



Understanding the Tax Reform Process: FAQs

(Updated for
What's
Happened
Lately)

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With Republicans controlling the White House as well as both chambers of Congress, tax reform (or, at least, significant tax legislation) is high on the legislative agenda. Although enactment of tax reform legislation in the near future would be difficult and is by no means certain, lawmakers’ interest in enacting tax reform soon may be higher now than at any other time since the Tax Reform Act of 1986 (the “1986 Act”) became law over three decades ago.

This document provides a high-level overview—in question and answer format—of what to expect regarding tax reform. This document also explains what steps businesses may want to consider taking now to prepare for the possibility of tax reform being enacted.

CAUTION: This document was initially released shortly after the November 2016 elections and was substantially updated on June 21, 2017. Future developments affecting the prospects, timing, and details of tax reform may occur rapidly. Thus, some information in this document might not be current after June 21, 2017.

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Prospects for Tax Reform

1. What's driving tax reform and how easy (or not) would it be to enact?

Republicans currently hold majorities in both the House and the Senate. As of June 21, 2017, there were (1) 241 Republicans and 194 Democrats in the House of Representatives¹ (compared to 247 Republicans and 188 Democrats at the end of the previous Congress); and (2) 52 Republicans and 48 Democrats in the Senate (compared to 54 Republicans and 46 Democrats at the end of the previous Congress).² Under the Constitution, the vice president of the United States (currently, Mike Pence) is president of the Senate and can vote to break a tie.

Both policy and political factors are driving the current tax reform effort. Considerable pressure for business tax reform has been building in the last decade and now that Republicans control the White House and both chambers of Congress, Republicans have a strong interest in showing that they can achieve tax reform as well as other priorities. Indeed, the political stakes of moving on tax reform appear to have grown as 2017 has progressed. Further, from a policy perspective, both President Trump and congressional Republicans share the same big picture goals of reducing tax rates for businesses and individuals.

¹ This includes Members who were elected in special elections held prior to June 21, 2017.

² The 48 Democrats in the Senate include two Independents who caucus, and often vote, with the Democrats.

Nonetheless, tax reform is inherently difficult and any number of things could derail the process. Without getting into the specifics of any particular tax reform proposal, here are just a few things to keep in mind:

- As a general matter, putting together tax reform is hard—really hard. Significant changes to the tax law not only can create “winners and losers” but also can have economic repercussions and alter the competitive landscape. Pressures from constituents, industry groups, businesses, and lobbyists can make it challenging to craft a politically palatable tax package that achieves distributional, revenue, and policy objectives. These challenges are part of the reason why tax reform does not happen often; in fact, the last time the Tax Code was substantially overhauled was over three decades ago (in 1986), and that legislation took a long and difficult road—and almost died at multiple points in the process.
- Even among Republicans, there are different views as to the proper size, shape, and details of tax reform. For example, some Republicans would be willing to enact tax cuts that might increase the deficit, while other Republicans favor reforms that congressional scorekeepers would score as “revenue neutral” (taking into account macroeconomic growth). Also, as we’ve seen already this year, some Republicans favor transformative changes, like moving towards a destination-based cash flow tax system with border adjustments, while others would prefer to stick to the existing income-based system, but with lower rates and a broader base. At this point in the process, Republicans are still working to reach consensus on the size and general shape of tax legislation.
- Even if Republicans reach consensus on the general goals of tax reform, the difficult process of working out the nitty-gritty details and fighting for constituent, local, and other interests, would remain. Members of Congress who represent different states and/or districts may have very different views on different proposals.
- The Senate generally requires 60 votes to approve legislation, unless special “budget reconciliation” rules can be used that provide a process for passing legislation with a simple majority of the Senate but that impose significant procedural hurdles. Given that there are only 52 Senate Republicans, achieving 60 votes to move tax reform through the Senate would require some Democratic support unless these budget reconciliation rules were used. As discussed in question 6, however, using budget reconciliation to move tax reform raises its own set of thorny issues that can affect the timing, substance, politics, and prospects of tax reform.

For these, and other reasons, enactment of tax reform in the short term remains difficult and, therefore, uncertain. Indeed, it is possible that lawmakers ultimately might pursue tax legislation that, while significant, falls short of fundamentally reforming the Tax Code. For more on this, see question 2.

2. Might “tax reform” be enacted in the near future?

That’s the billion (or trillion) dollar question. Unfortunately, no one knows the answer at this time—not even those lawmakers who are currently involved in the process. Further, the question of

what significant tax legislation rises to the level of constituting “tax reform” is, to some extent, in the eye of the beholder.

Broadly speaking, there are several possibilities. First, something transformative could be enacted—i.e., something that fundamentally and comprehensively overhauls the current Tax Code. Second, legislation could be enacted that cuts rates or that otherwise significantly changes current law, but that falls short of the level of change made when the Tax Code was last reformed in 1986. And, it’s even possible that no significant tax legislation might be enacted in the near future.

There currently are some Republicans who support transformative changes to the Tax Code and others who largely prefer major tax cuts. Republicans, however, can be expected to try hard to avoid the last outcome—no significant tax legislation. Only time can tell what ultimately will happen.

Process and Timing

3. What’s the legislative process expected to be?

In some sense, parts of the process already have taken place. Key lawmakers and their staffs have spent a lot of time in recent years assessing problems with the existing tax system and exploring, proposing, and examining potential reform alternatives. There also have been hearings on numerous tax reform topics, including the House blueprint’s border adjustment proposal and corporate integration (an issue of particular interest to Senate Finance Committee Chairman Hatch).

So, what’s ahead? At this point, the Trump Administration and Republicans in both the House and the Senate are working to reach consensus on the size and shape of tax reform by fall of 2017—and possibly even to produce some sort of draft legislation by that time. It is possible that members of the tax-writing committees might be involved behind-the-scenes in these discussions. It is also possible that key policymakers might use a process similar to that used for the 1986 Act in filling in the blanks and addressing the myriad of issues raised, after consensus on high level details is worked out.

a. What process was used for the 1986 Act?

