Reforming America's Tax Code

Sarah Helton, Director, Michael Best Strategies
T. 202.747.9575
schelton@michaelbeststrategies.com

Our country's economic growth and prosperity may largely be impacted by future tax reform. The need for tax reform is not lost on the American people or policymakers. Our tax code is complex, burdensome, and out of step with the rest of the world. It penalizes individual savings and investment and encourages business to move overseas, given we have one of the highest corporate income tax rates in the developed world and a worldwide system of taxation.

As the American people keep a close eye on the President-elect Donald Trump and the tax policies he supports, we should also pay attention to and engage with Congress on this important issue. House and Senate Committee leaders have begun to share their proposals that will serve as a foundation for future legislation. More so, they have set comprehensive tax reform as their top priority for next year and expressed their intent to work across the aisle – a necessity for a successful reform. Just as Congress will look to President-elect Donald Trump to help lead the reform effort, Trump will look to Congress for their support to secure a legislative win in the first several months of the new administration. So while we will inevitably see some political and policy challenges, it appears we are in a sweet spot for tax reform to be successful next year.

We see the energy behind tax reform with several tax plans proposed by various Members of Congress, including Senate Finance Chairman Orrin Hatch (R-UT), Senator Ben Cardin (D-MD), Senator Ron Wyden (D-OR), Congressman David Nunes (R-CA), and Congressman Jim Renacci (R-OH). Below are highlights from plans released by the House Republicans and the President-elect Donald Trump.

Speaker Paul Ryan (R-WI) and House Committee on Ways and Means Chairman Kevin Brady (R-TX) unveiled the House Republican's plan in June. Given the House will likely remain in control by the Republicans, we can expect legislation next Congress to encompass the plan's various components. The plan is written to neutralize the tax code and grow the economy by impacting the gross domestic product (GDP), which would require direct influence on the level of labor supply, physical capital, human capital, and technological innovation.[1] The plan moves from an income-based system to a consumption-based system that seeks to encourage savings and investment. The current seven individual tax brackets will be reduced to three at rates of 12, 25, and 33 percent. The standard deduction will be doubled and all itemized deductions, with the exception of the mortgage interest deduction and charitable contribution deduction, will be eliminated. The plan also looks to provide relief for low and middle income families through a

[1] A Better Way, Tax, Page 12, http://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf.

package of higher education tax benefits and reform to the earned income tax credit that incentivizes work.
To increase domestic and global competitiveness for American businesses, House Republicans propose moving to a territorial tax system providing for border adjustments. Corporate tax rates will be reduced from 35 percent to a flat rate of 20 percent and pass through entities will be subject to a maximum rate of 25 percent rather than the top individual tax rate. The cost of capital investment will be fully and immediately deductible and the business credit for research and development will be preserved. However, the plan is sure to activate various industry groups who will be threatened with the elimination of special interest deductions and tax credits.

House Republicans have released comparatively more information about their proposed tax reform than President-elect Donald Trump.[2] Similar to the Republican plan, Trump proposes to establish three tax brackets at 12, 25, and 33 percent, increase the standard deduction, and eliminate all deductions except for the charitable deduction and the mortgage interest deduction. He would also eliminate the estate tax. As for businesses, comparable to the House Republican's plan, Trump proposes to lower the corporate rate to 15 percent with pass through businesses also at 15 percent, fully expense investment costs, and eliminate business credits except for the research and development credit.

When looking at the revenue and economic impact between the two plans, the Tax Foundation finds that the House Republican's plan would significantly reduce marginal tax rates and the cost of capital, which would lead to 9.1 percent higher GDP over the long term, 7.7 percent higher wages, and an additional 1.7 million full time equivalent jobs while reducing revenue by $191 billion over the first decade and less over subsequent decades.[3] The Foundation finds that Trump's plan would also significantly reduce marginal rates and cost of capital leading to higher long run levels of GDP, wages and full-time equivalent jobs while reducing federal revenue by between $2.6 and $3.9 trillion.[4]

Overall, each of these proposals sheds light on the complexity of tax reform and how they may be integrated remains to be seen. More so, these plans highlight how our tax system impacts every American. Businesses and individuals alike need to engage with the federal government on this important issue as Congress and the Trump Administration begin to lay the foundation for what should be a more fair and less onerous tax system that will spur our country's economic growth.

[2] "Comparing the 2016 Presidential Tax Reform Proposals," Tax Foundation, http://taxfoundation.org/comparing-2016-presidential-tax-reform-proposals.

[3] "Details and Analysis of the 2016 House Republican Tax Reform Plan," Kyle Pomerleau, July 5, 2016, http://taxfoundation.org/article/details-and-analysis-2016-house-republican-tax-reform-plan.

[4] "Details and Analysis of Donald Trump Tax Reform Plan, September 2016," Alan Cole, September 19, 2016, http://taxfoundation.org/article/details-and-analysis-donald-trump-tax-reform-plan-september-2016.

For more information about proposed federal tax reform, please contact Sarah Helton, Director of Strategies' Office in Washington, D.C., at schelton@michaelbeststrategies.com.