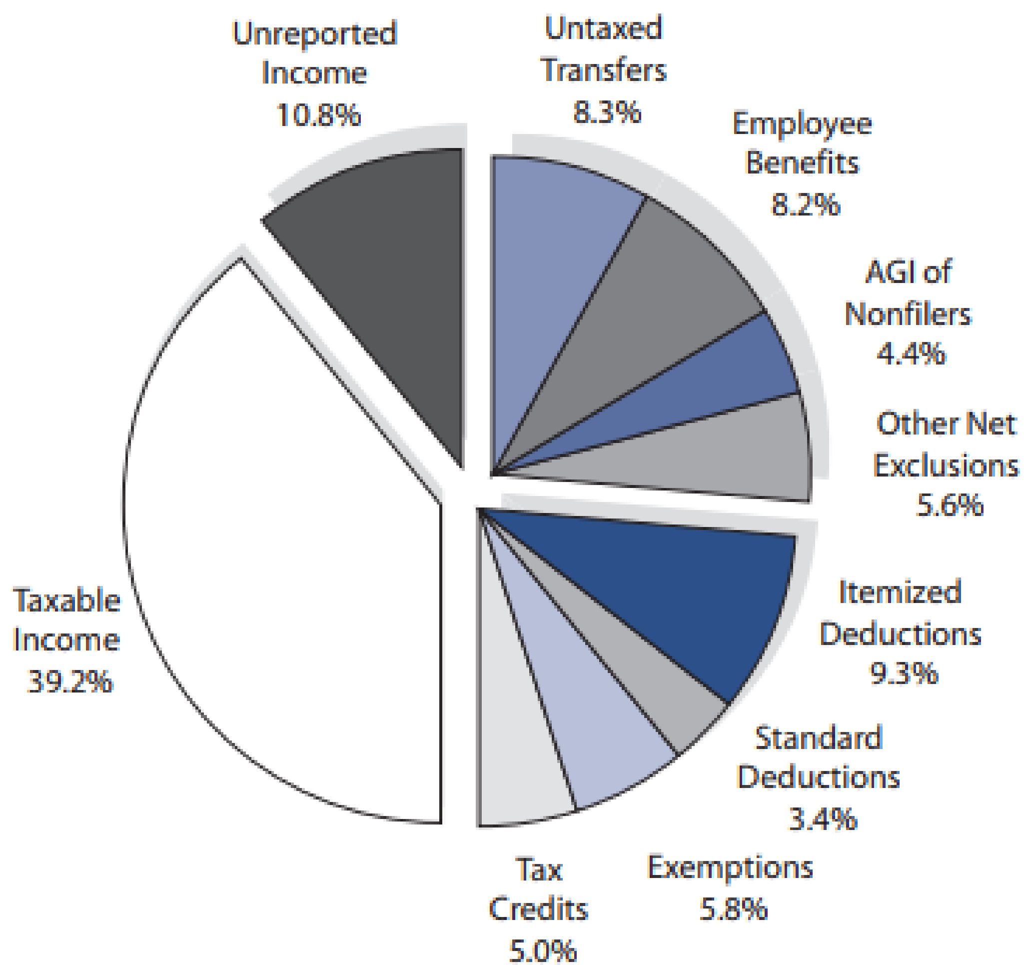
- Issues with the current tax code.
- How we got here.
  - A brief history of Republican and Trump tax reform plans since 2012.
- Where are we now?
  - The GOP Framework
  - What next?

Brief History of the Tax Code

- 1789 to 1909: U.S. government almost exclusively funded by excise taxes, tariffs, and land sales. State governments funded by property taxes.
- 1909 to 1940s: U.S. government adopts corporate, individual income, and payroll taxes. Individual income tax broadened to most people in 1942. States adopt sales taxes.
- 1964: Kennedy/Johnson tax cut.
- 1969: AMT adopted.
- 1981-86: Reagan tax bills, inc. 1986 reform.
- Post 1986: Rates have moved around but no major structural reform.

