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# Your Client's Taxes Under Trump

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Whether or not you approve of Donald J. Trump as the next president of the United States, if you're a high-income earner who would like to pay less to Uncle Sam, you'll likely approve of what his tax plan will do for you.

Trump, who will be sworn in as the country's 45th president on January 20, has proposed across-the-board tax cuts (more or less, because there are a few changes that would result in unfortunate increases for some of the country's lowest wage earners). Considering the fact that Republicans retain control over both the House and the Senate, conceptually, Trump's proposal should find favor in Congress, though there is still the question of how he plans to pay for it.

"I think Trump has a pretty unobstructed path to pushing his tax agenda forward," says Blake Christian, a CPA and partner at Los Angeles-based accounting firm Holthouse Carlin & Van Trigt. "I do expect Congress will water things down a bit to avoid spiking the deficit. So they may push some of the tax breaks out a year or two or increase his proposed 15% business tax rates to 20% or more, which would still be applauded by business owners."

More on all of that in a bit, but first let's look at how the proposal as it stands would affect individual pocketbooks.

**The Basics: Lower Taxes And Fewer Brackets**

Trump's plan would significantly reduce the tax burden of high-income earners. It also shrinks the number of tax brackets from seven to three, with 12%, 25% and 33% rates. The top income tax rate of 33% would apply to married couples earning $225,000 or more and single people making at least $112,500. Currently, the top rate is 39.6%, kicking in once income exceeds about $470,000 for married couples and $418,000 for single people. On top of that, effective January 2013 high-income taxpayers began paying the net-investment-income tax (NIIT), an additional 3.8% Medicare surtax on things like interest, rents, royalties and passive business income. Trump's plan eliminates this tax, something Tony A. Rose, founding partner of Encino, Calif.-based accounting firm Rose, Snyder & Jacobs, sees as a positive step.

"The net-investment-income tax was really a considerable tax increase that nobody's talking about, which happened with Obamacare," Rose says. "All of my clients have been paying significantly higher taxes since it was implemented."

The end of NIIT would also make the top rate on capital gains and dividends a true 20%.

Currently, qualified dividends and long-term capital gains (the sale of certain assets held longer than one year) are taxed at 15% for most taxpayers, while those in the 39.6% bracket pay 20% plus the 3.8% NIIT.

Overall, while Trump sold himself as a populist, his tax proposal benefits high-income earners more than those in the middle or lower brackets. The plan would reduce the average tax bill in 2017 by $2,940, increasing after-tax income by 4.1%, according to analysis by the Tax Policy Center of the Urban Institute and the Brookings Institution. But the highest-income taxpayers (0.1% of the population, or those with incomes over $3.7 million in 2016 dollars) would experience an average tax cut of nearly $1.1 million, more than 14% of after-tax income, while households in the middle would receive an average tax cut of $1,010, or 1.8% of after-tax income. The poorest households would see their taxes go down an average of $110, or 0.8% of their after-tax income.

High-income earners are also poised to benefit from Trump's proposed cuts in business taxes and the elimination of the federal estate tax.

**An Attractive Time To Die**

Under current law, if you die with an estate valued at more than $5.45 million, you pay a tax of 40% on the amount over $5.45 million (so if the estate is valued at $10 million, you pay a 40% tax on $4.55 million). Trump has said he will eliminate this tax.

The opportunity to pass a valuable estate on to your heirs tax-free is a rare one. Usually it takes a George Steinbrenner level of luck. You may remember that Steinbrenner died in 2010, during a one-year lapse in the estate tax. The timing ensured that the New York Yankees franchise stayed in the Steinbrenner's family, which saved them about $500 million that they would have otherwise had to pay Uncle Sam.

Under the president-elect's proposal, estates wouldn't go completely untaxed. His plan would tax the appreciation of estate assets valued at $10 million or more, but only when the beneficiary sells the assets, not immediately upon death.

Eliminating the estate tax gets rid of several economic distortions, such as the incentive to sell down assets to below the threshold for taxation, the TPC points out in its analysis. However, junking the estate tax also means the wealthy have less incentive to make charitable contributions.

**Big Tax Cuts For Business**

As Christian mentioned, Trump's plan significantly reduces the tax burden for businesses. U.S. corporations currently pay tax at a rate of 38.92%, the third-highest statutory rate in the world. Estimates vary on the effective rate—the amount paid after deductions—for American corporations, because there are a range of ways to calculate it and it varies from one industry to another. One estimate from the World Bank and International Finance Corporation put the United States' effective rate for 2014 at 27.9%.

Of course, we've all heard reports of corporations paying much less, so Trump's plan would certainly simplify the current system. One proposal that Trump's advisors have considered but not confirmed would cut the corporate rate to 15%, while eliminating most business deductions. However, businesses would be permitted to deduct the cost of asset acquisitions immediately, a big change from current law, which requires them to depreciate the cost of purchased assets over a number of years, greatly reducing the tax benefits. Those businesses that fully deduct asset costs will not be permitted to deduct interest on any borrowing, a stipulation intended to reduce corporate debt.

