How the Trump Tax Proposals Might Affect Planning

Will a Trump presidency buoyed by a Republican-controlled Congress usher in a new age of tax and estate planning?

At times like these, we like to remember what the legendary management guru Peter F. Drucker said: "Trying to predict the future is like trying to drive down a country road at night with no lights while looking out the back window."

Potential Planning Considerations

Discuss with your wealth strategist and tax advisor if any of the following are appropriate for you:

Individual:

- Gifting if the step-up in basis provision is eliminated and you are affected.
- Deferring 2016 income into 2017.
- Making charitable contributions in 2016.
- Accelerating deductions in 2016.

Business:

- Deferring 2016 income to the extent possible into 2017.
- Taking advantage in 2016 of any credits that may be eliminated.

What we do know is that President-elect Donald Trump has proposed a significant overhaul to the tax code. He is in favor of repealing the federal estate tax, the federal gift tax, and the generation-skipping transfer tax, among others. He is also on record for simplifying the tax code, collapsing individual brackets down to three, and lowering corporate tax rates (see Chart 1, page 3).

What we do not know is how these proposals will ultimately translate. While the Republicans control the House (238-193) and Senate (51-46), they do not have a super majority and will likely need to work with Democrats to implement major policy changes. There also are likely to be changes to what is proposed, especially given the scope of the proposals and their potential impact to the federal deficit, which at $590 billion is projected to grow to $6.9 trillion by 2026 under Mr. Trump's proposals. If adopted and implemented by Congress, the proposals would represent the most significant overhaul to the Tax Code since 1986.

This article provides a review of the president-elect's income and transfer tax proposals and some potential planning considerations to review with your advisors.

Proposals Could Mean More Gifting

Currently, for taxable estates of more than $5.49 million (single) and $10.98 million (married couples), an estate tax of 40% is imposed. Mr. Trump's plan calls for a repeal of this estate tax. That is good news for those with this level of wealth. The bad news is the proposed plan calls for a capital gains tax to be imposed on appreciated assets of estates over $5 million (single) and $10 million (married). What this means for taxpayers under the threshold is there would be no step-up in basis for appreciated assets.

A step-up in basis allows for a readjustment of the original value of assets in the estate to their appreciated value for tax purposes upon inheritance. Its elimination could create significant income tax liabilities in the form of capital gains to the beneficiaries of estates under the limits. For example, if you inherit a stock with an original cost of $1 per share but now worth $25 a share, you would have to pay capital gains on the $24 appreciation upon sale. The step-up in basis currently allowed by the IRS instead enables you to value the original cost at $25 a share, saving tax on the appreciation. It is unclear whether the step-up in basis would apply to estates over the $5 million/$10 million level, but it is assumed that it will stay since the estates are paying the capital gains tax on the appreciation at death.

Therefore, if you have assets under the $5 million (single)/$10 million (married) levels, the proposed law may make it more advantageous to gift assets that will appreciate or produce income to the next generation now, especially if the gift and generation skipping taxes (tax on transfers during one's lifetime above certain limits) are repealed as well.

Will Income Tax Planning Be the New Estate Tax Planning?

The individual tax proposals could potentially have a large impact on your overall tax planning. In addition to collapsing the individual brackets, Mr. Trump's tax plan eliminates the alternative minimum tax (AMT), the net investment income tax, and the head of household filing status. The proposed tax plan also eliminates the personal exemption, increases the standard deduction, and introduces child care-related tax provisions, such as making child care costs deductible from adjusted gross income for most Americans up to the average cost of care in their state (phased out at income over $250,000 for single and $500,000 for married filed jointly).

One aspect of the proposals that has garnered the most confidence is that taxes are unlikely to be higher under the incoming administration. In general, deferring taxes long term may not be as attractive as it once was and could make Roth conversions less attractive. But that is not a given. Even if the president-elect's proposals were enacted, a future administration could raise taxes again. We believe a wait-and-see approach is best in response to specific aspects of the proposals. However, deferring 2016 income into 2017 might make sense.

Perhaps the area that could elicit the most planning would be in regards to the proposed itemized deduction cap. Mr. Trump's plan puts a cap on itemized deductions at $100,000 for single filers and $200,000 married filing jointly. At this time, it is assumed the cap would not apply to charitable contributions or mortgage interest, but we will know more as the details get fleshed out. Depending on your individual tax situation and the AMT, it may be advantageous to accelerate deductions into 2016.

Businesses Look Set to Benefit

Mr. Trump's tax plan would reduce the corporate rate from 35% to 15% and simplify the tax code. The

The House "A Better Way" Plan Might Be a Strong Indicator of Tax Changes to Come

The Republicans in the House of Representatives have been working on their own tax proposal that might shed some light on the potential form of any changes to the tax regime in 2017. On June 24, 2016, House Republicans introduced what is known as the "A Better Way" tax plan. The plan is based on three pillars and has many similarities to Mr. Trump's tax plan.