TAX FOUNDATION Since 1937

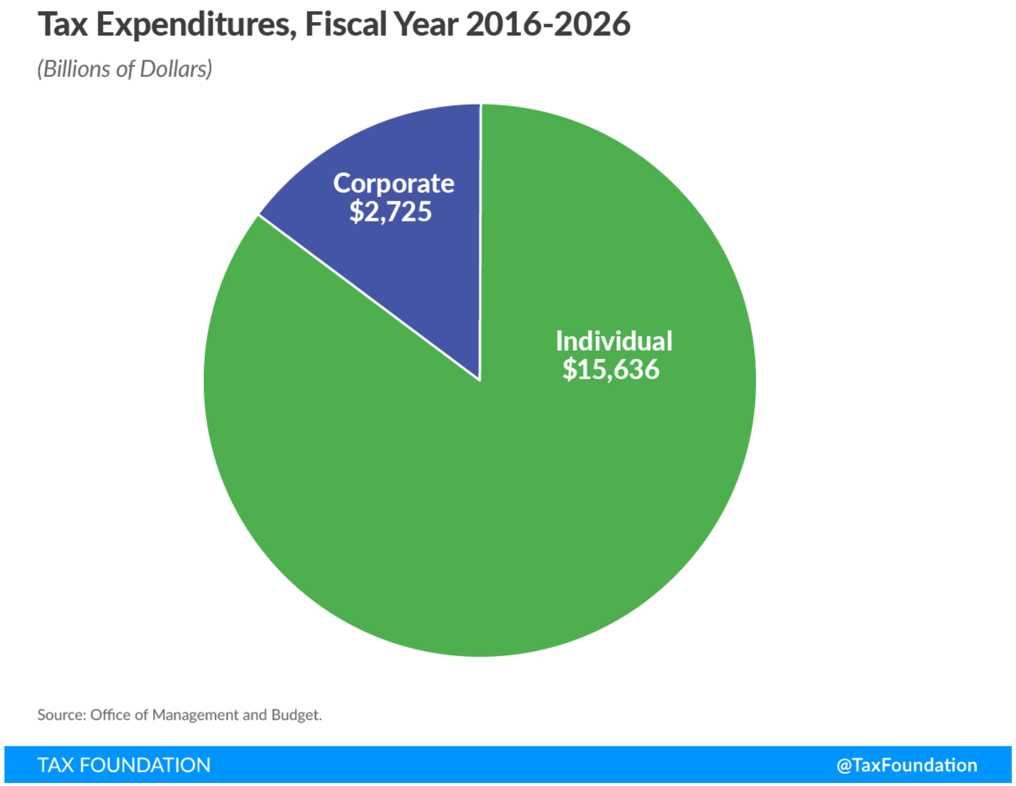
Why the Majority of Income is Tax-Free
Calendar Year 2006



Source: Tax Foundation calculations based on data from the Internal Revenue Service and the Department of Commerce's Bureau of Economic Analysis

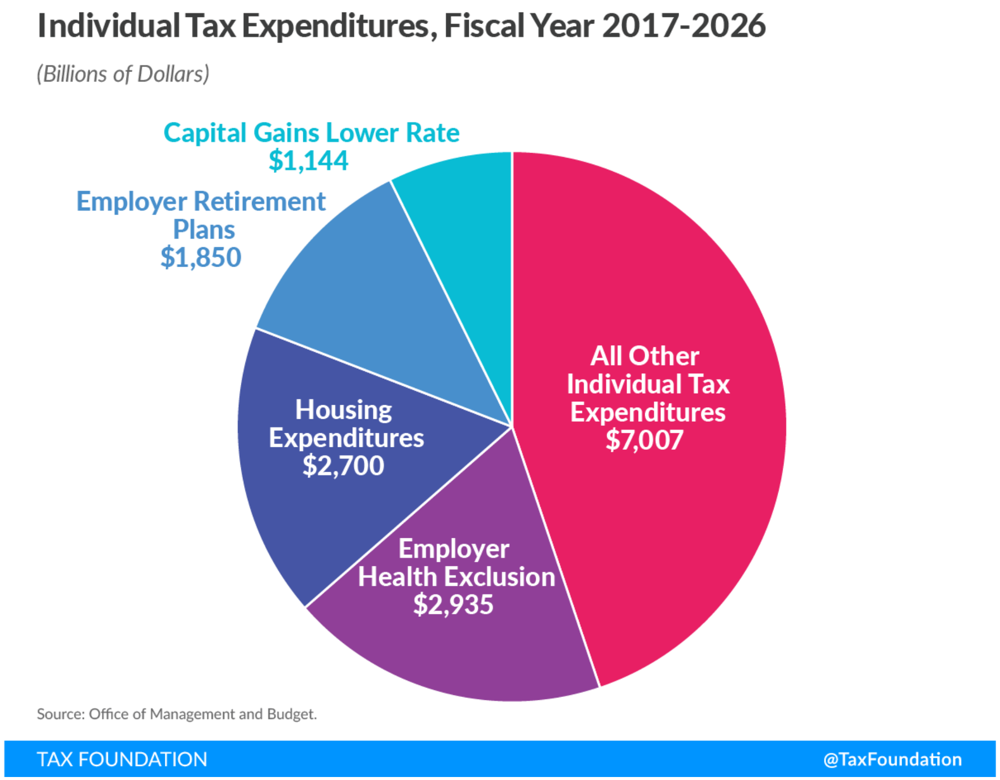
Why Tax Reform?

