MUNISERVICES GOVERNMENT RELATIONS

POLICY UPDATE

October 5, 2017

FEDERAL TAX REFORM / "BIG SIX"

"Big Six" Tax Framework

The details of the Republican Tax Plan are yet to be released to the public but based on what is known today about the proposal it has the potential for significant impacts on California residents. The Big Six Republican tax leaders include – two representatives each from the White House, the Senate and the House of Representatives.

The proposal (limited detail) will include: "Zero Tax Bracket"; "Individual Tax Rate Structure"; "Enhanced Child Care Tax Credit and Middle-Class Tax Relief"; "Individual Alternative Minimum Tax (AMT)"; "Itemized Deductions"; "Work, Education and Retirement"; "Other Provisions Affecting Individuals"; "Death and Generation Skipping Transfer Taxes."

State and Local Tax Exemption: The federal deduction for state and local taxes allowed Californians to reduce their taxable income by $101 billion in 2014. If eliminated this could take discretionary income out of the California economy unless other provisions in the tax plan offset the losses. The U.S. Conference of Mayors provided MuniServices with the following regarding the implication should a SALT deduction elimination occur: "If our taxpayers lose the deduction for their state and local income, property and sales taxes, they will face double taxation. Instead of allowing working families in every one of our communities to deduct the amount they pay in state and local taxes, the Federal government will basically be forcing taxpayers, who make up the backbone of our economy, to pay taxes a second time on the same income. The ripple impact gets worse when we realize that a loss in local revenues could result in a cut in critical services—police and fire protection, education, health care, transportation and housing. Facts show that 39% of taxpayers with annual earning between $50,000 to $75,000; and 70% of taxpayers with annual earning between $100,000 and $200,000 use the SALT deduction. "

Home Mortgage Interest Deduction: A reduction in the home mortgage interest deduction ceiling from $1,000,000 to $500,000 is also apparently still on the table for discussion in the Republican Plan. This provision would have a disproportionate impact on states like California with high housing costs. This reduction would increase the amount of Federal taxes paid by Californians with mortgage interest from loans in excess of $500,000. The California Realtors Association estimates that the average California home owner could pay as much as $3,000 more per year in taxes

Voter Impact: Loss of State and Local Tax deductions could also make voters more sensitive to future proposals for increased property taxes making it more difficult to obtain voter approval for tax increase measures including property tax financed voter approved bond measures.

Federal Legislation

Quill and Marketplace Fairness: *Quill* limits the collection of sales and use tax to vendors with a physical presence in the state. The State of South Dakota's October 2 petition to the U.S. Supreme Court urges overturning *Quill.*

Would Require Remote Sellers to Collect and Remit State Sales and use Taxes: Remote Transactions Parity Act (H.R 2193) in the House; Marketplace Fairness Act (S. 976) in the Senate; Online Simplification Act circulated by the House Judiciary Committee Chair

Limit States' Ability to Tax and Regulate Interstate Commerce Exclusively to Activity Conducted by Entities with Physical Presence: No Regulation Without Representation (H.R. 2887). State and local government groups see H.R. 2887 as an unprecedented and intrusion on state sovereignty and a violation of the 10th Amendment.

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UNIFIED FRAMEWORK FOR FIXING OUR BROKEN TAX CODE

SEPTEMBER 27, 2017

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OVERVIEW

> *It is now time for all members of Congress — Democrat, Republican and Independent — to support pro-American tax reform. It's time for Congress to provide a level playing field for our workers, to bring American companies back home, to attract new companies and businesses to our country, and to put more money into the pockets of everyday hardworking people.*
>
> President Donald J. Trump | Milwaukee Journal Sentinel | September 3, 2017

President Trump has laid out four principles for tax reform: First, make the tax code simple, fair and easy to understand. Second, give American workers a pay raise by allowing them to keep more of their hard-earned paychecks. Third, make America the jobs magnet of the world by leveling the playing field for American businesses and workers. Finally, bring back trillions of dollars that are currently kept offshore to reinvest in the American economy.

The President's four principles are consistent with the goals of both congressional tax-writing committees, and are at the core of this framework for fixing America's broken tax code.

Too many in our country are shut out of the dynamism of the U.S. economy, which has led to the justifiable feeling that the system is rigged against hardworking Americans. With significant and meaningful tax reform and relief, we will create a fairer system that levels the playing field and extends economic opportunities to American workers, small businesses, and middle-income families.

