

# **The Looming Possibility of Tax Reform**

**Leimberg Information Services**

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We've had the Trump Plan, the Ryan Plan, the Senate Plan (kind of), the Democrat Plan and now the **United Framework for Fixing our Broken Tax Code (the "Plan")**.

These materials are current through Sunday October 15, 2017.

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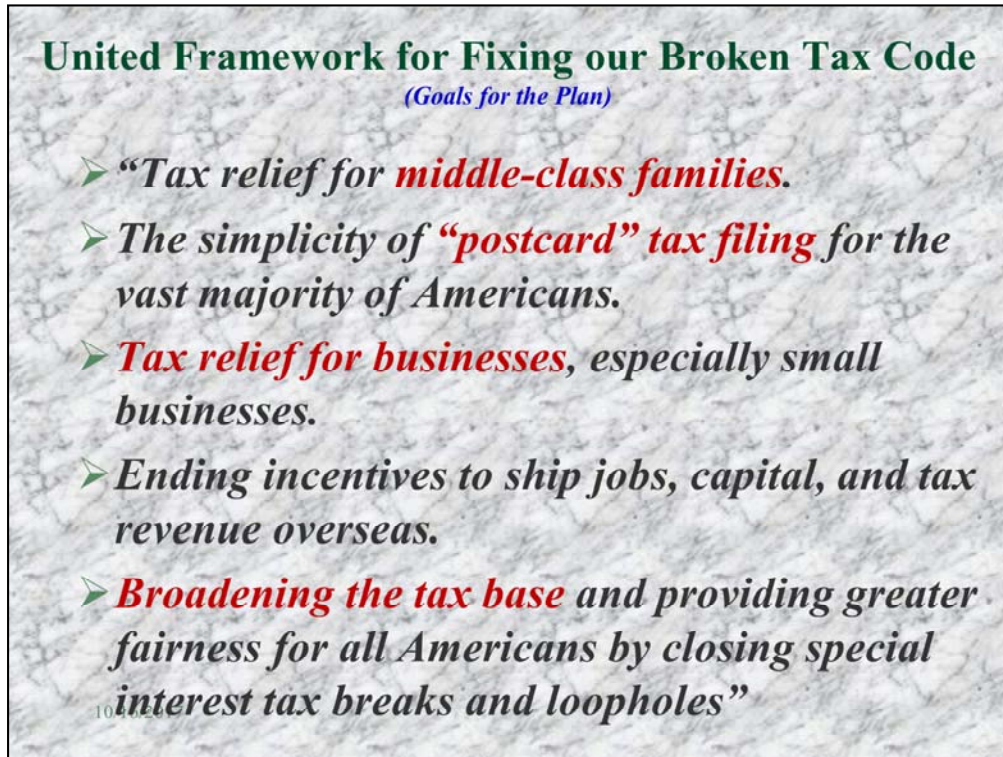
*Memorable Quotes*

*“Anyone who says they know what is going to happen next is either **Clairvoyant or Deranged.**”*

10/16/2017

There are too many uncertainties to predict the details of any final tax reform legislation.

- Too many political disagreements
- The lack of details in most of the Plan
- The struggles over the budget impact of any final bill



**United Framework for Fixing our Broken Tax Code was released on Wednesday September 27, 2017.**

Note the particular goals

- Relief for the **Middle class**, Not the poor
- **Business Tax Relief**
- **Simplification** of the tax code
- **Bringing Offshore profits back** to the US
- **Broadening the Tax Base** – discuss **the border tax** and **narrowing of revenue (tax) sources** over the last couple of decades
  - Even while the media discussion is focused on tax reduction, broadening the Tax Base has been a central goal of the Republican Tax Reform efforts. Many of the political battles that will make or break the Plan will occur in this arena .



**Tax Fact**

The Income Tax Code (as adopted in **1913**) had **27** pages

In 2015 it was reported that the Tax Code & Regulations contained **10,067,000** words



10/16/2017

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In 2015 it was reported that the Tax Code & Regulations contained **10,067,000** words

Source: The Tax Foundation

**Tax Fact**

**In 2016, Americans were  
expected to spend 8.9  
billion hours and \$409  
billion complying with the  
tax code**

10/16/2017

Source: The Tax Foundation

Due to increasing tax complexity, over **90 percent of taxpayers** now hire professional tax preparers or use tax preparation software.

