Client Update
The Trump Tax Reform Proposals

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Yesterday the Administration released its long-anticipated proposal for tax reform, promising "the biggest individual and business tax cut in American history." The one-page proposal sets out only general principles and is short on specifics, leaving many questions unanswered. The key takeaway is that the proposal would significantly lower tax rates. The Administration stated that it will hold listening sessions through the month of May, with the goal of adding detail to the proposal.

INDIVIDUALS

- There will be three income tax brackets (10%, 25% and 35%), reducing the top **individual** rate on ordinary income from 39.6% to 35%.
- The **standard deduction** will be doubled. Almost all **itemized deductions** and other tax preferences will be **eliminated** other than those for mortgage interest, charitable donations and possibly contributions to retirement plans.

<u>Comment</u>: The elimination of the deduction for state and local income and property taxes will disproportionately affect taxpayers living in jurisdictions with high state and local tax rates (*e.g.*, New York and California). Such taxpayers will pay federal tax on state and local tax. However, many individuals in these jurisdictions are subject to the alternative minimum tax and therefore do not benefit from this deduction.

- The individual alternative minimum tax and the estate tax will be eliminated.
- The top individual rate on **capital gains and dividends** will be 20%. The 3.8% Medicare tax on passive income will be repealed.
- **Carried interest** is not mentioned in the proposal and was not addressed at the press briefing introducing the proposal. President Trump's high-level outline of tax reform issued during his election campaign called for carried

interest to be taxed at ordinary rates for speculative partnerships that do not grow businesses, create jobs or risk their own capital.

BUSINESSES

- The **"business"** tax rate will be a flat **15%.**

Comment: Although the Administration's proposal refers to a general "business tax rate," reports have suggested that the 15% rate will apply to both corporate taxes and income from businesses held through pass-through structures (as was suggested in the proposal issued by President Trump during his election campaign). Secretary Mnuchin noted that there would be rules to prevent the wealthy from reducing their tax rate by setting up pass-through entities.

- **"Tax breaks for special interests"** will be eliminated.

Comment: The proposal provides no details on what these breaks are—for example, there is no guidance on whether the Administration's proposal would end or limit the deductibility of interest (as was suggested in the proposal issued by President Trump during his election campaign), nor is there any discussion of the related proposals to allow for immediate expensing of business investment.

INTERNATIONAL

- A **"territorial"** tax system will replace the current worldwide taxation system. Under a territorial system, American companies would only be taxed on income related to the United States; dividends from foreign subsidiaries and income from foreign branches would be exempt from U.S. tax.

Comment: A territorial system may spur considerable investment activity and share buy-backs because U.S. multinationals will no longer be subject to a tax penalty for repatriating foreign earnings.

- The proposal imposes a mandatory **one-time tax on offshore earnings**, which could then be repatriated without further U.S. tax.

Comment: The Administration's proposal does not specify the rate to be applied to the one-time deemed repatriation. The President proposed a 10% rate during his campaign.

Comment: Acquirors of foreign targets should consider making a "section 338 election" on the foreign targets to eliminate their accumulated profits, so that such profits are not subject to the one-time deemed repatriation tax.

- The proposal does not include the much-discussed "**border adjustment tax,**" under which exports would be exempted from tax and imports would be subject to tax. The border adjustment tax may resurface, however, in later proposals.

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Please do not hesitate to contact us with any questions.