The Trump Administration and Congress will work together to produce tax reform that will put America first.

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GOALS

The Trump Administration, the House Committee on Ways and Means, and the Senate Committee on Finance have developed a unified framework to achieve pro-American, fiscally-responsible tax reform. This framework will deliver a 21st century tax code that is built for growth, supports middle-class families, defends our workers, protects our jobs, and puts America first. It will deliver fiscally responsible tax reform by broadening the tax base, closing loopholes and growing the economy. It includes:

- Tax relief for middle-class families.
- The simplicity of "postcard" tax filing for the vast majority of Americans.
- Tax relief for businesses, especially small businesses.
- Ending incentives to ship jobs, capital, and tax revenue overseas.
- Broadening the tax base and providing greater fairness for all Americans by closing special interest tax breaks and loopholes.

This unified framework serves as a template for the tax-writing committees that will develop legislation through a transparent and inclusive committee process. The committees will also develop additional reforms to improve the efficiency and effectiveness of tax laws and to effectuate the goals of the framework. The Chairmen welcome and encourage bipartisan support and participation in the process.

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TAX RELIEF AND SIMPLIFICATION FOR AMERICAN FAMILIES

Over the last decade too many hard-working Americans have struggled to find good-paying jobs, make ends meet, provide for their families and plan for their retirement. They are the focus of this framework. Strengthening and growing the middle class, and keeping more money in their pockets, is how we build a stronger America. By lowering the tax burden on the middle class, and creating a healthier economy, we can give American families greater confidence and help them get ahead. At the same time, taxpayers deserve a system that is simpler and fairer. America's tax code should be working for, not against, middle-class families.

"ZERO TAX BRACKET"

Under the framework, typical middle-class families will see less of their income subject to federal income tax.

The framework simplifies the tax code and provides tax relief by roughly doubling the standard deduction to:

- $24,000 for married taxpayers filing jointly, and
- $12,000 for single filers.

To simplify the tax rules, the additional standard deduction and personal exemptions for the taxpayer and spouse are consolidated into this larger standard deduction. This change is fundamental to a simpler, fairer system.

In combination, these changes simplify tax filing and effectively create a larger "zero tax bracket" by eliminating taxes on the first $24,000 of income earned by a married couple and $12,000 earned by a single individual.

INDIVIDUAL TAX RATE STRUCTURE

Under current law, taxable income is subject to seven tax brackets. The framework aims to consolidate the current seven tax brackets into three brackets of 12%, 25% and 35%.

Typical families in the existing 10% bracket are expected to be better off under the framework due to the larger standard deduction, larger child tax credit and additional tax relief that will be included during the committee process.

An additional top rate may apply to the highest-income taxpayers to ensure that the reformed tax code is at least as progressive as the existing tax code and does not shift the tax burden from high-income to lower- and middle-income taxpayers.

The framework also envisions the use of a more accurate measure of inflation for purposes of indexing the tax brackets and other tax parameters.

ENHANCED CHILD TAX CREDIT AND MIDDLE CLASS TAX RELIEF

To further simplify tax filing and provide tax relief for middle-income families, the framework repeals the personal exemptions for dependents and significantly increases the Child Tax Credit. The first $1,000 of the credit will be refundable as under current law.

In addition, the framework will increase the income levels at which the Child Tax Credit begins to phase out. The modified income limits will make the credit available to more middle-income families and eliminate the marriage penalty in the existing credit.

The framework also provides a non-refundable credit of $500 for non-child dependents to help defray the cost of caring for other dependents.

Finally, the committees will work on additional measures to meaningfully reduce the tax burden on the middle-class.

INDIVIDUAL ALTERNATIVE MINIMUM TAX (AMT)

The nonpartisan Joint Committee on Taxation (JCT) and the Internal Revenue Service (IRS) Taxpayer Advocate have both recommended repealing the AMT because it no longer serves its intended purpose and creates significant complexity. This framework substantially simplifies the tax code by repealing the existing individual AMT, which requires taxpayers to do their taxes twice.

ITEMIZED DEDUCTIONS

In order to simplify the tax code, the framework eliminates most itemized deductions, but retains tax incentives for home mortgage interest and charitable contributions. These tax benefits help accomplish important goals that strengthen civil society, as opposed to dependence on government: homeownership and charitable giving.

