Election results may provide opportunities for major tax law changes in 2017

November 9, 2016

In brief

November 8 election results indicate that Republican candidate Donald J. Trump has been elected to serve as the 45th President of the United States. At this writing, President-elect Trump is projected to have won at least 276 electoral college votes against 218 for Democratic presidential candidate Hillary Clinton. Moreover, it appears that Republicans will retain control of the next Congress, but with reduced majorities in both the US House of Representatives and the US Senate.

President-elect Trump has stated that one of his top priorities is comprehensive tax reform to significantly lower individual and business tax rates. Under his proposed plan, the top individual tax rate would be lowered from 39.6 percent to 33 percent, and the US corporate tax rate would be lowered from 35 percent to 15 percent. Owners of partnerships, S corporations, and other "pass-through" business entities would be able to elect to be taxed on their pass-through business income at a flat rate of 15 percent, rather than under the regular individual tax rates. US-based manufacturers also would be allowed to elect full expensing of plant and equipment (with no deduction for interest expense). President-elect Trump also has proposed a 10-percent "deemed" repatriation tax on the foreign earnings of US-based companies.

President-elect Trump's call for action on comprehensive tax reform is expected to receive strong support from Republicans in Congress, but the divisive nature of the 2016 elections means that there will be no "honeymoon" period for the new president.

House Republicans have been drafting statutory language to advance the tax reform "blueprint" that they released earlier this year, which differs in some important respects from Trump's tax proposals. House Speaker Paul Ryan (R-WI) has said a Republican-controlled Congress could advance tax reform in 2017 by using "budget reconciliation" procedures that allow legislation to be approved in the Senate with a simple 51-vote majority, instead of the 60 votes generally needed to advance legislation.

Before the new 115th Congress is sworn into office on January 4, 2017, the current Congress will return next week for a "lame-duck" session. Congress must act on legislation to fund the federal government beyond December 9, when a temporary spending measure expires. Congress also could act on a limited number of other issues, including proposals to extend certain renewable energy tax provisions that are set to expire at the end of 2016. Additionally, work continues on the various stalled tax treaties to see if the objections of Senator Rand Paul (R-KY) can be resolved.

In detail

Outlook for 2017 tax legislation

The 2016 elections have highlighted sharp differences between the two political parties on many issues, as well as popular discontent with the established leadership of both parties. How best to reform US tax laws to promote economic growth and job creation, and to increase incomes for American families, has been one of the top issues during this long campaign season.

A key challenge facing President-elect Trump and the new 115th Congress will be to demonstrate that the federal government can respond to concerns of the American people about their future economic well-being. That challenge will be exacerbated by ongoing disagreements between the political parties on how to address many other issues, including national security, immigration, health care, trade, energy, and the environment.

Congressional Republicans generally have supported comprehensive tax reform that would lower both individual and business tax rates, and would overhaul US international tax rules to be more in line with those of other countries. While many Congressional Democrats have expressed support for business tax reform, Democrats in the House and Senate differ significantly with Congressional Republicans on how much tax should be paid by upper-income individuals. These disagreements would be especially relevant in the Senate where Democratic votes would be needed to reach the 60 vote threshold on any matter where 60 votes was required.

Recent international tax developments have raised some bipartisan concerns over a need for tax reform, but these concerns are unlikely to be sufficient to overcome political differences over individual tax rates. Congressional leaders have expressed bipartisan objections to recent "state aid" investigations by the European Commission that have been seen as disproportionately impacting US-based companies and encroaching on US tax jurisdiction. Members of Congress also have expressed concerns about some countries taking unilateral actions to impose international tax rules that deviate from the standards agreed to as part of the Organisation for Economic Co-operation and Development (OECD) "base erosion and profit shifting" (BEPS) action plan.

Budget reconciliation and tax reform

Speaker Ryan has said his "game plan" for early 2017 is to use budget reconciliation procedures to advance House Republicans proposals for tax reform and other changes to federal programs that are "fiscal in nature."

