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President Trump Has Been Inaugurated. What's Next for Tax Reform?

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President Donald J. Trump has just been inaugurated as the 45th President of the United States and his proposals regarding tax reform played a key role throughout his entire presidential campaign. Because Republicans retained control of both houses of Congress, President Trump and the Congressional Republicans will likely be in a position to implement significant portions of their tax reform proposals. Please be on the lookout for further updates from our Washington, D.C. office pertaining to these proposals as they are debated over the coming months.

In this alert, we will briefly summarize some of the significant proposals in both Trump's and the House Republicans' tax reform plans which would impact you or your business if enacted as proposed, including those U.S. citizens living abroad.

Simplifying Income Tax Brackets and Lower Rate Structure

- Each plan proposes to reduce the number of individual income tax brackets from seven to three. The three tax brackets would be 12 percent, 25 percent and a maximum rate of 33 percent, down from the current maximum rate of 39.6 percent.

- The Trump plan proposes to reduce the top corporate income tax rate from 35 percent to 15 percent and the House Republicans' plan proposes to reduce such rate to 20 percent.

- It is hoped that lower rates, especially at the corporate level, will increase productivity and growth.

Lowering Income Tax Rates on "Pass-Through" Business Income

- The Trump plan also includes a proposal that would affect so-called "pass-through entities," such as partnerships, LLCs and S corporations. If an election is made by a "pass-through entity" to be taxed under the rules applicable to C corporations, the entity would get the advantage of paying tax at the 15 percent corporate income tax rate proposed by Trump; however, the equity owners would then be subject to a second level of tax on distributions from the entity. Trump's proposal also provides that the second level of tax would not apply to certain "small" "pass-through entities," potentially making an election to be taxed as a C corporation beneficial for certain small businesses.

Retaining the Long-Term Capital Gain Preference

- The Trump plan proposes that taxpayers in the 12 percent income tax bracket pay zero tax on their long-term capital gains, while those in the 25 percent and 33 percent income tax brackets pay tax on their long-term capital gains at rates of 15 percent and 20 percent, respectively.

- The House Republicans' plan proposes that long-term capital gains be taxable at ordinary income rates; provided, however, that taxpayers would be permitted to exclude 50 percent of their long-term capital gain from gross income – resulting in a maximum effective tax rate on long-term capital gains of 16.5 percent.

Eliminating the Individual and Corporate Alternative Minimum Taxes

- The Trump plan and the House Republicans' plan each propose that the individual and corporate alternative minimum tax be eliminated. Significantly, however, neither the Trump plan nor the House Republicans' plan address what would become of AMT credits not utilized prior to repeal of the alternative minimum tax.

Taxing Carried Interest at Ordinary Income Tax Rates

- The Trump plan proposes to tax carried interest (often the profits interest received by the general partner of a private equity fund, but applicable in other contexts as well) at ordinary income tax rates.

- The House Republicans' plan would retain the current system of taxing carried interest at long-term capital gains tax rates.

Increasing the Standard Deduction and Eliminating Certain Filing Status

- The Trump plan proposes to increase the standard deduction to $30,000 for those filing jointly (from $12,600 in 2016) and $15,000 for those filing separate returns (from $6,300 in 2016). Moreover, Trump's plan eliminates the head of household filing status and also calls for the elimination of the personal exemption.

- The House Republicans' plan proposes to combine the personal exemption and standard deduction into a single deduction of $12,000 for single taxpayers with no children, $18,000 for single taxpayers with children and $24,000 for joint filers.

Limiting Itemized Deductions

- The Trump plan proposes to limit the ability of taxpayers to take advantage of itemized deductions. Trump initially proposed eliminating all itemized deductions other than the available deduction for payments of interest on a home mortgage and charitable contribution deductions. More recently, however, the President has proposed capping itemized deductions at $100,000 for taxpayers who are single or who are married and file separate returns and $200,000 for joint filers. Presumably, this cap on itemized deductions would apply to home mortgage interest and charitable contribution deductions, but that detail is not clear.

- The House Republicans' plan proposes to eliminate most itemized deductions other than deductions for payments of home mortgage interest, charitable contributions and education and retirement savings.

Repealing the 3.8 Percent Net Investment Income Tax

- Each plan proposes to eliminate the 3.8 percent Net Investment Income Tax. If repealed, this would represent a significant tax savings for U.S. citizens living abroad as historically this "tax" has not been allowed as a "tax credit" under the various double tax treaties enacted between the U.S. and other foreign countries.

Repealing the Medical Device Excise Tax

- The Trump plan and the House Republicans' plan each propose to repeal the 2.3 percent excise tax on the sale of certain medical devices.

Eliminating Most Corporate Tax Credits

- The Trump plan and the House Republicans' plan each propose to eliminate most corporate tax credits, other than the Research and Development (R&D) Tax Credit, which Trump has stated he intends to leave intact. Neither Trump nor the House Republicans have provided a specific list of those corporate tax credits which would be eliminated.

Tax on Deemed Repatriation of Offshore Profits

- The Trump plan proposes to tax deferred foreign income (income which was sourced to a foreign country and has not been repatriated to the United States) at a flat rate of ten percent as part of a one-time deemed repatriation.

- The House Republicans' plan also contemplates a one-time repatriation of deferred foreign income; however, under such plan, cash assets would be taxed at an 8.75 percent rate and non-cash assets would be taxed at a 3.5 percent rate. Further, under this plan the taxpayer would be permitted to elect to pay the tax over an eight year period.

Election for Full First Year Expensing for U.S. Manufacturers

- The Trump plan proposes to give businesses engaged in manufacturing activities within the United States the option to elect to expense capital investments fully in the year of acquisition, in lieu of depreciation over a longer period of time as provided under current law. If a manufacturer made this election, however, it would lose the ability to deduct corporate interest expense. This election would be revocable within the first three years, but after the third year it would become irrevocable.

- The House Republicans' plan would go further, allowing first year expensing for most assets regardless of the industry within which such assets are employed.

Estate Tax, Tax on Unrealized Appreciation and Gift Tax

- The Trump plan and the House Republicans' plan each propose an elimination of the federal estate tax. Under the Trump plan, however, estates would instead be subject to a capital gains tax on any unrealized appreciation in excess of $10 million. It should be noted that this is not the first attempt at eliminating the estate tax. Even with the Republican-controlled White House and Legislature, there still exists a strong possibility that the estate tax will continue.

- Neither plan is clear on whether the existing step-up in tax basis in estate assets would remain or how it might otherwise be affected. Likewise, the future of the federal gift tax is uncertain.

Border Tax Controversy

- The House Republicans' plan includes a border adjustability proposal that would generally subject imports to an additional tax while protecting exports from similar taxes. This measure is intended to partially offset the cost of lowering corporate tax rates. President Trump and other Senate Republicans, however, have publicly voiced their disapproval of this proposal. President Trump has also spoken in favor of a border tax on imports of companies which leave the U.S., but there are no details of such a plan yet.

The preceding summarizes only a few of the many important tax proposals by President Trump and the House Republicans. For now, these are merely proposals, are subject to change and, even if enacted, their effective dates and any transition rules would need to be determined. However, the Trump Administration and Republican-controlled 115th Congress have indicated the desire and have the ability to make significant changes to our nation's tax policy on a global level.

Please remember that advice and counsel regarding your particular tax-related issues, including the potential impact of the possible developments outlined above on you or your business, are dependent upon your specific facts and circumstances. For more information about how these issues may affect you or your business, or related matters, contact the co-authors of this alert, Tom Mahoney, Allen Blow, Stuart Schabes, Tyler Ball or any member of the Firm's Tax Group.