Deferral a Question Mark in Trump's Final Tax Plan

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Donald Trump's tax plan has quietly puzzled many economic analysts by reversing course on an important issue regarding the taxation of U.S. multinational corporations.

The unlikely Republican presidential nominee upended years of conservative orthodoxy to push for repealing the deferral of overseas corporate income and enacting immediate taxation of the worldwide profits of U.S. corporations in a tax plan released in September 2015.

An updated and apparently final plan released last month keeps much of his earlier plan intact, including a 10 percent deemed repatriation to bring currently deferred income home and a reduction in the corporate tax rate to 15 percent from 35 percent. But it no longer mentions deferral one way or the other or gives any indication of how to treat offshore corporate income moving forward—leaving many analysts scratching their heads.

"I have not heard that that has changed," said Dan Mitchell, a senior fellow at the Cato Institute, which advocates for libertarian economic policies. "I had just assumed that it would still be worldwide taxation."

The Tax Policy Center, a joint venture between the Brookings Institution and the Urban Institute, two Washington-based think tanks that skew left, assumed—after receiving no reply from Trump's campaign on the issue—that his plan had dropped the proposal to end deferral.

"It wasn't entirely clear from the documents. We assumed from our analysis that he no longer ended deferral, so we just assumed that he kept the current system the way it is, just with a lower rate," said Joseph Rosenberg, a senior research associate with the Tax Policy Center. "They never specifically qualified that, and I don't recall having seen anything in the intervening time period in the news."

U.S. Outlier

The U.S. tax system—unlike much of the rest of the world—taxes the total worldwide profits of U.S.-resident companies, although it gives a credit for foreign taxes paid. However, companies have the option to defer bringing home income earned overseas, delaying indefinitely when taxes on that income must be paid. While left-leaning critics claim this is a loophole that allows companies to avoid paying their full tax bill, conservatives—as well as corporate taxpayers themselves—have pushed for the U.S. to exempt all or most foreign income from taxation. The Joint Committee on Taxation recently estimated that U.S. companies have accumulated $2.6 trillion of earnings offshore.

Worldwide taxation isn't the only issue in Trump's tax plan that has left analysts guessing. Analysts with the conservative-leaning Tax Foundation also struggled to determine whether the 15 percent rate would also apply to passthrough entities. After facing criticism that this would disproportionately benefit self-owned businesses—including those owned by Trump—the campaign eventually backpedaled on this proposal, but offered apparently conflicting explanations for how it would apply to most businesses. The foundation ultimately offered two analyses based on two different interpretations of the proposal, an "upper bound" and "lower bound," depending on whether passthroughs get the lower rate.

A 15 percent corporate tax rate—well below that of many U.S. trading partners—would make the question of whether the U.S. system is territorial or worldwide less important. Many U.S. companies would find their income was being taxed, in effect, on a territorial basis, as foreign tax credits would eliminate U.S. tax obligations on foreign-source income. While worldwide taxation would still curb profit-shifting to low- or no-tax jurisdictions, the amount of money saved would be much less.

"If Trump is going to reduce the corporate tax rate to 15 percent, it does become a much less important issue," Mitchell said of the deferral issue. "We would still argue that it's the wrong policy, but it doesn't do much damage."

Shifting Dynamics

As the election nears and Trump's poll numbers continue to dwindle, the chances of his becoming president—let alone being able to implement his tax plan in its entirety—are becoming minute.

Still, the reversal-through-omission highlights interesting dynamics in the conservative tax world, as long-time goals—such as reducing the reach of the U.S. tax system and bolstering U.S. tax competitiveness—meet populist anger over perceived corporate abuses. Trump rarely raised the issue of corporate deferral on the campaign trail, but he often blasted corporate inversions and trade policies he claimed harmed America and its workers, charting a new course for the normally business-friendly GOP.

Alan Cole, an economist with the Tax Foundation who helped write its analysis of Trump's tax plan, characterized ending deferral as a left-wing policy. Republican candidates typically run in the primary from the right and then pivot to the center as the nominee; Trump's plan seems to be doing the reverse. Cole noted the input of key figures in conservative economic thinking, including Stephen Moore, a fellow at the Heritage Foundation, a Washington-based think tank, as well as economist and pundit Larry Kudlow.

"It makes more sense when you think about the fact that he was an outsider. He wasn't used to talking to the traditional Republican tax people," Cole said. "He's still trying to lock up the traditional conservative constituencies that more conventional Republicans might have had on board months ago, if not a year ago.”

Whatever is in Trump’s tax plan, the Republican Party platform’s language on this issue has remained largely unchanged from previous years, calling for a territorial tax system “so that profits earned and taxed abroad may be repatriated for job creating investment here at home.”

The tax overhaul plan unveiled by Republican House Speaker Paul D. Ryan (Wis.) in his “A Better Way” package of proposals would institute a destination-based tax system that also only taxes income earned in the U.S.

Democratic Side

Things aren’t necessarily clearer on the Democratic side. Former Secretary of State Hillary Clinton, the Democratic nominee, has released what the Tax Policy Center described as a “series of tax changes"—rather than a comprehensive plan—which is also silent on the overall taxation of foreign earnings. Her platform includes some proposals, such as an exit tax requiring companies to pay all deferred overseas taxes, which seem to presume there would be no structural changes in the international tax system. But she has also indicated she would support some kind of measure to bring deferred offshore income home, and her plan includes a vaguely described “business tax reform” to raise $275 billion in new revenue. Many have interpreted this to mean a deemed repatriation at a rate lower than the current 35 percent corporate tax rate.

The Democratic National Committee inserted language into the 2016 platform calling for ending deferral “so that American corporations pay United States taxes immediately on foreign profits and can no longer escape paying their fair share of U.S. taxes by stashing profits abroad.” The new language was seen as a concession to Sen. Bernard Sanders (I-Vt.), Clinton’s vigorous challenger in the Democratic primary, who also advocated ending deferral.

Henrietta Treyz, an analyst with Height Securities LLC, a Washington-based financial research firm, said Clinton’s vagueness on the topic will give her room to maneuver if she is elected. Treyz said bringing back offshore cash to pay for infrastructure improvements—and defining how worldwide income will be taxed going forward—likely would be a high priority during the first two years of Clinton’s term.

“This is one of the casualties of this very unique election cycle. She’s been able to speak broadly on the need for infrastructure, and use vagueries about business tax reform, which I see as code for repatriation,” Treyz said. “She has not had her feet held to the fire on that specific issue.”