Prospects for US Tax Reform

The recent election of Donald J. Trump as the next US president, combined with renewed Republican control of both the House and Senate, has created the possibility for the broadest tax reform the country has seen in decades. Mr. Trump has made numerous proposals, both on the campaign trail and through his campaign website, that would overhaul and simplify the current US tax code. However, it is likely that some of these proposals will be modified or omitted in any legislation drafted by Congress. The following summary presents the most updated tax reform initiatives put forward by Mr. Trump.

Individuals:

The Trump Plan would make the following changes with respect to the taxation of individuals:

Tax Rates

- Reduce the number of tax brackets from seven to three
- Decrease the taxable income threshold at which the top marginal tax rate applies (from $466,951 to $225,000 for married filers and $415,051 to $112,500 for single filers)
- Lower the top marginal tax rate on ordinary income from 39.6% to 33%
  - *Our Take:* Since tax rates are projected to decrease, individuals should defer large income recognition events into 2017 or later years
- Maintain the current rates for capital gains and qualified dividends at 0%, 15%, and 20%, adjusted for the new tax brackets

Proposed Tax Rates

Taxable Income			
Single Filers	**Married Filers**	**Ordinary Income Rate**	**Capital Gains & Qualified Dividends**
$0 - $37,500	$0 - $75,000	12%	0%
$37,500 - $112,500	$75,000 - $225,000	25%	15%
$112,500 and above	$225,000 and above	33%	20%

Deductions, Credits, & Incentives

- Increase the standard deduction amounts (from $12,600 to $30,000 for married filers and $6,300 to $15,000 for single filers)
- Eliminate personal exemptions and head-of-household filing status
- Limit the amount of itemized deductions to $200,000 for married filers and $100,000 for single filers

    - *Our Take:* How this provision would be implemented is unclear. For 2016, individuals should maximize their year-end charitable giving and prepay state income and real estate taxes, to the extent that does not generate AMT, to ensure that they receive the benefit of these deductions
- Allow a deduction for dependent care to taxpayers who have children under age 13 or dependent parents, including children whose care is provided by a stay-at-home parent or grandparent (only available to taxpayers with income below $500,000 for joint filers and $250,000 for single filers)
- Create a new form of tax-free savings account for dependents, including unborn children, with contributions capped at $2,000 per year

<u>Other Taxes</u>

- Repeal the federal estate tax imposed at death, but disallow any step-up in basis of assets for estates in excess of $10 million
    - *Our Take:* Because of the uncertainty surrounding how a potential repeal of the estate tax would be implemented, high-net-worth individuals should incorporate flexibility into their estate plans and be prepared to update wills and other documents when any new law is passed
- Eliminate the Alternative Minimum Tax on individuals
- Repeal all additional taxes included as part of the Affordable Care Act, including the 3.8% tax on Net Investment Income, the 0.9% additional Medicare tax on wages and the tax penalty for failure to have health insurance
    - *Our Take:* Harvesting tax losses on investments by the end of 2016 may be advisable, since those losses can offset income subject to the 3.8% investment income tax in what could be its final year

Businesses:

The Trump Plan would make the following changes with respect to the taxation of corporations, partnerships and sole proprietorships:

<u>Tax Rates</u>

- Reduce the "business" tax rate from 35% to 15% for C corporations and for any profits from sole proprietorships, S Corporations or partnerships that are re-invested into the business
    - *Our Take:* This change would put corporations on a more even playing field with flow-through entities, since any profits distributed out of either type of entity would be subject to a second layer of tax
- Encourage companies with profits overseas to "repatriate" that money by offering a one-time tax rate of 10% on profits brought back to the US

Deductions, Credits, & Incentives

- Eliminate the benefit of “corporate tax expenditures” except for the research and development credit
    - *Our Take:* While the Trump Plan does not specifically define “corporate tax expenditures,” this change would likely eliminate the domestic production activities deduction and other credits included in the “general business credit”
- Allow US manufacturing firms to fully deduct any capital investments if they elect to forgo the deduction for interest expense
    - *Our Take:* This proposal could produce huge tax savings for large manufacturers who cannot take advantage of the Section 179 deduction, and would discourage financing operations with corporate debt
- Increase the Section 179 expense limitation from $500,000 to $1 million

