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Certified Public Accountants

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**A Look at the Trump Tax Proposal**

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## INTRODUCTION

Many individuals and businesses involved in year-end tax planning are trying to predict the tax changes that may occur after 2016, with the election of Donald Trump as the 45<sup>th</sup> President of the United States. During his campaign, Mr. Trump emphasized tax reform as one of his major commitments. He repeatedly called for dramatic changes to the Federal tax laws, including: significant reduction in both business and individual income tax rates; elimination of the alternative minimum tax (AMT); and complete repeal of the estate tax. In addition, on June 24, 2016, the Republican-controlled House Ways and Means Committee released a “blueprint” for tax reform called “A Better Way,” which recommends several changes that are similar to the Trump proposals (e.g., lower tax rates for individuals and businesses; elimination of the AMT; repeal of estate taxes; reducing the relevance of itemized deductions; eliminating some business credits and deductions).

This letter highlights Mr. Trump’s most significant tax proposals as outlined at his website and during his campaign. Keep in mind that details of the tax changes recommended by President-elect Trump are not yet available. Therefore, this letter provides only a broad-brush summary of his tax proposals.

**Caution!** For any of these changes to become law, President-elect Trump and Congressional Republicans must first hammer out the differences between their tax proposals. Once an agreement is reached, a bill must be introduced in the Ways and Means Committee and must then be passed by the House and the Senate. During this process, the proposals outlined in this letter may be changed or eliminated and new provisions could be added. We do not expect to have reliable details of this anticipated tax legislation until 2017 – after a bill has been drafted and adopted by the House Ways and Means Committee.

## PROPOSED CHANGES IMPACTING INDIVIDUALS

**Changes To Income Tax Rates For Individuals.** There are currently seven tax rates for individual taxpayers: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. For 2016, a married couple filing a joint return pays tax at a 10% rate on the first \$18,550 of taxable income (the first \$9,275 if single), and pays tax at a 39.6% rate on taxable income in excess of \$466,950 (in excess of \$415,050 if single). Under President-elect Trump’s proposals, there would be only three income tax rates as follows:

<u>Tax Rate</u>	<u>Joint</u>	<u>Single</u>
12% Of Taxable Income Up To	\$ 75,000	\$ 37,500
25% Of Taxable Income From	\$ 75,001	\$ 37,501
	To	To
	\$225,000	\$112,500
33% Of Taxable Income Above	\$225,000	\$112,500

**Retain Current Capital Gain And Qualified Dividend Rates.** Long-term capital gains and qualified dividends are currently taxed at the following rates: **1) Zero percent tax rate** where the capital gain or dividend income would otherwise be taxed at 15% or less (for 2016, taxable income up to \$75,300 for joint filers and \$37,650 for single individuals is taxed at 15% or less), **2) 15% tax rate** where the capital gain or dividend income would otherwise be taxed above 15% and below 39.6%, and **3) 20% tax rate** where the capital gain or dividend income would otherwise be taxed at 39.6% (for 2016, taxable income in excess of \$466,950 for joint filers and \$415,050 for single individuals is taxed at 39.6%).

*Under the Trump proposal,* the current tax rates for long-term capital gains and qualified dividends would stay the same after being re-aligned to fit the new 3-income tax rate brackets as follows:

<b><u>Tax Rates For Capital Gains And Dividends</u></b>	<b><u>Joint</u></b>	<b><u>Single</u></b>
0% Where Total Taxable Income Does Not Exceed	\$ 75,000	\$ 37,500
15% Where Total Taxable Income Is From	\$ 75,001	\$ 37,501
	To	To
	\$225,000	\$112,500
20% Where Total Taxable Income Exceeds	\$225,000	\$112,500

**Increase In Standard Deduction.** Mr. Trump’s proposal would increase the standard deduction: **1)** To \$30,000 (up from the current \$12,600) for married individuals filing joint returns, and **2)** To \$15,000 (up from the current \$6,300) for single individuals.

**Elimination Of Personal Exemptions.** The deduction for personal exemptions (currently \$4,050 per exemption) would be eliminated.

**Itemized Deductions Capped.** Under Mr. Trump’s proposal, the maximum amount of itemized deductions for a married couple filing a joint return would be capped at \$200,000 (for single individuals, the cap would be \$100,000).

**Alternative Minimum Tax Eliminated.** Under current law, certain taxpayers may be subject to an “alternative minimum tax” (AMT) in addition to their regular tax liability. For example, the AMT could be triggered where an individual deducts personal exemptions, the standard deduction, state and local income taxes, and real estate taxes. The AMT could also apply to individuals with large capital gains, large amounts of dividend income, or who exercise incentive stock options. The Trump proposal would *repeal the AMT.*

**Repeal Of The 3.8% Net Investment Income Tax And The .9% Additional Medicare Tax.** The Affordable Care Act (ACA) imposes a 3.8% Net Investment Income Tax (3.8% NIIT) on certain

investment income (e.g., interest, dividends, capital gains, passive business income) for higher-income taxpayers. ACA also creates an “Additional Medicare Tax” of .9% on wages and other earned income of higher-income taxpayers. Consistent with his proposal to repeal ACA, Mr. Trump would *repeal both of these taxes*.

**New Tax Breaks For Child And Elder Care Expenses.** During his campaign, Mr. Trump proposed new tax breaks to assist individuals incurring child and elder-care expenses. Generally, his proposals include: **1) An *above-the-line deduction*** (i.e., allowed whether or not the taxpayer claims itemized deductions) for certain *child and elder care expenses*. The deduction would be available to married individuals filing joint returns with total income of \$500,000 or less and to single individuals with total income of \$250,000 or less; **2) A *refundable credit*** for *childcare expenses* equal to 7.65% of child care expenses (not to exceed 50% of the taxpayer’s FICA taxes) and available to married individuals filing a joint return earning \$62,400 or less (\$31,200 or less for singles); and **3) A new tax-favored *dependent care savings account*** (taxpayers could contribute up to \$2,000 annually to this account with the government possibly matching a portion of the contribution).

