JONES DAY

COMMENTARY

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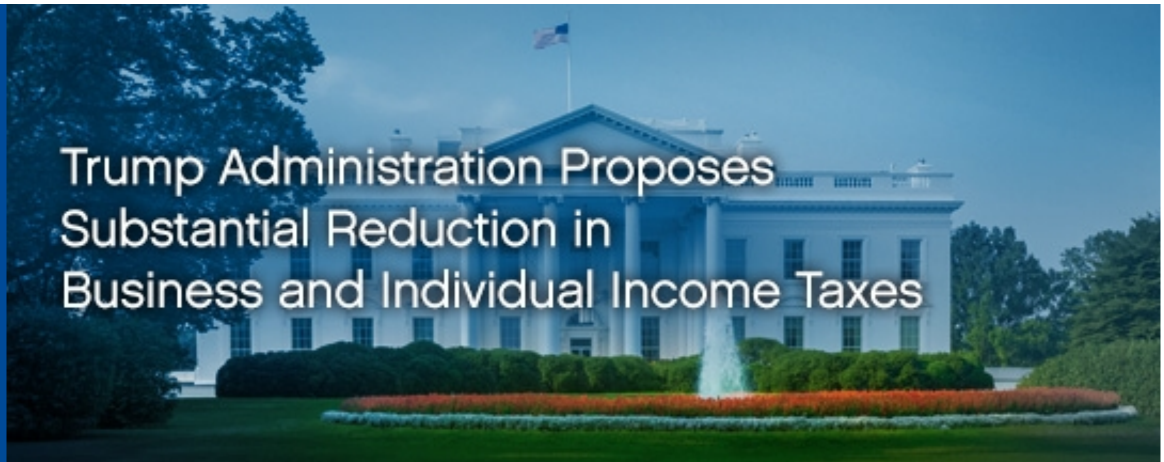

Trump Administration Proposes Substantial Reduction in Business and Individual Income Taxes

IN SHORT

The Situation: The Trump Administration summarized the President's tax reform plan in a one-page proposal on April 26, 2017.

The Result: Similar to the President's campaign proposals, the plan calls for substantial tax cuts and the elimination of the AMT and many deductions, except it shifts to a territorial system of taxation and is silent on immediate expensing and interest deductibility.

Looking Ahead: The Administration plans to hold "listening sessions" with stakeholders to receive their input and will continue working with Congress to develop a plan.

On April 26, 2017, the Trump Administration officially announced the President's tax reform plan in a one-page proposal calling for substantial business and individual tax cuts and the elimination of the AMT and many deductions. The expressed goals of the plan are to grow the economy, simplify the tax code, provide tax relief to middle-income families, and lower tax rates. The tax plan reflects the key principles that will be critical to the Administration during negotiations with Congress.

The tax plan is very similar to the President's campaign proposals, except that the plan omits details on the income thresholds for individual tax brackets, is silent on whether immediate expensing of capital investments would replace (or be an alternative to) a net interest expense deduction, and shifts from our current worldwide system of taxation for business income to a territorial system. The tax plan is notably silent on the House Republicans' border adjustment tax ("BAT") proposal.

The most significant change in business taxation would be the reduction of the corporate income tax rate from 35 percent to 15 percent and a reduced 15 percent rate for noncorporate business income earned by "pass-through" entities such as partnerships, S corporations, and certain limited liability companies, coupled with the elimination of most "tax breaks for special interests." The effect of a 15 percent tax on pass-through income will depend on how "business income," which is currently unspecified, is ultimately defined.

Treasury Secretary Steven Mnuchin, in remarks during the White House press conference introducing the tax plan, indicated that changes in pass-through taxation were designed to assist small businesses, although the tax plan contains no such limitation.

The tax plan retains the President's campaign promise to impose a one-time tax on deferred foreign earnings. Although the tax plan did not specify the repatriation rate (10 percent during the campaign), Secretary Mnuchin indicated that it would be "competitive." The House Republicans' tax proposal known as the "Blueprint" would establish separate rates for cash and cash equivalents (8.75 percent) as compared to other reinvested earnings (3.5 percent).