Article can be found at: <https://taxfoundation.org/press-release/americans-will-spend-89-billion-hours-409-billion-complying-us-tax-code-2016/>

## Tax Fact

For the 2014 tax year:

➤ Taxpayers in the **top 1%** paid \$542.6 billion in federal income tax – or **39.5%** of the total

➤ The **top 10%** paid **71%** of the total income tax

Source: New York Times September 22, 2017



The New York Times article noted: *“Do they pay the top rate? Not by a long shot. The average rate for the top 1 percent is 27 percent of their adjusted gross income. (It’s even lower — 24 percent — for the superrich in the 0.001 percent bracket.) The top 10 percent pay an average of 21 percent.”*

For an insightful video on “Tax Fairness” see the following WSJ presentation by Richard Rubin: <http://www.wsj.com/video/talking-taxes-whats-your-fair-share/D330A342-E16E-4AC4-BE93-7813BD9B5557.html>

## Tax Fact

# Federal Income Taxes are the New **Confiscation Tax** for most Moderately Affluent Taxpayers

✓ Annually Renewable (Compounded Cost)

✓ Lower Tax Thresholds



10/16/2017

Unlike the estate tax, you don't have to wait until someone dies to collect a tax – the taxpayer gets to repay the tax each year.

The threshold when the tax applies is much lower for income taxes than federal estate taxes (i.e., federal estate tax exemption of \$5.49 million in 2017)

At lower tax thresholds there is more tax planning. For most people in today's tax environment “**Income Tax Planning Trumps Federal Estate Tax Avoidance.**”

99.8% of Americans are not subject to a federal Estate Tax – but state death taxes may still apply



## **Legislative Timing of Tax Reform**

**First: House & Senate Pass a Budget Resolution, setting the maximum revenue reduction for the next 10 years**

**Second: House & Senate each Pass their Tax Bills**

**Third: House & Senate work on Reconciling their Bills**

**Fourth: Final Votes in House and Senate**



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The House and Senate reconciliation resolution unlocks the fast-track process of reconciliation & eliminates a Senate filibuster.

## **The Timing of Tax Reform**

**Looming over the entire Tax Plan:**

**What will be the **Effective Date:****

**Retroactive to **January 1, 2017****

**Plan Date: **September 27, 2017****

**January 1, 2018**

**the **date signed** by the President?**



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Will different tax changes have different effective dates because of budgetary impacts? For example, do the revenue increases kick in before the revenue reduction provisions?

**Budgetary constraints** may work against a retroactive effective date and support an effective date in 2018

**Running projections for Advanced tax planning is nearly impossible**

## The Impediments to Tax Reform

The **Vague** terms of the Proposed Plan leave lots of room for **Negotiation** and **Conflict**



Essentially the Plan is a **broad framework** with **few detailed proposals** – most details are left up to the tax committees to work out.

But even some of the proposals in the Plan are already meeting stiff resistance and may be revised or abandoned – such as the elimination of an itemized deduction for state & local taxes.

## **The Impediments to Tax Reform**

- **Bipartisan Disagreements**
- **Intra-Party Disagreements**
- **Lobbyists**
- **Attacks by Those on the Losing End of Change**



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Preliminary Estimates on the 10 Year Deficit impact of the Plan (based upon a lot of assumptions):

- The Plan: \$1.5 trillion
- The Committee for a Responsible Federal Budget: \$2.2. trillion
- Tax Policy Center: \$2.4 trillion

Note: to the extent any revenue raiser is modified or eliminated (e.g., the state and local itemized deduction), the Congress will either have to find a replacement source of revenue or increase the deficit, which increases the resistance of the deficit hawks and potentially opens the restoration of a Senate filibuster.

Note: To fix Social Security, Medicare and Medicaid, Congress will need to find substantial new sources of revenue or increase governmental borrowing.

**Some sources indicate that the Debt to GDP ratio of 76.7% is the highest since WWII.**

See: Wall Street Journal, October 12, 2017: *“Economists See GOP Tax Plan Producing Growth Spurt, But Split Over Long-Term Effect.”*

*Memorable Quotes*

*“Based on those [vague] details – and many assumptions – we estimate the plan calls for roughly **\$5.8 trillion of tax cuts** and **\$3.6 trillion of base broadening**, resulting in about **\$2.2 trillion of net tax cuts.**”*

The Committee for a Responsible Federal Budget

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*Memorable Quotes*

*“What I can tell you is that I'm not about to vote for any bill that increases our deficit, period“*

Senator Bob Corker (R-TN)



10/16/2017

He is not running for reelection in 2016.

The Republicans need Democrat support if they lose 2 Republican Senate votes. That will substantially change the final form of any tax reform (e.g., elimination of the estate tax).