**Repeal of the Estate Tax.** The Trump proposal includes a complete repeal of the Federal estate tax. It appears that the proposal also includes a carryover basis provision for income tax purposes to the extent the value of assets included in the estate exceed \$10 million.

## **PROPOSED CHANGES IMPACTING BUSINESSES**

**Changes To Income Tax Rates For Businesses.** Currently, regular “C” corporations have a top statutory income tax rate of 35%. In addition, the pass-through business income of an “S” Corporation or of an entity taxed as a partnership is taxed to the owners at the current individual income tax rates (discussed above). Mr. Trump proposes that the income of a regular “C” corporation should be taxed at **a flat rate of 15%**. In addition, it appears that under his proposal, the business income of pass-through business entities (e.g., S corporations and partnerships) would also be taxed at 15% to the extent the business income is retained in the business.

**Corporate Alternative Minimum Tax Eliminated.** President-elect Trump’s tax plan would *repeal the corporate alternative minimum tax*.

**Deductions For Businesses.** Mr. Trump’s proposed changes to business deductions are not well defined. However, the changes suggested include: **1) Increasing the maximum Section 179 deduction** from \$500,000 to \$1 million; **2) Allowing manufacturers to elect to deduct 100% of “capital investments”** in return for foregoing deductions for interest paid on corporate debt; and **3) Eliminating certain unspecified corporate “tax expenditures”** (presumably the term “tax expenditures” refers to various targeted business tax deductions and credits).

**Business Tax Credits.** Other than Mr. Trump’s proposal to eliminate unspecified corporate “tax expenditures,” his proposed changes to business tax credits are still largely undefined. However, he has specifically proposed that the overall cap for the current 25% business credit for an employer’s

on-site qualifying child care expenditures be increased from \$150,000 to \$500,000. It has also been reported that Mr. Trump is considering the retention of the current Research & Development credit.

**Taxing “Carried Interest” As Ordinary Income.** Owners of a “profits only” interest in a partnership generally qualify for the special “capital gains” rate for long-term capital gains and qualified dividends that are generated by the partnership and are passed through to the individual owners. These types of “profits only” interests in partnerships that own and operate private “investment funds” are sometimes referred to as “carried interests” in the partnership. Some believe that a “carried interest” owned by an investment manager in an investment-type partnership (e.g., hedge fund) allows income that is essentially compensation to be taxed at the favorable capital gains rates. Mr. Trump proposes that income generated by these types of “carried interests” be taxed at the higher ordinary income tax rates that generally apply to compensation income.

**Repatriation Of Certain Income Currently Held Overseas.** Based on his campaign website, Mr. Trump favors a one-time 10% income tax rate on U.S. companies that repatriate earnings that are held offshore. At present, the details of this proposal are sketchy. However, more details regarding the tax treatment of repatriated earnings and other international tax proposals are expected as Mr. Trump and Congressional Republicans work through the legislative process.

**Proposals For Expenditures For Infrastructure.** During his campaign, Mr. Trump repeatedly suggested that he favored a U.S. infrastructure renewal plan that could cost up to \$1 trillion. He has also indicated that this plan would include some form of government/private industry partnership. To finance this infrastructure renewal, Mr. Trump has proposed significant business tax breaks and credits to attract private investment in highways, bridges, seaports, and airports. It has also been reported that Mr. Trump supports using all or a portion of the taxes generated by the proposed repatriation of earnings held abroad to help fund the infrastructure program.

### **REPEAL AND REPLACE THE AFFORDABLE CARE ACT**

On the campaign trail, President-elect Trump repeatedly called for the repeal and replacement of the Affordable Care Act. However, his campaign materials contain few details as to how this proposal would actually be implemented. For example, it is not yet clear how the repeal of ACA would impact the existing “premium tax credit” that is available to qualifying individuals who purchase health insurance on government-sponsored health insurance exchanges.

### **ADDITIONAL PROPOSALS FROM THE “WAYS AND MEANS” COMMITTEE BLUEPRINT**

Recommendations in the Ways and Means Committee “blueprint” for tax reform (titled “A Better Way”) that are not currently reflected in Mr. Trump’s proposals, include: simplification of the tax benefits for higher education; elimination of all itemized deductions except the mortgage interest deduction and the charitable contribution deduction; the continuation of current tax incentives for retirement savings; reduction of the corporate tax rate to 20% (instead of 15% as proposed by

President-elect Trump); allowing net operating losses (NOLs) to be carried forward indefinitely (but not back); and, streamlining the Internal Revenue Service by dividing it into three major units – a unit devoted to families and individuals, a unit designed for businesses, and a new “small claims court” unit that would be independent of the IRS and designed to allow routine disputes to be resolved more quickly.

### **FINAL COMMENTS**

The proposals of President-elect Trump reflected in this letter are based largely on statements by Mr. Trump during the campaign, his campaign materials and information at his website. When President-elect Trump takes office and the new Congress convenes in January 2017, it may be some time before any tax changes actually become law. Until the new Trump Administration and Congress work through the legislative process, it is impossible to predict accurately what changes will be made to the tax law. However, since President-elect Trump’s proposals and the tax changes suggested in the Ways and Means Committee blueprint, “A Better Way,” are similar, the types of changes discussed in this letter are possible. More details about the tax proposals discussed in this letter should become available once the Ways and Means Committee drafts legislative language for a tax reform bill. In the meantime, please contact our office if you have any questions or you need a status report.

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