NAEPC

Journal of Estate & Tax Planning

Click here to view Issue 26

Blanche Lark Christerson
Managing Director, Senior Wealth Strategist

Tax Topics
2017-04

04/30/17

The road to tax reform, continued…

On April 26th, several days before President Trump's 100th day in office, the White House released a one-page description of Mr. Trump's tax plan, which Treasury Secretary Stevin Mnuchin also discussed with the media.

Here is a verbatim transcription of the document:

2017 Tax Reform for Economic Growth and American Jobs

The Biggest Individual And Business Tax Cut In American History

Goals For Tax Reform

- Grow the economy and create millions of jobs
- Simplify our burdensome tax code
- Provide tax relief to American families, especially middle-income families
- Lower the business tax rate from one of the highest in the world to one of the lowest

Individual Reform

- Tax relief for American families, especially middle-income families:
    - Reducing the 7 tax brackets to 3 tax brackets of 10%, 25% and 35%

- Doubling the standard deduction
- Providing tax relief for families with child and dependent care expenses

- Simplification:
  - Eliminate targeted tax breaks that mainly benefit the wealthiest taxpayers
  - Protect the home ownership and charitable gift tax deductions
  - Repeal the alternative minimum tax
  - Repeal the death tax
- Repeal the 3.8% Obamacare tax that hits small businesses and investment income

Business Reform

- 15% business tax rate
- Territorial tax system to level the playing field for American companies
- One-time tax on trillions of dollars held overseas
- Eliminate tax breaks for special interests

Process

- Throughout the month of May, the Trump Administration will hold listening sessions with stakeholders to receive their input and will continue working with the House and Senate to develop the details of a plan that provides massive tax relief, creates jobs, and makes America more competitive—and can pass both chambers.

Comments. These broad-brush strokes are very similar to what Candidate Trump set forth on his website late in his campaign, particularly as to child care benefits, and eliminating the alternative minimum tax (AMT) and the 3.8% tax on net investment income (the latter is one of the "Obamacare" taxes that took effect in 2013). Here is a brief comparison of his campaign website and the April 26th document:

- **Brackets:** Mr. Trump originally proposed three brackets of 12%, 25% and 33%; the 10% and 35% brackets listed above are both lower and higher than the original numbers.
- **Deductions:** Candidate Trump would have capped itemized deductions (which include deductions for state and local taxes, mortgage interest and charitable contributions) at $200,000 (married filing jointly) and $100,000 (single filers); here, the only itemized deductions preserved would be for mortgage interest and charitable contributions. Mr. Mnuchin confirmed that the deduction for state and local taxes would be eliminated.

- **Estate tax:** Mr. Trump again calls for the repeal of what he calls the "death tax." The April 26th document does not mention a capital gains tax at death for appreciated property, which Mr. Trump had promoted on his website, along with sheltering the first $10 million "as under current law."

- **Personal exemptions and "head of household" filing status:** In exchange for a larger standard deduction ($30,000 for married filing jointly and $15,000 for single taxpayers), Candidate Trump called for eliminating personal exemptions and "head of household" filing status (this applies to single parents with, say, dependent children and provides more favorable tax brackets than the "single" taxpayer status). The April 26th document is silent on these points.

- **Business tax rate:** Mr. Trump would lower the business tax rate from 35% to 15%. According to Mr. Mnuchin, this 15% rate would also apply to business income from passthrough entities, such as S corporations, partnerships and limited liability companies (currently, income from such entities is taxable to the entity member at ordinary income tax rates, which top out at 39.6%).

- **Territorial system:** Mr. Trump mentions a "territorial tax system" to level the playing field for American companies (Candidate Trump did not address this). Such a territorial system presumably would exempt overseas earnings from tax. Note that this is not the same thing as the "border adjustment tax" (BAT) that House Republicans have been promoting in their "A Better Way," a blueprint for tax reform that was issued last June (in a nutshell, the BAT would exempt export income from tax, but impose a 20% tax on imports; this proposal is highly controversial, and Mr. Trump's apparent lack of support for it in this April 26th document makes it an even heavier lift).

Budget implications? As details are unavailable, it is difficult for estimators to ascertain the fiscal impact of these tax proposals, which Mr. Trump believes will boost the economy to such an extent that any perceived revenue loss will not be an issue. Nevertheless, a number of budget hawks inside and outside of Congress have expressed concern that the proposals could significantly increase the deficit, barring what they view as an unrealistic growth rate for the economy (up to about 4%). Stated differently, many are skeptical that tax cuts pay for themselves, even when those cuts are favorably assessed using "dynamic scoring" (this seeks to take significant account of anticipated taxpayer behavioral changes – e.g., if taxpayers pay lower taxes, they have more to spend, thereby improving the economy).

