U.S. Tax Reform: Implications

Jack M. Mintz
President's Fellow, School of Public Policy
and
National Strategic Policy Advisor, EY Canada

House and Senate Bills

- House of Representatives and Senate have passed their own versions of the *Tax Cuts and Job Act*.
- Aim is for a Senate-House conference in December to come to a common bill.
- Each body will have to pass the final *Act*.
- President to sign law effective for 2018 expected prior to winter holiday.

What has been done so far

* Both Senate and House have passed a budget bill allowing for $1.5 trillion over 10 years in tax reductions.
* Budget enables a reconciliation bill to include tax reform requiring a majority in both the House and Senate (otherwise the Senate would need 60 votes).
* The Senate also must comply with the Byrd budget amendment requiring fiscal balance after 10 years for tax provisions to be made permanent.
* While press plays up differences in both bills, the overall approach is quite similar for the major items.

Major Provisions: Personal Income Tax

	House Bill	Senate Bill
Tax Rates	4 brackets with top rate of 39.6% (individual $500k+ and joint $1 mil)	7 brackets with top rate of 38.5% top bracket (same threshold at top).
Indexation	Chain CPI	Chain CPI
Standard Deduction (with indexation)	$12.2k (ind.) and $24.4k (joint) (amount includes indexation)	$12.2k and $24.4k (joint) (amounts include indexation)
Personal Exemption	Repealed	Repealed
Pass-through Income (sole proprietorships, partnerships)	25% capped on qualified business income with rebuttal cap of 70% being wage income and 30% business income.	Deduction of 23% of qualified business income (maximum federal rate of 29.64%) limited to 50% of wage income. Services excluded except for a max of $500,000 for joint filers.
Deductibility of state and local income, sales and property taxes	Repeal except for up to $10000 of property tax	Repeal except for up to $10000 of property tax
Child Tax Credit	Family tax credit: $1600 per child and $300 for each taxpayer in family	$2000 per child (phased out over $500k income)
Individual Alternative Minimum Tax	Repealed	Increased exemption and thresholds for phase-out

Major Provisions Corporate Income Tax

	House Bill	Senate Bill
Corporate Income Tax	20% as of 2018 Personal service corps at 25%.	20% as of 2019 Special rate repealed
Depreciation	100% expensing of property less than 20 year recovery for 5 years	100% expensing of property less than 20 year life for 5 years and phase-out over next five years.
Interest expense	Limit up to 30% of "EBITDA' with additional limit based on global group income.. Exception for small business	Limit up to 30% of EBIT with additional limit based on global debt/equity limit (phased down to 110%). Exception for small business.
Inter-corporate dividends	50% (instead of 70)%) deduction for uncontrolled and 65% (instead of 80%) for min 20% ownership	50% (instead of 70)%) deduction for uncontrolled and 65% (instead of 80%) for min 20% ownership
Small business	Expensing up to $5 mil phased out over $20 mil. up to 5 years. Cash accounting with gross receipts below $25 mil.	Expensing up to $1 mil phased out over $2.5 mil. Cash accounting with gross receipts below $15 mil.
Net operating losses	Limit to 90% of income	Limit to 80% of income
Corporate Alternative Minimum Tax	Repeal	n.a.

International Income

	House Bill	Senate Bill
Dividends from Affiliates	Participation exemption with 10% minimum ownership	Participation exemption with 10% minimum ownership
Transition Tax on Deferred Foreign Income	7% of illiquid and 14% of liquid assets	7.5% of illiquid and 14.5% of liquid assets
Global income	Inclusion of foreign high returns	Include global intangible income in tax base if low-taxed
Foreign-derived intangible income		Deduction permitted
Interest deduction -- outbound	Denial of interest in excess of 110% worldwide group debt/equity ratio	Denial of interest in excess of 130% worldwide group debt/equity ratio phased down to 110% by 2022
DISCs and IC-DISCs	n.a.	Repeal DISC
Base Erosion -- inbound	20% excise tax on certain payments to related foreign affiliates	Anti-abuse tax – excess of 12.5% of modified taxable income over regular tax liability.

