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TAX REFORM DISCUSSION

May 18th, 2017

KEY INDIVIDUALS IN TAX REFORM

▪ Administration:

- President Trump
- Secretary Steve Mnuchin (Treasury Secretary)
 - David Kautter (Nominee, Assistant Secretary for Tax Policy)
- Gary Cohn (NEC Director)
- Mick Mulvaney (OMB Director)

▪ Senate:

- Senator Mitch McConnell (Senate Majority Leader)
- Senator Chuck Schumer (Senate Minority Leader)
- Senator Orrin Hatch (Chairman, Senate Finance Committee)
- Senator Ron Wyden (Ranking-Member, Senate Finance Committee)

▪ House of Representatives:

- Speaker Paul Ryan
- Congressman Kevin Brady (Chairman, Ways and Means Committee)
- Congressman Mark Meadows (Chairman, House Freedom Caucus)
- Congressman Peter Roskam (Chairman, Ways and Means Subcommittee on Tax Policy)

▪ Joint Committee on Taxation

PRINCIPAL COMPONENTS OF BUSINESS TAX REFORM PLANS COMPARED TO PRESENT LAW

Business Tax	Current law	House Republican Blueprint	Trump Administration
Corporate rate	35%	20%	15%
Top pass-through rate	39.6%	25%	15%
Expensing of capital investment	27.5 years for buildings	100% expensing	No change provided
Interest deductibility	Generally, deductible	Disallow deduction for net interest	No change provided
International tax system	Worldwide w/ deferral	Territorial w/ border adjustment	Territorial
Transition tax on untaxed foreign profits	N/A	8.75% cash; 3.5% tax on	Yes, but no rate specified
Carried interest	Full flow-through	No change provided	Tax at ordinary rate?

PRINCIPAL COMPONENTS OF NON-BUSINESS TAX REFORM PLANS COMPARED TO PRESENT LAW

Individual and Estate Tax	Current law	House Republican Blueprint	Trump Administration
Top individual rate	39.6%	33%	35%
Top capital gains & dividends rate	23.8%	16.5%	20%
Top rate on interest income	43.4%	16.5%	35%
AMT	Applies	Repealed	Repealed
Standard deduction (joint)	\$12,700	\$24,000	Doubled
Itemized deductions	N/A	Repeals all, except charitable and home mortgage interest	Repeals all, except charitable and home mortgage interest
Estate tax	N/A	Repeal	Repeal

HOUSE REPUBLICAN BLUEPRINT

(Tax Policy Center 10-yr Estimates)*

- Principal offsets:
 - Expense capital investment in exchange for disallowing deduction of net interest -- \$447 billion (corporate) plus \$637.5 billion (pass-through)
 - Border tax adjustments (BTAs) – \$1,179 billion
 - Exports: revenues from exported goods and services would be excluded from taxable income.
 - Unlike consumption taxes, no rebates would be provided.
 - Instead, losses could be carried forward indefinitely, with an interest charge
 - Imports: Cost of imported goods and services would not be deductible.
 - Deemed repatriation on (likely) post-1986 E&P of CFCs -- \$138 billion
 - Repeal of specified tax expenditures (including sec.199) -- \$172 billion

* Caveat: These are not Joint Tax Committee estimates, but are included to indicate order of magnitude

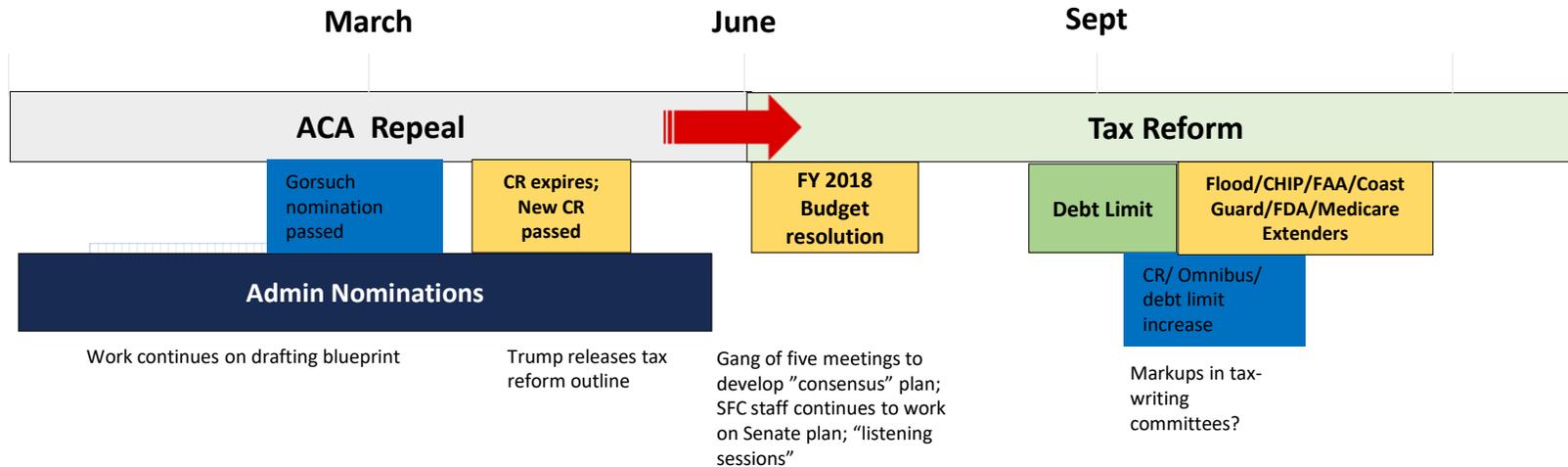
TRADE-OFF OF EXPENSING FOR INTEREST DEDUCTION