The pillars are simplicity and fairness, jobs and growth, and an Internal Revenue Service (IRS) that makes service its first priority. According to Speaker Paul Ryan's website, the plan seeks to make the tax code simpler for all taxpayers, to make it easier to create jobs, and to create a fairer IRS that puts the taxpayer first. Areas where the two plans align are thought to have a higher probability of becoming law, although they will need additional support to pass. The two plans align on the following points:

- condensing the code to three tax rates: 12%, 25%, and 33%;
- eliminating itemized deductions with the exception of mortgage interest and charitable contributions;
- doing away with personal exemptions;
- raising standard deductions, although the amounts in the plans are different;
- jettisoning the AMT;
- ridding the surtax on net investment income;
- lowering the corporate tax rate, with Mr. Trump's plan calling for 15% and the A Better Way plan, 20%; and
- eliminating the estate tax.

proposal does this by eliminating the corporate AMT, the domestic production activities deduction, and all other business credits except the research and development credit. Much like individuals, businesses should discuss with their advisors the benefits of deferring 2016 income to the extent possible into 2017 and taking advantage in 2016 of any credits that may be eliminated.

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Chart 1
2016 Current Tax Law versus Trump Tax Proposal

INCOME TAX PROPOSAL

CURRENT 2016				TRUMP PROPOSAL			
Single Individuals		**Married Filing Jointly**		**Single Individuals**		**Married Filing Jointly**	
Not over $9,275	10%	Not over $18,550	10%	Not over $37,500	12%	Not over $75,000	12%
Over $9,275 - $37,650	15%	Over $18,550 - $75,300	15%	Over $37,500 - $112,500	25%	Over $75,000 - $225,000	25%
Over $37,650 - $91,150	25%	Over $75,300 - $151,900	25%	Over $112,500+	33%	Over $225,000+	33%
Over $91,150 - $190,150	28%	Over $151,900 - $231,450	28%				
Over $190,150 - $413,350	33%	Over $231,450 - $413,350	33%				
Over $413,350 - $415,050	35%	Over $413,350 - $466,950	35%				
Over $415,050	39.6%	Over $466,950	39.6%				

CAPITAL GAIN AND DIVIDEND TAX		CAPITAL GAIN AND DIVIDEND TAX			
Tax Bracket		**Single Individuals**		**Married Filing Jointly**	
15% or less	0%	Not over $37,500	0%	Not over $75,000	0%
25%, 28%, 33%, and 35%	15%	Over $37,500 - $112,500	15%	Over $75,000 - $225,000	15%
39.6%	20%	Over $112,500+	20%	Over $225,000+	20%

UNEARNED INCOME MEDICARE CONTRIBUTION TAX			UNEARNED INCOME MEDICARE CONTRIBUTION TAX
Individuals	3.80%	$ 200,000	
Married Filing Jointly	3.80%	$ 250,000	**ELIMINATED**

STANDARD DEDUCTION & ITEMIZED DEDUCTION PHASEOUT THRESHOLD		STANDARD DEDUCTION & ITEMIZED DEDUCTION THRESHOLD	
Standard Deduction		**Standard Deduction**	
Single Filers	$ 6,300	Single Filers	$ 15,000
Married Filing Joint	$ 12,600	Married Filing Joint	$ 30,000
Itemized Deduction		**Itemized Deduction**	
Single Filers	$ 259,400	Single Filers	$ 100,000
Married Filing Joint	$ 311,300	Married Filing Joint	$ 200,000

ALTERNATIVE MINIMUM TAX		ALTERNATIVE MINIMUM TAX
Single Filer Exemption Amount	$ 53,900	
Married Filing Joint Exemption Amount	$ 83,800	**ELIMINATED**

BUSINESS INCOME TAX PROPOSAL

CURRENT 2016		TRUMP	
Corporate Income Tax Rate	35%	Corporate Income Tax Rate	15% (May only apply to C-Corps)
Pass-Through Entities	Individual Tax Rate	Pass-Through Entities	Individual Tax Rate (unclear about 15% Rate)
Carried Interests	Capital Gain Rate	Carried Interests	Ordinary Income Tax Rate

ESTATE AND GIFT TAX PROPOSAL

CURRENT 2016			TRUMP	
Estate			**Estate**	
Single	40%	Greater than $5.45M	**ELIMINATED**	
Married with portability	40%	Greater than $10.9M	**ELIMINATED**	
Basis Step Up		Market Value at Date of Death	Basis Step Up	Estates greater than $10.0M will not receive step-up in basis and taxed at capital gains rate
Gift			**Gift**	
Lifetime Exemption	40%	Greater than $5.45M	**ELIMINATED**	
Annual Exclusion Gift		$ 14,000	**ELIMINATED**	

Source: PNC

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