Very generally, for the 1986 Act, the House Ways and Means Committee held a meeting to “mark up” the “Chairman’s mark” of tax reform legislation. During the markup, members of the committee introduced amendments that were voted on by the committee. At the end of the markup, the members voted on the bill and, once approved, the bill was reported for consideration by the full House of Representatives.

A similar process unfolded in the Senate. That is, the Finance Committee marked up its Chairman’s mark of tax reform legislation. During the markup, members of the Finance Committee raised amendments to the chairman’s mark. After the Finance Committee reported

its version of legislation, the bill moved to the Senate floor where more amendments were considered. The Senate bill was different from the House bill in a number of significant ways.

Before legislation can be sent to the president, both the House and Senate need to pass identical versions of the legislation. For the 1986 Act, a conference committee composed of members of the House and the Senate convened to resolve differences between the House and Senate bills and produce a conference agreement. The House and Senate then voted on the conference agreement. The conference agreement then was sent to the president, who signed the legislation into law.

b. What about other processes?

As mentioned above, it's possible that much of the work on major tax legislation could be done behind the scenes by key members of the administration and Congress. If so, one critical question is to what extent members of the tax-writing committees (and, possibly, selected members of the "rank and file") might be involved in working out the details. It's also possible that a process might be used that eliminates the need for a conference between the House and the Senate.

For example, it would be possible for a consensus bill to be drafted—complete with technical details—largely behind the scenes by selected "players" from the Administration, House, and Senate, and for this bill to proceed directly to the House and Senate floors, without first being approved by the tax-writing committees. It would also be possible for various versions of a tax reform bill to "ping pong" back and forth between the House and Senate if amendments were made in either chamber until both chambers ultimately passed the same bill (avoiding a conference).

These approaches, however, might face practical and political obstacles, particularly given the complexity and nuances of reforming the Tax Code and the likely interest of tax-writing committee members in playing a major public role in the process.

4. How long might the tax reform process take?

Key Republicans have expressed a strong interest in enacting tax reform as soon as possible. Moreover, the upcoming November 2018 congressional elections loom over the congressional schedule and add to the considerable political pressure for Republicans to enact significant legislation, such as major tax legislation, before fall of next year.

However, even if the administration and congressional Republicans reach agreement on the size and shape of tax reform by early fall of 2017 (which is not certain), the legislative process still could take a while to play out, making passage in 2017 difficult (although not impossible). For example, it simply could take time for policymakers to work out all the details of tax reform given the complexity of our tax laws; the pervasive impact of tax on individuals, business, the economy, and different sectors of the marketplace; and the many different views lawmakers can expect to hear from lobbyists, constituents, interest groups, and others on a plethora of issues.

And, even if Republicans are able to navigate the intrinsically difficult issues associated with drafting substantial tax legislation fairly quickly, other issues and the general political atmosphere can affect the pace at which legislation in general is considered. Moreover, if Republicans use budget reconciliation to move tax reform, additional timing issues may be raised. See questions 6 and 7 for more on this.

5. How long did the process take in 1986?

It took a long time for the last major reform of the Tax Code to move through the Congress, even once lawmakers generally agreed on the high level principles of reducing rates and broadening the base. While the budget reconciliation process was not used and the income-based system was retained, reaching agreement on base broadeners, loophole closers, and other revenue raisers was a difficult and time-consuming process.

The 1986 Act was put together with a divided government (Republican president, Democratic-controlled House, and Republican-controlled Senate). About 13 months elapsed between the date that the House Ways and Means Committee began its markup of a tax reform bill and the day President Reagan signed the legislation into law. Specifically:

- In the lead-up to the 1986 Act, the Ways and Means Committee conducted 26 days of markup of tax reform; this markup began on September 18, 1985, included some breaks, and did not end until December 3, 1985.
- The House passed its bill about two weeks after the markup concluded (on December 17, 1985).
- The Senate Finance Committee reported its tax reform bill approximately four and 1/2 months after the House passed its version of tax reform. The Senate Finance Committee conducted 17 days of markup; its markup began on March 19, 1986, included some breaks, and concluded on May 6, 1986.
- After the Senate Finance Committee filed its report for the bill on May 29, 1986, the full Senate deliberated for a little under a month before passing the bill, with amendments, on June 24, 1986.
- The conference committee approved a conference agreement about two months after Senate passage and filed its report another month later (on September 18, 1986).
- The House and Senate then each passed the conference agreement, which was signed into law by President Reagan a few weeks later (on October 22, 1986).

6. What's budget reconciliation and how could it affect the design of tax reform?

In the Senate, subject to limited exceptions, it typically takes 60 votes to avoid a filibuster (which otherwise could delay or block legislative action). Although Republicans control the Senate, they hold only 52 seats. Thus, barring an unexpected change to long-standing Senate rules (a very controversial process known as the “nuclear option”), the support of at least some Democratic Senators would be needed to achieve the 60 votes required to thwart a filibuster and allow tax reform legislation to proceed—unless the special rules described below were used.

An alternative to the general Senate rules—known as “budget reconciliation”—provides a process by which some types of legislation (including certain tax measures) can be moved forward in the Senate with only a simple majority vote. These reconciliation rules include a number of complex procedural limitations and conditions that can affect the substance and design of the underlying legislation. For example, the reconciliation rules include a requirement that any title of legislation generally cannot increase the federal long-term deficit in any year beyond the “budget window” (which in recent years, has been a 10-year window).

Thus, as a very general matter, if Republican leaders want to be able to pass a tax bill in the Senate with fewer than 60 votes, that legislation may need to be drafted so as to not contain a net tax cut in years outside the budget window. A number of mechanisms might need to be included to satisfy this objective, possibly including phase-outs or expiration dates. For example, tax legislation passed during the Bush Administration using reconciliation included temporary (10-year) tax cuts. The prospect of temporary tax law changes, however, would not be optimal from a policy perspective and could reduce the estimated effect of tax reform on growth in the economy.

