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# Fairport's Five

## Tax Reform Prospects for 2017

The prospects for tax reform in the new Trump administration with a Republican controlled Congress appear more likely, but that's assuming Congress will be able to get over its traditional dysfunction.

A deeper look at the proposals from both President Trump and the House Republicans reveal major differences in both the style of tax reform as well as the implied deficits - which itself could actually prove a stumbling block to getting legislation passed.

**Corporate Income Tax**
Under a proposed President Trump plan, the business tax rate would decrease from 35% to 15%. There would be a deemed repatriation of corporate profits held offshore at a one-time tax rate of 10%. Trump also favors a 35% tariff on companies that move U.S. jobs overseas.

The House GOP plan would create a new business income tax system with a top rate of 25% for small businesses that are organized as sole proprietorships or pass-through entities instead of taxing them at individual rates. The corporate tax rate would be reduced to 20%. Both plans would eliminate the corporate alternative minimum tax (AMT).

The House GOP plan calls for a mandatory deemed repatriation tax at 8.75% on foreign cash holdings and 3.5% on reinvested profits. Taken together with a shift to a territorial tax system and border adjustments that would tax imports and exempt exports, the House's expectation is this will cause the recent wave of corporate inversions to come to a halt.

**Individual Income Tax**
While President Trump's original tax plan called for three tax brackets - 10%, 20%, and 25% - his current proposal would have a slightly different series of three brackets, with rates at 12%, 25%, and 33%. This is identical to the House GOP plan. Both proposals would drastically simplify the tax brackets, from the current seven tiers of tax rates, down to just three.

The House GOP plan is silent on where exactly the thresholds would come for each tax bracket, while President Trump's tax brackets proposal would set the 12% bracket for married couples at the first $75,000 of income; the 25% bracket from there up to $225,000; and the 33% bracket for all income over $225,000. For individuals, the brackets would simply be 50% of these amounts.

**Capital Gain Rates (And Qualified Dividends)**
Under President Trump's proposal, the current 3-tier capital gains tax structure, with 0%, 15%, and 20% rates, would remain in place (and continue to apply to qualified dividends as well). The three capital gains rates would correspond directly to the three individual income tax brackets - thus, those paying 12% ordinary income rates would pay 0% capital gains, those in the 25% bracket would get the 15% capital gains rate, and those in the top 33% bracket would get the 20% rate. In addition, the 3.8% Medicare surtax on net investment income that was enacted under the Affordable Care Act would be repealed.

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## Tax Reform Prospects for 2017 continued…

By contrast, the House GOP proposal would simply allow all individuals to exclude 50% of their investment income - including capital gains, qualified dividends, and even interest income - and then tax it at ordinary income rates. The fact that 50% of the income is excluded effectively means that all these types of investment income are taxed at half the ordinary income tax rates, translating to capital gains (and qualified dividend, and interest) tax rates of 6%, 12.5%, and 16.5%. The House GOP proposal would also repeal the 3.8% Medicare surtax.

**Itemized Deductions (and AMT)**
The current proposal from President Trump would keep all itemized deduction categories, but put a cap on total itemized deductions at $200,000 for married couples, or $100,000 for individuals. In addition, President Trump would consolidate the standard deduction and personal exemptions into a single, larger standard deduction of $15,000 for individuals, and $30,000 for married couples.

By contrast, the House GOP plan would keep the mortgage and charitable deductions (along with some incentives for retirement accounts and college savings), but eliminate virtually all other deductions altogether. In addition, the standard deduction and personal exemptions would again be combined into a larger standard deduction - $12,000 for individuals, $18,000 for individuals with a child, and $24,000 for married couples.

Notably, such limitations on deductions under either proposal, combined with the lower tax brackets, would also render the Alternative Minimum Tax (AMT) a moot point, and thus the AMT would be repealed under both proposals.

**Estate Tax**
Under current law, estates valued at more than $5.49 million are subject to a 40% tax rate on the excess. President Trump's plan would replace the estate tax with a capital gains tax on the appreciation of inherited assets of more than $10 million, subject to some exemptions for small businesses and family farms.  The House GOP plan would repeal the current estate tax but is silent on any step-up in basis at death.

**Conclusion**
It is important to note that President Trump's proposals are projected to create a substantial increase in the Federal deficit, even under "dynamic scoring" methods that consider positive economic growth as a result of the tax cuts could partially offset the economic impact. By contrast, the House Republicans have generally indicated a goal of keeping their tax reforms revenue neutral (at least on a dynamic scoring basis).

And there is still the reality that while the Republicans do have a majority in both the Senate and House of Representatives, they do not have the 60 votes required to avoid a filibuster, which means the Senate Democrats still have the potential to block substantive permanent tax reform. Alternatively, the Republicans could aim to pass legislation under the budget reconciliation rules, which can be accomplished with a simple majority vote. However, under the "Byrd rule", proposals that have a negative impact on revenue beyond 10 years must sunset at the end of that time period, setting up a reprise of President Bush's infamous sunset provision on his signature 2001 tax reform.



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