Tax Reform Update
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On May 23, 2017, President Donald Trump and his administration released their budget for the 2018 fiscal year – "A New Foundation for American Greatness."

In this plan, the administration called for simplification of the tax code and a reduction of rates, which could significantly impact individuals and businesses.

In a previous commentary, we summarized some of the key provisions of President Trump's plan. In this piece, we'd like to examine these provisions and others in more detail.

First, let's take a look at the proposed changes for individuals.

1. **Rate reduction:** The president has proposed a new three-bracket range with rates of 10 percent, 25 percent and 35 percent. Under current law, tax rates for ordinary income range from 10 percent to 39.6 percent. Details regarding the income level for each bracket have not yet been published.

2. **Long-term capital gains and qualified dividends:** The plan would eliminate the Net Investment Income Tax (NIIT) and place a maximum rate on capital gains and dividends of 20 percent. Under current law, high-income taxpayers pay an additional 3.8 percent NIIT on interest, rents, royalties and passive income.

3. **Standard and itemized deductions:** The plan would double the standard deduction, increasing the amount to $12,700 for singles and $25,400 for those that are married filing jointly. The plan would eliminate all itemized deductions, except for the charitable contributions deduction and the mortgage interest deduction. The Tax Policy Center estimates this change could reduce the percentage of itemizers from 30 percent to as low as 5 percent.

   The elimination of itemized deductions would especially affect taxpayers who itemize and live in states with high real estate, state and local income taxes, as the tax code now allows for the deduction of these taxes. The tax burden would shift from lower-tax states, such as Florida and Texas, to higher-tax states, such as New York and New Jersey.

4. **Elimination of the alternative minimum tax (AMT):** The administration's plan would eliminate AMT. According to the Tax Policy Center, the AMT mainly affects well-off households, but not those with the highest incomes. Instead, it is likely to affect taxpayers who are married, have large families and live in high-tax states. In 2017, 29.4 percent of households with "expanded cash income," a broad measure of

income, between $200,000 and $500,000 will be affected by the AMT. For those with incomes between $500,000 and $1 million, 62.9 percent will be affected. Only 19.9 percent of households with incomes greater than $1 million will pay AMT. This is because the 28 percent AMT rate is less than the 39.6 percent maximum rate that households with high incomes pay based on the regular income tax.

Now, let's review the key changes for businesses.

1. **15 percent corporate tax rate:** Under current law, the maximum corporate rate is 35 percent, even though many corporations pay a lower effective rate.

2. **15 percent tax on pass-through income:** Owners of partnerships, S corporations and sole proprietorships are taxed at individual rates, with the maximum rate being 39.6 percent. The president's plan would give business owners a maximum rate of 15 percent. This would give flow-through entities, which make up the majority of businesses, the same 15 percent rate as corporations.

   The campaign material has indicated it would prevent pass-through owners from converting their compensation income, which would be taxed at higher rates, into profits that would be taxed at the 15 percent rate.

If you have any questions about the new administration's tax plan, or how best to incorporate these proposed changes into your financial plan, please feel free to reach out to your advisor at any time.

Sources:

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