Other

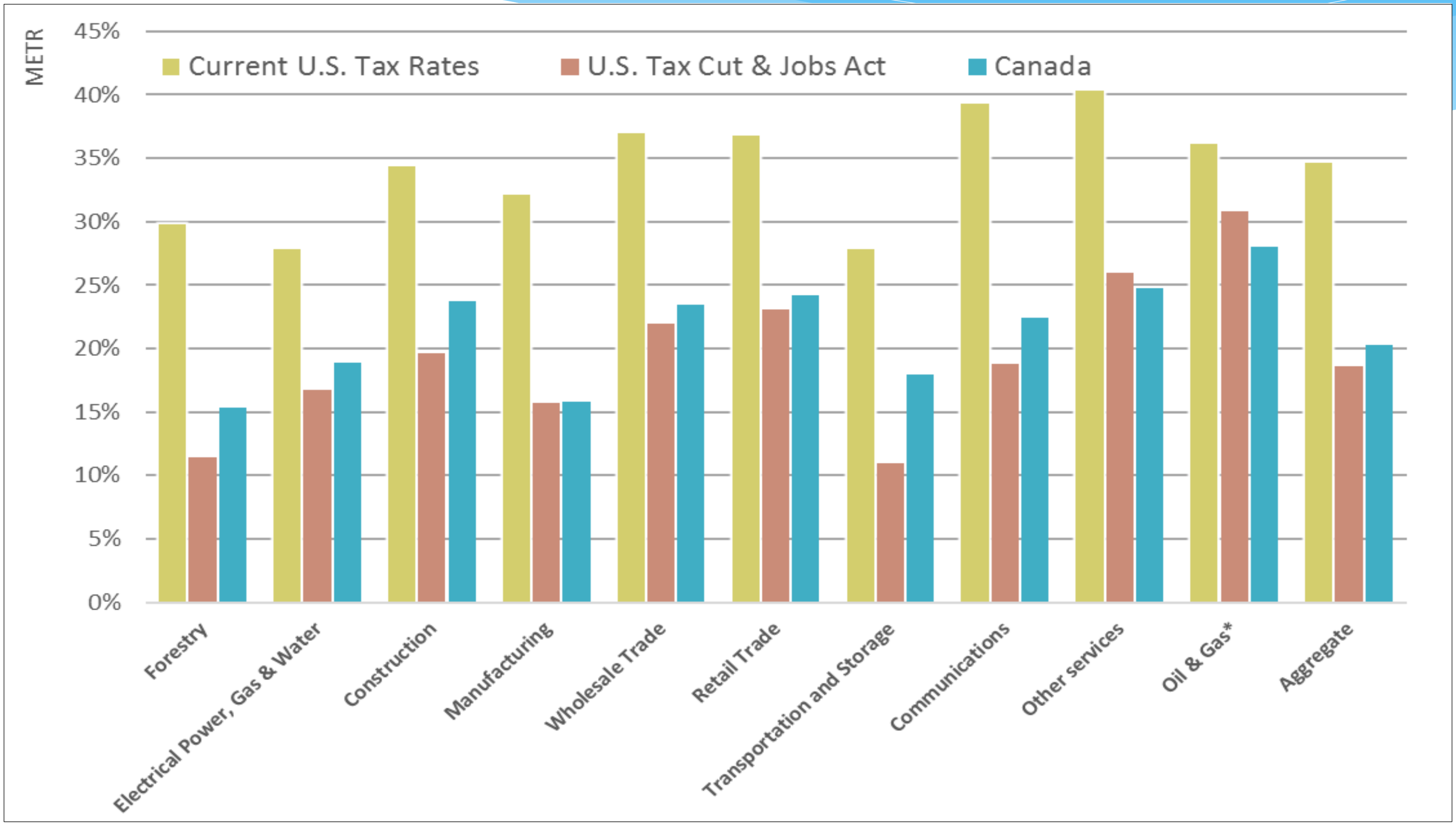
	House Bill	Senate Bill
State and local bonds	Private activity bonds interest subject to tax Interest no longer excluded for advanced refund bond	Interest no longer excluded for advanced refund bond
Estate Tax	Exemption doubled to $10 mil until 2023 when estate and gift tax repealed	Exemption doubled to $10 million
Employee Compensation– public corporations	Commissions and performance-based compensation included in $1 million limit	Commissions and performance-based compensation included in $1 million limit
Excise Tax on tax-exempt investment	1.4% tax on income for endowments of at least $100k per student	1.4% tax on income for endowments of at least $500k per student (exemption for colleges not receiving federal funds)
Individual Mandate Under Affordable Care Act	n.a.	Sets penalty rate to zero

U.S. to become much more competitive

	METR (%) (CIT, sales taxes on capital, capital taxes, transfer taxes)
United States Current	34.6 (31% with 2019 bonus depreciation)
United States Tax Cuts and Jobs Act	**18.6**
Canada	21.2
G7	27.4
BRIC	37.6
OECD	19.1
92 countries	20.7
Africa	28.7
Asia-Pacific	26.5
Europe	16.4
Americas	26.1
MENA	17.0

Canada Loses Tax Competitiveness measured by Marginal Effective Tax Rates if U.S. Reform Proceeds

(both bills have major provisions that are identical)



Impacts on Major Trading Partners

- U.S. investment would increase. Decline in METR by 46% would increase business investment by 15% (based on an elasticity of investment to gross of tax return of 0.7 but excluding macro impacts on interest rates, etc.).
- Capital flows resulting from repatriation of funds to U.S. due to foreign dividend exemption for U.S. parents and potential impact of anti-abuse rules.
- Debt less attractive to place in U.S. due to lower corporate rate and tighter rules for interest deductions.
- Profit shifting due to lower rate could cause U.S. corporate tax base increase by 12% (based on semi-elasticity of 0.8% per percentage point).
- Other factors influencing investment in the U.S. are deregulation and trade protectionism (eg. NAFTA).