The budget reconciliation process originally was designed to facilitate the adoption of deficit reduction legislation, and was used numerous times in the 1980's and 1990's to enact bipartisan budget agreements when the White House and Congress were controlled by different political parties. More recently, budget reconciliation has been used when one party controlled both the White House and Congress, but did not have a 60-vote "filibuster-proof" majority in the Senate. Under this procedure, Republicans achieved enactment of the 2001 and 2003 individual tax rate reductions and Democrats accomplished enactment of the final 2010 Affordable Care Act (ACA) legislation.

Reconciliation limitations

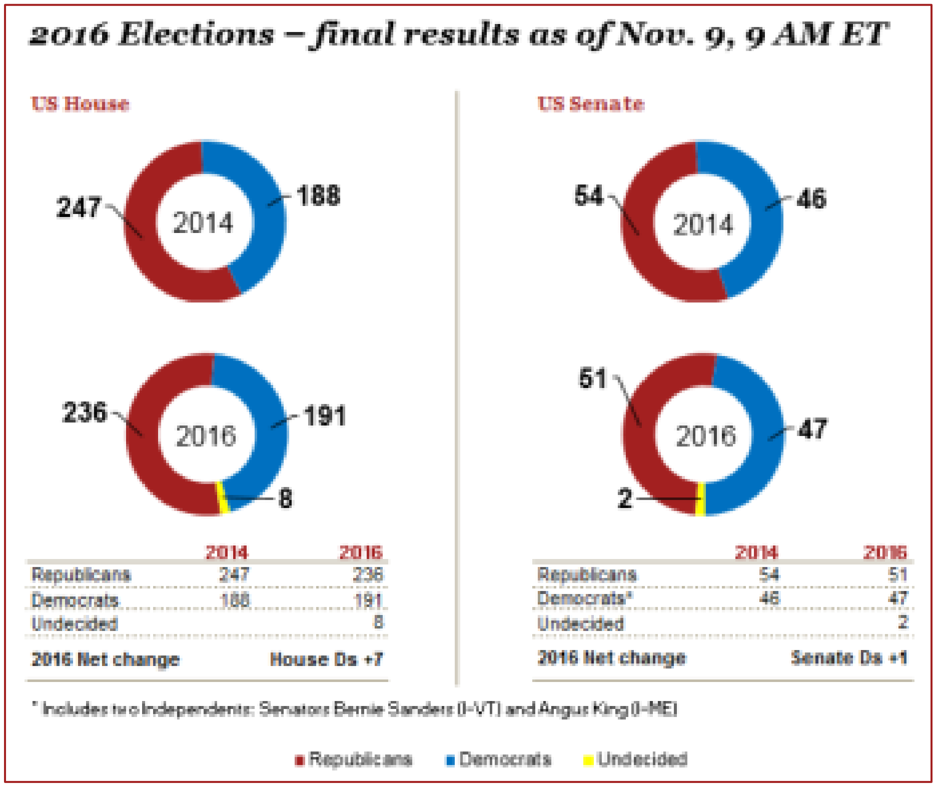
Budget reconciliation bills receive expedited consideration and have special procedural protections that facilitate passage. This is especially true in the Senate, where reconciliation bills cannot be filibustered and require a simple majority to pass.

However, there are a number of limitations on the use of budget reconciliation in the Senate. One longstanding limitation is the requirement for a 60-vote supermajority to approve provisions that lose revenue beyond the budget window (usually 10 years). The 2001 and 2003 tax rate reductions initially were enacted using budget reconciliation, and thus to satisfy this rule the tax cuts initially were set to "sunset" at the end of the budget period.

Note: The Taxpayer Relief Act of 2012, which was not a reconciliation measure, repealed various sunset provisions from the 2001 and 2003 Acts, and thus extended tax relief for most taxpayers while increasing taxes on some upper-income individuals.

In addition, Senate rules require that budget reconciliation be used only to enact measures that have a fiscal effect on the federal budget. For example, the current Republican-controlled Congress used budget reconciliation procedures to repeal major parts of the ACA earlier this year, but reconciliation rules did not allow for a full repeal of the ACA since some provisions do not have a direct effect on the federal budget. President Obama vetoed that partial repeal of the ACA.

It is likely that any tax reform bill considered under reconciliation procedures would need to rely entirely on securing unified Republican support for the final legislation. Most Congressional Democrats would strongly oppose the use of budget reconciliation for tax reform legislation, especially if it contains



deep reductions in the top individual marginal rate.