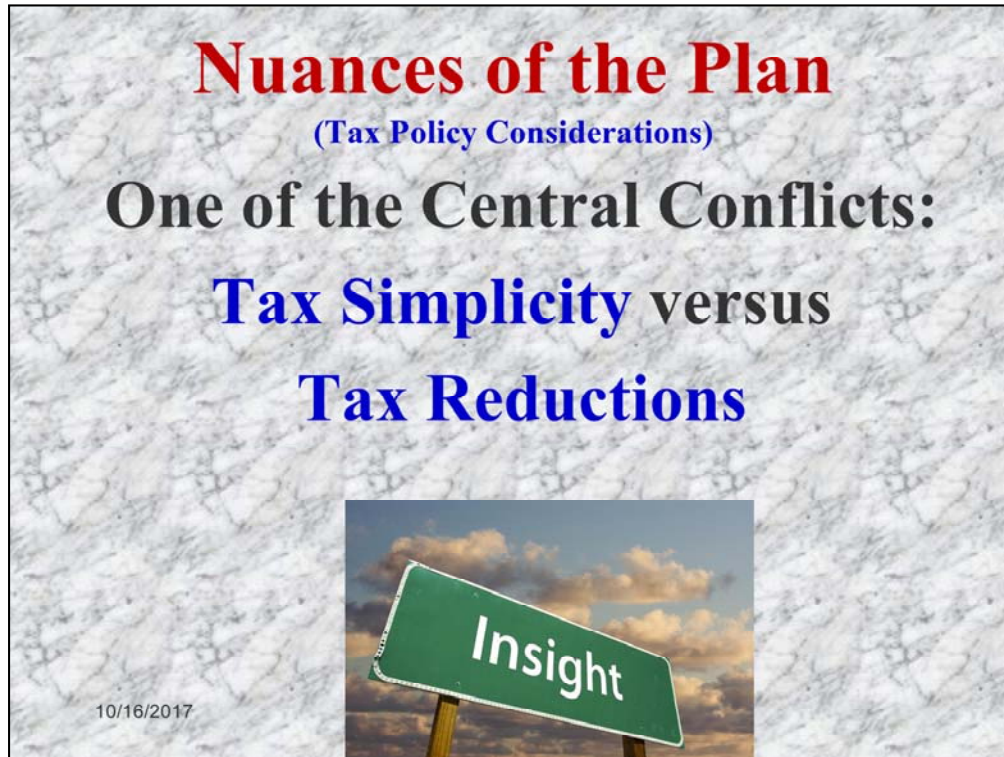
*Memorable Quotes*

*“And I must say that the  
Republicans, I think, have been  
cutting taxes with borrowed money,  
and the Democrats have been  
spending with borrowed money.  
They agree only on the borrowed  
money.”*

Alan Greenspan on PBS, September 24, 2010

10/16/2017





When tax reform occurred during the Reagan years, the percentage of **taxes paid by the top 10% of taxpayers went up.**

Senate Joint Economic Committee: *“The share of the income tax burden borne by the top 10 percent of taxpayers increased from **48.0 percent in 1981 to 57.2 percent in 1988**. Meanwhile, the share of income taxes paid by the bottom 50 percent of taxpayers **dropped from 7.5 percent in 1981 to 5.7 percent in 1988.**”* See: [https://www.jec.senate.gov/public/\\_cache/files/9576a929-37b4-497c-9b06-4bf3481f9f0a/the-reagan-tax-cuts-lessons-for-tax-reform-april-1996.pdf](https://www.jec.senate.gov/public/_cache/files/9576a929-37b4-497c-9b06-4bf3481f9f0a/the-reagan-tax-cuts-lessons-for-tax-reform-april-1996.pdf)

More information:

- [https://www.washingtonpost.com/opinions/on-tax-reform-take-a-page-from-ronald-reagan/2016/12/04/8de3237c-b8a3-11e6-b994-f45a208f7a73\\_story.html?utm\\_term=.4ebb61734e2d](https://www.washingtonpost.com/opinions/on-tax-reform-take-a-page-from-ronald-reagan/2016/12/04/8de3237c-b8a3-11e6-b994-f45a208f7a73_story.html?utm_term=.4ebb61734e2d)



# Federal Individual Income Taxes

For more information, see:

<https://www.nytimes.com/interactive/2017/09/27/us/politics/six-charts-to-explain-the-republican-tax-plan.html>

## 2017 Income Tax Rates

<u>Top Federal Tax Rates</u>	<u>2012</u>	<u>2017</u>
Top Income Rate	35%	39.6%
Phased out Itemized Deductions	-0-	1.19%
Phased out Personal Exemptions	-0-	1.05% <i>each</i>
Health Care Medicare Tax	-0-	0.9%
(Dividend and Capital Gain Rate	15%	20%
Health Care Surtax <small>(investments)</small>	-0-	3.8%
State Income Taxes	Ranging from 0% to 11%	
Local Income Taxes	Ranging from 0% to 3.876%	

In 2017, there are **18 Tax Benefits** with a Phase-Out

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**The reduction of tax deductions and credits may narrow the effective tax rates by eliminating the “ghost tax rates”**

