TAX ALERT

Year-End Tax Planning

THE "TRUMP EFFECT"

With President-Elect Trump's bullishness on tax changes and continued Republican control of Congress, the odds for major tax reform are higher than ever since 1986, when then-President Ronald Reagan accomplished a significant overhaul of the tax code. Given Mr. Trump's proposals, and the House GOP Blueprint issued in June of this year, we must consider the possibilities as part of 2016 year-end planning. At this point tax reform seems to be a question of when, rather than if – the primary question being: when will tax reform be effective, 2017 or 2018?

Normally, it pays to defer income and accelerate deductions. That strategy is even more important today, since tax rate reduction represents a potential opportunity to achieve permanent tax savings, as opposed to a deferral of tax in a constant tax rate world. Many taxpayers could benefit by deferring income from 2016 to 2017 and/or later years. In addition, accelerating deductions into 2016 could be beneficial because (1) deductions have more value when tax rates are higher, and (2) lowering the tax rates will very likely require reducing or eliminating various tax deductions. For example, the House GOP Blueprint calls for the elimination of deductions for medical expenses, state and local income taxes, real estate taxes, and miscellaneous itemized deductions. Consider the following:

- Both Mr. Trump and the House propose a maximum individual tax rate of 33%. Under current law the maximum income tax rate is 39.6%.

- Both plans call for a continuation of the current 20% preferential rate on long-term capital gains. However, both plans also propose to eliminate "Obamacare" related taxes, including the 3.8% Net Investment Income Tax.

- Both plans call for a significant tax rate reduction on business income. The current top federal tax rates are 35% for C corporations and 39.6% for pass-through entities (such as S corporations and LLC's/partnerships, where the business income is taxed at the individual owner level). Mr. Trump has proposed a 15% maximum rate on business income, while the House envisions maximum rates of 20% for C corporations and 25% at the individual level for pass-through entity income. Both proposals would significantly reduce tax rates on income earned by C corporations and pass-through entities.

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- Both plans would repeal the Alternative Minimum Tax ("AMT").

- Both plans call for a new way of looking at itemized deductions. Mr. Trump's proposal is to retain the existing rules but to cap all itemized deductions at $200,000 for married filing joint taxpayers and $100,000 for single filers. As noted above, the House plan effectively eliminates itemized deductions other than mortgage interest and charitable contributions.

- Both plans propose to eliminate the estate and generation-skipping transfer taxes. Mr. Trump's plan states that capital gains held until death and valued over $10 million will be subject to income tax (i.e. there would be no tax basis step-up in excess of $10 million). In terms of the gift tax, both proposals are vague and further clarity is needed.

- For business taxpayers, both plans propose to eliminate "most corporate tax expenditures" (Trump) and/or "special interest deductions and credits" (the House), other than the research and development credit. These eliminations are unspecified, but presumably would include things like LIFO, Section 199 (the "manufacturer's deduction"), percentage depletion, captive insurance, work opportunity tax credits, and a litany of other deductions and credits that have found their way into the tax code over many years. Immediate or enhanced deductions relating to depreciation/fixed assets will likely survive in some form given the plans' similarities in this area.

POTENTIAL ACTIONS

Consider the following actions:

- Defer property sales generating long-term capital gains, or try to use the installment method to spread out the gain over a period of time. If you already have large gains, consider taking some capital losses by the end of 2016.

- Defer ordinary income such as bonuses, interest income and business receipts. Cash-basis taxpayers in particular may have an opportunity to defer revenue recognition.

- Expense fixed asset purchases using Section 179 and/or bonus depreciation.

- Attempt to maximize business deductions and tax credits, especially those that may be eliminated or substantially cut back (see above).

- Individuals could pre-pay state and local income and real estate taxes (caution: beware the AMT) and could accelerate charitable contributions. These deductions may be eliminated or capped in future years as noted above.

Year-End Tax Planning cont.

- Maximize retirement plan and HSA contributions.

- IRA owners aged at least 70 ½ could satisfy their required minimum distributions by donating a portion of their IRA directly to charity.

- If you're planning to convert a traditional IRA to a Roth IRA, consider waiting for lower tax rates in a future year.

- Reevaluate any planned significant estate/gift tax planning in light of the possible repeal of the estate tax. Given the uncertainty of the future of the gift tax, it may be prudent to avoid large gifts until such time as there is more clarity in this area. Smaller gifts of up to $14,000 to any one person, however, would continue to be beneficial.

Recognize that each taxpayer's situation is unique, and as a result, the above noted actions may or may not be beneficial to you. Please contact your GBQ representative to help determine a specific strategy to best fit you and your business' circumstances.

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