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Prospects for Tax Legislation in a New Administration

Co-sponsor
American Tax Policy Institute
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BACKGROUND PAPER

By the Committee
Eric San Juan, Chair
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Chapman Univ. Fowler School of Law, Orange, Calif.
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PROGRAM
9 – 10:30 a.m.
Capitol Hill tax law and economic experts will evaluate the merits and likelihood of pending individual and business tax bills and legislative proposals of major presidential candidates.

Panelists:
- Barbara Angus, Chief Tax Counsel, House Ways & Means Comm. Washington, DC
- Todd Metcalf, Minority Chief Tax Counsel, Sen. Finance Comm. Washington, DC
- Eric Toder, Tax Policy Ctr. Urban/Brookings Inst. Washington, DC
- Alan Viard, American Enterprise Inst. Washington, DC

SELECTED PENDING TAX LEGISLATIVE PROPOSALS

INTRODUCTION

This paper identifies and summarizes relevant tax bills introduced in the 114th Congress along with other pending tax legislative proposals set forth by the Administration, major Presidential candidates, and others. The proposals discussed below concern both businesses and individuals, covering corporate and international reforms, as well as base-broadeners or consumption tax variants.

BUSINESS TAX PROPOSALS

Pending proposals reflect divergent approaches to spurring productivity through tax legislation. One approach would enact incentives to promote particular enterprises. Another approach would reduce tax rates, in keeping with the theory that low marginal rates tend to lessen economic distortion.[1]

Currently, the Administration has proposed $89 Billion (estimated over 2017-26) worth of tax incentives for job creation, manufacturing, research, and clean energy, $27 Billion of which is to enhance and simplify research incentives (*i.e.* the Int. Rev. Code § 41 research credit). The additional proposed incentives are to:

- extend and modify certain employment tax credits, including incentives for hiring veterans;
- provide a new manufacturing communities tax credit;
- provide a community college partnership tax credit;
- designate promise zones (*i.e.* target employment tax credits and additional depreciation in economically distressed geographic areas);
- modify and permanently extend the renewable electricity production tax credit and investment tax credit;
- modify and permanently extend the deduction for energy-efficient commercial building property;
- provide a carbon dioxide investment and sequestration tax credit;
- provide additional tax credits for investment in qualified property used in a qualifying advanced energy manufacturing project;
- extend the tax credit for second generation biofuel production;
- provide a tax credit for the production of advanced technology vehicles;
- provide a tax credit for medium- and heavy-duty alternative-fuel commercial vehicles; and

[1] *See* Molly F. Sherlock & Mark P. Keightley, *Tax Reform in the 114th Congress: An Overview of Proposals*, Cong. Res. Serv. (Jul. 9, 2015) R43060 (hereinafter "CRS") pg. 6.

- modify and extend the tax credit for the construction of energy-efficient new homes.[2]

Other business proposals are to reduce tax rates on corporations to 25 percent[3] or on corporations, pass-through, and unincorporated entities to 15 percent.[4] These proposals appear to reflect the theory that low tax rates increase economic efficiency.

INTERNATIONAL TAX PROPOSALS

Various current international tax proposals would either impose additional tax on foreign income, reduce rates for a one-time repatriation, broaden the base of foreign income subject to tax, or narrow the base through repeal of the tax on world-wide income.[5]

Currently, the Administration proposes to raise $484 Billion (estimated over 2017-26) of revenue through reform of the United States international tax system, $350 Billion of which would arise from imposition of a 19-percent minimum tax on foreign income.[6] The Administration's international package includes tax incentives for locating jobs and business activity in the U.S. coupled with removal of tax deductions for shipping jobs overseas, as well as repeal of delay in the implementation of worldwide interest allocation. The remaining revenue raisers in the Administration's international tax package would:

- restrict deductions of excessive interest of members of financial reporting groups;
- impose a 14-percent one-time tax on previously untaxed foreign income;
- limit shifting of income through intangible property transfers;
- disallow the deduction for excess untaxed reinsurance premiums paid to affiliates;
- modify tax rules for dual capacity taxpayers;
- tax gain from the sale of a partnership interest on look-through basis;
- modify sections 338(h)(16) and 902 to limit credits when non-double taxation exists;

