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President Trump and the Big Six Release Framework for Tax Reform

President Donald Trump and certain members of Congress released a "unified framework" for tax reform (Unified Framework for Fixing Our Broken Tax Code (https://www.treasury.gov/press-center/press-releases/Documents/Tax-Framework.pdf)). The document is scant on details and leaves the specifics of tax reform to be worked out by the House Ways and Means Committee and the Senate Finance Committee. The framework resulted from discussions among a group that has been dubbed the "Big Six" – House Speaker Paul Ryan, R-Wis., Senate Majority Leader Mitch McConnell, R-Ky., Treasury Secretary Steven Mnuchin, White House economic adviser Gary Cohn, House Ways & Means Committee Chairman Kevin Brady, R-Texas, and Senate Finance Committee Chairman Orrin Hatch, R-Utah.

The framework does not contemplate repealing the interest exclusion for municipal bond interest. 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. The framework states that certain industries and sectors are governed by special tax rules and that such rules will be "modernize[d]... to ensure that the tax code better reflects economic reality and that such rules provide little opportunity for tax avoidance." The framework provides no insight as to the "rules" intended to be targeted by this statement.

Brady indicated that his plan is to turn the framework into legislation to be passed by the end of this year. Also, Mnuchin has said that Trump would like the tax reform provisions to be retroactive to Jan. 1.

Highlights of the framework include:

Business tax reform.

- New top rate for pass-throughs. The maximum tax rate applied to the business income of small and family-owned businesses conducted as sole proprietorships, partnerships and S corporations would be 25 percent. The framework "contemplates that the committees will adopt measures to prevent the recharacterization of personal income into business income to prevent wealthy individuals from avoiding the top personal tax rate."
- New corporate tax rate. The framework would reduce the corporate tax rate to 20 percent (down from the current top rate of 35 percent). It also seeks to eliminate the corporate alternative minimum tax (AMT).
- Full expensing for five years. The framework calls for businesses to immediately write off (i.e., expense) the cost of new investments in depreciable assets, other than structures that are made after Sept. 27, for at least five years.
- Interest expense deductions. The frameworks calls for "partially limiting" the deduction for net interest expense incurred by C corporations (without providing details on what this means). The tax-writing committees are instructed to consider how interest should be treated by noncorporate taxpayers.
- Repeal of deductions and credits; research and low-income housing credits retained. The framework states that, because of the rate reduction for businesses, the Section 199 domestic production activities deduction would no longer be necessary. The framework further contemplates that "numerous other special exclusions and deductions" would be repealed or restricted. However, it is anticipated that the research credit and the low-income housing tax credit would be retained. It leaves open the possibility of the committees retaining other business credits "to the extent budgetary limitations allow."

International tax reform.

- Foreign dividend exemption; repatriation. The framework would provide for a 100 percent

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exemption for dividends from foreign subsidiaries, defined as companies in which the U.S. parent owns "at least a 10% stake." To accomplish the transition to the exemption, the framework would treat accumulated offshore profits as repatriated, which would give rise to a one-time repatriation tax (set at a "low" but unspecified tax rate) that could be paid over five years. Accumulated foreign earnings "held in illiquid assets" would be subject to a lower tax rate than foreign earnings held in "cash or cash equivalents." Adoption of the exemption would move the United States to a territorial tax system (as opposed to the existing worldwide system of taxation) and allow for future foreign earnings to be repatriated to the United States without additional tax.

- Anti-erosion rules. The framework provides for rules that would "protect the U.S. tax base by taxing at a reduced rate and on a global basis the foreign profits of U.S. multinational corporations."

Individual tax reforms.

- Increased standard deduction; elimination of personal exemptions. The framework calls for increasing the standard deduction to $24,000 for married taxpayers filing jointly, and $12,000 for single filers. To simplify the tax rules, the additional standard deduction and personal exemptions for the taxpayer and spouse are consolidated into this larger standard deduction.
- Reduced number of tax brackets. The framework calls for reducing the number of tax brackets from seven to three: 12 percent, 25 percent and 35 percent. However, the proposal does not state the income brackets for each of the rates specified. The framework allows that "[a]n additional top rate may apply to the highest-income taxpayers to ensure that the reformed tax code is at least as progressive as the existing tax code." The framework does not address the current law's 3.8 percent surtax on net investment income or the 0.9 percent additional Medicare tax.
- AMT repealed. The framework seeks to repeal the individual AMT.
- Itemized deductions eliminated, but home mortgage interest and charitable contribution deductions retained. The framework calls for the elimination of "most" itemized deductions (including the state and local tax deduction), but seeks to retain tax incentives for home mortgage interest and charitable contributions.
- Work, education and retirement benefits. The framework contemplates the retention of "tax benefits that encourage work, higher education and retirement security." However, the tax-writing committees are "encouraged" to make these tax benefits simpler and more effective.
- Estate and generation-skipping transfer taxes repealed. The framework calls for the repeal of the estate tax and the generation-skipping transfer tax. The gift tax would remain.

IRS Withdraws and Reissues Proposed Regulations on Private Activity Bonds

The Treasury Department and the IRS issued proposed regulations (REG-128841-07 (https://s3.amazonaws.com/public-inspection.federalregister.gov/2017-20661.pdf)) updating the public approval requirement under Section 147(f) applicable to tax-exempt private activity bonds issued by state and local governments. The IRS withdrew two sets of existing proposed regulations and replaced them with new proposed regulations reflecting statutory changes and advances in technology for providing reasonable notice of a public hearing. The proposed regulations also include rules for the public approval of mortgage revenue bonds, qualified student loan bonds and qualified 501(c)(3) bonds issued for pooled financings (as described in Section 147(b)(4)). (Section references are to the Internal Revenue Code of 1986, as amended.)

IRS Rules on Consequences of Settlement Involving REMICs

The IRS has issued additional private letter rulings – Private Letter Rulings 201738001 (https://www.irs.gov/pub/irs-wd/201738001.pdf) and 201738003 (https://www.irs.gov/pub/irs-wd/201738003.pdf) – relating to the tax consequences of certain REMICs' receipt of settlement proceeds. Regarding the REMICs that made a timely, valid and continuing REMIC election pursuant to the applicable governing agreement, and that sued certain mortgage sellers for breaching the representations and warranties in the sales agreements, none of their execution of the settlement agreement, right to receive or receipt of settlement payments caused each taxpayer to fail to meet the requirements of Section 860D(a)(4), relating to the definition of a REMIC, since the settlement payments arose from each of their interests in mortgage loans and status as a REMIC.

IRS Issues Notice Loosening FATCA Reporting Requirements

The IRS issued Notice 2017-46 (https://www.irs.gov/pub/irs-drop/n-17-46.pdf) modifying the requirements for financial institutions to collect taxpayer identification numbers (TINs) pursuant to the Foreign Account Tax Compliance Act (FATCA). The notice states that foreign financial institutions (FFIs) required to report TINs for U.S. taxpayers' accounts under a FATCA intergovernmental agreement will not be considered significantly noncompliant for 2017-2019 if they are unable to provide the TIN and they (a) report the account holder's date of birth, (b) annually request the missing TIN from the account holder and (3) did not find the TIN after searching the FFI's electronically searchable data. The notice further states that the Treasury Department and the IRS intend to modify Treasury Regulation Section 1.1441-1T(e)(2)(ii)(B) and narrow the circumstances in which U.S. financial institutions are required to provide foreign TINs and dates of birth for foreign account holders. The notice delays the start date for the requirement to provide foreign TINs from Jan. 1, 2017, to Jan. 1, 2018.

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