North American Management
Financial Planning Note

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What's All This About Tax Reform?

Whether you voted for the Democrats or Republicans in this last election, changes to our tax code are afoot. While many of the proposals put forth by our new President will undoubtedly have far-reaching societal impact, I thought I would lay out a few of the tax-related changes that could be implemented. These proposals were first discussed in the House Republican "Blueprint" of June 23, 2016.

Simplifying Individual Taxes

1. ***Flattening of the Tax Brackets***: We currently have seven Federal tax brackets with the highest marginal rate being 39.6%. The Blueprint calls for a compression of the brackets down to three, with the highest rate being 33%. This could save on taxes for the highest earners, but with some of the other provisions below, there may be minimal net reductions for many individual taxpayers.

2. ***Elimination of the Alternative Minimum Tax (AMT)***: This will reduce the burden of preparing two sets of tax calculations, but could result in certain taxpayers going from the max AMT bracket of 28% to 33%.

3. ***Reduced Taxes on Investment Income***: By creating a new deduction of 50% of capital gains, dividends and interest income for individual taxpayers, effective tax rates on investment income will be lowered to a max of 16.5% rather than the current effective rate of 25% for the highest earners. This, by the way, is significantly different from President Trump's tax plan, which would keep the current capital gains rate.

4. ***Simplification of Family Tax Benefits***: By increasing the standard deduction and enhancing the child and dependent care benefits, the Blueprint proposes to eliminate the additional standard deduction and the personal exemptions.

5. ***Itemized Deductions***: The Republican plan calls for the elimination of all itemized deductions, except for the mortgage interest deduction and the charitable giving deduction.

Universal Savings Accounts

The Blueprint also calls for an exploration of more general savings vehicles to encourage people to save not only for retirement but for other financial goals. Universal Savings Accounts are an intriguing concept, allowing taxpayers to contribute cash and control all the investment decisions, with the additional ability to withdraw both contributions and earnings at any time, without penalty. This could be a great way to save for a home purchase or other significant goal. The downside to these accounts could be that they become an alternative (rather than an addition) to saving for retirement.

The stated goal of these individual income tax changes is not only to reduce the complexity of the tax code, but spur additional savings and investment in the American economy. While we may never be able to *literally* file our tax return on a postcard, that is an "objective" of the simplified return, as evidenced by the following chart contained in the Blueprint.

"Postcard" TAX FILING
1. Wage & compensation income
2. Add ½ of investment income
3. Subtract contributions to specified savings plans
4. Subtract standard deduction OR
5. Subtract mortgage interest deduction
6. Subtract charitable contribution deduction
7. Taxable income
8. Preliminary tax (from tax table)
9. Subtract child credit
10. Subtract earned income credit
11. Subtract higher education credit
12. Total tax
13. Subtract taxes withheld
14. Refund due/taxes owed

Repeal of Estate and Generation Skipping Taxes

This idea may be the most talked about provision of the Blueprint, as so much of estate planning revolves around avoiding these two taxes. Despite the chatter, the House didn't provide much detail on this proposed repeal. Many tax and estate experts believe that even with repeal, such relief would not be permanent. And, even if the Federal estate tax is repealed, many states may be reluctant to forego estate tax income and will likely diverge from the Federal statutes to ensure continued revenue collection. The most prudent approach to drafting new estate documents may be to continue to look for ways to get assets out of your estate, through gifting, charitable contributions, and the continued use of portability provisions. With estate tax repeal, the question of step-up for inherited assets becomes a key focal point in estate planning. Bottom line – you still need an estate plan!

Corporate Tax Changes

1. ***Limit the Tax Rate for Small Businesses***: Currently partnerships and other types of small business entities pass-through their income to the individual owners, where it is taxed at the owner's tax rate. This proposal would limit this tax rate to the 25% tax bracket.

2. ***Limit the Tax Rate for Large Businesses***: A flat tax rate of 20% is proposed for corporations. The Corporate AMT would also be eliminated. The effect desired here is for corporations to put that increased profit to work spurring U.S. economic growth.

3. ***Immediate Write-Off of Depreciable Assets:*** This would allow companies to expense the entire cost of equipment and intellectual property, rather than writing off purchases over time.

4. ***Territorial Taxation of Global Income & Repatriation of Cash***: The goal of this provision is to simplify and reduce the "double" taxation of overseas revenue. Eliminating the tax hurdles to bring cash back into the U.S. should spur economic growth, but trade agreements are complex and changes could certainly hurt the growth of certain U.S. products and services overseas.

We have already begun to hear from the new administration on some of these proposals. If implemented as laid out in the Blueprint, there will be significant impact for individual taxpayers as well as U.S. companies. We will be watching these developments closely over the coming months.

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