Games in Process and Policy

David Kamin
Professor of Law, NYU School of Law
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The Disempowerment of Treasury

- Treasury was totally disempowered in this legislative process (compare to ‘86 where Treasury played a lead role or even mid-2000s where provided analytic support to then-failed tax reform commission).

- Reflects a gradual trend with regard to Treasury’s powers in legislation (rise of the NEC in the 90s and so on), though degree of Treasury disengagement in this process was unusual.

- Risk Treasury is also to some degree disempowered when it comes to regulatory process relative to OMB/White House. Current fight over OIRA review.

Further Disempowered for a Reason: To Give Modest Cover to Rhetorical Claims

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

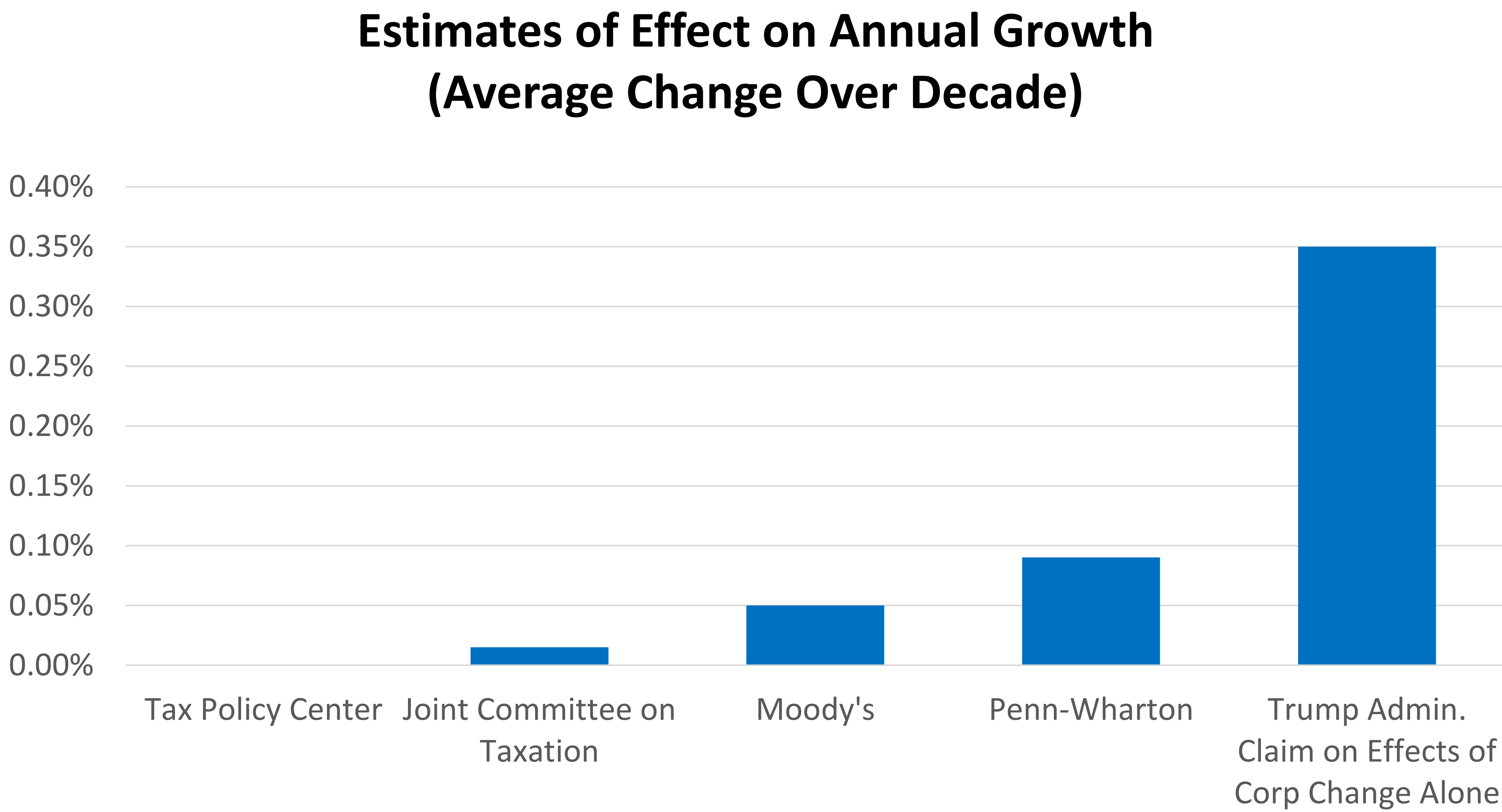
Analysis of Growth and Revenue Estimates Based on the U.S. Senate Committee on Finance Tax Reform Plan
December 11, 2017

