STRADLEY RONON

# Tax Insights

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Tax Practice Group

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## News From the 2017 Mutual Funds and Investment Management Conference

The 2017 ICI Mutual Funds and Investment Management Conference included a panel on tax reform and its possible impact on the fund industry and fund investors. Some of the issues discussed included the following:

Corporate Integration

House Republicans issued a “blueprint” for comprehensive tax reform in June 2016. The blueprint is viewed as the “base document” for tax reform. Senate Finance Committee Chairman Orrin Hatch (R-Utah) has been working on a corporate integration discussion draft. The release date for this draft is uncertain. Corporate integration would eliminate double taxation of corporate earnings through a dividends-paid deduction at the corporate level. Dividends would be taxed through a withholding tax on shareholders. Interest would be deductible at the corporate level and taxed at the lender level.

Competing Objectives

The panelists noted that health care reform must be solved prior to tax reform being possible.

Trump’s Plan

Trump’s plan for tax reform has been revised to more closely align with that of House Republicans. His corporate tax proposals include reducing the business income tax rate to 15 percent, allowing businesses to elect immediate expensing of new business investments with no deduction for net interest expenses and imposing a 10 percent rate on repatriated earnings.

House Republicans’ Blueprint for Individuals

The House Republicans’ blueprint for individual tax reform calls for:

- A 33 percent top individual rate.
- A 16.5 percent top capital gains/dividend rate.
- The repeal of the alternative minimum tax (AMT) and the 3.8 percent Medicare tax on net investment income.
- The repeal of all deductions other than deductions for charitable contributions and mortgage interest.
- The repeal of the estate tax.

The House Republicans’ blueprint for corporate tax reform calls for:

- A 20 percent top corporate rate.
- A 25 percent top pass-through rate.
- The repeal of the corporate AMT.
- The immediate expensing of new business investments.
- The repeal of business deductions and credits (other than for research and development).

- The repeal of the net business interest expense deduction.
- The deemed repatriation of foreign earnings (8.75 percent cash and 3.5 percent noncash investments).
- The implementation of a new border adjustment mechanism to exempt exports and tax imports.
- The repeal of Subpart F (other than the foreign personal holding company rules).

Possible Use of Budget Reconciliation

If Democratic support for tax reform cannot be obtained, a budget reconciliation measure is likely to be used. Legislation enacted through budget reconciliation cannot increase the deficit outside the 10-year budget window. Consequently, the legislation (or certain provisions) would "sunset" after 10 years (similar to the Bush tax cuts) unless subsequently extended or made permanent.

International Tax Reform – Border Adjustment

The border adjustment is designed to pay for the benefits of tax reform. It is expected to raise $1.1 trillion to $1.3 trillion over 10 years. Under the border adjustment tax, imports would be subject to tax, but exports would not be. The blueprint for tax reform does not address how the border adjustment would work for the financial services industry.

Taxation of Derivatives

There seems to be consensus on moving to a mark-to-market system of taxing derivatives, with the resulting gain or loss taxed as ordinary income and not capital gain. The ICI has questioned whether a mark-to-market regime is best for all derivatives and has commented that a significant implementation period would be needed. The ICI has also commented that ordinary treatment creates specific concerns for RICs, as RICs are not permitted to claim a net operating loss carryforward under current law.

Municipal Bond Interest

The blueprint does not mention municipal bonds directly, but does mention repealing unnamed special-interest provisions. This has caused some to be concerned that the exemption for interest on municipal bonds could be included. Such a step would have a significant impact on municipal bond funds. At one point Trump indicated, when meeting with a group of mayors in December 2016, that he would maintain the exemption for interest on municipal bonds.

## IRS Rules Matching Services Are Not Established Securities Markets

In Private Letter Ruling 201710019 (https://www.irs.gov/pub/irs-wd/201710019.pdf), the IRS ruled that matching services offered by a broker-dealer to facilitate the buying and selling of nonpublicly traded limited partnership interests are not established securities markets for the purpose of Section 7704. (Section references are to the Internal Revenue Code of 1986, as amended.)

## Housing Cost Allowances Issued for Those Working Abroad in High-Cost Areas

For purposes of foreign housing cost income exclusion under Section 911(a), the IRS provided a table in Notice 2017-21, 2017-13 IRB (https://www.irs.gov/pub/irs-drop/n-17-21.pdf), identifying locations in countries with high housing costs compared with the U.S. and setting out an adjusted limitation on housing expenses for qualified individuals incurring expenses in listed locations in 2017 for use in determining housing expenses under Section 911(c)(2)(A). Without adjustment for higher-cost cities and regions, the applicable limit for 2017 is $30,630.

## President Trump Releases Budget Blueprint

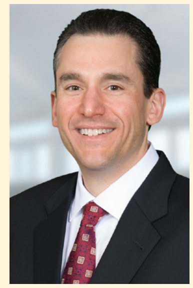
President Donald Trump released his 53-page "skinny budget" — "America First, A Budget Blueprint to Make America Great Again" (https://www.irs.gov/pub/irs-drop/n-17-21.pdf) — a wish list of spending requests for Congress and some basic economic projections in which he lays out his plans for boosting military spending and cutting foreign aid and an array of domestic programs — including a $239 million funding reduction for the IRS. A more complete budget is set for release in May. The skinny budget does not address Trump's promised tax cuts or other tax changes. It focuses on "discretionary" programs that are subject to renewal every year and not "entitlement" programs such as the Social Security retirement program and the Medicare and Medicaid health programs. The budget outline also does not incorporate Trump's promised $1 trillion infrastructure plan.

The president's budget requests $12.1 billion in discretionary resources for the Department of the Treasury's domestic programs — a $519 million (or 4.1 percent) decrease from the 2017 annualized level.

The president's Treasury budget includes a $239 million funding reduction from the 2017 annualized level for the IRS. It asserts that diverting resources from antiquated operations that are still reliant on paper-based review in the era of electronic tax filing would achieve significant savings.

### NYSBA Tax Section Proposes Future Regs on Debt Instruments

The New York State Bar Association Tax Section has submitted a report (http://www.stradley.com/~/media/Files/Publications/2017/03/NYSBA-AHYDO.pdf) on changing the treatment of applicable high-yield discount obligations (AHYDO) by modifying the current AHYDO rules under Section 163 that defer, and in some cases deny, the ability to take deductions of accrued original issue discounts for issuers of high-yield debt instruments.



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