AALU

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Big Six Framework

The Big Six released their anticipated framework yesterday. This represents the starting gun for serious tax reform deliberations on Capitol Hill. We are at the beginning of a lengthy and challenging process on tax reform. There will be a number of ups and downs as legislative details are developed in Congress.

AALU agrees with most political observers that it will be very difficult to complete tax reform by end of the year, and even Republican leaders concede it’s an ambitious goal. March or April of 2018 is a more realistic timeframe.

Tax Reform has not been achieved in three decades because getting it right is very difficult. There are no guaranteed results to this process. For more on the historical context and challenges of tax reform to discuss with your clients, please reference the following pieces:

- [June Tax Reform Client Communication]
- [Talking to Your Clients About the Estate Tax]

AALU Priorities

AALU is focused on three priority buckets: 1) Continuation of Today's Responsible and Appropriate Tax Treatment of Life Insurance Products for both Individual and Business Uses 2) Permanence and Certainty for Effective, Long-Term Estate Planning, and 3) a Tax Code that Equitably Treats All Businesses, Regardless of Size or Structure.

Of particular note for the life insurance industry, none of the Camp Draft provisions directly impacting life insurance companies, or provisions impacting products, such as COLI and NQDC plans, are included in the framework. On the other hand, the framework does propose repeal of the estate and generation-skipping transfer taxes.

Big Six Framework Details

The framework provided some more detail, but it is relatively light on specifics, particularly with respect to offsets and payfors.

Other Key Details in the Big Six Framework:

- Business Taxes: 20% C Rate; 25% pass-through rate
  - Full immediate expensing for at least five years
  - Partial elimination of deduction for net interest for C corporations (no specific figure or further details)
  - Elimination of Section 199 domestic manufacturing credit

- <u>Territorial System for International Taxation:</u>
    - One-time repatriation of foreign profits
    - Going forward: 100% exemption for dividends of foreign subsidiaries
- <u>Individual Taxes:</u> From 7 brackets to 3: 35%, 25%, and 12%
    - Doubles standard deduction
    - Notes the potential of an “additional top rate” to ensure the wealthy continue to pay their fair share
    - <u>Deductions and Tax Expenditures:</u> Specifically keeps mortgage interest and charitable deductions, also will “retain tax incentives” for **retirement**, work, and higher education; noting their importance, recommending their simplification, and laying out the goal of maintaining or raising retirement plan participation.
    - <u>Eliminates the State and Local Tax deduction</u>
    - <u>Repeals the estate and generation-skipping transfer taxes</u>
- Repeals AMT; both corporate and individual

Unanswered Questions/Remaining Issues:

- There remains more we do not know at this point than what we do know.
- Where is the spinach? With a few notable exceptions, the framework does not describe what will be eliminated or sacrificed from the code to offset the desired changes.
- The framework envisions that the tax writing committees may retain some additional business credits. This is something to watch; the more it happens, the more it limits the ability to cut rates.
- As relates to the new rate for passthroughs; how do the tax writers construct the rules to help small businesses, without creating a potential loophole in the code?
- As relates to the international system; what are the details around the base erosion controls?

The issue for Republicans is trying to fit all of their tax objectives, including those specified in the framework, into a Budget that is likely to allow for around $1.5 trillion in deficits over ten years. Reconciliation restrictions mean that they must either find additional revenues or trim their ambitions if they want permanent reform. Alternatively, Republicans could consider enacting temporary reform using deficit financing, with the enacted tax provisions sunsetting. This was the case for the Bush tax cuts.

Challenges: The Process Going Forward

As Congress buckles down to tackle major changes to the tax code, they face a number of challenges, including a difficult political and legislative environment. There are just thirty legislative days where both the House and Senate are in session before the Continuing Resolution (CR) funding the government expires on December 8th, and the most recent failure to repeal and replace Obamacare through reconciliation means that health care issues will continue to take up time and attention through the Fall.

Cost of Reform: The details provided in the framework, particularly the substantial reductions in business tax rates, will significantly reduce revenues from the federal government. The Center for a Responsible Federal Budget gave an initial figure of $2.2 trillion in revenue losses, but given lack of detail that should be taken as a rough estimate. Given the constraints of reconciliation, which require deficit-neutrality in the out years of the budget window (after 10 years), Republicans will need to find significant revenues. As Republicans flush out the details of the payfors over the next weeks and months, more vocal opposition from interest stakeholders is expected.

Budget Resolution: Both the House and Senate still need to agree on an FY 18 budget resolution with reconciliation instructions for tax reform to avoid the filibuster in the Senate. This process could take three weeks or more of October to complete. Chairman Brady has been clear that Ways and Means will not produce legislative text until after a budget resolution is adopted.

Political Environment: Another big challenge will be selling a major tax reform package to the American people in the current climate. When the Bush tax cuts of 2001 and 2003 were enacted, it was a completely different economic and political environment. The federal budget was in surplus when President Bush was elected in 2001—there was even talk about how the Federal Reserve would conduct monetary policy if the United States had no debt, and therefore no government bonds for open market operations. Tax reform was pitched in part as giving the American people their hard-earned money back.

Today, the US budget is not in surplus; rather, we had a $552 billion deficit in 2016. In September 2017 the national debt crossed over $20 trillion. Further, the financial crisis in 2008 cast a long shadow over the financial outlook of a number of American families, with inequality at post-New Deal highs.

AALU Activity

AALU is following the long-term strategic plan on tax reform that was developed after the election, and we continue to educate Members about the benefits of life insurance products and the negative impacts of the Camp Draft. Given all the uncertainty, we are continually monitoring changes in the environment as we execute our strategy.

We have a number of meetings lined up with Ambassadors and internal staff, and we have engaged our tax reform working groups. Additionally, we received strong feedback on the client pieces we put out after the November election—these pieces explained the significant challenges to passing tax reform and the importance of continuing with planned insurance purchases. We will continue to provide members with tools to navigate this period of uncertainty as tax reform details are developed.

It will be very difficult to complete tax reform by the end of 2017, and we are most likely at the beginning of a long process that will not wrap up before March or April 2018 at the earliest—and could be stymied by any number of factors. We will update members on tax reform developments as warranted. Your sustained engagement is important to our efforts, and we will continue to engage AALU members directly as this process unfolds in the coming weeks.

If you have any questions or comments, or intelligence to share, please call us at (202) 742-4638.

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