Other Taxes

- Eliminate the corporate alternative minimum tax
- Repeal the additional taxes imposed by the Affordable Care Act, including the medical device tax and the “Cadillac tax” for high-dollar health plans

Political & International Environment

Tax law changes must go through the legislative process, so it is important to look to the current thinking of the House Ways & Means Committee, led by Rep Kevin Brady (R, Texas) and the Senate Finance Committee, led by Sen. Orrin Hatch (R, Utah). Last summer, House Republicans released the tax “Better Way Blueprint,” coincidentally one day after the Brexit vote. The Blueprint provided many suggestions for the Trump tax campaign proposals, but there are a few significant differences; thus, the actual tax proposals to be generated by the legislative staff writers are still unknown and subject to political persuasion, including Democrat influence; dynamic or static scoring by the Joint Committee on Taxation; lobbying by interested parties; and the speed of expectations of the public. Expect strong arguments by powerful actors right up until final language is presented for the President’s signature. Rep Brady wants a one-page tax return “postcard” usable by 95% of US individuals. If tax proposals create deficits, the fiscal hawks will object. Do not expect final, comprehensive tax policy to be passed within the First 100 Days of Trump’s presidency.

International tax reform will have to be considered in any comprehensive reconstruction, and other countries are not standing still. Commentators in the Bloomberg/KPMG Tax Reform summit, held on November 15, indicated that major tax disagreements are ahead, not just between companies and the government, but between countries: witness the most recent tax judgements by the EU against Apple and others. The US Treasury realizes it must act quickly to avoid a tax grab by friendly, but competing countries in Europe and elsewhere. The enthusiasm for the US’s complete adoption of the BEPS initiatives (Base Erosion and Profit Shifting Action

Plan) is uncertain, at least for the near term. FATCA, the Foreign Account Tax Compliance Act, passed in 2010 as part of an information sharing agreement among countries, seems to be well settled into place, according to the commentators. But Rep Kevin Brady indicated that he would like to see the elimination of FIRPTA--the Foreign Investment in Real Property Tax Act, a 1980 law that imposes tax on foreign persons disposing of US real estate—because he believes it discourages US investment. There are considerations for an entirely new approach to cross-border taxation and income sourcing, including border adjustments, but profound shifts in policy may take time to build consensus.

Important US Tax Regulations that have been issued in proposed or tentative form may be slowed down or postponed, according to Congressional staffers' comments. These are commonly known by their US Internal Revenue Code Section, including: §385 Rules for Debt/Equity on companies (issued); the §704 Allocations by Partnerships; the §355 Rules for Corporate Spinoffs; and the §2704 rules for Valuation Discounts on Closely Held Businesses. But IRS officials also said they are continuing to work on these projects and this is *not* a "pens down" moment.

2016 Year End Planning?

"Normal" tax planning usually suggests deferring the recognition of income when possible and accelerating deductions, simply to take advantage of the time value of money and defer tax payments when appropriate. However, if major tax reform is pointed in the direction of lowering and simplifying marginal and effective rates, these same prescriptions could produce permanent tax savings, not temporary deferrals. Consider deferring income recognition; harvesting losses and deductions; watching AMT considerations and NII taxes; it is important to distinguish between *marginal* vs *effective* tax rates. Details matter and year end decisions require careful consideration of your unique situation.

What to Conclude?

When Mr. Trump takes office in January 2017, he will have the benefit of a Republican-controlled House and Senate, allowing his proposals to move forward more easily. After years of gridlock in Washington, the stage is now set for major tax reform which may mean significant tax reductions for individuals and businesses. However, the process of working out the details of tax legislation and political compromises can be a slow one. Further, he will likely have to compromise on some issues with fiscal conservatives who may oppose the broad-based tax reductions he is proposing. It remains to be seen whether any of these proposals can be advanced quickly enough to be considered in 2017 and, if so, whether they will be made retroactive to January 1, 2017. Because of the uncertainty regarding the specifics and implementation of Mr. Trump's tax reform, proper tax planning for individuals and businesses is more important than ever.

For more information on Mr. Trump's proposed tax law changes and how they might affect you or your business, please contact your Bennett Thrasher representative by calling 770-396-2200.

The above information is general in nature and should not be relied upon for any specific tax implication or investment decision. Actual results may differ, and readers are cautioned not to place reliance on these general observations. Consult with your adviser or counsel before undertaking any specific action.