Source: Phased out Calculations per Kiplinger Tax Letter, January 18, 2013

\*

# Trust and Estate Income Taxes

	<u>2012</u>	<u>2017</u>
Top Federal Income Rate	35%	39.6%
Health Care Surtax	<u>0%</u>	<u>3.8%</u>
<b>Top Federal Ordinary Tax Rate</b>	<b>35%</b>	<b>43.4%</b>
Dividend and Capital Gain Rate	15%	20%
Health Care Surtax	<u>0%</u>	<u>3.8%</u>
<b>Top Federal Ordinary Tax Rate</b>	<b>15%</b>	<b>23.8%</b>

State Income Tax Rates: 0% to 11%

Top Potential Rate: **54.4%+**

*Beginning at \$12,500 in 2017*

10/16/2017

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**United Framework for Fixing our Broken Tax Code**  
*(Individual Tax Rates)*

- **Top Individual Tax Rate drops to 35%**
- **Repeal of Individual AMT Taxes**
- **No changes in the Obamacare Taxes**
- **No comment on changes in Trust & Estate Income Tax Rates**

10/16/2017

From the Wall Street Journal November 6, 2016: *“The AMT—an alternative set of rules for calculating income tax—was enacted in 1969 with the objective of targeting 155 filers with incomes of \$200,000 (an exorbitant amount at the time) who avoided paying any federal income tax. While their actions were 100% legal—they were using deductions and legislated tax breaks appropriately—their \$0 tax liability was an embarrassment, calling for action by lawmakers.”*

*“Rather than targeting the highest income earners, the AMT is **disproportionately hitting many middle-class families**. In practice, AMT is more likely to hit taxpayers with families, those who are married and those who live in high-tax states.”*

**United Framework for Fixing our Broken Tax Code**  
(Federal Tax Rate Changes)

*“An additional top rate may apply to the highest-income taxpayers to ensure that the reformed tax code is at least as progressive as the existing tax code and **does not shift the tax burden** from high-income to lower- and middle-income taxpayers”*

This part of the Plan has not gotten much media attention. It is unclear what this additional tax tier might be.

**United Framework for Fixing our Broken Tax Code**  
**(Individual Tax Changes)**

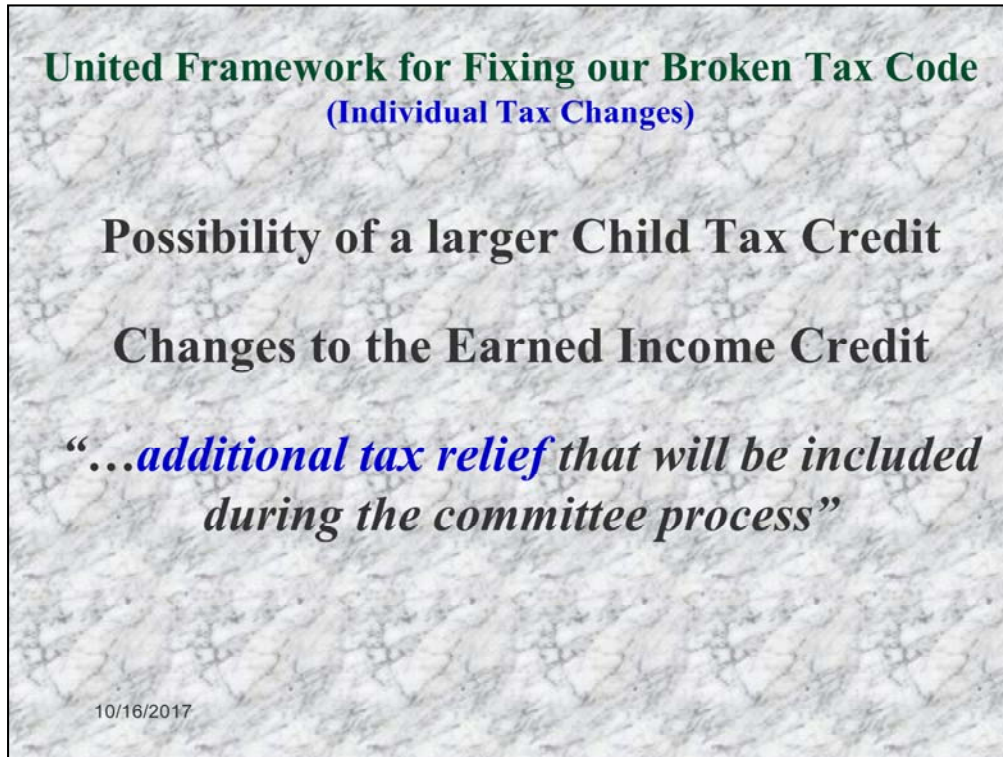
*“To simplify the tax rules, the additional **standard deduction** and **personal exemptions** for the taxpayer and spouse are consolidated into this larger standard deduction*

