WRNewswire
An AALU Washington Report

Thursday 14, June 2016 WRN 16.06.14

# Special Report: An Analysis of the House Republican Tax Reform Blueprint

On June 24th, House Republicans released their long-awaited tax reform blueprint. It does not contain legislative text or provide specific proposals in a number of areas, though the draft does go into some conceptual detail. Rather, the blueprint provides a framework that outlines Republican principles to reform the tax code and create greater economic growth. House Republicans will use the remainder of 2016 to seek input on the blueprint from Members and stakeholders, with a goal of having legislative text ready to go for the new Congress in 2017.

As expected, there is no mention of any of the Camp bill provisions directly affecting the life insurance industry or life insurance products—including the Camp bill's proposed changes to COLI or NQDC. In addition, the estate tax and generation-skipping tax are repealed.

The lack of specific provisions impacting life insurance in this blueprint reflects the continued hard work of our membership and our partners in the life insurance community to educate Congress about the unique benefits of life insurance products and the negative impact of previous tax reform efforts.

However, the release of this draft reflects the fact that comprehensive tax reform remains a serious goal for Members of Congress, and detailed proposals will continue to be offered and to attract serious attention. There are several issues discussed in the blueprint that could pose challenges for the life insurance industry as the details of this draft are fleshed out, and AALU will closely monitor the development of the blueprint as specifics are added and legislative text is developed.

## Problems/Challenges with the Current Tax Code

It is no secret that Republicans have a strong interest in comprehensive tax reform to promote economic growth. The House Ways and Means Committee has held a series of hearings on tax reform since the beginning of the year, allowing Members both on and off the tax writing committee to put forth their ideas and proposals.

The blueprint outlines House Republican views regarding five challenges with the current Tax Code. The challenges:

1. Burdensome Paperwork and Compliance Costs
2. Current Code Delivers Special Interest Subsidies and Crony Capitalism
3. Savings and Investment are Penalized
4. Businesses are Encouraged to Move Overseas
5. Tax Collection Administration is Broken

There are no specific provisions in the blueprint that directly impact the life insurance industry, as opposed to those detailed in former Ways and Means Committee Chairman Dave Camp's (R-MI) tax reform legislation. However, there are several issues and concepts raised in the draft that could have an effect as the details of a comprehensive tax reform package are developed, as discussed in more detail below.

## Individual Tax Rates

The blueprint simplifies and lowers tax rates for families and individuals, in addition to reduced tax rates on capital gains, dividends, and interest income. Major provisions for individuals:

- Three brackets: 12%, 25%, and 33%.
- 50% of capital gains can be excluded from income tax, with the remaining portion subject to ordinary income tax rates.
- The individual alternative minimum tax (AMT) is repealed.
- The estate tax and generation-skipping taxes are repealed.
- Mortgage interest deduction and charitable deductions will remain.

NOTES:

The House Ways and Means Committee is looking at options to increase savings by creating a more general savings account. Universal Savings Accounts were singled out in the blueprint as an idea—these are investment accounts that allow withdrawals of contributions at any time without penalty, up to a cap. These accounts have been introduced in legislation before, in this Congress by Rep. Dave Brat (R-VA). However, the blueprint does not commit to including a more general savings account in future tax reform legislation.

While the blueprint repeals the estate tax, it does not indicate whether such repeal would include a step-up in basis, like the legislation sponsored by Ways and Means Chairman Kevin Brady (R-TX) that passed the House in 2015. Estate tax repeal is likely to remain a partisan issue, with only seven House Democrats voting for Brady's 2015 bill, while all but three Republicans supported the legislation. The Brady bill was scored as costing $269 billion over 10-years, and including it (or a bill like it) in future tax reform legislation would make the effort to lower tax rates across the board more difficult to achieve in a revenue-neutral manner.

### Business Tax Rates

As with individual rates, the blueprint lowers business taxes across the board. For pass-through entities and sole proprietorships, tax rates are limited to 25%. Under the new approach outlined in the draft, sole proprietorships and pass-through businesses could have some income taxed at the lowest individual bracket of 12%. For C corporations, the top tax rate is reduced to 20%, and the corporate AMT is eliminated. The blueprint also allows businesses to fully and immediately write off business expenses for both investments of tangible property (except land) and intangible assets.

### Major Provisions:

- 20% tax rate for C corporations; 25% tax rate for sole proprietorships and pass-through entities.
- 100% immediate write-off for business expenses.
- The corporate Alternative Minimum Tax (AMT) is repealed.
- Last-In, First Out (LIFO) Accounting is preserved.
- A territorial tax system is adopted.

### NOTES:

While the blueprint repeals the corporate AMT, it does not address AMT credits. Under the Camp bill, a taxpayer that has AMT credit carryforwards would be able to claim a refund of 50 percent of the remaining credits (to the extent the credits exceed regular tax for the year) in tax years beginning in 2016, 2017, and 2018. Taxpayers would be able to claim a refund of all remaining credits in the tax year beginning in 2019. The provision would generally be effective for tax years beginning after 2014.

### Budgetary Impact

While there is no official revenue score for this draft, revenue neutrality is a short-term goal of the package. However, it is important to note that the combination of baseline assumptions and reliance on dynamic scoring in the blueprint are based on the outlined reforms leading to significant economic growth. Should the expected revenue from increased economic growth not materialize, then the impact on the deficit could be greater.