- Expensing
 - Encourages growth by speeding up capital recovery and eliminating tax on the normal return to capital.
 - Merely a timing difference
- Interest deduction
 - Ordinary and necessary business expense that should be deductible in measuring income.
 - Depends on characterization of tax as income tax or consumption-like tax
 - Permanent difference
- Tradeoff – will increase cost of capital for many capital-intensive businesses
 - Likely needed to argue BTAs are legal for WTO purposes.
- Trump campaign proposal makes the tradeoff elective
 - Administration’s recent tax principles document is silent on this issue.

TREATMENT OF PASS-THROUGHS

- House Republican Blueprint – 25% rate
 - “same percentage rate reduction as corporate rate”
- Trump administration plan – 15% rate
 - Same rate as corporate rate
- How do you define pass-through income?
 - Capital as a material-income-producing factor
 - Deduct “reasonable compensation” first (taxed at ordinary income rates)
 - Formula?
 - Retained earnings
- Likely criticisms
 - Expensive and distributional effects
 - Difficult to enforce; creates incentives to recharacterize income

POTENTIAL SCHEDULE OF TAX REFORM



Will we begin tax reform mark-ups before August recess?
 Will we complete action on tax reform before year-end?

BUDGET RECONCILIATION PROCESS

- Must first pass a budget resolution between House and Senate
 - Will be partisan; not as easy as it sounds (e.g., will spending targets be addressed?).
- If resolution passes, any reconciliation bill meeting established spending or revenue targets will have procedural protections on the Senate floor.
 - Privileged (i.e., no debate on motion to proceed); only need 51 votes; 20 hours for debate; vote-a-rama.
- Amendments offered must be germane or subject to a 60-vote point of order
- Byrd rule – six definitions of items that can give rise to points of order requiring 60 votes to overcome.
 - No fiscal effect; not in compliance with instruction; outside jurisdiction; fiscal effect merely incidental relative to the policy change; adds to long-term deficit; affects social security.
 - May need to sunset provisions (a la Bush tax cuts)
 - Try to avoid out-year effects
 - Extend budget window?

NMHC PRIORITIES

- Protect the treatment of flow-through entities;
- Preserve the deduction for business interest;
- Retain like-kind exchanges;
- Provide for sensible depreciation rules;
- Continue to tax carried interest at capital gains rates; and
- Maintain the Low-Income Housing Tax Credit.

IMPEDIMENTS TO TAX REFORM REMAIN

- Winners and losers/Sacred cows
 - Reaction to Camp
 - Can this be avoided with extra headroom?
- No agreed framework among Republicans
- Business community divided over international
 - BAT vs. minimum tax
- Can a special rate for pass-throughs be designed effectively?
- Haven't really engaged the electorate
- Deficit hawks – Are we worried about long-term deficits and demographic issues?
 - Revenue neutral?
- Reconciliation – partisan process
 - Can they pass a budget resolution?
 - Narrow margin of error in both bodies.

POSSIBLE ALTERNATIVES TO BLUEPRINT

- President Trump's Plan
 - 2001-type Bill -- deficit-tax cuts to reduce rates and avoid controversial offsets
 - Dynamic scoring
- "Camp Lite"
 - 1986 style reform
 - May need less revenue than Camp
 - Current policy baseline; dynamic scoring; PATH Act
 - International reform: Ryan/Schumer/Portman/Enzi
 - Minimum tax -- some corporations are adamantly opposed
- Hybrid consumption/income tax proposals
 - Cardin/Renacci
 - Subtraction method
 - Possibly with separate wage tax subsidy (e.g., payroll tax relief)