- **\$24,000** for married taxpayers filing jointly
- **\$12,000** for single filers”

10/16/2017

Currently 70% of tax filers use the Standard Deduction. In reviewing an earlier version of the Plan the Tax Policy Center said it could increase to 84%

\*



**United Framework for Fixing our Broken Tax Code**  
**(Individual Tax Changes)**

**Possibility of a larger Child Tax Credit**

**Changes to the Earned Income Credit**

*“...**additional tax relief** that will be included  
during the committee process”*

10/16/2017

See: Wall Street Journal article: “*Republicans Hammer Out Child Tax Credit Details,*”  
October 4, 2017.

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**Nuances of the Plan**  
 (Non-Child Dependent Tax Changes)  
**\$500 tax credit** for non-child dependents

✓ In 2017 \$4,050 per dependent at a tax rate of 35% = **\$1,417.50** in tax savings

✓ Equivalent tax bracket for the \$500 credit would be **12.4%**



10/16/2017

Child care credit may make up for some losses of the Dependent Deductions BUT what about non-child dependents?

**The Plan:** *“The framework also provides a non-refundable credit of \$500 for non-child dependents to help defray the cost of caring for other dependents.”*

The new \$500 credit compared to current dependency deduction: In 2017 \$4,050/dependent times (an assumed) tax rate of 35% = \$1,417.50.

The equivalent tax bracket would be 12.4%

\* Note: it is not clear that each dependent gets you a separate tax credit

**Query:** There currently is a phase-out of the Dependent Deduction. Will there be a Phase-out of the tax credit?

**United Framework for Fixing our Broken Tax Code**  
(Individual Tax Changes)

*“Numerous other **exemptions, deductions and credits** for individuals riddle the tax code. The framework envisions **the repeal of many of these provisions** to make the system simpler and fairer for all families and individuals, and allow for lower tax rates.”*

10/16/2017

**New York Times September 29, 2017:** *“Eliminating some of the more costly tax measures would make it impossible for Republicans to enact the deep cuts to tax rates that they are trying to achieve. Repealing personal exemptions, which diminishes the impact of doubling the standard deduction, for example, raises **\$1.5 trillion**. Getting rid of the state and local deduction raises **\$1.3 trillion** in revenue over 10 years.”*

Note: The deduction for state and local income taxes and property taxes is often called the “**SALT**” deduction

See: Wall Street Journal September 28, 2017: *“Republican Tax Plan Quickly Hits First Hurdle”*

**United Framework for Fixing our Broken Tax Code**  
(Itemized Deductions)

*“In order to simplify the tax code, the framework **eliminates most itemized deductions**, but retains tax incentives for **home mortgage interest and charitable contributions**”*

**Query: Retained Itemized Deduction Limitations?**

10/16/2017

Although not in the Plan, there have been discussions of lowering the mortgage interest deduction to \$500,000 of loan value rather than \$1 million.

The increase in the standard deduction has realtors and homebuilders concerned about the effective benefit of the mortgage interest deduction. See: Wall Street Journal, October 16, 2017:

- *“Housing Groups Spar Over Mortgage Deduction”*
- *“GOP Tax Plan Would Keep the Mortgage Break But Threaten Irrelevancy”*

The so called “Pease limitations” was reinstated by the Taxpayer American Taxpayer Relief Act of 2012 (effective in 2013). Pease itemized deduction limitations apply to **charitable donations**, the **home mortgage interest** deduction, **state and local tax** deductions and **miscellaneous itemized deductions**. They do not apply to medical expenses, investment expenses, gambling losses, and certain theft and casualty losses.



**Tax Fact**

*In 2015, 9 million  
taxpayers deducted **\$87  
billion** on Medical  
Expenses on Schedule A*

*Source: Wall Street Journal, October 1, 2017*

10/16/2017

In 2017, taxpayers can only deduct unreimbursed expenses that exceed 10% of their adjusted gross income – an 2.5% increase from the previous 7.5% AGI floor.