Balance of power and new Congressional leadership

Based on election results available at this writing, Republicans are on track to retain reduced majorities in both the House of Representatives and the Senate.

In the current Congress, House Republicans hold 247 seats, their largest majority since 1928. Available results indicate that House Republicans will hold at least a 236 to 191 seat majority in the 115th Congress, with Democrats having gained a net increase of 7 House seats; eight races are undecided at this time.

Senate Republicans have retained at least a 51 to 47 majority in the Senate, though that number may grow to as much as 53-47 depending on the last two Senate races which remain unresolved. Senator Kelly Ayotte (R-NH) is leading in her undecided race, and the outcome of the Louisiana Senate race will be decided by a December 10 run-off election, where the Republican candidate John Kennedy is heavily favored. Senate Republicans have held a 54 to 46 seat majority in the current Congress, so the Democrats' net gain of 1 to 2 seats was insufficient for them to attain a Senate majority in the next Congress.

When the current Congress returns next week to begin a lame-duck session, Republicans and Democrats will begin the process of electing leaders for the new 115th Congress. Rep. Paul Ryan (R-WI) is expected to be re-elected to serve as Speaker of the House, but may face a challenge from some "Freedom Caucus" House Republicans. Rep. Nancy Pelosi (D-CA) is expected to continue as House Minority Leader. Senator Mitch McConnell (R-KY) is expected to continue as Senate Majority Leader. Senator Charles Schumer (D-NY), currently a member of the Finance Committee, is expected to be elected Minority Leader of the Senate; current Senate Minority Leader Harry Reid (D-NV) is retiring.

Orientation sessions will be held in coming weeks for new Members of Congress, and official committee assignments will be made in January. The final election outcomes and resulting change in the balance of power in each chamber may affect the ratio of Republicans and Democrats on the tax committees, and the number of open seats on each tax committee. These determinations will be made in January during the organization of the 115th Congress.

The **House Ways and Means Committee** currently has 24 Republican and 15 Democratic members. Current Ways and Means Committee Chairman Kevin Brady (R-TX) and Ranking Member Sander Levin (D-MI) are expected to continue in their positions. Reps. Charles Rangel (D-NY) and Jim McDermott (D-WA) did not seek re-election in 2016 and are retiring. Rep. Todd Young (R-IN) was elected to the Senate, and Rep. Charles Boustany (R-LA) ran for the Senate but failed to make the December 10th runoff. All other current Ways and Means Committee members who ran for re-election won their races except for Rep. Bob Dold (R-IL).

The **Senate Finance Committee** currently includes 14 Republicans and 12 Democrats. Current Finance Committee Chairman Orrin Hatch (R-UT) and Ranking Member Ron Wyden (D-OR) are expected to continue in their positions. Committee member Dan Coats (R-IN) did not seek re-election in 2016 and is retiring. All current Senate Finance Committee members running for re-election won their races.

Senate Republicans in the 2016 elections defended 24 seats held by their party against 10 held by Democrats. In the 2018 elections, this situation reverses, with Democrats defending 25 Senate seats held by their party against eight seats currently held by Republicans. Five of the seats that Democrats are defending in 2018 were won overwhelmingly by President-elect Trump.

Senate Finance Committee members facing the prospect of running for re-election in 2018 are Senators Sherrod Brown (D-OH), Maria Cantwell (D-WA), Ben Cardin (D-MD), Tom Carper (D-DE), Bob Casey (D-PA), and current Chairman Hatch.

Trump tax proposals

President-elect Trump has proposed large corporate and individual tax cuts intended to promote economic growth and domestic investment.

President-elect Trump has proposed reducing the US corporate tax rate from 35 percent to 15 percent. He also would repeal the corporate alternative minimum tax (AMT).

Under his plan, owners of sole proprietorships, partnerships, S corporations, and other pass-through businesses could elect to be taxed on their pass-through business income at the 15-percent corporate rate, rather than individual tax rates.

Also, President-elect Trump has proposed to allow US-based manufacturers to elect full expensing of plant and equipment; businesses making this election would give up the ability to deduct interest expense. According to a campaign summary, an election once made can be revoked only within the first three years; after three years, the election would be irrevocable.