7. Would using the budget reconciliation process for tax reform be easy?

Using budget reconciliation to enact tax reform would not be easy—and has potential to slow down the timing of the process.

As a threshold matter, to be able to use budget reconciliation to move a tax bill with a simple majority in the Senate, Congress first would have to create “reconciliation instructions” charging specified committees to report legislation in the form of a “reconciliation bill” that achieves certain revenue objectives. Reconciliation instructions may only be created as part of the annual congressional budget process by being included in an annual budget resolution.³ Budget rules generally provide that:

- The number of reconciliation bills that may be considered in a fiscal year is limited, and
- Only one reconciliation bill that affects federal revenues may be considered by Congress at a time.

The current budget resolution was passed by Congress in January 2017 and authorized committees to begin work on a reconciliation bill for fiscal year 2017 (FY17) that would modify the

³ A “budget resolution” provides a nonbinding framework for congressional consideration of revenue, spending, and other budget-related legislation. A budget resolution must be passed by the both the House and Senate with a simple majority vote and does not need to be approved by the president.

Affordable Care Act. The legislative process with respect to this health-care related reconciliation bill is still ongoing.

Because budget rules only allow Congress to actively consider one revenue-related reconciliation bill at a time, if Republicans decide to use reconciliation to address tax reform, then either:

- The present FY17 reconciliation bill addressing health care must be disposed of—through enactment, abandonment or other means—before Congress can pass an FY18 budget resolution authorizing a new FY18 reconciliation bill to be used for tax reform; or
- Congress must abandon the plan to use the FY17 reconciliation bill for health care matters and determine if it is possible to use the already existing reconciliation instructions to enact tax reform.

Both of these options, however, create their own distinct challenges for congressional leaders. For example:

- An attempt to pass a FY18 budget resolution may well face a number of difficult political challenges unrelated to tax matters. In particular, there are indications that a number of Republicans would like to see the budget resolution for FY18 not only set targets for tax reform, but also address a number of spending issues, including possible entitlement reform and a reexamination of military spending. With fairly small majorities in both the House and Senate, addressing divisive issues could prove to be a challenge for passage of the budget resolution in both chambers—even by simple majorities.
- An attempt to “repurpose” the FY17 reconciliation instructions for use for tax reform raises a number of procedural questions. Without digging into these too deeply, it is unclear whether the various details contained in a reconciliation bill designed to be utilized for a health care reform package would suffice for use for a tax reform package. Furthermore, there is some question as to whether the FY17 reconciliation bill would be available for use after FY17 ends on September 30, 2017.

Also, keep in mind that the difficulties associated with reaching agreement on budget issues could be compounded if Republicans have to deal with raising the debt limit before, or in close proximity to, dealing with the budget. Raising the debt limit is another area where different Republicans may have different views and where spending and entitlement issues can come into play. In fact, it is possible that support from some Democrats (who may try to extract some concessions) may be needed to increase the debt limit. Right now, it’s looking like Congress might deal with the debt limit as soon as July—which, from a political perspective, could raise the volume on whether spending and entitlement issues should be addressed in conjunction with a budget resolution.

Thus, using a budget resolution to address tax reform is complicated.

8. What’s the interplay between health care and tax reform legislation?

Question 7 addresses how what happens with health care legislation could affect the timing of tax reform if congressional Republicans try to use the budget reconciliation process for tax reform. But, that’s not all. There are also other interplays that could affect the politics, content, and cost of tax reform.

For example, if legislation repealing and replacing (or substantially modifying) the Affordable Care Act is not enacted, Republicans may feel even more pressure to enact tax reform legislation before the next elections in order to show success on at least one high priority item.

Further, the House version of health care legislation, as well as discussion draft of a possible Senate bill, include repeal of some of the tax provisions that were in the Affordable Care Act, such as the 3.8% net investment income tax. If health care legislation is not enacted before tax reform is addressed, policymakers may have to decide whether to address these issues in the context of tax reform. This could affect the content and the cost of tax reform.

Read a KPMG [report](#) on the House health care bill and taxes.

9. How involved are congressional Democrats likely to be in the tax reform process?

The odds of the two parties working together on significant legislation appear low at this time. Taking into account the larger political setting, the better bet right now would seem to favor a Republican-only process.

As explained in question 6, however, a Republican-only process could raise its own set of challenges. Republicans could only afford to lose a small number of Republican votes to secure passage—and keeping most Republicans on board may not be easy, particularly if the legislation includes some unpopular provisions. The need for sufficient Republican support also provides negotiating leverage to various Republican caucuses in the House, as well as to every Republican in the Senate, which can make reaching an agreement all the more difficult if there is not any Democratic support.

Nonetheless, anything is possible—and there's still talk of trying to make tax reform a bipartisan process. Indeed, some Republicans may prefer to have at least some Democratic support (if feasible) for a variety of reasons. For example, they may believe such support may make it easier to pass tax reform, they may want to avoid having to use the budget reconciliation process for tax reform, or they may want to have some company from the other side in voting for potentially unpopular proposals or for changes that may have unexpected consequences.

It is also worth at least noting that there is some common ground between some Republicans and some Democrats with respect to *business* tax reform. Some Democrats (including Minority Leader Schumer) agree that the rules applicable to multinational businesses need to be changed. Indeed, the previous administration (the Obama Administration) supported key aspects of business tax reform, including a lower C corporation tax rate. Republicans and Democrats, however, tend to differ as to what the optimal individual rate structure should be, making bipartisan agreement on individual reforms (and the proper treatment of passthrough entities) more difficult. There also could be expected to be differences on key issues such as the over-all size and distributional consequences of reform.