**Tax Fact**

*In 2015, 45 million  
taxpayers deducted **\$550  
billion** on State & Local  
Taxes on Schedule A*

*Source: Wall Street Journal, October 1, 2017*

10/16/2017

Note: The deduction for state and local income taxes and property taxes is often called the “**SALT**”  
**deduction**

\*

## Memorable Quotes

*“Repealing the break would free over the next decade more than **\$1 trillion** that the party plans to use to lower tax rates.*

*“Politically, it would be good for most Republicans, **shifting more of the federal tax burden from states they represent onto states they don’t...**”*

*Wall Street Journal, September 29, 2017*

10/16/2017

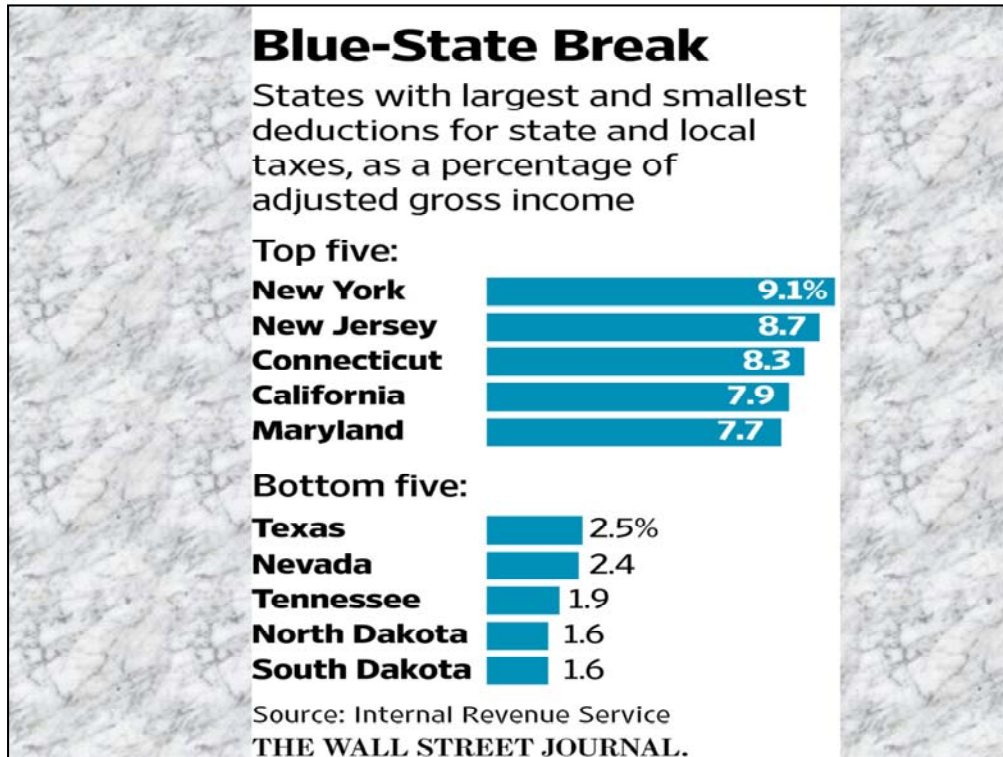
The “break” is the itemized deduction for state and local taxes (income and property taxes).

**Number of Republican senators from the top 5 states: NONE**

Per New York Times on September 29, 2017: **Number of Republican representing the top 20 districts with returns claiming the state and local tax deduction: 9**

Wall Street Journal October 12, 2017: Discussed a number of options for leaving a partial SALT deduction, including:

- Phase-out the deduction for higher income taxpayers
- Allow the deduction for property taxes, but not income taxes
- Capping the total available deduction



### Number of Republican senators from:

- the top 5 states: NONE
- 8 Senators from the Bottom 5 States

Per New York Times on September 29, 2017: **Number of Republican** representing the top 20 districts with returns claiming the state and local tax deduction: 9

Plus there are a significant number of Republican House members representing the top 5 states

The above graph comes from the Wall Street Journal, September 28, 2017: “Republican Tax Plan Quickly Hits First Hurdle.”


New York Times September 29, 2017: “Eliminating some of

*the more costly tax measures would make it impossible for Republicans to enact the deep cuts to tax rates that they are trying to achieve. Repealing personal exemptions, which diminishes the impact of doubling the standard deduction, for example, raises **\$1.5 trillion**. Getting rid of the state and local deduction raises **\$1.3 trillion** in revenue over 10 years. .... Overall, 38% of the deduction's value goes to California, New York and New Jersey, which have 21% of U.S. households.”*



**Nuances of the Plan**  
(Individual Tax Changes)

**Piggy-backing State Tax  
Laws may increase the  
effective Tax cost**



10/16/2017

States imposing a state income tax generally use the federal computation of taxable income as a base for determining the state taxable income.

For residents of states with high income tax rates, the combined impact of higher state taxable income and lower federal tax deductions could substantially raise their income taxes.

**Point:** If federal **deductions and exemptions** are eliminated or reduced, it can drive up the calculation of **taxable income** for both federal and state law purposes.

Generally, changes in federal income **tax rates** or federal **tax credits** does not impact a state's determination of its taxpayer's state income taxes.

