



Federal Tax Reform 2017

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Tax Reform in 2017

- Why Tax Reform?
- The Tax Proposals
- Final Comments



Why Tax Reform?

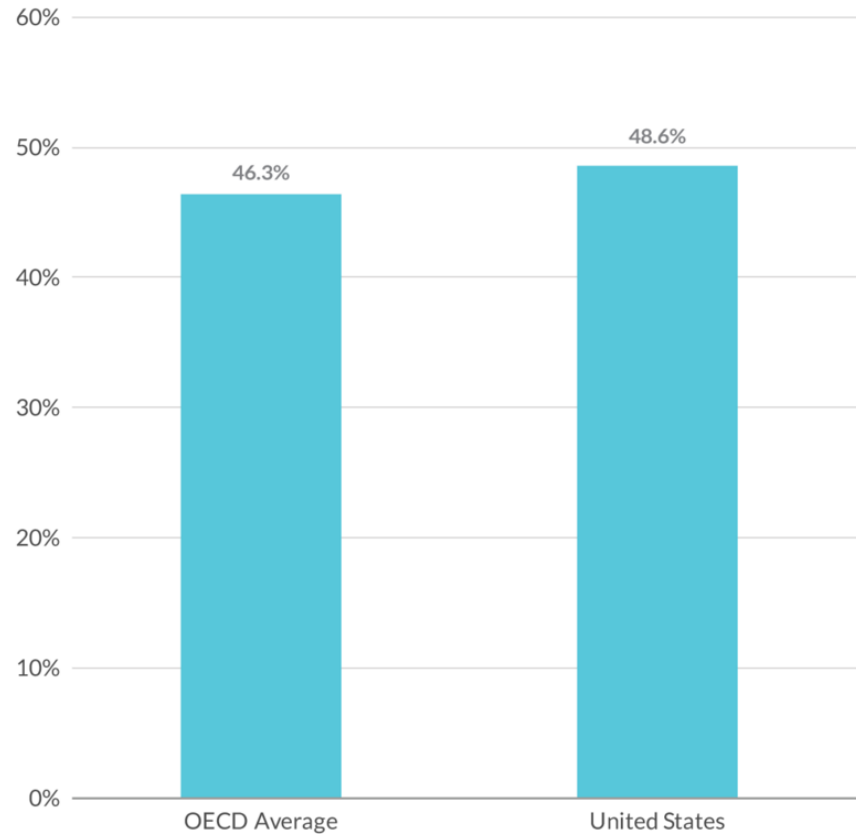
- High marginal tax rates on both businesses and individuals
 - Marginal corporate rate is highest among major nations.
 - High marginal rates on individuals (not just at the top).
- Poorly defined base
 - Double taxation of corporate income, poor cost recovery, worldwide tax system.
 - Lots of stuff that is currently exempt from individual income tax should be taxed.
- Complex in many ways
 - Lots of social policy built into both the individual and corporate tax code.
 - Some policies are worthwhile, but are probably more complicated than necessary.

Why Tax Reform?

High marginal tax rates, narrow tax base

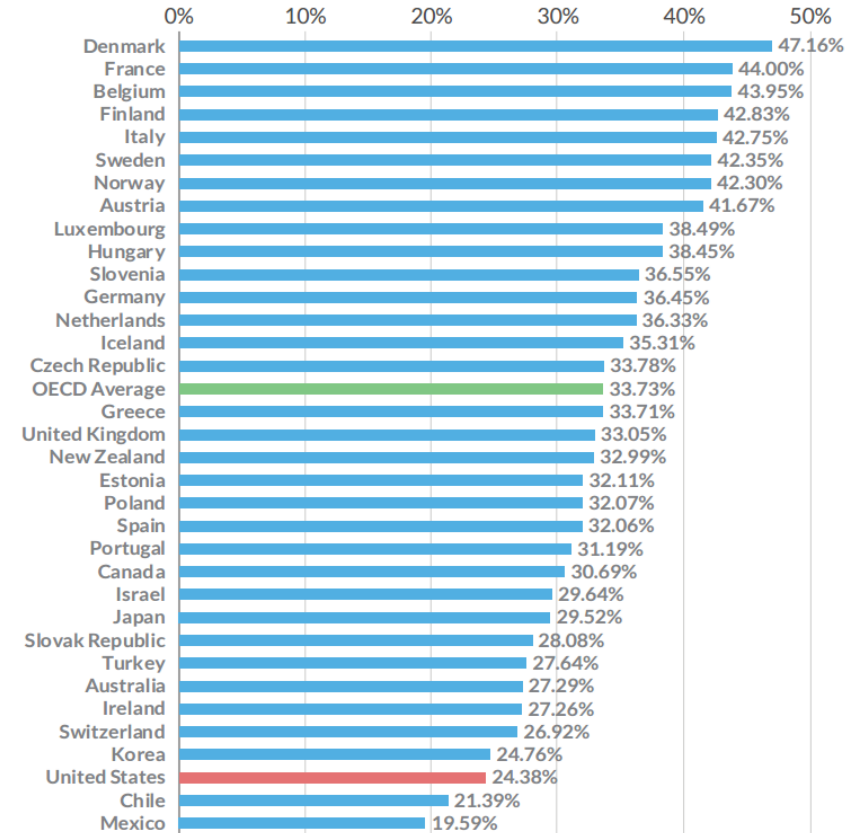
The Top Marginal Tax Rate on Labor Is Higher in the U.S. than in the OECD

Top Marginal Tax Rates on Income, the U.S. and OECD (2014)



The U.S. Collects Less in Taxes than Other Developed Nations

Government Tax Revenues, by OECD Country, as a Percentage of Gross Domestic Product (2012)



Overview of the Tax Reform Proposals

Two plans are being considered:

- The House GOP “Better Way” Plan
- Donald Trump’s Campaign Proposal



Tax Reform Proposals

Plans are similar at first glance, but have some important differences.

