Post-election focus: five things to know about the House GOP's tax reform Blueprint

In the wake of elections that gave Republicans control of both the White House and Congress, the chances of enacting comprehensive tax reform are greater than they have been in many years. The House Republican tax reform "Blueprint," released in June, provides the broad framework for legislative action on tax reform in 2017. This overview explains some of the key elements of the Blueprint and provides context for the policy debates ahead.[1]

The Blueprint is the culmination of the work of a Republican tax reform task force set up by House Speaker Paul Ryan (R-WI) and chaired by House Ways and Means Committee Chairman Kevin Brady (R-TX). Although it differs in some ways from the tax reform proposals put forward by Donald Trump, there is significant overlap — with both proposing to lower tax rates and broaden the tax base.

The Blueprint is both a call to action and a broad outline of "pro-growth" policy changes House Republicans favor. It proposes lowering tax rates and, in perhaps its most innovative feature, moving the current corporate income tax system toward a destination-based cash flow tax.

Brady has indicated that further details and legislative text could be released early in 2017. Given this timetable and the magnitude of the changes proposed, it is important to engage and provide feedback to policymakers on issues important to your business. To assist in these efforts, below are five key points about the Blueprint:

1 The Blueprint is a foundational document for tax reform efforts and represents a significant departure from the current US income tax system

Each step toward tax reform builds upon what has come before, and most tax reforms, such as the Tax Reform Act of 1986, resulted from a gradual, years-long process. Some of the Blueprint's ideas come from recent reform proposals, while others are new.

Significantly, if enacted, the Blueprint would shift the current US income tax base toward a destination-based, cash-flow tax. This shift would result from the cumulative effect of several proposals in the Blueprint, including ones that would generally deny interest deductions, eliminate many current targeted tax incentives (although a research and development incentive would remain), impose an essentially territorial international tax system, and implement border adjustments (discussed below) that would generally exempt income from exports and generally fully tax income from imports.

Details need to be built out on many aspects of the Blueprint, and businesses are encouraged to provide feedback to help shape these proposals. The Blueprint specifically requests comments about the practical effects of the concepts outlined — these comments will be used to help craft the final legislation and any related transition rules.

[1] A version of this article originally appeared July 25, 2016, in *Financial Executives International Daily*. It has been updated to account for post-election developments.

2 Tax rates would drop under the Blueprint

The Blueprint would generally lower tax rates and broaden the tax base. It proposes moving toward a cash-flow approach to business taxation and a consumption-based tax model.

Businesses

Corporations would pay a flat tax rate of 20%. Businesses would be able to immediately expense 100% of the cost of investments, both tangible and intangible. Net operating losses would still be allowed to be carried forward, but carrybacks would no longer be permitted.

In a significant departure from current law, the Blueprint would create a new 25% rate for the "business income" of pass-through businesses and sole proprietorships (instead of taxing income from individual partners at the individual tax rates). Wage income from these businesses would still be taxed under the proposed individual rate structure, with rates of 12%, 25% and 33% depending on exact income levels.

International

The Blueprint would move to a territorial tax system with a 100% exemption for dividends paid from the future active earnings of foreign subsidiaries. It would impose an 8.75% tax rate on previously untaxed accumulated foreign cash or cash-equivalent earnings and a 3.5% tax rate on all other accumulated foreign earnings, payable over eight years.

Individuals

The Blueprint would consolidate the number of individual tax brackets; the new rates would be 12%, 25% and 33%. Taxpayers would be able to deduct 50% of net capital gains and dividend and interest income (resulting in rates of 6%, 12.5% and 16.5%). The individual alternative minimum tax and the estate tax and generation-skipping transfer tax would be repealed. The Blueprint would eliminate all itemized deductions, except the mortgage interest deduction and charitable contribution deduction. It would also consolidate the various family tax benefits currently available into a larger standard deduction and a larger child and dependent care credit.

3 Border adjustments would change the tax treatment of imports and exports

The Blueprint outlines a destination-basis system under which export sales would be exempt from tax and imported "inputs" would not be deductible. While border adjustments are currently allowed and are used with many countries' value-added taxes, they are prohibited for income taxes under World Trade Organization rules, so this proposal could be subject to challenge. However, the Blueprint indicates that the move to a consumption-based, cash-flow approach for taxing business income would permit the use of such border adjustments.

The Blueprint further provides that the adoption of border adjustability rules would obviate the need for any additional anti-base erosion measures in conjunction with the move to a territorial system.[2]

4 Debt and equity would receive more equal tax treatment than under the current system

The Blueprint would eliminate the current deduction for interest expense on a net basis. The Ways and Means Committee plans to work to develop rules on interest expense for financial services companies that take into account the role of interest income and interest expense in those businesses.

The Blueprint suggests that the immediate expensing of capital expenditures for tangible and intangible assets that is included in the proposal is a more neutral substitute for the deductibility of interest expense. In combination, the changes envisioned under the Blueprint are thought to result in more similar taxation of equity and debt than under current law, with the effective tax rates on debt-financed investment rising somewhat and those on equity-financed investment falling significantly.

[2] For more on the Blueprint's border adjustability proposals, see the EY Tax Alert, "US tax reform — what you need to know about border adjustments," November 22, 2016, https://www.taxnavigator.ca/Login/ViewEmailDocument.aspx?AlertID=35933. Also find the latest tax reform updates from the EY Center for Tax Policy at http://www.ey.com/us/en/services/tax/tax-policy.

5 The Blueprint aims to achieve economic growth without adding to the deficit

The Blueprint's overarching goal is economic growth through job creation, tax code simplification and IRS modernization. While no revenue estimates are included, the Blueprint is intended to be both pro-growth and revenue-neutral, meaning it would not increase the deficit.

The document uses several key revenue assumptions. It uses a revenue baseline that assumes current tax policies will be permanently extended. By doing so, it is estimated that at least $400 billion of the 10-year cost of the plan can be eliminated because the baseline incorporates permanent extension of the tax provisions that were extended temporarily in last year's legislation.

The Blueprint also builds in anticipated positive revenue effects from the economic growth that policymakers expect from its tax policy changes. Finally, the Blueprint proposes repeal of all of the tax increases that were part of the Affordable Care Act, such as the 3.8% tax on net investment income, the 0.9% payroll tax, the medical device excise tax and other industry-specific tax increases. The Blueprint further assumes that these items should not ever have been enacted and that the amount of revenue they produce will not be replaced.

Next steps

While the exact timing and procedures for considering tax reform legislation remain to be determined, tax reform is a top priority for both the Trump Administration and congressional tax writers. With the Blueprint as a starting point, businesses should closely monitor the debate and model the potential effects of these proposals on their situations. Companies that understand the concepts behind the Blueprint and engage with policymakers now will be better positioned as the final product takes shape.

More information

To find out more about the House GOP Blueprint or how its proposals may impact your company, go to **ey.com/taxreform** or contact:

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