## Potential Challenges for the Life Insurance Community

Again, while the blueprint does not contain provisions that would specifically impact the life insurance community in a negative way, challenges for our industry could arise depending on how Congress addresses several key areas for reform (as set forth in the blueprint). More specifically, these issues are more likely to arise under two of the blueprint-identified reform categories.

### Current Code Delivers Special Interest Subsidies and Crony Capitalism

The blueprint discusses how the Tax Code is littered with hundreds of subsidies and preferences that pick winners and losers, rather than letting the market reward the best businesses and products.

Once again, cracking down on tax expenditures was a major theme, with the blueprint explaining that, "Many of these tax preferences, sometimes referred to as 'tax expenditures,' are special-interest giveaways that are masked as tax breaks instead of direct grants."

Of course, despite misperceptions by some in the DC policy community, life insurance is taxed appropriately. No provision in the Tax Code excludes, exempts, or deducts inside buildup from gross income or imposes a preferential rate on gains actually received—a point the Joint Committee on Taxation (JCT) affirmed last year when it removed inside build-up from its tax expenditure list.

The blueprint makes clear that any tax expenditure not specifically discussed in the draft would be on the table for potential repeal in any final tax reform package, which will "generally eliminate special-interest deductions." While the JCT has affirmed our proper tax treatment, we must remain vigilant as this draft develops.

Savings and Investment are Penalized

Reducing obstacles to savings and investment is one of the centerpieces of the House Republican tax blueprint, a goal shared by the life insurance community. The blueprint claims that income from savings and investment is subject to double taxation, which the current Tax Code only partially mitigates.

The blueprint states that the current tax incentives for savings in the Tax Code will be continued, but explains that the Ways and Means Committee will "work to consolidate and reform the multiple different retirement savings provisions in the current tax code to provide effective and efficient incentives for savings and investment."

It is unclear from the draft what types of consolidation and reform House Republicans are considering, and we will monitor the development of this effort as it moves forward. There are several particular issues raised by the blueprint's discussion of savings and investment.

In addition, it is unclear how some aspects of the savings and investment reforms will work together. For example, with lower tax rates across-the-board, and a 100% immediate expensing regime that creates a new environment for the acquisition of assets, it is uncertain what impact—if any—this could have on life insurance and other financial products.

Consumption Tax

One aspect related to savings and investment discussed in the blueprint is a move towards a consumption-based tax system. The blueprint states that "consumption-based tax systems are widely regarded to be more pro-growth than income-based tax systems like the current tax code." Further, the blueprint notes that income-based tax systems "discourage saving and investment," and explains that there is substantial empirical evidence that moving towards a consumption-based tax system would have significant economic benefits.

The blueprint makes it clear that House Republicans believe a move towards a consumption-based system does not have to include an explicit consumption tax—such as a retail sales tax—but could be achieved by reforms that exclude certain features of the income tax base. The blueprint does not commit to pursue any specific reform that would impose additional consumption-based taxes.

Yet, given the strong language around the benefits of a consumption-based tax system, it is something that bears watching as this blueprint develops. There is some support on the House Ways and Means Committee for this style of reform, particularly among newer members to the committee, though House Republican leadership and senior committee members have not indicated that they support adopting a consumption-based system.

## Deduction of Interest Expenses

Under the reform plan outlined by the blueprint, businesses can offset interest expenses against any interest income, but there is no current deduction for net interest expenses—though such net interest expenses may be carried forward indefinitely and allowed as an offset against net interest income in future years.

In discussing net interest expenses, the blueprint explains that the Ways and Means Committee will, "work to develop special rules with respect to interest expense for financial services companies, such as banks, insurance, and leasing, that will take into account the role of interest income and interest expense in their business models."

It is good to see that the blueprint acknowledges the necessity of ensuring that changes to interest expensing take into account the business models of the life insurance industry. Of course, the devil is in the details, and as the Ways and Means Committee develops specifics around these "special rules," it will be important to remain vigilant and continue educating Members of Congress about our industry and the benefits it delivers to American families every day.

## Next Steps

The House Republican blueprint was drafted in large part by House Republican leadership and Ways and Means Committee staff. Now that the blueprint has been released, staff will be reaching out to the entire Republican caucus to both fully explain the draft and receive feedback, in addition to outreach with industry stakeholders.

Major legislation, such as comprehensive tax reform, is often passed within the first year or two of a President's first term. Republicans aim to turn this blueprint into legislative text that can be ready to be considered when the new Congress convenes in January 2017, in the event that the political environment is ripe to move this type of major reform.

This election cycle has been one that continually defies pundit expectations and conventional wisdom, so it can be difficult to make any predictions about November results with much confidence. Hillary Clinton is currently the favorite to win the White House, Democrats have a good chance at retaking the Senate, and the House will almost certainly remain Republican led. But that outlook could change as we approach Election Day.

A Clinton Presidency would make achieving comprehensive tax reform in 2017 or 2018 very difficult, though not impossible. A Trump Presidency, on the other hand, would provide a real opportunity for passing a comprehensive tax reform package. The Senate would likely remain Republican-controlled under such a scenario, and with budget reconciliation available as an option to prevent Democratic filibusters in the Senate, we could see movement on tax and entitlement reform.

Regardless of the electoral outcome, as we saw with the Camp bill, once provisions are included in legislative text they often serve as a basis for future reform efforts, so it is important to remain vigilant.

AALU will monitor the development of the blueprint closely as Congressional Members and staff put meat on the bones of this proposal, and will educate them about any provisions that would negatively impact the life insurance community. In addition, it is also important for AALU members to continue to engage and educate their Representatives and Senators about the value our industry delivers to the American people.

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