Additionally, owners of pass-through entities (sole proprietorships, partnerships and S corporations) might be able to choose a flat rate on their pass-through income rather than the individual income tax rate, which, again, under Trump's plan tops out at 33%.
Under current law, S corporations and partnerships do not pay entity-level tax; instead, the income is allocated to the owners, who pay the corresponding tax at the individual level. In other words, after initially proposing a 15% rate on all business income, Trump's advisors backpedaled and stopped providing clarity. For clients who own businesses, the ultimate rate enacted by Congress will have a major effect on after-tax income.

**Closing A Loophole Doesn't Mean Higher Taxes**
The president-elect's plan also closes the "carried interest loophole," something Trump talked up during his campaign. Carried interest, which is mostly associated with hedge funds, is the income of certain investments that the law currently treats as preferentially taxed capital gains and taxes at 20%.

In the simplest terms, this income is similar to a bonus. For example, say a hedge fund manager sells a portfolio he's been managing and makes a profit of $2 billion for his clients. And say his contract stipulates he receive 20% of those profits, or $400 million, on top of any regular fees he's earned for managing the fund. Under the current law, this carried interest income (really a performance bonus) is taxed at 20%. For most employees, performance bonuses are taxed at anywhere from 25% to 39.6% depending on whether they're grouped with regular income and the size of the bonus.

"Carried interest is treated as a capital gain for them, as if they sold a capital asset, even if they have no money at risk," says Richard Rampell, a CPA and principal at MBAF in Palm Beach, Fla. "Trump says it should be treated as if you got a bonus working for a company, which is more the reality. My sense is that it's perfectly reasonable that this income should be taxed as regular income."
And the handful of hedge fund clients he works with feel the same, Rampell says. "I think they have a sense of fairness about it."

That said, the reality is that those who earn this type of income wouldn't see their taxes on carried interest go up under Trump's plan, because carried interest would qualify for the special 15% business tax rate, meaning the tax on this income would actually go down.

**Deduction Changes Hit Low-Income Families**
Meanwhile, Trump's plan would limit deductions. Currently, all taxpayers can claim either certain itemized deductions, such as real estate taxes, charitable contributions and mortgage interest, or a standard deduction of $12,600 (if they are married, half that if single). In addition, each taxpayer may claim a $4,050 personal

exemption for themselves, their spouse and any dependents.

Trump's proposal caps itemized deductions at $200,000 for couples filing jointly and $100,000 for single filers, and it increases the standard deduction from $12,600 to $30,000 for married couples and $15,000 for single people. It also eliminates personal exemptions, as well as the "head of household" filing status, which "would cause many large families and single parents to face tax increases," according to the TPC's analysis.

"Under the head of household filing status, if you're a single parent, you pay taxes at a lower rate than if you were a single person," Rampell says. "So getting rid of that hurts single people with children, which is kind of a weird thing to pick on."

These exemption and filing status changes come in addition to an increase in the bottom tax bracket to 12% from 10%. Put all of this together and the result is 7.8 million low-income large families will experience increased tax bills under the Trump plan, according to a study performed by Lily Batchelder, professor of law and public policy at NYU School of Law.

For example, a family of five that currently claims the standard deduction will actually lose deductions under the Trump plan. Under today's law, they are entitled to a $12,600 standard deduction and $20,250 of personal exemptions, for a total tax benefit of $32,850. The Trump plan replaces that with a $30,000 standard deduction and no personal exemptions.

**The Great Unknowns**

What remains unclear is when the new tax law will kick in. Historically, presidential tax plans have taken effect on one of the following dates: January 1 of the year it's passed (in this case 2017); the date of passage; or January 1 of the following year (2018).

"So I would probably advise clients to continue to defer income since rates [under Trump's plan] will go down," says Carolyn Mazzenga, the partner-in-charge at accounting and advisory firm Marcum in its Melville, N.Y., office. "I might also recommend accelerating deductions such as contributions, interest and taxes, since the Trump proposal includes a limitation of itemized deductions. A tax projection should be done, though, before you implement."

The bigger and more important question is how does he plan to pay for such large tax cuts? On this Trump has provided few details. However, one thing is certain. When there are fewer tax dollars coming in, Congress has only two choices: It can cut spending or it can borrow money.

According to the TPC's analysis of Trump's plan as it stands, federal revenues would fall by $6.2 trillion over the first decade, before taking into account added interest costs and macroeconomic effects. Including those factors, the federal debt would rise by at least $7 trillion over the first decade and by at least $20.7 trillion by 2036.

Again, Congress likely will reduce or delay some of the cuts to soften their effect. Exactly how they will balance any changes to the plan with spending reductions and debt management will be the $7 trillion question. ◘