[2] *See* Dep't of the Treas. *Gen. Explanations of the Admin's FY 2017 Revenue Proposals* (Feb. 2016) https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2017.pdf (hereinafter "GreenBook") pps. 37-61.
[3] *See* Kasich Action Plan, https://s3-us-west-2.amazonaws.com/john-kasich-assets/wp-content/uploads/2015/10/Kasich-Plan-Fact-Sheet-Cutting-Taxes-1.pdf.
[4] *See* Trump: Tax Reform that Will Make America Great Again, https://www.donaldjtrump.com/images/uploads/trump-tax-reform.pdf; *see also* Jim Nunns, Len Burman, Jeff Rohaly & Joe Rosenberg, *An Analysis of Donald Trump's Tax Plan*, Urban-Brookings Inst. Tax Pol'y Ctr. (Dec. 22, 2015), http://apps.urban.org/features/tpccandidate/.
[5] *See* CRS, *supra* note 1, at pg. 3.
[6] *See* GreenBook, *supra* note 2, at pps. 2-28.

- close loopholes under subpart F (*i.e.* create a new category of subpart F income for transactions involving digital goods or services, and expand foreign base company sales income to include manufacturing service arrangements);
- restrict the use of hybrid arrangements that create stateless income; and
- limit the ability of domestic entities to expatriate.

In the House of Representatives, introduced bills would extend permanently certain international tax exemptions. The Permanent Active Financing Exception Act of 2015, H.R. 961, would make permanent the subpart F foreign personal holding company exemption for income derived from the conduct of an insurance business, or the active conduct of a banking, financing, or similar business, such as a securities dealer. The Joint Committee on Taxation (JCT) has estimated the cost of a version of this bill at $78 Billion (over 2016-25).[7]

The Permanent CFC Look-Through Act of 2015, H.R. 1430, would make permanent the exemption of dividends, interest, rents, and royalties received or accrued from certain Controlled Foreign Corporations by a related entity from treatment as foreign holding company income (thus permitting tax deferral of such income). JCT has estimated the revenue cost of a version of this bill at $22 Billion (2015-26).[8]

Additionally, a proposal intended to attract foreign profits of American MNCs back into the country would replace the current Federal tax regime imposed on world-wide income with a territorial system.[9] To counter the advantages of earning overseas, another proposal would repeal the deferral of corporate tax on foreign income.[10] In sum, competing international tax proposals encompass both base contraction and base broadening.

PROPOSALS TO BROADEN THE TAX BASE

Several revenue proposals arising across the spectrum would affect both individuals and businesses. In particular, Administration, Congressional, and candidate proposals would effectively repeal certain tax expenditures for high-income individuals, while imposing new taxes on the financial industry.

Currently, the Administration proposes to raise $1.03 Trillion (2017-26) in revenue through reforms of upper-income tax benefits, capital gain tax, and the

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[7] *See* JCT, *Description of an Amendment in the Nature of a Substitute to the Provisions of H.R. 961, a Bill to Permanently Extend the Subpart F Exemption for Active Financing Income* (Sept. 16, 2015) JCX-123-15.
[8] *See* JCT, *Description of an Amendment in the Nature of a Substitute to the Provisions of H.R. 1430, the "Permanent CFC Look-Through Act of 2015"* (Sept, 16, 2015) JCX-125-15.
[9] *See* Kasich, *supra* note 3.
[10] *See* Trump, *supra* note 4.

taxation of financial institutions.[11] Reduction in the value of certain tax expenditures would produce $646 Billion of the estimated revenue.