# Tax Fact

## Phased Out Tax Benefits

### Tax Credits

- ✓ Hope Scholarship
- ✓ Lifetime Learning
- ✓ Child Tax
- ✓ Adoption Expenses
- ✓ First Time Home Buyer
- ✓ Elderly & Disabled
- ✓ Earned Income



### Tax Deductions

- ✓ Education Costs
- ✓ Education Loan Interest
- ✓ Medical Costs
- ✓ Miscellaneous Itemized Deductions
- ✓ Itemized Deductions
- ✓ Charitable Contributions
- ✓ IRA Deductions

### Tax Exemptions

- ✓ Personal Exemptions
- ✓ Dependent Exemptions
- ✓ AMT Exemption

10/16/2017

Source: <http://www.taxpolicycenter.org/briefing-book/background/issues/phaseouts.cfm>

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# Nuances of the Plan

(Phase-outs & Tax Complexity)

There is no discussion of  
eliminating any of the tax code  
**Phase-outs** that add **complexity**  
and a **tax increase** to taxpayers



10/16/2017

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**Definition of a Tax Attorney:**

**Someone who solves a  
problem you didn't  
know you had in a way  
you don't understand**

10/16/2017



The background of the slide is a square with a marbled pattern in shades of grey, white, and light brown. The text is centered on this background.

# **Federal Business & Investment Income Taxes**

*Memorable Quotes*

*“It's tough to make  
predictions,  
especially about the  
future.”*

Yogi Berra

\*

**United Framework for Fixing our Broken Tax Code**  
**(Federal Tax Rate Changes)**

- **Top C Corporation Tax Rate drops to 20%**
- **Top Tax Rate for Pass Through Entities drops to 25%**
- **Repeal of Corporate AMT Taxes**

10/16/2017

According to the Harvard Business Review, half of all companies were formed as C corporations in 1985. The number is **just 20 percent today**, with the rest being pass-through entities. See: <https://www.bloomberg.com/view/articles/2017-09-14/mnuchin-s-tax-comments-sound-like-class-warfare>

The Plan reduces the corporate tax rate to 20% – which is below the 22.5% average of the industrialized world.

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**United Framework for Fixing our Broken Tax Code**  
**(Federal Tax Rate Changes)**

*"The framework contemplates that the (congressional tax) committees will adopt measures to prevent the recharacterization of personal income into business income to prevent wealthy individuals from avoiding the top personal tax rate".*



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## Memorable Quotes

*“Treasury Secretary Steven Mnuchin said two weeks ago that the Administration would ensure partners at services firms such as accounting, law and financial firms would not benefit from a new, lower pass-through rate. Tax experts, however, have said it would be difficult for congressional tax writers to exempt partners at services firms from using the new pass-through rate.”*

Thomson Reuters September 29, 2017

10/16/2017


**Per New York Times on September 29, 2017: Pass through entities represent 95% of US Businesses**

*“If you’re an accountant firm and that’s clearly income, you’ll be taxed an income rate, you won’t be taxed at a pass-through rate,” Mnuchin said. “If you’re a business that’s creating manufacturing jobs, you’re going to get the benefit of that rate because that’s going to be passed through to help create jobs and better wages.”*

# Nuances of the Plan

(Tax Policy Considerations)

**Supposition: Income from Wages**  
should be taxed at substantially  
higher rates than **Income from**  
**Capital Sources**



10/16/2017

Supposition defined: “*an uncertain belief.*”

With capital gains already preferred, this adds to the comparative tax cost of wage income versus capital sourced income.

**By one estimate 60% of upper middle class taxpayers would see an increase in their taxes.**

Tax benefits given to income from capital sources versus wage income:

- No Payroll taxes
- Lower Capital Gain Tax Rates
- Flow through Entities (if passed)

### *Memorable Quotes*

*"The biggest share of people with increased taxes will be ... people who might be considered **upper-middle-income people**, high-income professionals, people whose income is between **\$150,000 and \$300,000** in a year in 2017"*

Tax Policy Center

**United Framework for Fixing our Broken Tax Code**  
**(Business Tax Changes)**

*“The framework allows businesses to **immediately write off** (or “expense”) the cost of new investments in **depreciable assets other than structures** made after **September 27, 2017**, for at least **five years.**”*

10/16/2017

Business owners should be careful about relying upon the Plan to make new capital expenditures, because:

**The proposed Plan may never be adopted.**

**The effective date could be changed.**

**The amount of the deduction could be reduced to reduce the budget impact.**

**The detailed requirements of the deduction may make the expenditure less than acceptable to business owners.**



\*

**United Framework for Fixing our Broken Tax Code**  
**(Business Tax Changes)**

*“The deduction for net interest expense incurred by **C corporations** will be partially limited.*

*The committees will consider the appropriate treatment of interest paid by non-corporate taxpayers.”*

10/16/2017

**Issue:** loss of deductions for highly leveraged businesses and individuals. The individual mortgage interest deduction may be limited further.