Key Players

10. Who are some of the key administration and congressional players?

In the administration, Treasury Secretary Steve Mnuchin and National Economic Council (“NEC”) Director Gary Cohn have been prominently engaged in tax reform discussions. Some key positions in Treasury have not yet been confirmed, including the Assistant Secretary for Tax Policy.

In the House, Paul Ryan (R-WI), the Speaker, is a strong proponent of tax reform (particularly “transformational” tax reform that is permanent and revenue neutral, taking into account estimated economic growth). Kevin Brady (R-TX), the chairman of the Ways and Means Committee, was the head of the task force that put together the House Republican blueprint for tax reform. For a full list of Ways and Means Committee members, see the Ways and Means Committee [website](#). It is not clear what role House Democrats might play in the process given the limited role the minority party typically plays in the House; however, if they are involved, ranking Democrat on the Ways and Means Committee, Richard Neal (D-MA), could be expected to play a part.

In the Senate, Mitch McConnell (R-KY), Orrin Hatch (R-UT), and Mike Enzi (R-WY) can be expected to play key roles in the process. Senator McConnell is the Senate Majority Leader. Senator Hatch is chairman of the Finance Committee. For a full list of Finance Committee members, see the Finance Committee [website](#). Senator Enzi, the Chairman of the Budget Committee, largely would be responsible for ruling on the long-term budgetary effects of a reconciliation tax reform bill—which could affect whether tax reform is drafted as permanent or temporary. (See questions 6 and 12.)

It also is worth noting that, on the Democratic side, Senate Minority Leader Charles Schumer (D-NY) has a strong interest in international tax reform (and finding funds for infrastructure). Senator Wyden (D-OR) is the ranking Democrat on the Finance Committee and has done a lot of groundwork on business tax reform and has issued discussion drafts on several tax reform topics.

The Substance of Tax Reform

11. Is tax reform likely to address both individuals and businesses?

Both congressional Republicans and President Trump generally support comprehensive tax reform that includes lowering business and individual rates. Although high level discussions among the administration, House Republicans, and Senate Republicans are still ongoing, at this time it appears that the focus is on addressing both business and individual tax reform as part of the same legislation. Moreover, as indicated in question 16, there appears to be considerable consensus between congressional Republicans and President Trump on the approach to individual tax reform (although there’s still a lot of discussion as to the best approach for business tax reform).

Note, however, that it is not yet clear how the benefits and burdens of tax law changes would be divided between corporations and individuals. And, although policy concerns with the corporate side of the Tax Code have been playing a major role in driving tax reform efforts, at the end of the day, it's possible that some Members of Congress might be more concerned with delivering individual (and small business) tax cuts to their constituents than with corporate tax cuts.⁴

12. Would tax reform be permanent or temporary?

It depends on whether budget reconciliation procedures are used. If reconciliation procedures are used, tax cuts might need to be drafted as temporary to avoid increasing the deficit in a year beyond the budget window. (See question 6.)

Currently, a 10-year window is used for budget reconciliation purposes. Recently, a letter from the Joint Committee on Taxation ("JCT") became public that showed that a three-year corporate tax rate cut resulted in a non-negligible revenue loss in the tax years immediately following the budget window, notwithstanding the temporary nature of the rate reduction. This was due to projected increases in the amount of credits carried to years outside the window, as well as a lowering of the "repatriation baseline" due to the temporary increase of repatriation during the period of reduced taxes.

Because as little as a three-year tax corporate rate reduction could run afoul of the budget reconciliation rules, there has been talk of possibly using a longer budget window (perhaps 20 years) so that there could be a longer temporary corporate rate reduction (perhaps up to 12 years). Using a longer window, however, could raise other issues and it is not clear whether such an approach ultimately would be adopted.

It is also worth noting that it might be possible to craft a version of tax reform that would not increase the deficit outside the budget window. In such case, Congress could make tax reform permanent even using the budget reconciliation process.

If reconciliation procedures are not used, tax reform in all likelihood would be drafted as permanent—whether deficit neutral or not. But, as noted, not using reconciliation might not be feasible from a political perspective.

13. What has the president proposed on tax reform?

In his election campaign, now-President Trump advocated among the following tax law changes:

- Provide a 15% business rate for "all businesses, both small and large, that want to retain the profits within the business"
- Allow firms engaged in manufacturing in the United States to elect to expense capital investment and lose the deductibility of corporate interest expense
- Eliminate most business "tax expenditures," but not the research credit

⁴ Keep in mind that the 1986 Act increased taxes on corporations to fund individual rate cuts. Of course, the drivers of tax reform were different then than they are now. Nonetheless, many observers of the 1986 Act process were surprised at the extent to which the overall tax burden on corporations was increased.

- Immediate taxation of CFC profits (at a 15% rate), with foreign tax credits
- Provide tax incentives for investment in infrastructure
- Repatriate accumulated offshore earnings at a one-time 10% rate
- Change the individual ordinary income rate structure to 12% / 25% / 33%, but retain 20% maximum capital gains rate
- Repeal the net investment income tax
- Cap itemized deductions (\$200,000 for joint filers)
- Tax carried interest as ordinary income
- Repeal the estate tax, but tax certain capital gains over \$10 million at death
- Repeal both the corporate and individual alternative minimum tax (“AMT”)

More recently, Treasury Secretary Mnuchin and NEC Director Cohn announced at a White House press conference on April 26, 2017, what they called “core principles” of the Trump Administration’s plan for tax reform and simplification. They indicated that the administration is working with the House and the Senate on details and on turning the plan into legislation. These core principles, which subsequently were referred to in the administration’s budget proposals for the fiscal year that begins October 1, 2017, are as follows:

Business Reform

- Lower the income tax rate on corporations, as well as on passthroughs to 15% (possibly limited to passthroughs that are “small” or “medium” in size), with an unspecified mechanism to be discussed with Congress to address concerns that some individuals might attempt to use passthroughs as a mechanism to avoid paying the properly applicable individual tax rate
- Move from a worldwide to a territorial tax system
- Impose a one-time tax on existing overseas profits (with the rate to be determined in consultation with the House and Senate)
- Eliminate tax breaks for “special interests”