In a significant shift toward the House Blueprint, the tax plan provides that future foreign income would be subject to a territorial system. Our current worldwide system taxes U.S. taxpayers on all their income, both foreign and domestic, generally allowing a tax credit for taxes paid to foreign countries. This results in the often publicized inefficiency of foreign subsidiaries of U.S. multinationals collectively holding trillions of dollars to avoid U.S. taxation until the income is repatriated. A territorial system generally would exempt income earned, and dividends paid, by foreign subsidiaries from U.S. taxation.

Significantly, the tax plan is silent on the House Blueprint's destination-based cash flow tax regime, including the BAT. Speaking at the White House press conference, Secretary Mnuchin and White House National Economic Council Director Gary Cohn declined to indicate whether the President would entertain the BAT in negotiations. During the campaign, the President indicated a willingness to impose tariffs to address unfair trade practices; two days before releasing the tax plan, on April 24, 2017, the Administration announced that it would impose a 20 percent tariff on Canadian softwood lumber imports. A simpler alternative to the BAT, Secretary Mnuchin suggested that tariffs had a role to play along with tax reform to make U.S. companies more competitive and grow the economy. Given that the tax plan adopts a territorial system, the Administration may also include rules to prevent base erosion and discourage U.S. taxpayers from shifting income offshore. Secretary Mnuchin may have been alluding to this when he stated in his briefing that the United States would continue to tax income "related to the United States."

For individuals, the tax plan adopts three tax brackets, 10 percent, 25 percent, and 35 percent. It also repeals the 3.8 percent tax on net investment income enacted in connection with the Affordable Care Act, doubles the standard deduction, and appears to eliminate all itemized deductions except for mortgage interest and charitable contributions (notably, state and local taxes).

> “While the tax plan is silent on the treatment of carried interest, which the President campaigned to repeal, White House Chief of Staff Reince Priebus reported in interviews on April 30, 2017, that the Administration continues to support treating carried interest as ordinary income. The tax plan would repeal the estate tax.”

Of note, the tax plan omits mention of its cost. The Committee for a Responsible Federal Budget, however, has estimated the cost at between $3 trillion and $7 trillion in federal revenues over a decade, depending on design choices. Secretary Mnuchin and Director Cohn expressed the Administration's view that the tax plan would spur significant economic growth and put the United States on course to achieve annual growth of three percent of U.S. GDP. Without bipartisan support to avoid a filibuster, Senate Republicans would likely need to rely on the "reconciliation" process, which requires revenue neutrality for legislation to endure beyond 10 years, to enact tax reform.

In sum, the President has proposed substantial tax cuts for businesses and individuals similar to his campaign proposals. Unlike the House Blueprint, the tax plan does not shift to a destination-based cash flow tax regime, and maintains the basic architecture of the U.S. income tax system. Many aspects of the tax plan would significantly impact business structuring and organizational decisions (i.e., reduced taxation of pass-throughs), foreign transactions (i.e., territoriality), and M&A (i.e., powered by repatriated cash). Many questions remain (e.g., identification of deduction and credit "loopholes," deductibility of interest, and expensing). The Administration plans to "hold listening sessions with stakeholders to receive their input and will continue working with the House and Senate to develop the details of a plan that…can pass both chambers." Jones Day will continue to follow the dialogue as tax reform takes its next step.