- The Individual Income tax is a mess: many redundant and complex provisions. Example: education benefits. Another example: Earned Income Tax Credit and the Child Tax Credit.
- Trillions in "tax expenditures."
- Marginal rates need to be higher to make up for the lost revenue.
- Most rich pay a lot but some pay nothing (taking lots of deductions or hiding income). Most poor pay nothing but some pay a lot (EITC structure, low standard deduction).



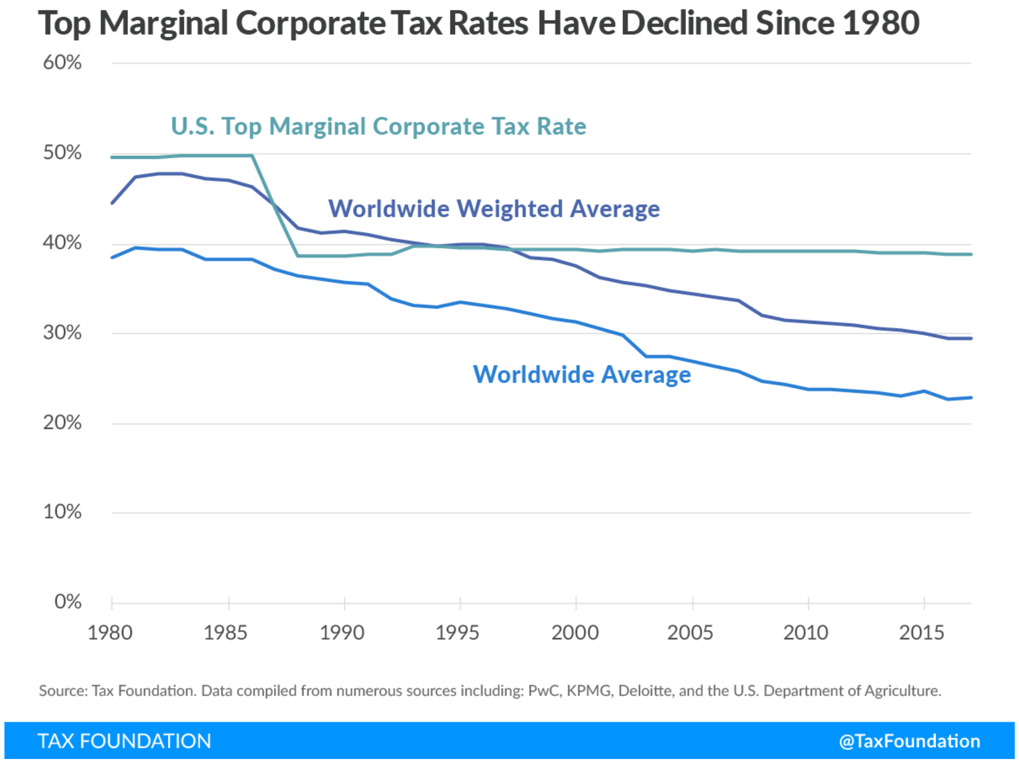
Why Tax Reform?

- Many individual income tax expenditures are popular and benefit middle-income taxpayers.
- Largest individual expenditures are social and economic policy. Example: Employer-sponsored health insurance.
- Other expenditures are economic policy. Retirement plans, lower capital gains rate both move towards “consumption-based” tax.



