KPMG

The Trump Administration and Tax Reform

December 2016

Tax reform - The state of play

— For the first time since 2006, the Republican Party (GOP) will control the House, Senate, and White House simultaneously.

— In the intervening decade, the urgency for tax reform, long a GOP priority, has increased for a number of reasons:

- The United States now has the highest statutory corporate rate in the Organisation for Economic Co-operation and Development (OECD)
- Gross domestic product (GDP) growth continues to lag behind historical averages
- The U.S. manufacturing sector continues to decline
- The development of the base erosion and profit shifting (BEPS) recommendations puts effective rate pressures on U.S. multinationals
- The European Commission's State Aid cases cast doubt on the predictability of the global tax system
- Significant migration of business income into partnerships and other passthroughs has eroded the U.S. tax base
- Corporate inversions further erode the tax base and raise questions of fairness.

— Speaker of the House Paul Ryan was a driving force behind the development of the House GOP "Blueprint on Tax Reform" released in June 2016.

— Donald Trump's campaign tax plan borrowed heavily from the Blueprint's concepts, suggesting at least some consensus between the incoming administration and congressional Republicans.

Tax reform - Observations

- The House GOP Blueprint (released June 24, 2016) is the likely starting point for tax reform
- The Blueprint would make a number of dramatic changes to the tax code, largely pushing the tax system closer to a consumption-based tax
- Many of the Blueprint policy choices are intended to encourage GDP growth
- The Blueprint is designed, *in theory*, to be revenue neutral—that necessarily involves revenue trade-offs that create the possibility of winners and losers
- Failure to achieve revenue neutrality could undercut support for reform on both sides of the aisle
- Achieving passage in the Senate will be a complex task—for both procedural and political reasons

Links:

House Blueprint

KPMG: Observations on Blueprint

KPMG: Trump Tax Plan – Blueprint Comparison

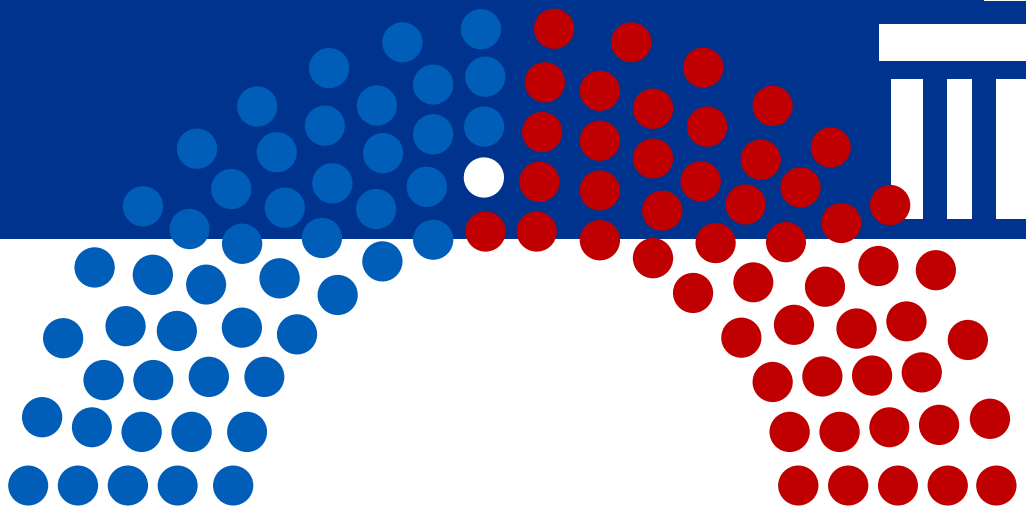
Senate 2017

Democrats	48 (+2)
Republicans	51

*One seat yet to be determined – Louisiana will conduct runoff on 12/10/16

Majority Leader:
Mitch McConnell (R-KY)

Chairman, Senate Finance:
Orrin Hatch (R-UT)