Individual Reform

- Reduce the number of individual income tax brackets from seven to three, resulting in 10%, 25%, and 35% brackets
- Double the standard deduction
- Repeal the 3.8% net investment income tax, reducing the maximum capital gains rate to 20%
- Repeal the individual alternative minimum tax
- Repeal the estate tax

- Eliminate all itemized deductions, except the mortgage interest and charitable contribution deductions
- Provide tax relief to help families with child and dependent care expenses

14. What's the starting point for tax reform in the House?

The starting point for tax reform in the House has been the blueprint released by House Republicans on June 24, 2016. Read the [blueprint](#) on the Ways and Means website. As released in June 2016, the blueprint is a high-level conceptual document. Ways and Means Republican staff have been working on the details behind the scenes and hearings have been held on some aspects of the proposal.

The future of the blueprint is not clear at this time. Some of the blueprint's proposals (such as a proposed border adjustment) have been the subject of intense lobbying (both for and against), and some Republicans are arguing for a different approach to tax reform. Speaker Ryan and Chairman Brady, however, still appear committed to the blueprint's approach (with modifications/transitions to some of the proposals), on both policy and revenue grounds.

Very generally, the blueprint proposes to reduce tax rates for businesses and for individuals and to move the U.S. tax system closer to a consumption-based tax system through reforms of the income tax rules (without providing a value added tax ("VAT") or national sales tax). The blueprint includes among the following proposals:

- Lower the C corporation tax rate to a flat rate of 20%
- Allow businesses to fully and immediately expense the cost of investments in tangible property (such as equipment and buildings) and intangible assets (such as intellectual property), but not land
- Allow businesses to deduct interest expense against interest income, with any net interest expense not being deductible but being carried forward indefinitely to use against future net interest income (and with Ways and Means working to develop special rules for financial services companies that would take into account the role of interest income and expense in their business models)
- Allow net operating losses (NOLs) to be carried forward indefinitely and to be increased by an interest factor that compensates for inflation and a real return on capital, although NOLs would not be allowed to be carried back and the deduction with respect to NOL carryforwards would be limited to 90% of the net taxable amount for the year determined without regard to the carryforward
- Eliminate various "special-interest deductions and credits" that are designed to encourage particular business activities (such as the section 199 domestic manufacturing deduction and other unspecified incentives)
- Move towards a destination-based tax system under which the taxing jurisdiction for business income would be based on the location of consumption (i.e., where goods are

sold or services are performed) rather than the location of production; this new system (1) would replace the current system of taxing U.S. persons on their worldwide income with a territorial tax system and (2) would provide for “border adjustments” exempting exports and taxing imports

- Change the individual ordinary income rate structure to 12% / 25% / 33%, but cap the tax rate applicable to “active business income” from sole proprietorships and passthrough entities at 25%, except to the extent of an owner-operator’s “reasonable compensation” for services (which would be subject to the general ordinary rate structure)
- Allow individuals to deduct half of their net capital gains, dividends, **and interest** income (leading to basic rates of 6%, 12.5%, and 16.5% on such income depending on the applicable rate bracket)
- Repeal the net investment income tax (as part of separate health care reform legislation)
- Eliminate or modify various unspecified exemptions, deductions, and credits for individuals
- Eliminate all itemized deductions except the mortgage interest deduction and charitable contribution deduction (which might be modified)
- Repeal estate and generation-skipping transfer taxes
- Repeal both the individual and corporate AMT
- Change the structure of the IRS

For a more complete list of the blueprint’s proposals and for observations and analysis of the blueprint, read KPMG’s [report](#) that was released shortly after the blueprint was issued in June 2016.

a. **How does the blueprint propose to move from a worldwide tax system to a territorial system?**

The blueprint would move from the current worldwide system—which permits deferral of the U.S. tax on foreign active business earnings until those earnings are repatriated—to a “territorial” system. It would exempt foreign active business income by providing a 100% exemption for dividends received from foreign subsidiaries. The blueprint notes that the 100% exemption is designed both to increase the competitiveness of U.S.-based companies vis-à-vis foreign based multinationals and to eliminate the “lock-out effect” of current law (i.e., the disincentive to repatriate earnings due to residual U.S. taxation). The 100% rate is more generous than some prior proposals for an exemption system, which would impose a small (~5%) “haircut” as a proxy for not disallowing domestically incurred expenses attributable to the exempt foreign income.

Although the blueprint provides little detail on the mechanics of the new system, it proposes to repeal most of the current “subpart F” regime that subjects certain income of controlled foreign corporations (CFCs) to current U.S. taxation. The blueprint specifically focuses on the foreign base company income rules and notes that the bulk of the subpart F rules, which were intended

to discourage U.S.-based multinationals from conducting certain activities overseas, would no longer be needed because the move towards a consumption tax system would eliminate the tax incentives to locate business activities outside the United States.

The blueprint would retain the foreign personal holding company income rules, however, that generally focus on passive foreign income, such as dividends, interest, and royalties. As part of the shift to a territorial system, the blueprint would impose a one-time tax on accumulated foreign earnings. The blueprint would impose an 8.75-percent tax on accumulated foreign earnings held in cash or cash equivalents and a 3.5-percent tax on all other accumulated foreign earnings (with companies able to pay the repatriation tax over an eight-year period).

b. How would the blueprint move to a consumption-based tax system?

As proposed, the blueprint's primary mechanism for moving to a consumption-based tax system is the provision allowing businesses to fully and immediately expense the costs of investments in tangible property and intangible assets (but not land). With this feature, the proposed system could be viewed as economically equivalent to a "subtraction method" VAT (albeit with a deduction for labor costs if current deductibility of compensation is retained).

c. What are the proposed border adjustments?