His plan would eliminate "most business tax expenditures," except for the research credit. "Carried interest" would be taxed at ordinary rates.

President-elect Trump's tax plan also would impose a one-time, 10-percent repatriation tax on overseas corporate profits. Earlier in his campaign, Trump's tax plan specifically called for the repeal of tax deferral on the foreign earnings of US-based companies, but his most recent plan does not include this proposal.

For individuals, President-elect Trump has proposed to replace the current six tax brackets with three brackets, with rates set at 12 percent, 25 percent, and 33 percent. The individual AMT also would be repealed.

The plan would retain the current 20-percent tax rate on long-term capital gains and qualified dividends. He has proposed to repeal the 3.8-percent net investment income tax enacted as part of repealing the ACA.

President-elect Trump proposes to increase the standard deduction to $30,000 for joint filers and to $15,000 for single filers. He would eliminate personal exemptions as well as head-of-household filing status.

Itemized deductions would be capped under his plan at $200,000 for joint filers and $100,000 for single filers.

President-elect Trump has proposed to repeal the estate and gift tax, but capital gains on assets held until death and valued at more than $10 million – assumed to apply per couple – would be subject to tax. The plan states that contributions of appreciated assets into a private charity established by the decedent or the decedent's relatives would be disallowed.

The table below summarizes key individual and business tax proposals as offered by President-elect Trump during his campaign. He is expected to offer more details on his tax proposals next year when he submits an FY 2018 budget to Congress. The President is required to submit a budget by the first Monday in February (February 1); however, in the case of a newly elected President, the budget submission typically is delayed by several weeks.

In the absence of official revenue estimates by Treasury Department or Joint Committee on Taxation staff, the table below incorporates revenue estimates by the Tax Policy Center (TPC) of the Urban Institute and Brookings Institution. The TPC made a variety of assumptions as to how certain provisions in President-elect Trump's tax plan would apply, which may differ from how they were intended to apply by the campaign.

According to the TPC, President-elect Trump's tax proposals would decrease revenues by $6.2 trillion over 10 years under traditional scoring methods and by $7.0 trillion using "dynamic" macroeconomic scoring methods.

The Tax Foundation, a nonprofit tax policy research organization, estimates that President-elect Trump's proposals would decrease federal tax revenue by between $4.4 trillion and $5.9 trillion over 10 years on a traditional scoring basis.

The Tax Foundation attributes the difference to uncertainty over the specifics of Trump's proposed 15-percent pass-through business tax rate. For example, the Trump campaign at one point stated that "owners of large businesses will incur dividend taxes." This statement was subsequently withdrawn.

Under their dynamic macroeconomic scoring model, the Tax Foundation projects that his tax proposals would

Revenue effects of major tax provisions proposed by President-elect Trump	10-yr revenue effect $ billion (2016-2026)
Corporate provisions	
Reduce corporate tax rate to 15% and repeal corporate AMT	(2,354.8)
Election to expense capital investment and disallow interest deduction	(592.8)
Eliminate most corporate tax expenditures except for R&D credit	167.0
One-time 10% deemed repatriation tax on overseas corporate profits	147.8
Individual provisions	
Individual income tax brackets of 0%, 12%, 25%, 33%	(1,490.4)
Eliminate AMT	(412.8)
Repeal head of household filing status	130.5
Retain maximum 20% tax rate on capital gains and dividends	No estimate
Increase standard deduction to $30,000 (married) or $15,000 (single)	(1,688.4)
Cap itemized deductions at $200,000 (married) or $100,000 (single)	558.6
Repeal personal exemptions	1,999.7
Childcare provisions	(131.5)
Tax “carried interest” as ordinary income	10.3
Elective 15% rate for pass-through businesses; distributions from large pass-through entities taxed as dividends	(894.6)
Election to expense capital investment and disallow interest deduction (pass-through)	(689.2)
Eliminate most pass-through tax expenditures except for R&D credit	58.0
Eliminate the 3.8% net investment tax	(144.5)
Repeal estate and gift taxes; tax capital gains at death with $10 million per couple exemption	(174.2)

Source: Urban Institute and Brookings Institution Tax Policy Center, An Analysis of Donald Trump’s Revised Tax Plan, October 18, 2016. Assumptions made by the TPC on the application of some proposals may differ from the campaign’s intended design.

decrease federal tax revenues by between $2.6 trillion and $3.9 trillion, based on their projections that account for economic growth from increases in the supply of labor and capital.

