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Economics Group

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Capitol Hill Update: Tax Details Finally Begin to Emerge

The "Big Six" group of leaders on tax reform released its opening bid for reforming the U.S. tax code last week. We believe the eventual outcome will yield a far smaller tax cut than was proposed.

Big Six Gets the Ball Rolling on Tax Policy Changes

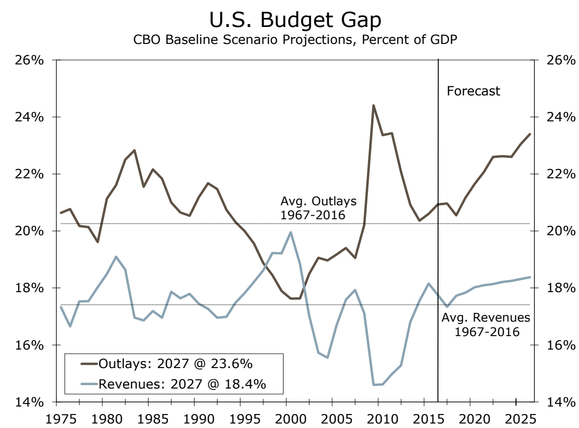
Last Wednesday, top Republican officials released their proposal to reform the tax code. The plan included the following tax policy changes: a doubling of the standard deduction, a consolidation of current tax rates to three brackets of 12 percent, 25 percent and 35 percent and the removal of "most" deductions except home mortgage interest and charitable contributions. The proposal also increases the child tax credit and repeals the alternative minimum tax and the estate tax. On the business side, the proposal lowers the top statutory corporate rate to 20 percent, introduces full expensing of capital investments for "at least five years" paired with a "partial limitation" of net interest expense for C corporations. The proposal also creates a special 25 percent rate for pass-through businesses.

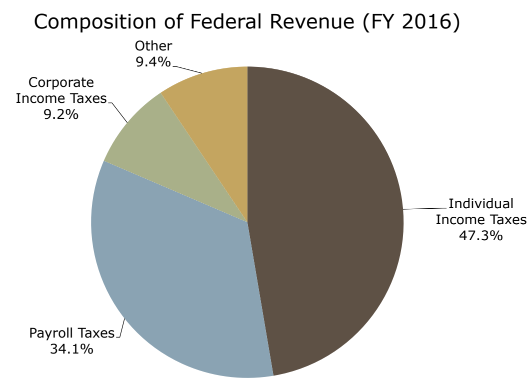
Our readers should bear in mind that last week's proposal from the Big Six is just that: a proposal that has no binding impact. This plan is merely an opening bid that will likely have multiple iterations to come, just as occurred with the Affordable Care Act repeal-and-replace effort.

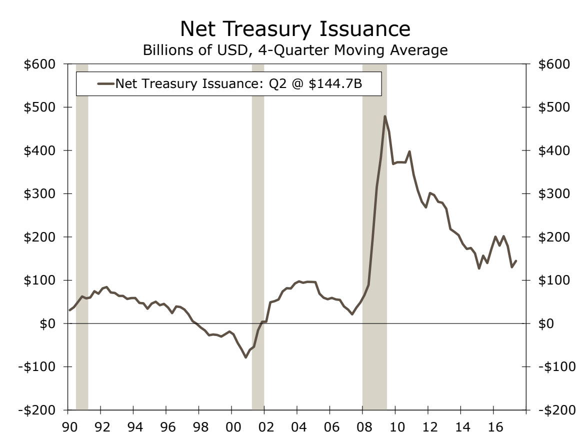
In our view, the likelihood of this proposal passing in its current form is highly unlikely. The real challenge boils down to this: the Republican plan is aggressive in its tax cutting efforts, making the plan *very* costly in the absence of revenue raisers, which have yet to be fully fleshed out and agreed on. We maintain the view that the only provisions likely to become law are a doubling of the standard deduction, an increase in the child tax credit, a lowering of the corporate rate to 25 percent and a repatriation tax holiday on corporate profits.

What Will the Process Look Like?

In order for Congress to move forward on tax policy, both chambers will need to agree on a FY 2018 budget resolution. As was done with the attempted Affordable Care Act repeal, reconciliation instructions, in this case for tax cuts, will be attached to the budget resolution in order to proceed in the Senate with only 51 votes as opposed to the usual 60 votes needed to end a filibuster. As of this writing, it appears that the Senate is crafting its budget resolution with space for $1.5 trillion in potential tax cuts over the next 10 years. This value, if also agreed to in the House, would have two major implications for tax policy and net Treasury issuance. First, if Congress is unable to come to an agreement on the revenue-raising aspects of the proposal, the tax cuts in the Big Six proposal would be far larger than the $1.5 trillion agreed to in the budget resolution, meaning some of the proposed tax cuts would likely need to go to keep the plan from costing more than $1.5 trillion. Second, the implication is that, even with some back-filling of planned budget cuts and a tax cut, net Treasury issuance will rise next fiscal year, but the extent to which it would increase is not nearly as large as it would be under a more major tax cut.







Source: U.S. Department of the Treasury, Congressional Budget Office and Wells Fargo Securities

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