Tax Reform 2017: A Look at Competing Proposals

PROVISION	CURRENT LAW	HOUSE BLUEPRINT	TRUMP 2015 CAMPAIGN	TRUMP 2016 CAMPAIGN	2017 TRUMP PLAN
Corporate Income Tax Rate	35%	20%	15%	15%	15%
Pass-Through Business Income Tax Rate	35% for corporate partners, 39.6% for individuals	25%	15% ("small" pass-throughs)	15% ("small and large" pass-throughs if profits are "retained")	15%
Depreciation & Amortization	Allows	Immediate expensing	Silent	U.S. manufacturers may elect immediate expensing or net interest deduction	Silent
Interest Deduction	Allows	Eliminates net interest deduction	"Phase-in reasonable cap on deductibility of interest"	U.S. manufacturers may elect immediate expensing or net interest deduction	Silent
Other Business Deductions	Allows	Eliminates most except R&D credits	"Reduce or eliminate loopholes that cater to special interests"	Eliminate "most" tax expenditures except R&D credit	"Eliminates tax breaks on special interests"
Taxation of Future Foreign Earnings	Worldwide system, with deferral	Territorial system and BAT	Worldwide system, repeal deferral	Worldwide system, eliminates "most" corporate tax expenditures	Territorial system, no specified base erosion rules
Taxation of Deferred Foreign Earnings	Deferral	8.75% on cash and cash equivalents, 3.5% on other (payable over 8 years)	One-time 10% tax on accumulated deferred earnings	One-time 10% tax on accumulated deferred earnings	One-time tax on accumulated deferred earnings, rate to be determined
AMT	Imposes	Repeals corporate and individual AMT	Repeals corporate and individual AMT	Repeals corporate and individual AMT	Repeals individual AMT, silent on corporate AMT
Carried Interest	Tax as capital gains	Silent	Tax as ordinary income	Tax as ordinary income	Silent
Individual Ordinary Income Tax Rates	Seven brackets	12%, 25%, 33%	0, 10%, 20%, 25%	12%, 25%, 33%	10%, 25%, 35%
Capital Gains and Qualified Dividends	23.8%	50% exemption (top rate of 16.5%)	Taxed at current rates, adjusted to new brackets	Taxed at current rates, adjusted to new brackets	20%, eliminates 3.8% Medicare tax on net investment income
Standard Deduction/ Personal Exemption/ Itemized Deductions	Standard deduction is $6,350 for single taxpayers and $12,700 for married taxpayers filing joint returns. Personal exemption and itemized deductions are allowed, with phase-outs.	Consolidate the standard deduction and personal exemptions into larger $12,000 standard deduction ($24,000 for joint filers) and increased child credit. All itemized deductions eliminated except charitable and mortgage interest.	Reduce and eliminate deductions for very rich. Steepen personal exemption phase out and "Pease limitation" on itemized deductions. Preserve charitable giving and mortgage interest deductions.	Consolidated the standard deduction and personal exemptions into larger $15,000 standard deduction ($30,000 for joint filers and increased child credit. Cap joint itemized deduction at $200,000. Preserve charitable giving and mortgage interest deductions.	"Double" standard deduction, and provide tax relief for child expenses. Eliminate tax breaks mainly benefitting wealthiest taxpayers. Preserve charitable giving and mortgage interest deductions.
Estate Tax	Applies	Eliminates	Eliminates	Eliminates, but disallows basis step-up for estates over $10 million	Eliminates

FIVE KEY TAKEAWAYS

1. Similar to President Trump's campaign proposals, the tax reform plan focuses on business and individual tax cuts, and on the elimination of the AMT and numerous deductions. The goals of the tax plan are to grow the economy, simplify the tax code, provide tax relief to middle-income families, and lower tax rates.

2. Under the President's plan, the rate for U.S. corporations would drop from 35 percent to 15 percent. The 15 percent rate would also apply to noncorporate business income earned by "pass-through" entities.

3. There is no mention of the House's destination-based cash flow tax regime, including the BAT.

4. A one-time tax on deferred foreign earnings is also in the package, but the specific repatriation rate has not been defined. In a nod to the House's tax proposal, the plan indicates that future foreign income would be subject to a territorial system.

5. Parts of the tax plan would affect business structuring decisions for years to come. The Administration plans "listening sessions" with key constituencies.

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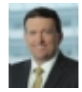

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