JONES DAY

COMMENTARY

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IN SHORT

The Situation: The Trump Administration, in collaboration with the House and Senate, has introduced a Framework for tax reform legislation that could bring sweeping changes to U.S. tax laws.

The Provisions: The reforms include a reduction in corporate tax rates, immediate expensing (versus depreciation over time) of certain business assets, a shift to a territorial system of international taxation, and rules to "level the playing field" on foreign-based multinationals.

Looking Ahead: Tax-writing committees in the House and Senate will prepare draft legislation. It remains to be seen if the reforms will be included as part of the budget reconciliation process or addressed in separate legislation.

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On September 27, 2017, the Trump Administration, in collaboration with the House and Senate, issued a unified framework for tax reform ("Framework"). The Framework proposes sweeping changes that incorporate several previous proposals while providing the White House and Congress with breathing room to negotiate among their numerous constituencies.

Tax Reform Framework Summary

- Corporate tax rate reduction from 35 percent to 20 percent
- Creates a new 25 percent rate for pass-through "business" income
- Full expensing of new investments in certain assets made after September 27, 2017
- Shift to a territorial system of international taxation with 100 percent exemption of (presumably active) business income earned by at least 10 percent-owned foreign subsidiaries
- One-time deemed repatriation tax on U.S.-based multinationals' foreign earnings
- Current tax on certain (presumably passive) foreign income earned by U.S.-based multinationals
- Adoption of rules to "level the playing field" on foreign-based multinationals

> The Framework proposes sweeping changes that incorporate several previous proposals while providing the White House and Congress with breathing room to negotiate among their numerous constituencies.

Business Tax Reform

Under the Framework, business tax rates would be lowered across the board. Entities taxed as corporations for U.S. federal income tax purposes would see their income tax rate lowered from 35 percent to 20 percent, and the alternative minimum tax would be eliminated for such entities. "Small and family-owned businesses" held through sole proprietorships, partnerships, and S corporations would be taxed at a rate of 25 percent on their business income, but rules would be adopted to prevent the recharacterization of personal income into business income.

The Framework also would allow businesses the immediate, full expensing of new investments in depreciable assets other than structures, effective September 27, 2017. This would allow the full cost of acquiring depreciable assets to be deducted in the year of purchase for U.S. federal income tax purposes, rather than depreciating the assets over time as currently required.

To offset these tax rate reductions, the Framework describes a number of potential tax reforms that would raise government revenues. First, the Framework provides that deductions for net interest expense by entities taxed as corporations for U.S. federal income tax purposes would be "partially limited," with the impact upon non-corporate taxpayers to be "considered." Next, the Framework states that "numerous" special exclusions and deductions would be repealed or restricted, and that special tax regimes for certain industries and sectors would be modernized.

U.S. International Tax Reform Proposals

With respect to U.S. international taxation, the Framework would transition from taxation on a worldwide basis to a "territorial" system whereby dividends from foreign subsidiaries to U.S. parent companies would be 100 percent exempt from U.S. federal income tax (provided that the recipient owns at least 10 percent of the foreign subsidiary). To transition to this system, the Framework would treat all accumulated foreign earnings as deemed repatriated, subjecting them to a one-time tax paid over multiple years. The rate for this one-time deemed repatriation tax is still being discussed, although the Framework provides that earnings held in cash and cash equivalents would be subject to a higher rate.

The Framework provides that rules would be created "to level the playing field between U.S.-headquartered parent companies and foreign-headquartered parent companies." No further explanation is provided in the Framework for such rules, but they call to mind the oft-criticized border adjustment tax proposed by congressional Republicans as part of their "A Better Way" tax reform plan blueprint published on June 24, 2016.

Comparison to Past Proposals

The Framework follows on the heels of many other reform proposals that have been published over the past several years. It builds upon the tax reform pronouncement issued by the Trump Administration in April 2017 and contains many of the Trump campaign's tax reform proposals.

The Framework appears to differ significantly in critical respects from the Better Way tax reform blueprint. That blueprint focused upon a border adjustment tax that would tax goods and services imported into the United States at a higher rate than those exported from the United States to other countries.

Looking Forward

The Framework has been provided to tax writers in the House Ways and Means Committee, and their next step will be to prepare draft legislative language. Any consideration of tax reform legislation must wait until the House and Senate pass fiscal 2018 budget resolutions, which could contain language allowing tax reform to be decided by a simple majority (without the possibility of a 60-vote filibuster) if made part of the budget reconciliation process. However, key Republican congressmen have indicated that they believe tax reform to be too significant and permanent to be decided via budget reconciliation, which could suggest that proposed tax legislation will need bipartisan support from Democrats and Republicans.

THREE KEY TAKEAWAYS

1. The tax reform Framework includes a reduction in the corporate tax rate from 35 percent to 20 percent.

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2. Regarding U.S. international taxation, the Framework would transition from taxation on a worldwide basis to a "territorial" system whereby dividends from foreign subsidiaries to U.S. parent companies would be 100 percent exempt from U.S. federal income tax.

3. Depending on how the Framework's reforms are introduced (either by budget reconciliation or independent legislation), bipartisan support could be crucial.


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