The tax expenditure claw-back would limit the tax value of specified deductions or exclusions from Adjusted Gross Income (AGI) for high-income taxpayers. This limitation would reduce to 28 percent the value of the specified exclusions and deductions that would otherwise reduce taxable income in the 33-, 35-, or 39.6-percent brackets. The income exclusions and deductions limited by this provision would include those of:

- tax-exempt State and local bond interest;
- health insurance paid by employers or pre-tax employee dollars;
- health insurance costs self-employed individuals;
- employee contributions to defined contribution retirement plans and IRAs;
- income from domestic production;
- certain employee trade or business expenses;
- moving expenses;
- contributions to Health Savings Accounts and Archer Medical Savings Accounts;
- interest on student loans; and
- itemized deductions.

The capital gain tax proposal would increase the highest long-term capital gain and qualified dividend tax rate from 20 to 24.2 percent. Moreover, bequests of appreciated assets would be deemed a realization of gain by the decedent, resulting in tax to be paid by his or her estate.

Within the Administration's package of high-income tax reforms is a version of the so-called Buffett Rule, which would impose a new minimum tax, to be denominated as the Fair Share Tax (FST), layered on top of the existing AMT, IRC § 68 overall "Pease" limitation on itemized deductions, and surtax on net investment income.[12] Generally, the 30-percent FST would apply to AGI of $1 Million or more. The FST would allow preferences for charitable contributions, foreign tax paid, gasoline and special fuel expenses.

Finally, the Administration's base-broadening package would assess a fee on certain liabilities of large firms in the financial sector. Generally, the fee would apply to banks, bank holding companies, insurance companies, savings and loan holding companies, exchanges, asset managers, broker-dealers, specialty finance corporations, and financial captives with assets of at least $50 Billion. The fee

[11] *See* GreenBook, *supra* note 2, at pps. 153-59.
[12] The surtax was enacted by the Health Care & Educ'n Reconciliation Act of 2010, Pub. L. No. 111-152 § 1402, adding IRC § 1411.

would amount to 7 basis points of covered liabilities, *i.e.* assets less equity (minus separate accounts in the case of insurance companies).

The Congress has introduced bills to enact versions of the Buffett Rule and the financial fee. The Paying a Fair Share Act of 2015, H.R. 362/S. 161, would codify the Buffett Rule.[13]

In the 113th Congress, the Tax Reform Act of 2014, H.R. 1, contained a variant of the financial fee. Section 7004 of this bill would have imposed an excise on a "systemically important financial institution" amounting to .035 percent of assets over $500 Billion.[14]

In sum, the proposals to broaden the tax base would reduce the effect of some tax expenditures in the case of high-income individuals. The proposed FST, resembling the existing AMT, as well as the upper-income claw-back on tax expenditures, layered on top of the existing Pease limitation, would increase complexity. For businesses, the proposals would create new taxes on the financial sector.

INDIVIDUAL, SIMPLIFICATION, AND CONSUMPTION TAX PROPOSALS

Both the Administration and Members of Congress have introduced proposals to cut taxes on individuals. The former would target low- and moderate-income families, increasing progressivity. The latter would simplify taxation in part by flattening the brackets, reducing redistributive effects.

Currently, the Administration proposes to cut individual taxes by $245 Billion (over 2017-26), primarily by creating a second-earner tax credit worth $87 Billion.[15] The second-earner proposal would allow a non-refundable credit up to $500 to a double-income couple who are married filing jointly. The credit, with a phase-out to target low- and moderate-income individuals, could amount to 5 percent of the lower earner's earned income up to $10,000.

The Administration's package of "middle-class and pro-work tax reforms" also proposes to:

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[13] *See also* a Plan to Raise American Incomes, https://www.hillaryclinton.com/issues/plan-raise-american-incomes/; Richard Auxier, Len Burman, Jim Nunns & Jeff Rohaly, *An Analysis of Hillary Clinton's Tax Proposals,* Urban-Brookings Inst. Tax Pol'y Ctr. (Mar. 3, 2016) http://apps.urban.org/features/tpccandidate/; *cf*. Trump, *supra* note 4 (proposing to steepen "the curve of the Personal Exemption Phaseout and the Pease Limitation on itemized deductions").

