Trump Unveils Tax Reform Proposal

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Today, President Trump released a one page outline of his proposal for tax reform (the “Trump Plan”). The document is entitled “2017 Tax Reform for Economic Growth and American Jobs.” The plan claims that the proposal will result in the “biggest” individual and business tax cut in American history.

The newly-released plan is similar in many ways to the plan that President Trump put forward as a candidate. The Trump Plan does in fact call for drastic reductions in the corporate tax rate (from 35% to 15%) and a smaller reduction in the individual tax rate (from 43.4% to 35%).

Business Tax Reform

Currently, corporate profits are taxed at a rate that can go as high as 35%. Under the Trump Plan the rate would be lowered to 15%.

The Trump Plan is silent as to whether the corporate alternative minimum tax (AMT) would be repealed. The AMT is an alternative tax regime with a higher tax base and a lower tax rate (20%). As a candidate, President Trump proposed repealing the corporate AMT.

Currently, individuals are taxed at normal tax rates on their business income. These rates can go as high as 39.6%. We understand that the Trump Plan appears to propose a regime by which noncorporate businesses may be able to avail themselves of the proposed lower corporate tax rate of 15%. It is possible that this lower rate will only apply to profits that are retained in the business.

The lower tax rates under the Trump Plan would be offset by the elimination of many favorable deductions and credits. The plan does not specify which provisions will be retained and which will be repealed. However, President Trump has previously stated that the research and development (R&D) credit will be retained (but possibly revised to make it more effective and efficient). The Trump Plan is silent as to whether the benefits of carried interest will be retained.

International Tax Reform

Currently, U.S. corporations are generally allowed to defer paying tax on foreign investments until the profits are brought back to the U.S. This deferral scheme has resulted in attempts by U.S. companies to make the deferral permanent by engaging in inversion transaction (by which the parent corporation is moved from the U.S. to a foreign country).

The Trump Plan proposes to charge a one-time tax on all foreign deferred income. The tax rate is not specified in the plan. However, President Trump proposed a rate of 10% as a candidate.

Going forward, the Trump Plan proposes a territorial system for US businesses. This appears to mean that US companies will not be subject to US tax (or only a limited US tax) on income earned by their foreign subsidiaries.

The Trump Plan is silent as to how foreign investors in the US will be taxed. Currently, foreign investors are generally subject to a 30% withholding tax on passive income (subject to reduction by treaty) and at graduated rates on business income. If the tax on business income is reduced to 15%, it is possible that the withholding rate will also be reduced.

Individual Tax Reform

Currently, individuals are taxed at graduated rates (10%, 15%, 25%, 28%, 33%, 35% and 39.6%). In addition, high-income taxpayers are subject to an additional tax of 3.8% on net investment income. As a result, investment income can be taxed at a rate as high as 43.4%.

The Trump Plan proposes to reduce the number of rate brackets from seven to three (10%, 25%, and 35%) and to repeal the 3.8% tax on net investment income. As a result, the highest tax rate would be reduced from 43.4% to 35%.

The Trump Plan is silent as to the income that would be subjected to the three rate brackets. As a candidate, President Trump proposed offering the largest tax cuts to married couples (to eliminate the so-called “marriage penalty”) and much smaller tax cuts (or increases) to single individuals.

Currently, dividends and long-term capital gains are taxed at a maximum rate of 23.8% (20%, plus the 3.8% tax on net investment income). This would be lowered under the Trump Plan to 20%.

The Trump Plan proposes to repeal the individual AMT. The AMT is an alternative tax regime with a higher tax base and a lower tax rate (28%).

The Trump Plan proposes drastic changes with regard to itemized deductions. Deductions for medical expenses, state and local taxes, and miscellaneous expenses would be repealed. The home mortgage and charitable contribution deductions would be retained.

Currently, US individuals with an estate of over $5.49 million (and $10.98 million for married couples) are subject to an estate tax upon death. Foreign individuals may face the US estate tax on US property with a value of over $60 thousand (unless a treaty provides relief). The Trump Plan proposes to repeal the estate tax.

The Trump Plan proposes several provisions designed to reduce the taxes of lower and middle income individuals. The plan would double the standard deduction. In addition, tax relief would be granted to families with child and dependent care expenses.

WTS Observation

The newly-issued Trump Plan is only one page long and contains less detail then the plan issued when President Trump was a candidate. As a result, much of the plan will need to be fleshed out over the coming weeks.

One important detail that is missing from the plan is the effective date. As a result, it may be prudent to suspend any significant tax planning actions that are in process until there is a better idea of what tax rules will be in effect for 2017.

The Trump Plan states that the Trump Administration will hold “listening sessions” with stakeholders during the month of May to receive input on the plan. The administration intends to work with the House and Senate to develop details and further refine the plan.

It remains to be seen whether the Trump Plan will be able to pass both houses of Congress and, if so, what compromises will be needed to allow that to happen.

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