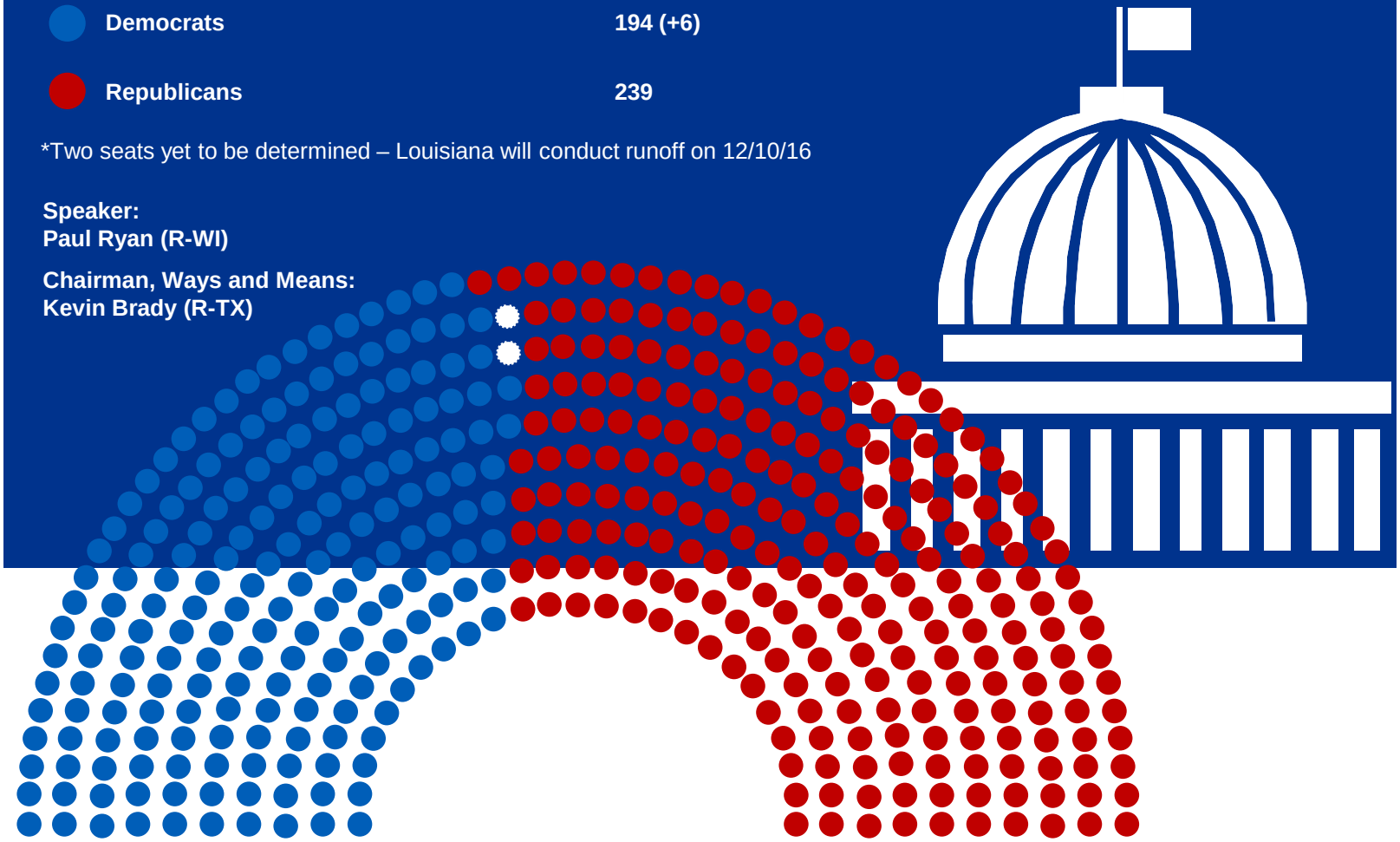
House 2017 (as of 11/25/16)

Democrats	194 (+6)
Republicans	239

*Two seats yet to be determined – Louisiana will conduct runoff on 12/10/16

Speaker:
Paul Ryan (R-WI)

Chairman, Ways and Means:
Kevin Brady (R-TX)



GOP House Blueprint – Highlights

Corporate:

- Reduce rate to 20 percent
- Full expensing
- True territorial international tax system
- Border adjustable
- Repatriation at 8.75 percent (cash and equivalents)/3.5 percent (non-cash and equivalents)
- Repeal of Alternative Minimum Tax (AMT)
- Interest expense nondeductible (except against interest income)
- Would retain versions of R&D and LIFO
- Nearly all other credits/deductions eliminated

GOP House Blueprint – Highlights (continued)

Individuals:

- Three brackets (12 percent, 25 percent, and 33 percent)
- Deduction for half of dividends, interest, and capital gains (thus rates of 6 percent, 12.5 percent, and 16.5 percent for that income)
- AMT repealed
- Versions of home mortgage interest and charitable deductions maintained
- Cap exclusion for employer provided healthcare
- Other deductions likely to be eliminated
- Increase standard deduction

Pass-throughs:

- Tax rate on business income capped at 25 percent
- Business income defined in reference to “reasonable compensation”
- No specific rule for carried interest

Tax reform plus/minus

Factors favoring reform		Countervailing factors
Increased urgency around tax reform	⟷	Repeal and replacement of the Affordable Care Act possibly a higher GOP priority
U.S. statutory corporate tax rate highest in the OECD	⟷	U.S. multinationals' effective rates largely in line with OECD averages—could erode political support
Unified GOP control of House, Senate, and White House	⟷	Senate rules generally require 60 votes (8 Democrats) to pass most legislation
GOP may have "budget reconciliation" option to avoid Senate 60-vote filibuster threshold	⟷	Budget reconciliation rules can impose budgetary "straitjacket," making policy options less desirable
Mandatory repatriation of foreign earnings to pay in part for infrastructure investment could draw bipartisan support	⟷	Use of repatriation revenue to pay for spending could be viewed as a violation of the pledge not to raise taxes signed by more than 250 members of Congress
Use of new rules requiring dynamic scoring could reduce costs of rate reduction	⟷	Little precedent for use of dynamic scoring in official revenue estimates—benefits could prove to be de minimis
Goal of revenue neutrality reduces budgetary pressures of rate cuts	⟷	Revenue neutrality increases likelihood of losers and winners

Tax reform - factors affecting outcomes

Factors suggesting lower tax burden	Factors suggesting higher tax burden
High number of domestic suppliers, foreign customers	High number of foreign suppliers, domestic customers
Asset-intensive business	Multinational with significant cross-border financing
Low-leverage business model	High-leverage business model
Domestically domiciled IP	Value chain relies on imports from foreign affiliates
Tax burden currently determined largely by the statutory tax rate	Currently manage tax burden via heavy use of deductions, credits, preference items, and other incentives and special rules

Next steps

Possible process for action on tax reform

The House

- Ways and Means releases tax reform draft
- Ways and Means Chairman releases Chairman's mark and/or modified mark
- Ways and Means "marks up" tax reform bill, including amendments
- Full House of Representatives passes bill approved by Ways and Means (further amendments unlikely)
- House bill sent to Senate

The Senate

- Senate Finance releases mark (could be similar to or different from House bill)
- Senate Finance Chairman releases modified mark
- Senate Finance "marks up" its own tax reform bill, including amendments
- Full Senate considers bill approved by Senate Finance (further amendments possible)
- If bill achieves 60 votes, then to conference with the House
- Alternatively, "budget reconciliation" vehicle to achieve Senate approval
- Senate considers policy changes to conform with Budget Reconciliation rules

Conference

- House and Senate call for conference to reconcile differences between the two versions of the bill
- House and Senate Republicans and Democrats appoint conferees to negotiate conference report
- If conferees resolve their differences, the negotiated Conference Report sent back to House and Senate for approval
- No amendments to Conference Report permitted
- Senate may achieve 60 votes or 51 (via Reconcilation) for passage
- If approved, the bill is sent to president

Signature

- Conference report sent to president for signature, veto, or nonaction
- Treasury and Internal Revenue Service begin process of implementing the new law

Action steps

- Tax reform in 2017–2018 is far from a certainty
- Still, with the election of Donald Trump and a GOP-held Congress, the likelihood is significantly greater
- Taxpayers should engage with congressional tax-writers *now* to make sure concerns are heard and understood
- Once Congress begins to act, it may be too late
- Consider the following list of actions:
  1. Read the Blueprint
  2. Apply client facts to the Blueprint
  3. Consider where the Blueprint lacks sufficient detail to determine application
  4. Develop high-level economic model of effect on the company's tax position and business results
  5. Identify allies (trade association, industry, etc.)
  6. Consider advocacy priorities and reasonable legislative options
  7. Consider carve-outs (industry, unique facts, etc.)
  8. Develop appropriate transition rule proposals
  9. Plan for technical corrections

Thank you

For more information, contact your KPMG LLP adviser for tax or:

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