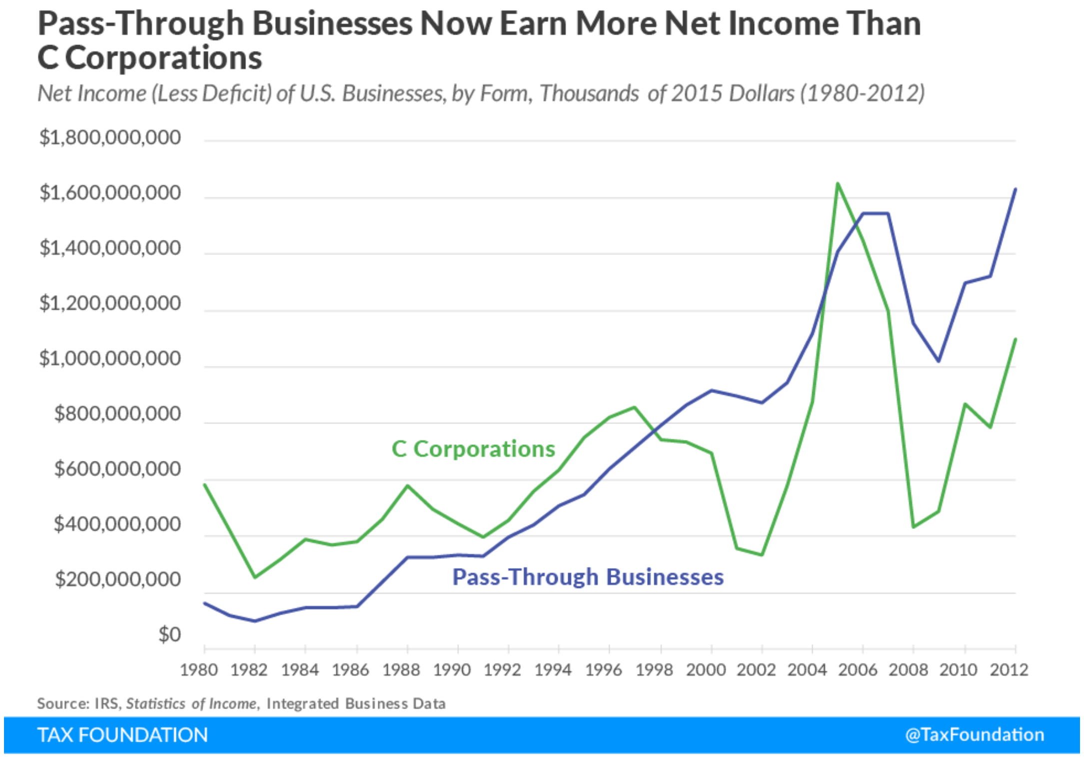
Why Tax Reform?

- One of the highest corporate income taxes in the world (profit shifting).
- High effective rate too, varying by industry.
- International system encourages inversions.
- Debt-equity bias: debt is favored in corporate tax code.



Why Tax Reform?

- Not one, but two business tax systems.
- "Pass-through businesses taxed on owners individual tax returns at ordinary rates.
- No "double tax."
- Number and significance of pass-through businesses has grown over the past 30 years.

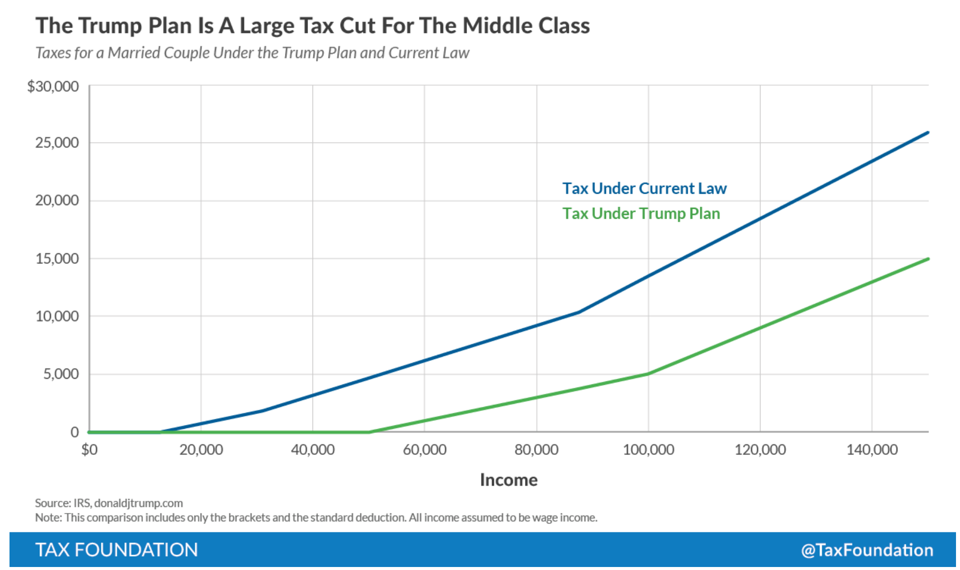


What's the Holdup?