OTP has modeled the revenue impact of higher growth effects, using the Administration projections of approximately a 2.9% real GDP growth rate over 10 years contained in the Administration's Fiscal Year 2018 budget.[2]

OTP compared this 2.9% GDP growth scenario to a baseline of previous projections of 2.2% GDP growth. Treasury expects approximately half of this 0.7% increase in growth to come from changes to corporate taxation. We expect the other half to come from changes to pass-through taxation[3] and individual tax reform, as well as from a combination of regulatory reform, infrastructure development, and welfare reform as proposed in the Administration's Fiscal Year 2018 budget.

We acknowledge that some economists predict different growth rates. OTP projects that at approximately 0.35% of incremental annual GDP growth, Treasury tax receipts would generate approximately $1 trillion of incremental revenue.

And Let's Just Say That Growth Assumption Was an Outlier…..



That Other $500 Billion? – "Current Policy"

- In scoring, it is all about what a proposal is compared to. The baseline.
- "Current policy" baseline used to justify knocking off ~$500 bn from cost of bill. BUT, that wasn't counting continuation of expiring provisions IN THE BILL + scoring macrodynamically relative to current law.

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-27
Official Score of Bill	-$136	-$280	-$259	-$221	-$178	-$138	-$120	-$115	-$41	$33	-$1,454
Cost of Continuing Expiring Provisions Before Dec. '17	-$25	-$31	-$60	-$68	-$55	-$45	-$41	-$41	-$42	-$44	-$451
50% Bonus Depreciation	-$8	-$19	-$46	-$52	-$37	-$25	-$18	-$15	-$13	-$13	-$247
Other Expiring Provisions	-$17	-$12	-$14	-$16	-$17	-$20	-$23	-$26	-$29	-$31	-$204
Cost of Extension of Expiring Provisions in 2017 Tax Bill	$0	-$1	-$4	-$6	-$7	-$10	-$17	-$22	-$180	-$257	-$503

And…Now…Continuation of *New* Expiring Tax Cuts Is Current Policy

Table 11–2. ADJUSTMENTS TO THE BALANCED BUDGET AND EMERGENCY DEFICIT CONTROL ACT (BBEDCA) BASELINE ESTIMATES OF GOVERNMENTAL RECEIPTS

(In billions of dollars)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2019–2023	2019–2028
BBEDCA baseline receipts	**3,340.5**	**3,424.3**	**3,613.3**	**3,832.9**	**4,094.7**	**4,388.9**	**4,677.8**	**4,947.7**	**5,346.1**	**5,716.9**	**6,040.3**	**19,354.1**	**46,082.9**
Adjustments to BBEDCA baseline:													
Extend individual income tax provisions [1]	....	....	....	....	....	....	....	....	–112.7	–194.9	–204.7	....	–512.4
Extend estate and gift tax provisions	....	....	....	....	....	....	....	....	....	–14.2	–15.1	....	–29.2
Total, adjustments to BBEDCA baseline	....	....	....	....	....	....	....	....	**–112.7**	**–209.1**	**–219.8**	....	**–541.6**
Adjusted baseline receipts	**3,340.5**	**3,424.3**	**3,613.3**	**3,832.9**	**4,094.7**	**4,388.9**	**4,677.8**	**4,947.7**	**5,233.5**	**5,507.8**	**5,820.5**	**19,354.1**	**45,541.4**

[1] This provision affects both receipts and outlays. Only the receipt effect is shown here. The outlay effects are listed below:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2019–23	2019–28
Extend individual income tax provisions	....	....	....	....	....	....	....	....	–3.9	15.3	15.9	....	27.3
Total, outlay effects of adjustments to BBEDCA baseline	....	....	....	....	....	....	....	....	–3.9	15.3	15.9	....	27.3

