



# KPMG report: Unified framework for comprehensive tax reform, initial observations

September 27, 2017

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The White House, Republican leaders of the U.S. House and Senate, and the chairs of the House and Senate tax-writing committees today released a “unified framework” for tax reform.

Read the nine-page [unified framework for tax reform](#) [PDF 172 KB]

A [statement](#) from the House Committee on Ways and Means indicates that the framework “serves as a template for the tax-writing committees that will develop legislation through a transparent and inclusive committee process.”

The following discussion provides initial impressions and observations about the unified framework for tax reform.

### KPMG observation

The framework is expected to be the starting point for tax-writing committees as they flesh out the details of tax legislation. The framework is a short and high-level document. Unlike the tax reform “joint statement” released in July 2017—read [TaxNewsFlash](#)—the framework references a few “revenue raising” proposals. Nonetheless, the framework does not include significant technical details. It also does not specify effective dates for most of its proposals (with one significant exception—the expensing proposal described below).

Elements of the framework’s proposals can be expected to be modified, as details are formulated in the course of the legislative process. Given the uncertainties associated with the legislative process, it remains uncertain whether significant tax legislation will be enacted in the near future.

### Individual tax proposals

#### Individual tax rates

The framework proposes the creation of three brackets at 12%, 25% and 35%. However, the framework expressly leaves open the possibility that the tax-writing committees will create a fourth top bracket, noting that “an additional top rate may apply to the highest-income taxpayers.”

The income thresholds applicable to the new tax brackets are not specified, leaving those details to the tax-writing committees. The framework also notes that the “use of a more accurate measure of inflation for purposes of indexing the tax brackets and other tax parameters” is envisioned.

## **KPMG observation**

The framework specifies that the reformed tax code should be “at least as progressive” as the existing one. It appears that the decision to leave a number of details (such as the creation of a fourth tax bracket, identification of the income thresholds, child tax credit amounts, and other items) to be fleshed out by the House Ways and Means and Senate Finance Committees was made, at least in part, so that these committees will be able to adjust these items to achieve goals relating to progressivity and the tax burden distributions. It is noteworthy that the addition of a fourth tax bracket would not affect the special passthrough rate for business income, described below, which would also affect the progressivity of the proposal as compared to current law.

## **Standard and itemized deductions**

The standard deduction would be increased to \$12,000 (single filers) and \$24,000 (married filing jointly) under the framework. Personal exemptions for taxpayers and dependents would be repealed, considered subsumed by the increased standardized deduction. As expected, the framework proposes the elimination of “most” itemized deductions, but specifies that the tax incentives for home mortgage interest and charitable contributions would be retained.

## **KPMG observation**

The plan to eliminate most itemized deductions presumably includes some limitation, if not repeal, of the deduction for state and local taxes. Elimination of that deduction, when combined with the increased standard deduction, would have the effect of eliminating the benefit of itemizing deductions for many taxpayers who currently itemize. Details of the extent or the manner in which the tax-writing committees may modify the state and local tax deductions, however, have yet to be identified.

## **Alternative minimum tax (AMT)**

The framework proposes the repeal of the individual AMT.

## **Estate and generation-skipping transfer taxes**

The framework would repeal the estate tax and the generation-skipping transfer (GST) tax. No details are provided regarding whether any changes will be made to other related matters, such as stepped-up basis for inherited assets or changes to the gift tax.

## **Other individual income tax items**

The framework identifies a number of other reform proposals and goals affecting individual taxpayers, including:

- A “significantly” increased child tax credit, with the first \$1,000 refundable and modified phase-out income thresholds.
- A nonrefundable \$500 non-child dependent credit.
- Retention of tax benefits that “encourage work, higher education and retirement.” The framework notes that the tax-writing committees are encouraged to simplify and improve these benefits and to work to maintain or increase worker participation in retirement plans and resource availability.
- The repeal of many other exemptions, deductions, and credits to “make the system simpler and fairer” and to allow for lower rates.

## **Business tax proposals—in general**

The framework includes the following proposals of relevance to businesses in general.

### **C corporation rate / corporate AMT / integration**

The framework proposes a 20% tax rate for C corporations, as well as the repeal of the corporate alternative minimum tax (AMT). It also indicates that the tax-writing committees might consider methods to reduce the double taxation of corporate earnings.

### **KPMG observation**

The chairman of the Senate Finance Committee, Senator Orrin Hatch (R-UT), has been exploring for several years the possibility of corporate integration (i.e., moving to one level of tax for C corporation earnings), likely through a dividends paid deduction. The framework appears to recognize the possibility of a partial dividends paid deduction being used to further effectively reduce the rate of tax on income paid by dividend-paying C corporations.

### **Passthrough rate**

The framework proposes limiting to 25% the maximum tax rate applied to the “business income of small and family-owned businesses conducted as sole proprietorships, partnerships and S corporations.” It also contemplates that the tax-writing 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.”