[14] *Cf*. Income and Weath Inequality, https://berniesanders.com/issues/income-and-wealth-inequality/ ("enact a tax on Wall Street speculators"); *see also* Frank Sammartino, Len Burman, Jim Nunns, Jos. Rosenberg & Jeff Rohaly, *An Analysis of Sen. Bernie Sanders's Tax Proposals,* Urban-Brookings Inst. Tax Pol'y Ctr. (Mar. 4, 2016) http://apps.urban.org/features/tpccandidate/.

[15] *See* GreenBook, *supra* note 2, at pps. 119-33.

- Reform child care tax incentives (relating to IRC § 21);
- Simplify and better target tax benefits for education (relating to IRC §§ 25A, 221 & 222);
- Expand and simplify the earned income tax credit (EITC) for workers without qualifying children (relating to IRC § 32); and
- Extend the exclusion from income for cancellation of certain home mortgage debt (relating to IRC § 108).

The Congress has introduced bills to simplify taxation of individuals along with business taxpayers. Various proposals contain tax cuts with reduced complexity.[16] One feature of these proposals would be reduction in the number of income tax brackets.[17] Flattening the brackets essentially would reduce progressivity, potentially going to horizontal equity.[18] At the same time, targeted tax provisions could increase vertical equity within flatter brackets.[19]

Two bills would consolidate the brackets. First, the Flat Tax Act, H.R. 1040, would allow an individual or business to elect a 19-percent tax (which would fall to 17-percent in 2 years) in lieu of the existing income tax. The Flat Tax Act would allow standard deductions for each of the individual taxpayer and dependents. Additionally, the bill would repeal the estate, gift, and generation-skipping transfer taxes.

Second, the Simplified, Manageable, and Responsible Tax (SMART) Act, H.R. 1824/S. 929, generally would replace the existing marginal income tax brackets with a single rate of 17 percent for individuals or business entities. The bill would repeal income tax credits, the AMT, and the estate, gift, and generation-skipping transfer taxes. At the same time, the SMART Act would repeal pension plan rules that currently impose limits on contributions and distributions, as well as on discrimination in favor of highly-compensated employees.

Another approach to simplification would replace the Federal regime of taxation on income with one based on consumption, particularly in the form of a

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[16] *See e.g.* Kasich, *supra* note 3 ("Reduce long-term capital gains rates to 15 percent" and "Simplify Deductions [yet] Preserve the tax deduction for charitable donations for all taxpayers and the mortgage interest deduction").

[17] *See* Kasich, *supra* note 3 ("reducing the number of brackets from seven to three"); Trump, *supra* note 4 ("the tax rates will go from the current seven brackets to four simpler, fairer brackets"); Cruz: More of Americans' Hard-Earned Wages Should Be Able to Stay in Their Wallets (Apr. 15, 2015) https://www.tedcruz.org/news/cruz-more-of-americans-hard-earned-wages-should-be-able-to-stay-in-their-wallets/ ("imagine a simple, flat tax that lets Americans fill out their taxes on a postcard"); *see also* Jos. Rosenberg, Len Burman, Jim Nunns & Daniel Berger, *An Analysis of Ted Cruz's Tax Plan* Urban-Brookings Inst. Tax Pol'y Ctr. (Feb. 16, 2016) http://apps.urban.org/features/tpccandidate/.

[18] *See* CRS, *supra* note 1, at pg. 3.

[19] *See e.g.* Kasich, *supra* note 3 ("Increase the Earned Income Tax Credit by 10 percent").

national sales tax. Regressivity would be tempered by a family allowance relating to poverty.

Specifically, the Fair Tax Act of 2015, H.R. 25/S. 155, would impose a 23-percent national sales tax in lieu of existing Federal income, employment, and estate and gift taxes. The bill would allow a Family Consumption Allowance based upon family size and poverty. The States would collect the national sales tax, and the Internal Revenue Service would become obsolete.

In sum, proposals to cut individual taxes could either increase or descrease progressivity. Likewise, the proposals could either decrease or increase simplicity.

CONCLUSION

Pending legislative proposals run the gamut from business to individual taxation, including international and consumption tax issues. Some proposals would broaden the base while others would flatten the brackets. While simplification is a desirable slogan, several proposals would increase complexity.