Bye-bye state and local tax deduction? The state and local tax deduction is an itemized deduction that chiefly benefits taxpayers who live in high-tax states such as California, New York, New Jersey, Connecticut, etc. It has long rankled many Republicans who do not believe other taxpayers should help subsidize a taxpayer's choice of residence. And even though the AMT eliminates this deduction for many taxpayers (it is an "add-back" for AMT purposes), it can still benefit those who are not subject to the AMT (for example, taxpayers who pay "enough" tax so that the AMT doesn't apply to them). Eliminating this deduction would offer a significant revenue offset to help pay for the desired lower tax rates. Yet both Republicans and Democrats whose constituents would be adversely affected by such a change are already gearing up to preserve the deduction.

And the 15% tax rate for passthrough income? If there really were a 15% rate for income received through passthrough entities, it is easy to imagine a new cottage industry springing up to assist taxpayers in trying to rearrange their business income to be eligible for this low rate. Although Mr. Mnuchin has acknowledged that this approach could open a significant loophole, he believes that problem could be adequately addressed.

Bottom line? Tax reform is difficult and requires many trade-offs. This April 26th document offers broad guidelines, but little hint of how these will all be accomplished. And there is not yet a unified Republican approach on what tax reform (or tax cuts) should look like. It will be interesting to see how this unfolds.

Trump to Mnuchin: review tax regulations!

On April 21st, President Trump signed an executive order (EO) directing Treasury Secretary Mnuchin to review "all significant tax regulations" that were issued on or after January 1, 2016. The reason is to ensure that the Federal tax system is "simple, fair, efficient and pro-growth," and to address the numerous tax regulations issued over the last several years that have "effectively increased tax burdens, impeded economic growth, and saddled American businesses with onerous fines, complicated forms, and frustration."

Within 60 days of this EO (about June 20th), Mr. Mnuchin is directed to complete an interim report that identifies the significant regulations this EO targets; within 150 days of this EO (about mid-September), Mr. Mnuchin is directed to submit a report recommending specific actions to mitigate the burden imposed by these regulations.

So what is meant by "significant" tax regulations? The EO refers to "all such regulations that:

- (i) impose an undue financial burden on United States taxpayers;
- (ii) add undue complexity to the Federal tax laws; or
- (iii) exceed the statutory authority of the Internal Revenue Service."

Furthermore, earlier determinations of whether a regulation is "significant" under a 1993 Executive Order (# 12866, signed on September 30, 1993, as amended), "shall not be controlling." In other words, the 1993 EO has more narrow guidelines (it focuses on the annual dollar impact of a regulation on the economy, whether the regulation creates a serious inconsistency, materially alters the budget impact of entitlements, grants, etc., or raises novel legal or policy issues). Thus, the April 21st EO seems to give Mr. Mnuchin wide latitude to review tax regulations that have been issued since January 1, 2016, as any one of the three separate guidelines above could arguably describe aspects of many of the tax regulations that have been issued since then.

In the context of wealth planning, what might this mean for the proposed regulations on basis reporting and basis consistency (issued on March 3, 2016) and for the proposed regulations on valuation discounts for transfers of family controlled entities (issued on August 2, 2016)?

The proposed basis reporting and consistency regulations offered clarity in many areas, but also created some controversial rules, including that the basis of after-discovered property could be zero and mandating basis reporting if a beneficiary later gives away property that was initially subject to the basis reporting. (See the 03/31/16 *Tax Topics* for a discussion of these rules, which generally apply to estate executors and beneficiaries.)

The proposed valuation discount regulations have been widely criticized as hurting family businesses; they have been the subject of thousands of negative comment letters to the IRS and Treasury, and many Republicans in Congress have urged the Treasury Department to simply withdraw the regs. (See the 08/31/16 *Tax Topics* for a discussion of these rules, and the 09/30/16, 10/31/16, 11/28/16 and 12/19/16 editions for additional comments on these rules.)

So will these two sets of regs make Mr. Mnuchin's interim report detailing "significant regs about which we must do something"? Based on the broad guidelines above, it certainly seems possible, particularly as to the valuation discount regs.

Between pushing Mr. Trump's goals for tax reform and his review of significant tax regs, Mr. Mnuchin will have his hands full for many months to come.

May 7520 rate

The May 2017 7520 rate is 2.4%, a 0.20% (20 basis points) drop from the April rate of 2.6%. The May mid-term applicable federal rates (AFRs) are also down slightly: 2.04% (annual), 2.03% (semiannual), and 2.02% (quarterly and monthly). The April mid-term AFRs were: 2.12% (annual), 2.11% (semiannual), and 2.10% (quarterly and monthly).

Blanche Lark Christerson is a managing director at Deutsche Bank Wealth Management in New York City, and can be reached at blanche.christerson@db.com.