### **KPMG observation**

Although the framework indicates that the maximum tax rate for passthroughs and sole proprietorships would apply to “small” and “family-owned” businesses, it is not clear what the use of these terms means. Further, the framework does not specify what kinds of measures the tax-writing committees might adopt to prevent recharacterization of “personal” income into business income, although it certainly suggests that such measures will be included. Thus, passthrough entities and sole

proprietorships will need to watch how the tax-writing committees address the scope of the passthrough rate proposal (e.g., whether the rate might apply only to passthroughs meeting certain criteria and what “anti-abuse” rules might be provided).

## **Expensing**

The framework proposes allowing businesses to expense immediately the cost of new investments in depreciable assets **other than structures** for at least five years. This rule is proposed to apply to investments made after September 27, 2017 (i.e., the date the framework was released). The framework also indicates that the tax-writing committees may work to continue to enhance “unprecedented expensing” for business investments, particularly to provide relief for small businesses.

### **KPMG observation**

The focus on depreciable assets and exclusion of “structures” would seem to exclude buildings and land from the assets qualifying for immediate write-off. Query as to whether the exclusion of structures might relate to making the interest expense limitation (described below) applicable to C corporations (subject to the tax-writing committees’ determinations as to whether to apply those limitations to passthroughs). In other words, is the framework leaving the door open to real estate partnerships not being subject to interest expense limitations (unless the tax-writing committees decide otherwise) given that their leveraged assets might not benefit from expensing?

The expensing proposal also is the only proposal in the framework that has an effective date. The reference to today’s date appears to signal the intent of Republican leadership that qualifying investments made after today’s date will benefit from the expensing proposal (if such proposal becomes law), presumably intended to avoid creating a disincentive for investment while tax reform is being considered.

### **Interest expense limitation**

The framework proposes partially limiting the deduction for net interest expense **incurred by C corporations**. However, it indicates that the tax-writing committees will consider the appropriate treatment of interest expense paid by non-corporate taxpayers.

### **KPMG observation**

The framework does not specify how the amount of interest expense deduction subject to the limitation would be determined or whether the limitation would apply to existing debt. Thus, C corporations will need to monitor how the technical details of the proposal are developed by the tax-writing committees. Passthrough entities and sole proprietorships that incur interest expense also will need to closely watch whether the tax-writing committees propose interest expense limitations on business entities other than C corporations.

## Other business deductions and credit

The framework specifically mentions that the current law domestic manufacturing deduction under section 199 will no longer be necessary given the substantial rate reduction proposed for “all businesses.” Further, it explicitly indicates that it would preserve the research credit and the low-income housing credit, but states that “numerous other special exclusions and deductions will be repealed or restricted.” However, it notes that the tax-writing committees “may decide to retain some other business credits to the extent budgetary limitations allow.”

### KPMG observation

The framework does not explicitly mention whether repealing the LIFO accounting method is being considered. Also, query whether the reference to a substantial rate reduction for “all business” has any bearing on the thinking as to whether (or not) the special passthrough rate might be limited to only “small” and “family-owned” businesses? (See the KPMG observation above). Likewise, query whether the reference to the tax-writing committees having discretion to retain some business credits “to the extent budgetary limitations might allow” might mean that tax-writing committees are starting from the assumption that most or all credits except the research credit and low-income housing credit would be repealed and would need to “find revenue” elsewhere in order to retain other credits.

## Industry-specific provisions

The framework proposes to modernize the tax treatment of special tax regimes that exist to govern the tax treatment of certain industries and sectors to better reflect economic reality and to ensure that the rules “provide little opportunity for tax avoidance.”

### KPMG observation

Given the lack of technical detail, it is not clear what changes the tax-writers might contemplate with regard to industry specific tax regimes. Nonetheless, businesses that use or are subject to such regimes should be aware that changes could be on the table and should monitor developments closely.

## Tax proposals specific to multinational businesses

The framework proposes the following with respect to multinational businesses.

### Territorial taxation

The framework proposes to exempt foreign profits, when they are repatriated to the United States, by replacing the current worldwide system with a 100% exemption for dividends from foreign subsidiaries in which the U.S. parent owns at least a 10% stake.

## Base erosion rules

The framework also indicates that rules will be included to 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. It also indicates that the tax-writing committees will incorporate rules to level the playing field between U.S.-headquartered parent companies and foreign-headquartered parent companies.

### KPMG observation

The references to "a reduced rate" and "on a global basis" appear to contemplate a U.S. "top off" tax to ensure that combined U.S. and foreign tax rates imposed on foreign income equal a specified rate. The mechanics of the rule are left to the tax-writing committees, although the chosen language may indicate that any foreign tax rate thresholds are to be applied across all foreign subsidiaries on an aggregate basis. In addition, recent international tax reform proposals, including most notably the international provisions of the proposed Tax Reform Act of 2014, have included a variety of anti base erosion proposals—among other things proposals to apply modified subpart F rules to intangibles income or to restrict the deductibility of interest expense.

## Mandatory repatriation

To transition to the territorial system, the framework proposes treating foreign earnings that have accumulated overseas under the current system as repatriated. It further states that accumulated foreign earnings held in illiquid assets will be subject to a lower rate than foreign earnings held in cash or cash equivalents and that payment of the tax liability will be spread out over several years.

### KPMG observation

The framework does not specify the rates at which illiquid assets and cash (or cash equivalents) would be taxed. It also does not specify over how many years the tax liability would be spread.

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