Note: President-elect Trump has called for repealing the entire ACA and related taxes, which include the 3.8-percent net investment income tax. Congress delayed the implementation of the “Cadillac” excise tax on high-cost employer-sponsored health insurance until 2020 as part of last year’s “tax extenders” legislation. The 2015 tax extenders package also included a two-year (2016 and 2017) moratorium on the medical device excise tax and suspended an ACA health insurance provider excise tax; both provisions are set to be reinstated at the end of next year absent further action by Congress.

The prospects for full repeal of the ACA are unclear, given the general ability of Senate Democrats to block legislation that does not have 60 votes in that chamber and the limitations (noted above) of the budget reconciliation process by which a partial repeal of the ACA was passed earlier this year. For more on the 2017 outlook for health care legislation, see our PwC Health Research Institute Insight.

Recent Congressional tax reform proposals

House Speaker Ryan has called for action in 2017 on the comprehensive tax reform “blueprint” that was outlined earlier this year by House Ways and Means Chairman Brady. The House Republican tax reform plan would lower the top corporate tax rate to 20 percent and would replace the current six individual tax brackets with three brackets, with rates set at 12 percent, 25 percent, and 33 percent. The plan also would create a new 25-percent pass-through business tax rate, and provide full expensing for business costs (with no deduction for net business interest expense). In addition, the plan would move the United States from a worldwide international tax system to a “territorial” dividend-exemption system, and impose a mandatory “deemed” repatriation tax (8.75% for cash or cash equivalents and 3.5% for other accumulated foreign earnings). For more on the House GOP tax reform blueprint, see our June 24 Tax Insight.

Senator Schumer, who is expected to become Senate Minority Leader, co-chaired with Senator Rob Portman (R-OH) a 2015 Finance Committee bipartisan working group on international tax reform that expressed support for moving to a dividend exemption system with "robust and appropriate base erosion rules."

Senate Finance Chairman Hatch and his staff have been working on a detailed corporate integration proposal that focuses on subjecting business income to a single level of tax. The proposal, which has not been released, is expected to adopt a dividends-paid deduction approach in which dividends are treated like interest (i.e., deductible payments) and a withholding tax is imposed on both to ensure one level of US tax on both interest and dividend income.

Senate Finance Ranking Member Wyden has introduced comprehensive tax reform bills in past years that have proposed lowering the corporate tax rate to 24 percent, with revenue offsets that have included a repeal of deferred taxation on the foreign earnings of US corporations. In 2016, Senator Wyden has released detailed statutory tax reform discussion drafts addressing cost recovery rules, the tax treatment of derivatives, and retirement savings. Senator Wyden also has been working on international tax legislation to address corporate inversions, base erosion, and profit shifting.

Other 2017 legislative issues

Additional issues that may affect the prospects for tax legislation next year include:

- A temporary suspension of the federal debt limit will expire on March 15, 2017. While the Treasury Department can use "extraordinary measures" to postpone the need for an increase in the statutory debt limit until later in the year, debate over this issue could focus attention on projected increases in future federal budget deficits, which would be affected by tax legislation.
- Previously enacted measures to impose caps on discretionary defense and non-defense federal spending will be effective again when the federal government's fiscal year 2018 (FY 2018) begins on October 1, 2017. President-elect Trump has called for increased defense spending.
- Efforts by President-elect Trump and the Republican-controlled Congress to repeal and replace the Affordable Care Act may affect how much time there is in the legislative calendar to address other significant policy issues next year.
- Federal Aviation Administration authorization legislation and federal excise taxes on aviation fuel and air transportation services are set to expire on September 30, 2017.

President-elect Trump also will need the Senate to confirm his cabinet members and other top federal appointees, including an open seat on the US Supreme Court (no action will be taken during the lame-duck session to confirm President Obama's Supreme Court nominee, D.C. Circuit Chief Judge Merrick Garland).