- Obama insisted any tax reform be revenue-positive by at least $1t.
- Corporate-only reform that improves competitiveness loses revenue.
- Pass-throughs oppose corporate-only reform.
- Individual tax cuts are very expensive without base broadening.
- Base broadeners are unpopular with those who benefit from them.
- Reconciliation permits tax changes with 50 votes but Byrd Rule precludes *increases to the deficit outside the baseline*.
- Static scoring and 2012 tax plan incoherence led to focus on boosting economic growth (territorial, expensing, permanence)
- House regular order vs. Hastert rule/leadership control of agenda
- Senate filibuster threats
- @realdonaldtrump

Brief History of Trump's Tax Plan

- Trump was one of the 12 Republican presidential candidates who released a tax plan.
- Trump original Tax Plan was a *very* large tax cut: $12 trillion over a decade (1/4 of all federal revenue).
- Significant tax cut for individuals. $25k standard deduction and top tax rate of 25 percent.
- Business rates cut to 15 percent.
- Very little base-broadening: trims itemized deductions and interest deductibility for businesses.



Brief History of Trump's Tax Plan

- One year later: Trump tax plan 2.0
- Still a significant tax cut, but loses only a portion of the revenue ($6 trillion vs. $12 trillion).
- Slightly higher rates (top rate of 33%); a little more base broadening (no SALT deduction); same business tax rates.
- Ambiguous treatment of pass-through business income: The most criticized aspect of the tax plan. (See article clip)

The New York Times

Conflicting Policy From Trump: To Keep, and Remove, Tax Cut

By BINYAMIN APPELBAUM SEPT. 16, 2016

WASHINGTON — A few hours after Donald J. Trump publicly backed away from a $1 trillion tax cut for small businesses, campaign aides on Thursday privately assured a leading small-business group that Mr. Trump in fact remained committed to the proposal — winning the group's endorsement.

The campaign then told the Tax Foundation, a conservative-leaning Washington think tank it asked to price the plan, that Mr. Trump had indeed decided to eliminate the tax cut.

Call it the trillion-dollar lie: Both assertions cannot be true.

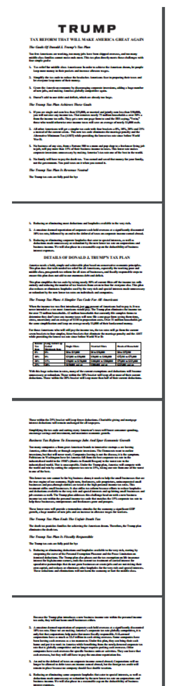
At issue is whether Mr. Trump's plan would tax small businesses, partnerships and other "passthrough" entities at the same 15 percent rate as large corporations, as he proposed last year, or whether they would continue to pay individual income taxes, at rates as high as 33 percent.

The campaign's conflicting accounts of its own proposal are particularly remarkable because Mr. Trump and his advisers have taken months to refine the details, which Mr. Trump, the Republican presidential nominee, unveiled in an economic policy speech on Thursday in New York.

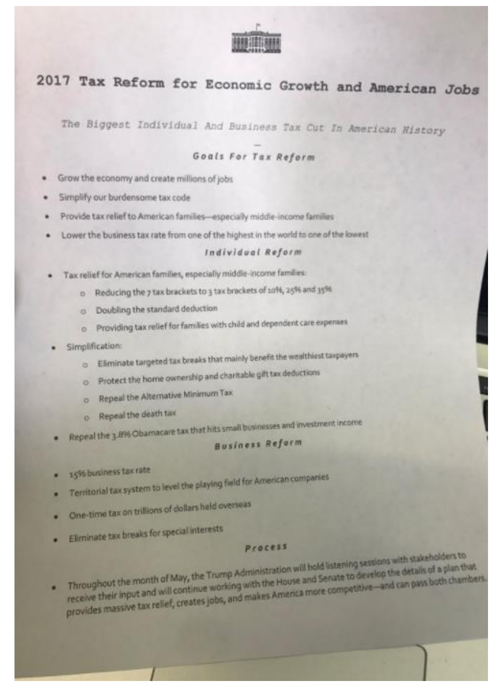
Brief History of Trump’s Tax Plan

- The Trump Administration released an updated tax plan in April 2017.
- 12 bullet points, laying out goals. Very few details: not enough to actually figure out the fiscal and economic impact (where are the tax brackets???)
- Keeps some of the important features of the original plans: 15% corporate and business rate, no estate tax, eliminate state and local tax deduction

