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How to Tell the Difference Between a (Tax) Plan and a Wish

Yesterday, the much-anticipated Republican tax plan was released to the public. Many hoped this document would provide specifics about what tax reform might actually look like. However, this latest draft is just an expanded version of the two-page document the White House released in April.

While this latest installment leaves much to be desired for those of us hoping to see an actual plan, it does have a lot to say as a “tax reform wish list.”

The Wish List

Before we talk about what’s missing from the plan, let’s get a better understanding of what was released — which does touch almost every tax category in the code.

Individual Taxes

- Individual rates are set at 12%, 25% and 35% — with the option for a fourth bracket on the highest-income households, should finding a Democrat to vote “yes” become necessary
- Standard deduction is doubled – $24,000 for married couples and $12,000 for individuals – and the personal exemption is repealed
- Personal exemptions for dependents are repealed but the child tax credit is increased
- The Alternative Minimum Tax (AMT) is repealed
- The only available itemized deductions would be for mortgage interest and charitable contributions

Estate Tax

- The estate and generation-skipping transfer (GST) taxes are repealed

Corporate Taxes

- Pass-through entities have a 25% tax rate — with the directive to create "measures" to stop re-characterizing personal income as business income
- Corporate tax rate is 20% and corporate AMT is eliminated
- Immediate write-offs available for newly purchased depreciable assets and a partial limitation of the net interest deduction
- The research and development (R&D) and low-income housing incentives are preserved

Off-Shore Income

- All dividends from foreign subsidiaries of a U.S. parent are provided a 100% income tax exemption
- All accumulated foreign earnings are deemed repatriated
- Rates on foreign profits of U.S. multinational corporations are reduced

Unpacking The List

There's more to what's behind these bullet points than meets the eye – and, ultimately, what we really care about is how likely any of this is to actually become law – so let's break it all down to get a better understanding of what it means.

Starting with the income tax section. We know that, in 2013, approximately 42 million American households fell into the 15% bracket, which means they earned a maximum income of $37,650 for individuals and $75,300 for married couples. Those 42 million Americans would see their individual tax rate drop by 3%. But with the elimination of all deductions – including state and local taxes, medical and dental expenses, business use of home and car, and possibly qualified plan contributions –the income tax burden on those families might actually increase.

If we presume that the income amounts inside each tax bracket stays the same then the biggest income tax reduction would be for those taxpayers in the 28%, 33%, and 35% brackets — a total of 30 million Americans. Those individuals would then see their rates drop to 25% — a reduction of 3–10%. Only the 860,000 Americans whose income is in excess of $446,950 – for married couples – would be in the highest bracket of 35% and would receive a 4.9% rate reduction.

What Might It All Mean?

These income tax reductions were meant to benefit low and middle class Americans, but it appears that the majority of Americans, the 136.2 million taxpayers who are in the 0% - 15% bracket, would only receive a rate reduction of 3% as compared to the 3–10% reduction for the 31 million at the top of the income scale.

This proposal also repeals both the estate and GST taxes — a move the Joint Committee on Taxation estimated would cost the U.S. $269 billion over the next ten years.

And the personal tax cuts are just the beginning. The current proposal is to lower the maximum corporate tax rate from 35% to 20% — a marginal improvement over Trump's initial 15% maximum rate, which was estimated to have cost $2.4 trillion over the next 10 years.

Don't forget that the projected 2018 corporate tax revenue is $340 million, accounting for 10% of all federal revenue. This tax plan supports those rate cuts with the notion that "loopholes" and deductions for special interests will be closed, while also stating that those special tax regimes for certain industries and sectors will be modernized to better reflect economic reality. Which puts Congress and lobbyists for those industries and sectors in charge of determining what that modernization looks like.

Finally, the tax proposal looks to incentivize U.S. companies who keep foreign earnings offshore – a sum estimated in 2016 to be $2.6 trillion – to bring that money back on shore by reducing their U.S. tax burden with a 0% tax initially and lower rates going forward. To give some context to this number, the average effective corporate rate is 15%, meaning that providing a full exemption for those assets will cost the federal government at least $300 billion. Then, going forward, foreign offshore earnings would be subject to taxes based on the type of asset, with illiquid assets getting a lower tax rate than the rate that applies to cash and cash equivalents.

Pulling It All Together

Ultimately, this tax framework is an outline of all the changes Republicans would like to see, if money and opposition were no matter. This framework is too light on details and too costly to be anything more than an initial negotiating position. There are still members of Congress who worry about what stimulating economic growth will do to the federal deficit, which means that these proposals are facing an uphill battle. It also leaves many of the truly crucial details to be ironed out by the various tax writing committees, giving all parties room to move as they try to turn this wish list into an actual tax plan. In many ways, this proposal feels much like the now-failed multi-year campaign to “repeal and replace” the Affordable Care Act. It’s heavy on rhetoric and light on specifics.