WORK, EDUCATION AND RETIREMENT

The framework retains tax benefits that encourage work, higher education and retirement security. The committees are encouraged to simplify these benefits to improve their efficiency and effectiveness. Tax reform will aim to maintain or raise retirement plan participation of workers and the resources available for retirement.

OTHER PROVISIONS AFFECTING INDIVIDUALS

Numerous other exemptions, deductions and credits for individuals riddle the tax code. The framework envisions the repeal of many of these provisions to make the system simpler and fairer for all families and individuals, and allow for lower tax rates.

DEATH AND GENERATION-SKIPPING TRANSFER TAXES

The framework repeals the death tax and the generation-skipping transfer tax.

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COMPETITIVENESS AND GROWTH FOR ALL JOB CREATORS

Small businesses drive our economy and our communities, and they deserve a significant tax cut. This framework creates a new tax structure for small businesses so they can better compete. Furthermore, America's outdated tax code has fallen behind the rest of the world – costing U.S. workers both jobs and higher wages. In response, the framework puts America's corporate tax rate below the average of other industrialized countries and promotes greater investment in American manufacturing.

TAX RATE STRUCTURE FOR SMALL BUSINESSES

The framework limits the maximum tax rate applied to the business income of small and family-owned businesses conducted as sole proprietorships, partnerships and S corporations to 25%. The framework contemplates that the committees will adopt measures to prevent the recharacterization of personal income into business income to prevent wealthy individuals from avoiding the top personal tax rate.

TAX RATE STRUCTURE FOR CORPORATIONS

The framework reduces the corporate tax rate to 20% – which is below the 22.5% average of the industrialized world. In addition, it aims to eliminate the corporate AMT, as recommended by the non-partisan JCT. The committees also may consider methods to reduce the double taxation of corporate earnings.

"EXPENSING" OF CAPITAL INVESTMENTS

The framework allows businesses to immediately write off (or "expense") the cost of new investments in depreciable assets other than structures made after September 27, 2017, for at least five years. This policy represents an unprecedented level of expensing with respect to the duration and scope of eligible assets. The committees may continue to work to enhance unprecedented expensing for business investments, especially to provide relief for small businesses.

INTEREST EXPENSE

The deduction for net interest expense incurred by C corporations will be partially limited. The committees will consider the appropriate treatment of interest paid by non-corporate taxpayers.

OTHER BUSINESS DEDUCTIONS AND CREDITS

Because of the framework's substantial rate reduction for all businesses, the current-law domestic production ("section 199") deduction will no longer be necessary. Domestic manufacturers will see the lowest marginal rates in almost 80 years. In addition, numerous other special exclusions and deductions will be repealed or restricted.

The framework explicitly preserves business credits in two areas where tax incentives have proven to be effective in promoting policy goals important in the American economy: research and development (R&D) and low-income housing. While the framework envisions repeal of other business credits, the committees may decide to retain some other business credits to the extent budgetary limitations allow.

TAX RULES AFFECTING SPECIFIC INDUSTRIES

Special tax regimes exist to govern the tax treatment of certain industries and sectors. The framework will modernize these rules to ensure that the tax code better reflects economic reality and that such rules provide little opportunity for tax avoidance.

THE AMERICAN MODEL FOR GLOBAL COMPETITIVENESS

The framework puts America on a level international playing field and puts an end to the incentives for shipping jobs overseas.

TERRITORIAL TAXATION OF GLOBAL AMERICAN COMPANIES

The framework transforms our existing "offshoring" model to an American model. It ends the perverse incentive to keep foreign profits offshore by exempting them when they are repatriated to the United States. It will replace the existing, outdated worldwide tax system with a 100% exemption for dividends from foreign subsidiaries (in which the U.S. parent owns at least a 10% stake).

To transition to this new system, the framework treats foreign earnings that have accumulated overseas under the old system as repatriated. Accumulated foreign earnings held in illiquid assets will be subject to a lower tax rate than foreign earnings held in cash or cash equivalents. Payment of the tax liability will be spread out over several years.

STOPPING CORPORATIONS FROM SHIPPING JOBS AND CAPITAL OVERSEAS

To prevent companies from shifting profits to tax havens, the framework includes rules to protect the U.S. tax base by taxing at a reduced rate and on a global basis the foreign profits of U.S. multinational corporations. The committees will incorporate rules to level the playing field between U.S.-headquartered parent companies and foreign-headquartered parent companies.