ADJUSTMENTS TO THE BALANCED BUDGET AND EMERGENCY DEFICIT CONTROL ACT (BBEDCA) BASELINE

An important step in addressing the Nation's fiscal problems is to be upfront about them and to establish a baseline that provides a realistic measure of the deficit outlook before new policies are enacted. This Budget does so by adjusting the BBEDCA baseline to reflect the true cost of extending major tax policies that are scheduled to expire but that are likely to be extended. The BBEDCA baseline, which is commonly used in budgeting and is defined in statute, reflects, with some exceptions, the projected receipts level under current law.

However, current law includes a number of scheduled tax changes that the Administration believes are unlikely to occur and that prevent it from serving as a realistic benchmark for judging the effect of new legislation. These

A Game of Rate Differentials

Rate Differentials: Ordinary Individual Income Versus C-Corp Versus Qualifying Pass-Through		
	Pre-2017 Tax Legislation Rates	Post-2017 Tax Legislation Rates
A. If Income Is Taxed as Ordinary Income to an Individual		
Top "Ordinary" Individual Income Tax Rate	44.6%	40.8%
B. If Income Is Taxed to a C-Corporation		
Top Corporate Tax Rate	35.0%	21.0%
Top Dividends/Capital Gains Rate (Second Level of Tax)	25.0%	23.8%
Combined Top Rate on Corporate Income *If* Income Immediately Distributed (Corp Rate + Div Rate x (1 - Corp Rate))	51.3%	39.8%
Differential: Corporate Versus Individual	*+6.6% to -9.6%*	*-1.0% to -19.8%*
C. If Income Is Taxed To a Qualifying Pass Through		
Qualifying Pass-Through Rate	44.6%	33.4%
Differential: Corporate Versus Individual	*0.0%*	*-7.4%*

How to Reduce/Avoid the Second Level of Corporate Tax?

1. Retain earnings within c-corp and avoid various restrictions on doing so (often doable through planning techniques)

2. Borrow to maintain as much liquidity as needed. Potentially can borrow from c-corp—just do so at applicable federal rate (and may need to offer collateral).

3. Defer and, in best of all possible worlds, die. Step-up in basis.

The Many Complications of the 20% Pass-Through Deduction

1. Restrictions Applying Irrespective of Income
   - Can’t be an employee. Have to be an independent contractor, partner, S-corp owner.
   - Can’t be “reasonable comp” for services (BUT apparently only S-corp restriction), guaranteed payment, or payment to partner not acting in capacity as partner. (FYI—all easily avoided)

2. Restrictions Applying Above $315K in Taxable Income (Married) / $157.5K (Single)
   - Can’t supply restricted services (there’s a list – drs., lawyers, consultants, etc) or have business whose principal asset is services/reputation of owners/employees.
   - Get the greater of 20% deduction on qualifying income OR 50% of firm payroll OR 25% of payroll + 2.5% of unadjusted basis in property

Oh…and none of those restrictions apply to REITS…and there’s the grain glitch (20% of GROSS income rather than NET income), etc.

SALT Limitation Is Not an "Original Sin" But It Wasn't Thought Through

The ways potentially around $10K SALT limitation:

1. Charitable deductions for giving to state (+ individual-level credit).

2. Payroll tax rather than income tax on wages (+ individual-level credit).

3. Entity level tax on pass throughs (+ individual-level credit).

To What Degree Were These Kind of Tax-Planning Behaviors Taken Into Account in Estimates?

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- Importantly, official scorekeepers did <u>not</u> to change their scores in the midst of the rush to legislate even as new info. was gained on the types of planning techniques people/states were likely to use.

- I'm pretty confident they didn't take into account <u>any</u> state response on SALT.

- On pass through compare annual score from Penn-Wharton Budget Model which assumed significant shift toward indep contractor status to JCT (assumption unknown).

JCT Versus Penn Wharton on Pass Through Deduction

Penn-Wharton assumes a significant shift toward independent contractor status; JCT -- ???