The details and structure of the blueprint's "border adjustments" are not specified. The blueprint explains that the intended result is that products, services, and intangibles that are exported outside the United States are intended to be exempt from U.S. income tax, while products, services, and intangibles that are imported into the United States would be subject to U.S. tax, regardless where they are produced. The border adjustments appear intended to increase domestic growth by encouraging companies to locate in the United States and to use domestically produced input.

Although it is not certain, it appears that the border adjustments might include denying deductions for all or part of imported input, while exempting income from exports from tax. If expenses for imports are not deductible, businesses that sell products largely domestically but that rely heavily on imported input could end up paying tax on a broader base (albeit at a lower corporate rate) than under current law. Conversely, businesses that are net exporters could end up benefiting from possible border adjustments. Because the United States is a net importer (i.e., imports exceed exports), the blueprint's border adjustments can be expected to provide significant revenue to reduce or offset costs of other aspects of tax reform; they also might contribute to positive macroeconomic growth effects.

d. How might the WTO view the proposed border adjustments?

The United States is one of the few developed nations that does not impose a national-level VAT. The blueprint notes that VAT systems allow countries to make border adjustments to exports and imports that reduce the costs borne by exported products and increase the costs borne by imported products. Although the net effect of these border adjustments should be neutral when both the exporting and importing countries employ VAT systems, the blueprint notes that World

Trade Organization (WTO) restrictions have created an imbalance for the United States because the WTO prevents border adjustments for exports with respect to direct taxes like traditional corporate income tax systems. These restrictions do not apply to VAT systems and other indirect consumption taxes. As a result, exports from the United States implicitly bear the cost of the U.S. income tax while imports into the United States do not bear any U.S. income tax.

The blueprint explains that its proposed consumption-based tax approach would in effect make the U.S. cross-border system similar to a VAT and thereby allow the United States to counter this imbalance by incorporating border adjustments in a new tax system that is consistent with WTO rules. It remains to be seen, however, whether the blueprint's tax reform proposal that includes border adjustments, once fully structured, would in fact be viewed as compliant with WTO rules. That might turn not only on whether the WTO views the new tax system taken as a whole (once tax reform is enacted) as sufficiently "indirect" to allow for border adjustments, but also on the structure of those adjustments.

15. What's the likely Senate starting point for tax reform?

At the current time, all options appear to be on the table in the Senate, including proposals included in the Tax Reform Act of 2014, which was introduced in the House in February of 2014 by then-Chairman of the House Ways and Means Committee, Dave Camp (R-MI) ("2014 Reform Bill"). (See question 16 for more on the 2014 Reform Bill.) Chairman Hatch also can be expected to consider corporate integration through a dividends-paid deduction—an issue his staff has studied extensively in recent years.

In a statement on June 8, 2017, Chairman Hatch noted that "virtually any potential offset for reduced tax rates should be on the table." He also indicated that some Republicans may have a difficult time supporting a package that adds to the deficit and that he would have to "see where the votes are." Nonetheless, he expressed his personal view that he doesn't "see a problem with a tax reform proposal that loses revenue in the short-term if we can show that it will help put the economy on a better growth path."

With respect to rate reduction, the Chairman indicated that, although the general goal is to get rates as low as possible under the circumstances, he is not committed to any specific rate targets. He also noted the need to convert to a territorial system with safeguards to prevent base erosion. He also remarked that:

My goal in tax reform is to find the proverbial "sweet spot," that will maximize the growth potential of the final package without jeopardizing its prospects for passage. To that end, I am in constant contact with the administration and the leaders in the House, as well as the Senate leadership, in an ongoing effort to find that balance.

Read more about Senator Hatch's recent statement: [TaxNewsFlash](#)

16. What was the 2014 Reform Bill's approach to tax reform?

In 2014, Rep. Camp, the then-Chairman of the House Ways and Means Committee, introduced a lengthy tax reform bill that offered base broadening provisions to offset the costs of proposed individual and corporate rate reductions—the 2014 Reform Bill. Today's policymakers can be expected to consider some of the base-broadeners (and other reform proposals) included in that bill as they craft the details of tax reform legislation. Nonetheless, some of revenue raisers (like the “MACRS” proposal mentioned below) likely are now less favored in light of feedback received on the 2014 Reform Bill.

In 2014, KPMG released a lengthy report on a discussion draft of the 2014 Reform Bill. The report includes a summary of the discussion draft's proposals as well as observations and technical analysis. Read the [KPMG report](#) [PDF 3 MB].

Some of the many proposals in the 2014 Reform Bill were:

Business Provisions – In General

The 2014 Reform Bill proposed to reduce the statutory maximum corporate tax rate to 25% over five years, eliminating the current 15% tax bracket. It would also eliminate the corporate AMT (and unused AMT credits would be refundable over several years).

The cost of the reduction in the rate would be offset by base-broadening measures to eliminate or modify substantially dozens of tax preferences for various activities and products, including the following:

- The modified accelerated cost recovery system (“MACRS”) for business assets would be repealed and would be replaced with a system that lengthens recovery lives and indexes the depreciable basis for inflation.
- Research and advertising expenses would be amortized, instead of being expensed as they are currently.
- Net operating loss (NOL) rules would be modified to limit the amount of NOL deductions permissible in any year.
- The last-in, first-out (LIFO) and lower-of-cost-or-market methods of accounting for inventory would be repealed.
- The deduction currently allowed for U.S. manufacturing income would be phased out.

The bill also would tax some income from the partnership profits interest of managers of some investment funds as ordinary income—the “carried interest” income that currently may be taxed as capital gains. Other provisions relevant to passthrough entities include changes to the employment tax rules for partners and S corporation shareholders; changes to some of the technical subchapter K and subchapter S rules; and changes to the rules regarding which publicly traded partnerships (PTPs) can be taxed as partnerships.

Financial institutions

The bill proposed a new excise tax on the assets of “systemically important” financial institutions. Assets of such institutions above \$500 billion would be subject to an annual charge of 14 basis points.

