

PUBLICATION

Congressional Republicans and White House Release Outline of Tax Reform Proposal

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On September 27, the White House and its allies on Capitol Hill released the outline of their long-promised tax reform proposal. Generally, the outline seeks to create three individual income tax rates (12, 25, and 35 percent), eliminate many personal exemptions and deductions, lower the corporate tax rate to 20 percent, and implement a territorial tax system. The plan is primarily based on House Speaker Ryan's "A Better Way" with the exception of the Border Adjustment Tax, which was not included. The proposal was only an outline, and much of the plan will need to be worked out by the tax-writing committees in the House and Senate. Look for the debate over tax reform to be intense as congressional Republicans attempt to move the measure through the streamlined reconciliation process over the coming months.

Background and Analysis: Since July, policymakers had been eagerly awaiting the September 27 announcement when the so-called "Big Six" tax reform negotiators – Treasury Secretary Steven Mnuchin, National Economic Council Director Gary Cohn, House Speaker Ryan, Senate Majority Leader McConnell, House Ways and Means Committee Chair Kevin Brady (R-TX), and Senate Finance Committee Chair Orrin Hatch (R-UT) – announced they had reached an agreement on a vision for the plan. The new outline begins to fill in the details of the broader principles announced in July, but leaves the development of specific legislative language to the House Ways and Means and Senate Finance Committees to work out over the coming months.

The outline does include significant new information as to where the ongoing policy process is expected to proceed. For personal taxes, the proposal simplifies the tax code, reducing the current seven tax brackets ranging from 10 percent to 39.60 percent to three tax brackets ranging from 12 percent to 35 percent – though the framework does not specify income levels to which these rates would apply. The proposal calls for nearly doubling the standard deduction to \$12,000 for single filers and \$24,000 for joint filers. The plan would also repeal most personal exemptions and itemized deductions with the exceptions of the mortgage interest and charitable contribution deductions. Finally, the proposal would repeal the estate tax.

The outline includes significant changes to the business tax code. Perhaps most importantly, the outline calls for a reduction in the corporate income tax to 20 percent and the repeal of the corporate alternative minimum tax. The proposal also allows for full expensing for new investments for at least five years and moves the U.S. to a territorial taxation system while imposing a one-time tax on unrepatriated foreign earnings (though the details of this remain unclear). Interestingly, the plan calls for a partial limit on the ability of corporations to deduct net interest and repeals the domestic production activities deduction, adding to the corporate tax burden for some companies. The proposal includes a 25 percent rate for pass-through businesses and urges Congress to consider rules to prevent "personal income" from being taxed at this rate.

With all Democrats expected to oppose the legislation, Senate Republicans will face a similar dynamic to what they faced in the debate over the Affordable Care Act when they tried (and failed) to craft legislation that pleased both the more moderate and conservative wings of the Republican caucus while still attracting support from at least 50 senators. Divisions have already begun to emerge with more conservative members such as

Senator Rand Paul (R-KY) pushing for deeper cuts, and deficit hawks such as Senator Bob Corker (R-TN) who said he would likely oppose any proposal that adds to the federal deficit. Republican leadership has not yet identified pay-fors (corresponding spending cuts) to fund the proposed tax cuts. Meanwhile, congressional Democrats have raised the alarm, accusing Republicans of supporting a tax plan that will lead to significant cuts in entitlement spending.

The proposal is expected to be considered under the budget reconciliation process, the outlines of which were formally proposed by the Senate Budget Committee at the end of September. The budget, if adopted, would allow Republicans to pass tax cuts without Democratic support in the Senate that reduce federal revenue by much as \$1.5 trillion over the coming decade. However, according to the Tax Policy Center, the tax proposal is expected to reduce federal revenues by \$2.4 trillion over the first decade and \$3.2 trillion over the following decade. Congressional Republicans rejected the Tax Policy Center's analysis, calling it "misleading, unfounded, and biased." The Senate is expected to consider the budget proposal in the coming weeks. The House approved its version of the budget on October 4 that outlines slightly different tax cut targets. Some sort of a compromise between the House and Senate versions will likely be negotiated in a conference committee over the coming months and will likely provide the final outline for the tax reform debate that is expected to take place this fall.