

Proposed Federal Income Tax Reform: Who Will the Winners and Losers Be?

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The inauguration of President Donald J. Trump and seating of the Republican controlled 115th Congress brings with it a significant opportunity for an overhaul of the federal income tax system. While the proposed lower marginal income tax rates receive most of the attention in the popular press, other aspects of the Republican tax proposals may have a much larger impact on the final tax bills of many businesses and individuals. As currently constituted, these proposed changes are sure to produce clear winners and losers going forward. Pinpointing who might be in each of those categories at this point is mostly a guessing game, however.

Great uncertainty about the proposed income tax changes remains. Notwithstanding the expansive list of policy priorities laid out during the Trump campaign, income tax reform does appear to have both Presidential and Congressional support early in the new administration, despite differences between their proposals. It is still too early to tell which provisions are most likely to be implemented as is, and which will be subject to change or elimination as various constituencies weigh in. Generally speaking, there is also still a glaring sparsity of detail regarding many of the income tax proposals. It is also worth noting that the Republicans do not have a filibuster proof majority in the U.S. Senate, so any tax reform may have to be enacted through the budget reconciliation process which will impose certain further limitations on implementing legislation. Consequently, as discussed in *Planning Now: Possible Federal Transfer Tax Repeal*, ascertaining the final details of any income tax reform is at this point like "reading tea leaves through a shattered crystal ball."

The attached chart, available at tinyurl.com/Proposed-Fed-Income-Tax-Chart, outlines the state of current income tax law provisions, and the proposed changes suggested by Congressional Republicans last summer, and President Trump during his campaign.

As these proposals are debated in Congress over the next several months, there will be necessary compromises and changes. For example, President Trump has already suggested that he is uncomfortable with the border adjustability provisions of the House GOP blueprint. That provision, in and of itself, has the potential to substantially increase the taxes on retail businesses, automobile manufacturers and other industries that rely on imported goods and products notwithstanding the dramatic drop in the corporate income tax rate. Of course, exporters of U.S. made products and services could benefit substantially from such a provision. It has been reported that the border adjustability provisions and other tax proposals received a great deal of attention during the President's first meeting with U.S. business leaders. It should also be noted that Senate Republicans have expressed doubts about border adjustability. Consequently, Senate Finance Committee Chair, Orrin Hatch (R-Utah) has proclaimed that the Senate Republicans will be preparing their own separate tax bill.

The proposed changes to the depreciation and immediate expensing of capital expenditures, together with the new limitations on the deductibility of interest expenses, could profoundly affect many businesses. Capital intensive industries would seem poised to benefit from the immediate expensing of those costs. On the other hand, those businesses that rely heavily on leverage, including private equity and venture capital firms, could see great disruption in their business models due to the limitations proposed on the deductibility of interest expense.

As with any tax rate cuts, it is also anticipated that those at the top of the income spectrum will see the greatest percentage cuts in their net taxes while even those in more modest tax brackets will see some benefit. If President Trump's proposal with respect to itemized deductions is enacted, it could severely impact large charitable gifts due to the loss of a charitable contribution deduction. The GOP proposal would appear to protect those charities since the full charitable contribution deduction would be retained along with the home mortgage interest deduction. Similar winners and losers will emerge with respect to many of the other proposed changes as well, if enacted.

Nevertheless, it may still be too early to plan in earnest for any of these proposed changes until further developments come out of Washington. President Trump has promised to fully present his tax proposal in the coming weeks. Presumably, this presentation will contain more detail than the provisions outlined above. The coming months will then see all of the proposals make their way through the Congressional legislative process. As seemingly happens with all federal legislation, there will likely be contentious debate and horse trading with respect to all of the proposed tax changes during that process. Thus, while we can anticipate tax cuts to benefit many taxpayers at some point under a Republican regime, placing a bet on any particular tax reform proposal to survive the legislative process intact is somewhat foolhardy. Given all of the moving parts, it seems unlikely that any tax legislation would be finalized until later in 2017 and possibly not even until 2018. Stay tuned!

If you have questions or would like additional information, please contact Bill Hussey (husseyw@whiteandwilliams.com; 215.864.6257) or another member of our Tax and Estates Group.

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