Both plans would:

- Cuts tax rates for both individuals and businesses.
- Limit itemized deductions, but expand the standard deduction and introduce new family benefits.
- Reduce federal revenue.
- Tend to grow the economy in the long run.



Individual Income Tax Reform

Both plans would 1) reduce marginal rates and 2) consolidate brackets

Tax Brackets for Ordinary Income Under Current Law and the Two Proposals

Current Law	Trump	House GOP	Single Brackets
10%	12%	12%	\$0 to \$9,275
15%	12%	12%	\$9,275 to \$37,650
25%	25%	25%	\$37,650 to \$91,150
28%	25%	25%	\$91,150 to \$112,500
28%	33%	25%	\$112,500 to \$190,150
33%	33%	33%	\$190,150 to \$413,350
35%	33%	33%	\$413,350 to \$415,050
39.6%	33%	33%	\$415,050+

- Slight marriage penalties remain.
- Trump’s plan eliminates head of household filing status.
- GOP plan taxes cap gains and dividends as ordinary income with 50% deduction.



Individual Income Tax Reform

- Both plans increase the standard deduction, change personal exemption

	Single	Joint	HoH	Personal Exemption
Current Law	: \$6,300	\$12,600	\$9,300	\$4,000
Trump	: \$15,000	\$30,000	Repealed	Repealed
House GOP	: \$12,000	\$24,000	\$18,000	\$500 <i>Credit</i>

- Both plans limit itemized deductions

Trump: Cap value of itemized deduction at \$100,000 (\$200,000 MFJ)

House GOP: Eliminates all itemized deductions except home mortgage and charitable



Individual Income Tax Reform

“IvankaCare”

- Allows families to exclude childcare expenses from AGI.
- Augments EITC for certain low-income families.
- Benefits are regressive with respect to income (an exclusion is worth \$1 times your marginal rate).
- A priority of the administration, meant to replace personal exemption (doesn't entirely do so for many taxpayers!).
- **Part of Trump proposal, not GOP proposal.**



Business Tax Changes

Both plans Seek to cut marginal tax rates on business and reform the business tax code

- Both plans significantly reduce the corporate income tax rates. The GOP plan to **20 percent**
Trump's plan to **15 percent.**
- Both plans also eliminate many extraneous deductions and credits from the business tax code such as Section 199, historic preservation credit, etc.
- Both plans also enact “deemed repatriation.” Currently deferred foreign profits will face a one-time tax.



Business Tax Changes

Pass-through businesses

- Both plans would alter the treatment of pass-through businesses.
- Pass-through businesses are those that pay tax through the individual income tax: LLCs, S corporations, and sole proprietorships.
- Both plans would place a maximum tax rate on this income: Trump 15% and GOP 25%.
- Not clear how this would be administered yet.



Business Tax Changes

GOP Tax Plan’s “destination-based cash-flow tax.”

- Businesses would be taxed based on their location of sales. Much harder to game (businesses cannot profit shift!), far fewer distortions than current corporate income tax.
- Four significant changes from current law:
 - 1)** Full expensing of capital investment
 - 2)** No deduction for net interest expense
 - 3)** No residual tax on foreign profits
 - 4)** A border adjustment: eliminate deduction for import expenses, exempt export income



Revenue and Budgetary Impacts

Both plans would result in lower federal revenue, but would grow the economy in the long run.

Economic and Budgetary Impact

	Trump	House GOP
GDP (Change in level)	8.2%	9.1%
Wage Rate (Change in level)	6.3%	7.7%
Full-time Equivalent Jobs (in thousands)	2,155	1,687
Static Revenue Impact (Billions, 10-years)	-\$5,906	-\$2,418
Dynamic Revenue Impact (Billions, 10-years)	-\$3,932	-\$191

- Both plans cut marginal rates on work, saving, and investment, which tend to grow the economy.
- Both plans cut marginal rates more than they broaden the base.

Source: Tax Foundation Taxes and Growth Model, March 2016

Note: Numbers are listed with the higher-rate assumption first and the lower-rate assumption second.

Distributional Impacts

Both plans would reduce the progressivity of the federal tax code

Static Distributional Analysis

% Changes in After-Tax Incomes

Income Group	House GOP	Trump
0% to 20%	0.3%	1.2%
20% to 40%	0.5%	0.8%
40% to 60%	0.2%	1.3%
60% to 80%	0.2%	1.9%
80% to 100%	1.0%	6.5%
90% to 100%	1.5%	8.3%
99% to 100%	5.3%	16.0%
TOTAL	0.7%	4.3%

- All taxpayers in all income groups get a tax cut (caveats in the Trump proposal).
- Top earners see largest tax cuts, driven primarily by top bracket reduction.



Final Comments

- No legislative language yet.
- Senate hasn't really started looking into tax reform yet (they tend to be slowpokes).
- Even in initial stages, some pieces are controversial. For example, the border adjustment. (Tax reform is never easy, but it is worth doing!).



For More Information

taxfoundation.org