# Tax Reform Update June 20, 2017

KUTAK ROCKup

#### Presented by:

#### Mitch Woolery

Partner Kansas City Mitch.Woolery@KutakRock.com (816) 502-4657



Atlanta | Chicago | Denver | Fayetteville | Irvine | Kansas City | Little Rock | Los Angeles | Minneapolis | Oklahoma City | Omaha | Philadelphia | Richmond | Rogers | Scottsdale | Spokane | Washington, D.C. | Wichita

#### Tax Reform Is Really, Really Hard

- A brief journey down memory lane
- The Internal Revenue Code of 1986



## Competing Visions of Tax Reform

#### • Comprehensive income tax reform (Brady/Ryan/Camp)

- Cut rates/eliminate deductions/broaden the base (Possibly Hatch and definitely various others)
- Revenue neutral vs. deficit financed

(Brady/Ryan vs. Hatch/Trump)



#### The Search for Revenue

- Border-adjustment tax (BAT): raises about \$1.1 trillion over 10 years if Year 1 fully phased-in.<sup>1</sup>
- Eliminating interest deductibility (ID): raises about \$1.2 trillion over 10 years.<sup>2</sup>
- Everything else (estimates vary widely)

<sup>1</sup> Tax Foundation January 2017

<sup>2</sup> CNBC March 15, 2017 (citing Tax Foundation)



#### The Search for Revenue

- Border-adjustment tax (BAT): raises about \$1.1 trillion over 10 years if Year 1 fully phased-in.<sup>1</sup>
  - <u>New BAT proposal (6/13/2017): five-year phase in.</u> <u>Raises about \$900 billion over 10 years</u>.<sup>2</sup>
- Interest deductibility (ID): raises about \$1.2 trillion over 10 years.<sup>3</sup>
- Everything else (estimates vary widely)
- <sup>1</sup> Tax Foundation January 2017
- <sup>2</sup> Tax Notes June 14, 2017 (citing Tax Foundation)
- <sup>3</sup> CNBC March 15, 2017 (citing Tax Foundation)



#### $BAT^*$

#### • What is it?

\*Per A.J. Auerbach (as cited by Investopedia)



#### BAT: What is it?

- Fully expense capital investments rather than depreciate them over a number of years or decades.
- No deduction of net interest expense against taxable income.
- Foreign profits not subject to domestic taxation.
- Make corporate income tax "destination-based" (i.e., the U.S. income tax would be border-adjustable).

#### Source: Tax Foundation, February 2017

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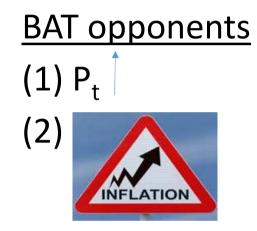


#### What is Border Adjustment?

- Imports. U.S. businesses no longer able to deduct the cost of purchases from abroad.
- Exports. U.S. businesses no longer taxed on the revenue attributable to sales abroad.



#### BAT: Macro effects





#### BAT: Macro effects

BAT proponents (1) \$  $(2) D_t$ 

**Result: Trade Effect Neutral** 



#### BAT

• What is it?

#### • Who loves it?

• Exporters



#### BAT

- What is it?
- Who loves it?
- Who hates it?
  - Importers



## Eliminating ID





## Eliminating ID

- What is it?
- Who loves it?
  - Upper Market Companies that can pay cash and don't need to borrow.



## Eliminating ID

- What is it?
- Who loves it?
- Who hates it?
  - Middle Market Companies and Small Businesses who need to borrow in order to grow.



Organizations Opposed to Eliminating ID

- Build Coalition. <u>http://buildcoalition.org/</u>
  "You can't expense what you can't afford."
- Association for Corporate Growth (ACG).
  - "The Voice of the Middle Market."
  - Cites RGL study that estimates \$1.1 trillion to \$2.5 trillion equity value loss for Middle Market companies.\*

\*https://www.rgl.com/assets/Uploads/Documents/RGL-CIT-Analysis.pdf



#### Current status

- Revenue neutrality
- BAT
- ID



## Countervailing pressures

# Repealing Obamacare (frees up \$1.2 trillion over 10 years)\*

\*This depends on hundreds of assumptions which may or may not be true. Forbes, March 13, 2017 (citing CBO)



## Countervailing pressures

- Repealing Obamacare (frees up \$1.2 trillion over 10 years)
- House Freedom Caucus



## Countervailing pressures

- Repealing Obamacare (frees up \$1.0 trillion over 10 years)\*
- House Freedom Caucus
- Vladimir Putin



#### Timeline

- Brady/Ryan
- Hatch
- Trump
- House Freedom Caucus



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