2015



2017



2017 Tax Reform for Economic Growth and American Jobs

The Biggest Individual And Business Tax Cut In American History

Goals For Tax Reform

- Grow the economy and create millions of jobs
- Simplify our burdensome tax code
- Provide tax relief to American families—especially middle-income families
- Lower the business tax rate from one of the highest in the world to one of the lowest

Individual Reform

- Tax relief for American families, especially middle-income families:
  - Reducing the 7 tax brackets to 3 tax brackets of 10%, 25% and 35%
  - Doubling the standard deduction
  - Providing tax relief for families with child and dependent care expenses
- Simplification:
  - Eliminate targeted tax breaks that mainly benefit the wealthiest taxpayers
  - Protect the home ownership and charitable gift tax deductions
  - Repeal the Alternative Minimum Tax
  - Repeal the death tax
- Repeal the 3.8% Obamacare tax that hits small businesses and investment income

Business Reform

- 15% business tax rate
- Territorial tax system to level the playing field for American companies
- One-time tax on trillions of dollars held overseas
- Eliminate tax breaks for special interests

Process

- Throughout the month of May, the Trump Administration will hold listening sessions with stakeholders to receive their input and will continue working with the House and Senate to develop the details of a plan that provides massive tax relief, creates jobs, and makes America more competitive—and can pass both chambers.

The GOP Blueprint, June 2016

- In June 2016, the House GOP released a tax reform plan.
- On the surface, some similar features with Trump's second tax plan (Trump actually changed his plan to look more similar to GOP plan).
- However, the plan had major reforms: significant base broadening and a transformation of business taxation in the United States.
    - Introduced the "DBCFT" (Destination-based cash flow tax), which included the "border adjustment," full expensing of capital investments, and the elimination of the net interest expense deduction. Rate of 20%.
    - The border adjustment was a anti-base erosion provision, but many (including business groups) had a tough time wrapping their heads around it.
    - Border adjustment also raised a significant amount of revenue.

The Framework (Sep. 2017)

- Tax rates: 12%, 25%, 35% and maybe a fourth top rate
- Elimination itemized deductions, increases standard deduction to $12,000 ($24k for married)
- Repeals personal exemption and replaces it with a new $500 new non-child dependent credit and a larger child tax credit
- Calls for the elimination of the alternative minimum tax and the estate and gift tax
- 20% corporate income tax
- 25% maximum tax rate for pass-through businesses
- 100% bonus depreciation for five years
- Partial limitation of the interest deduction for C corporations
- Moves to a territorial tax system. Calls for anti-base erosion provisions and “deemed repatriation” of currently deferred foreign profits
- Increase economic growth and maintain progressivity of current code
- Details left to committees

Provision	**House TCJA**	**Senate**
Indiv. Rates & Brackets	Four, top 39.6% + bubble	Seven, top 38.5%
Deductions & Exemptions	Standard $12,200 Cap SALT $10,000 property Limit MID $500,000 1st	Standard $12,000 Eliminates SALT MID end equity debt ded
Credits	Child credit $1,600, phaseout above $230,000 $300 family credit	Child credit $1,650, phaseout above $1m
Pass-throughs	25% rate cap with 70-30 anti-abuse rule	17.4% deduction, service providers excluded
Corporate Rate	20%, effective 2018	20%, effective 2019
Capital Investment	Increases 179 cap to $5m, phaseout at $20m Caps interest ded at 30%	Increases 179 cap to $1m, phaseout at $2.5m Caps interest ded at 30%
NOLs	Eliminates carrybacks, allows 90% carryforwards with inflation adjustment	Eliminates carrybacks, allows 90% carryforwards
International Tax	Territorial w anti-abuse excise tax; 14%/7% deemed repat	Territorial w/ anti-abuse min tax; 10%/5% deemed repat
Estate Tax	Repeal after six years	Double exemption

State Impacts

SALT

- Barely survived in 1986 thanks to fierce lobbying by New York
- Used only by itemizers (~35% of returns) and majority of benefit accrues to high-income, high-tax states. Repeal is a big progressive shift.
- Strong fight to keep property tax portion
- States add it back so no state revenue impact

Other Base Broadening (MID limits, miscellaneous deductions)

- Will flow through to states that adopt federal definition of income

Corporate Changes

- Conformity with them will be a big topic in 2018 onwards (inc. in AZ)
- Deemed repatriation will be a one-time windfall for states

Long-Term Changes

- Growth, jobs, dynamic effects

State Options: conformity, phase in, trigger, contingent enactment, special sessions, opportunity to reform

Questions?

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