Other provisions of interest to financial institutions included a rule that would prevent arbitrage of deductible interest expense and tax-exempt income. Also, certain derivatives transactions would be marked to market annually, and interest paid on private activity bonds would no longer be tax-exempt.

Multinational entity taxation

The bill proposed significant changes to the taxation of business income earned outside the United States. It would move from the current system, which permits deferral of the U.S. tax on foreign active business earnings until those earnings are repatriated, to a “territorial” system. Active foreign earnings of U.S. companies would be allowed a dividends received deduction of 95%—thus eliminating most residual U.S. tax. This system is necessarily quite complex, however, as the exemption of virtually all active foreign earnings from U.S. tax requires effective measures to prevent the offshore shifting of profits, which would erode the U.S. tax base.

Income from intangibles deemed to be income in excess of 10% of the basis of assets would be subject to tax, but at a reduced rate effected, after phase-in, by a 40% deduction.

The bill also included other measures to avoid erosion of the U.S. tax base through, for example, the excessive placement of debt in the United States relative to worldwide group debt.

The transition to the territorial system would address accumulated, untaxed foreign earnings, reportedly in excess of \$2 trillion. It would deem those earnings to be repatriated to the United States, but taxed at one of two reduced rates, depending on how the earnings have been deployed. Earnings in cash or cash equivalents would be taxed at 8.75%, while other earnings, perhaps invested in plant and equipment, would be subject to a 3.5% rate. The resulting tax could be paid in installments over eight years.

Individual provisions

The bill proposed reducing the seven current tax brackets to three: 10%, 25%, and 35%. The 35% bracket resulted from a 10% surtax on modified adjusted gross income (MAGI) over certain thresholds. MAGI would be decreased by qualified domestic manufacturing income

Capital gains and dividends would be taxed at these same ordinary rates, but only after a 40% deduction, correspondingly reducing the effective rate. The individual AMT, like the corporate AMT, would be repealed. At the same time, the standard deduction would be increased.

The revenue cost of these changes would be offset by modifying or eliminating a number of tax preferences, many of them significant and of long standing. Personal exemptions would be eliminated. For those who itemize deductions, the principal limitation of the home mortgage interest deduction would be reduced from \$1 million to \$500,000, and the deduction for state and local taxes would be eliminated. In addition, the benefit of itemized deductions (other than the deduction for charitable contributions) and the standard deduction would be capped at the 25% rate, reducing their value to higher-income taxpayers.

Also capped at the 25% rate would be tax preferences involving exclusions from income, in essence imposing a 10% surtax on these items. Among the capped preferences would be the exclusion for employer-provided health, accident, and defined contribution retirement benefits, along with excluded foreign earned income, tax-exempt interest, and untaxed Social Security benefits. Deductions for health premiums for the self-employed and for contributions to health savings accounts would be subject to the cap.

A host of special credits and deductions also would be repealed.

17. What are the key similarities and differences between the administration’s “core principles,” the House blueprint, and the 2014 Reform Bill?

KPMG has prepared a chart that compares at a high level key elements of the administration’s core principles, the House blueprint, and the 2014 Reform Bill. Read the [chart](#).

As illustrated in the chart, there appears to be considerable consensus between current congressional Republicans and President Trump on the general approach to individual tax reform—that is, cut rates by eliminating many deductions. However, there’s still a lot of discussion as to the best approach for business tax reform—with all options still on the table. And, there still does not appear to be agreement on key big picture issues, such as the extent to which tax reform needs to be revenue neutral. (See next question for more on this.)

Revenue Considerations

18. What’s the revenue target for tax reform?

It’s not clear yet. As explained in question 1, Republicans in the Congress and the administration are still discussing what the revenue target for tax reform should be, including whether or not tax reform needs to be revenue neutral using estimates from the official congressional scorekeepers. Different Republicans have different views regarding the appropriate revenue target.

19. What are the revenue consequences of the House blueprint and the administration’s proposals?

The Joint Committee on Taxation (“JCT”) provides the official revenue score of tax legislation for the Congress. The JCT has not yet released a score of either the blueprint or the administration’s core principles. Further, the administration’s core principles are very general; it would be difficult to provide a score without making a host of assumptions. However, some general observations can be made.

First, the JCT can be expected to provide a “conventional” score of tax reform legislation before such legislation is marked up by the tax-writing committees in the House and the Senate and at certain other points in the process. This score would take into account expected behavioral changes resulting from the legislation, but not growth in overall GDP. In addition, the JCT is expected to provide an estimate of the projected macroeconomic effect of the legislation—that is, the expected effect on growth in the economy.

Second, some outside groups have done their own revenue estimates of the blueprint and the president’s tax proposals made during the campaign. These estimates use different models and make various assumptions about the technical details of specific proposals. The models used may differ from the models the JCT uses in its official estimate. In addition, some of the assumptions made could turn out to be inaccurate when more details about the proposals are released.

Nonetheless, estimates from outside groups may be useful at a high level in getting a sense of the relative magnitude of the proposals. For example, estimates from both the Tax Foundation and the Tax Policy Center suggest that the tax proposals made by the Trump campaign during 2016, taken as a whole, would reflect a larger overall net tax cut and may increase the deficit significantly more than the House blueprint, even taking into account expected macroeconomic growth. The following summarizes the estimates contained in the Tax Policy Center’s “An Analysis of the House GOP Tax Plan”⁵ and “An Analysis of Donald Trump’s Revised Tax Plan”,⁶ and the Tax Foundation’s “Details and Analysis of the 2016 House Republican Tax Reform Plan”⁷ and “Details and Analysis of the Donald Trump Tax Reform Plan, September 2016”:⁸

	Blueprint	Trump Campaign Proposals
Tax Policy Center	\$3.1 trillion revenue cost to government over first 10 years, without accounting for added interest costs and macroeconomic growth. With these facts, federal debt would rise by at least \$3 trillion over the first 10 years.	\$6.2 trillion revenue cost to government over first 10 years, without accounting for added interest costs and macroeconomic growth. With these facts, federal debt would rise by at least \$7 trillion over the first 10 years.
Tax Foundation	\$2.4 trillion over the first 10 years on a “static” basis. Taking into account the larger economy and the broader tax base, however, the plan would reduce revenue by \$191 billion over the first 10 years.	Between \$4.4 trillion and \$5.9 trillion over the first 10 years on a “static” basis (depending upon how passthrough business income is taxed). Taking into account the larger economy and the broader tax base, however, the plan would reduce revenue by between \$2.6 trillion and \$3.9 trillion over the first 10 years.

