Business Tax Proposals Set Stage for Upcoming Negotiations

The White House recently announced its tax reform plan — a broad outline of policies, with details expected to be worked out as discussions with Congress progress.¹ The administration's tax reform proposals include a reduction in the top corporate tax rate from 35% to 15%. The announcement seemed to indicate that the 15% rate would also apply to business income that is reported on individual income tax returns; for example, income that passes through to individuals from entities like partnerships, S corporations, and limited liability companies.

In order to help pay for business tax cuts, both Congress and the administration have proposed changes to how U.S. corporate taxes reach beyond the national border. This is likely to be a focus of future negotiations.

Taxing Worldwide Profits

Under existing corporate tax rules, when U.S. companies sell goods outside the United States, they are generally taxed on profits returned to the United States, with a credit for foreign taxes paid. When companies sell imported goods in the United States, they can deduct the cost of goods when calculating income tax. This system has contributed to some companies moving production overseas, as well as leading some multinational companies to keep profits overseas and/or execute "inversions" to establish corporate headquarters in more tax-friendly countries.

Border Adjustment or Territorial Tax

In a 2016 tax reform "blueprint" released by House Republicans, companies — foreign and domestic — would be taxed on all goods sold in the United States and would not be able to deduct the cost of imported goods. (Companies that buy or manufacture in the United States would still be able to deduct the associated cost of goods.) Goods sold outside the United States would not be subject to U.S. taxes.² The distinction between goods sold inside or outside the country is one reason that this tax structure is considered "border adjusted."³

As an alternative to the border adjustment tax, the tax reform plan announced by the administration indicates that the lower 15% corporate rate would be implemented as part of a new "territorial tax system," explaining that U.S. companies would pay tax only on income related to the United States and would no longer be subject to tax on worldwide income. In addition, a one-time tax (rate to be defined) would apply to overseas dollars repatriated to the United States.³ Based on the announcement, it's unclear how this system would differ from the border adjustment tax.

¹, ³ Briefing by Steven Mnuchin, Secretary of Commerce, and Gary Cohn, Director of the National Economic Council, April 26, 2017, whitehouse.gov
² better.gop, June 24, 2016
IMPORTANT DISCLOSURES

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