Key **tax policy-related positions** to be filled next year include Secretary of the Treasury, Assistant Secretary for Tax Policy at the Treasury Department, Commissioner of the Internal Revenue Service, Chief Counsel of the IRS, and Director of the White House Office of Management and Budget. The five-year term of current IRS Commissioner John Koskinen ends on November 12, 2017, but he could choose to step down earlier.

Lame-duck session

The House and Senate will return next week for a lame-duck session to complete action on government funding for the remainder of FY 2017, which ends September 30, 2017. The current temporary funding measure expires on December 9, 2016. The outgoing Obama Administration and Congress are expected to work toward an agreement that will cover the remainder of FY 2017, but Republicans in Congress may prefer a temporary funding measure that runs only through early 2017 so that they can work with President-elect Trump on setting funding levels and so-called "policy riders" affecting federal regulations and programs.

Congress may consider additional legislative proposals during the lame-duck session, including possible extension of certain renewable energy tax incentives. The 2015 tax extenders law made permanent 22 provisions, including an expanded refundable child tax credit, the research credit, and the Subpart F exception for active financing income. The law also extended five provisions through 2019, including 50-percent bonus depreciation (with a phase-out beginning in 2018), Subpart F look-through rules for controlled foreign corporations, and certain solar and wind renewable energy tax credits (with a phase-out).

The 2015 tax extenders law also extended 30 other individual and business tax provisions through December 31, 2016. Provisions set to expire at the end of this year include additional renewable energy tax incentives covering fuel cells, combined heat and power systems, qualified small wind energy property, and certain other technologies. Several House and Senate tax-writers have expressed support for action to extend these renewable energy tax credits before they expire at the end of this year. Senate Majority Leader McConnell has said that the Senate may consider proposals to extend expiring renewable energy tax provisions, but House Ways and Means Committee Chairman Brady has said that all currently expiring tax provisions should be considered next year as part of tax reform legislation.

Congress could consider additional tax-related legislation during the lame-duck session. The House has approved a number of tax-related bills, including a "mobile workforce" measure to establish consistent criteria for state taxation and employer withholding for nonresidents who work temporarily in a state. The Senate Finance Committee has approved legislation to promote retirement savings and enhance the solvency of pension plans, as well as a separate measure to fund retired coal miner pension and health benefits. Congress also could consider legislation making technical corrections to previously enacted tax laws.

In addition, the Senate could consider several pending tax treaties, if an agreement can be reached with Senator Paul, who has blocked ratification of tax treaties in recent years because of his concerns over privacy issues. Senator Paul has objected to expedited floor consideration of proposed new income tax treaties with Chile, Hungary, and Poland, and proposed protocols to existing income tax treaties with Luxembourg, Japan, Spain, and Switzerland. If the proposed treaties and protocols are not approved this year, they will be returned to the Senate Foreign Relations Committee for further consideration during the next Congress.

The takeaway

The results of the 2016 elections for control of the White House and Congress will have a significant impact on the direction of tax reform over the next four years.

President-elect Trump and the Republican-controlled Congress are expected to push for action on comprehensive tax reform that would lower both individual and business tax rates. Still, prospects for the enactment of such legislation remain in question, given differences between the two political parties on how much tax should be paid by upper-income individuals.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

Tax Policy Services

Pam Olson
(202) 414-1401
pam.olson@pwc.com

Rohit Kumar
(202) 414-1421
rohit.kumar@pwc.com

Brian Meighan
(202) 414-1790
brian.meighan@pwc.com

Scott McCandless
(202) 312-7686
scott.mccandless@pwc.com

Ed McClellan
(202) 414-4404
ed.mcclellan@pwc.com

Todd Metcalf
(202) 346-5119
todd.metcalf@pwc.com

Larry Campbell
(202) 414-1477
larry.campbell@pwc.com

Don Carlson
(202) 414-1385
donald.g.carlson@pwc.com

Janice Mays
(202) 312-7589
janice.a.mays@pwc.com

Andrew Prior
(202) 414-4572
andrew.prior@pwc.com

National Economics & Statistics

Drew Lyon
(202) 414-3865
drew.lyon@pwc.com

Peter Merrill
(202) 414-1666
peter.merrill@pwc.com