⁵ Authored by Jim Nunns, Len Burman, Ben Page, Jeff Rohaly, and Joe Rosenberg, and published on September 16, 2016.

⁶ Authored by Jim Nunns, Len Burman, Ben Page, Jeff Rohaly, and Joe Rosenberg, and published on October 18, 2016.

⁷ Authored by Kyle Pomerleau and published on July 5, 2016.

⁸ Authored by Alan Cole and published on September 19, 2016.

Note that neither the Tax Policy Center nor the Tax Foundation has yet provided a revenue estimate of the Trump Administration’s “core principles” document (which is not detailed).

20. How might revenue costs affect the substance of tax reform?

Revenue considerations can be expected to play a big role in the substance of tax reform. Even if cuts in taxes are scored as increasing economic growth, significant revenue raising provisions might still need to be included (with the amount needed being a function of the revenue goal). Revenue-raising provisions may be particularly important if lawmakers attempt to enact *permanent* tax cuts using budget reconciliation procedures (i.e., given the need to not increase the deficit outside the scoring window).

As indicated, neither the blueprint nor the administration’s “core principles” specify all the incentives and other “tax expenditures” that may be considered as potential revenue raisers. Any revenue raisers that have been included in past reform proposals—as well as new proposals—potentially could be on the table.

Winners and Losers

21. Could tax reform result in winners and losers?

Yes, and that’s part of what makes tax reform so difficult to enact. Even if a tax reform bill is “revenue neutral” in the aggregate, any given taxpayer, depending on its facts, could end up paying more, or less tax, than it does under current law. As a result, businesses may want to model various tax reform proposals, making reasonable assumptions about details.

For example, looking just at the House blueprint and keeping in mind that models would need to take into account specific facts and circumstances, some of the factors that generally might contribute to a more favorable result than current law might include:

- Business has a high number of domestic suppliers relative to foreign suppliers and a high number of foreign customers relative to U.S. customers
- Business is asset-intensive
- Business does not use much leverage
- Business’s tax burden under current law is mainly determined by the tax rate (not by using deductions and incentives to lower the tax base)
- Business does not depend on particular tax incentives to be viable

Conversely, some of the factors that might contribute to a less favorable result than under current law might include:

- Business has a high number of foreign suppliers relative to domestic suppliers and a high number of U.S. customers relative to foreign customers
- Business has multi-national operations and significant cross-border financing

- Business is highly leveraged
- Business's tax base under current law is significantly reduced by incentives and deductions
- Business model depends on particular tax incentives to be viable

More generally, if tax reform is enacted, whether a business views itself as a “winner” or “loser” also may be affected by how tax reform might affect its business model, its product and service offerings, and the competitive landscape, and how associated changes in the U.S. economy and global financial and tax systems might affect its sales and operations.

Effective Dates and Transition Rules

22. What about effective dates and transition relief?

It is too soon to know for sure what the effective dates of particular provisions in tax reform legislation might be, assuming tax reform ultimately is enacted. Some effective dates could turn on when tax reform legislation is completed. For example, if legislation is finalized towards the end of a calendar year, it is possible (although not certain) that taxwriters might decide not to make provisions effective until the beginning of the next year.

Revenue, policy, and political considerations also could affect effective dates. For example, taxwriters might consider whether some “favorable” provisions should be retroactive to when the legislative process begins to discourage taxpayers from delaying desirable economic activities. They also might consider phasing in some favorable provisions to achieve revenue goals. Conversely, taxwriters might consider whether some revenue-raising provisions should be effective immediately (or even retroactively, perhaps to discourage certain activities) or should be effective prospectively or on a phased-in basis (to alleviate possible economic and political impact of tax law changes). For example, Chairman Brady recently has made some statements about potentially phasing in some elements of the blueprint's proposals (such as the proposed border adjustment).

Note that the blueprint explicitly indicates that transition rules are on the table, given the significance of the changes contemplated. Specifically, the blueprint indicates that taxwriters “will craft clear rules to serve as an appropriate bridge from the current tax system to the new system, with particular attention given to comments received from stakeholders.”

Businesses and industries should begin considering whether transition relief may be needed early in the legislative process.

Preparing for Tax Reform

23. What can businesses do to prepare for the possibility of tax reform?

Given the possibility that tax reform may move forward in the next couple of years, businesses may want to develop strategies for (1) monitoring tax reform proposals and developments, (2) assessing how proposals might affect them, (3) incorporating the possibility of significant tax law changes into current planning, and (4) communicating with Congress on significant issues. For example, businesses may want to do the following:

- Consider how tax reform proposals that are currently being considered might affect their particular facts and circumstances, as well as the potential impact on future plans
- Develop a high level economic model of the possible effects of tax reform on the specific business, using reasonable assumptions or alternative scenarios in situations in which details of blueprint are not clear
- Discuss the potential impact of tax reform with the “C suite,” considering the potential impact on the business’s tax burden as well as broader effects on a company’s products, business model, the competitive landscape, and the economy
- Develop strategy for monitoring ongoing legislative developments
- For areas of significant concern, identify potential allies (trade associations, industry groups, etc.)
- Consider advocacy priorities and reasonable legislative options, including possible carve-outs
- Develop appropriate transition rule proposals

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