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**United Framework for Fixing our Broken Tax Code**  
**(Business Tax Changes)**

*“Because of the framework’s substantial rate reduction for all businesses, the current-law domestic production (“section 199”) deduction will no longer be necessary.*

*Domestic manufacturers will see the lowest marginal rates in almost 80 years. In addition, numerous other special exclusions and deductions will be repealed or restricted.”*

10/16/2017

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**United Framework for Fixing our Broken Tax Code**  
**(Potential Tax Changes)**

**Other Potential Changes to the Tax Code**

**Limits on Like-Kind Exchanges**  
**Eliminate or Limit Stretch IRAs**  
**Tighten Residential Interest Deductions**  
**Restrict Carrybacks of Net Operating Losses**

10/16/2017

These are tax changes that have been discussed in various media and tax sources.

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**United Framework for Fixing our Broken Tax Code**  
**(Business Tax Changes)**

*“The framework explicitly preserves business credits in two areas where tax incentives have proven to be effective in promoting policy goals important in the American economy: **research and development (R&D) and low-income housing**. While the framework envisions repeal of other business credits, the committees may decide to retain some other business credits to the extent budgetary limitations allow.”*

10/16/2017

The Plan: *“Special tax regimes exist to govern the tax treatment of certain industries and sectors. The framework will modernize these rules to ensure that the tax code better reflects economic reality and that such rules provide little opportunity for tax avoidance.”*

**Query: Does this mean that everything else is on the negotiating table?**



**United Framework for Fixing our Broken Tax Code**  
**(Business Tax Changes)**

*“It will replace the existing, outdated worldwide tax system with a **100% exemption for dividends from foreign subsidiaries** (in which the U.S. parent owns at least a 10% stake).”*

*“To transition to this new system, the framework treats foreign earnings that have accumulated overseas under the old system as repatriated.”*

10/16/2017

**United Framework for Fixing our Broken Tax Code**  
**(Inflation Adjustments)**

*“The framework also envisions  
the use of a more **accurate**  
**measure of inflation** for purposes  
of indexing the tax brackets and  
other tax parameters”*

**MEMORABLE QUOTES**

*“If Patrick Henry thought that taxation without representation was bad, he should see how bad it is with representation.”*

The Old Farmers Almanac

10/16/2017



# **Transfer Tax Reform**



## Tax Facts

- ✓ Only **0.2%** of all Decedents are subject to a Federal Estate Tax (4,918 estates in 2015)
- ✓ Annual Revenue Impact of **\$17-19 billion** – less than 1% of total Federal Revenue
- ✓ There has been a reduction in Federal Income Taxes as a result of Higher Basis Adjustments at Death
- ✓ For the Fiscal Year ending September 2012, the Audit rate for estate over \$10 million was **116%**

Wall Street Journal October 6, 2017: “In 2008, 0.7% of the deceased had taxable estates; in 2000, 2.2% did.”

“In 2015, More than a third was raised from the richest of the rich—the 266 estates valued at \$50 million or more brought in \$7.4 billion to the Treasury.”

# Looming Inheritances

A 2003 Boston College report (that updated a 1999 report) projected that the largest intergenerational wealth transfer in history would occur by the year 2052, with a total transfer of approximately

**\$41 trillion**



10/16/2017

## *Memorable Quotes*

**In 1906 Theodore Roosevelt called for an Estate Tax as a “*progressive tax on all fortunes beyond a certain amount .... a tax so framed as to put it out of the power of the owner of one of these enormous fortunes to hand on more ...to any one individual.*”**

Transfer Taxes have largely become a “***SOCIETAL TAX***” designed to limit the accumulation of Wealth across generations. It provides a nominal part of the total federal revenue base.

## **Federal Taxes on Legacies have been Enacted Five Times**

**1797-1802 to fund a Naval Buildup**

**1862-1870 to Fund the Civil War**

**1894-1895 an Income Tax on Gifts and  
Inheritances**

**1898-1902 to fund the Spanish American War**

**1916-present**

10/16/2017

Federal Estate Taxes have historically been enacted to pay for the **cost of wars** and then are eliminated – except the Estate Tax created in 1916 during WWI.



**Federal GST Taxes have been  
Enacted Twice**

**The Tax Reform Act of 1976**

**The Tax Reform Act of 1986  
retroactively repealed the 1976  
GST Rules and enacted the  
Current GST Rules**

10/16/2017

Historic Context: The 1976 GST Tax rules were virtually **incomprehensible** and was largely **ignored** by the IRS and tax practitioners.

\*

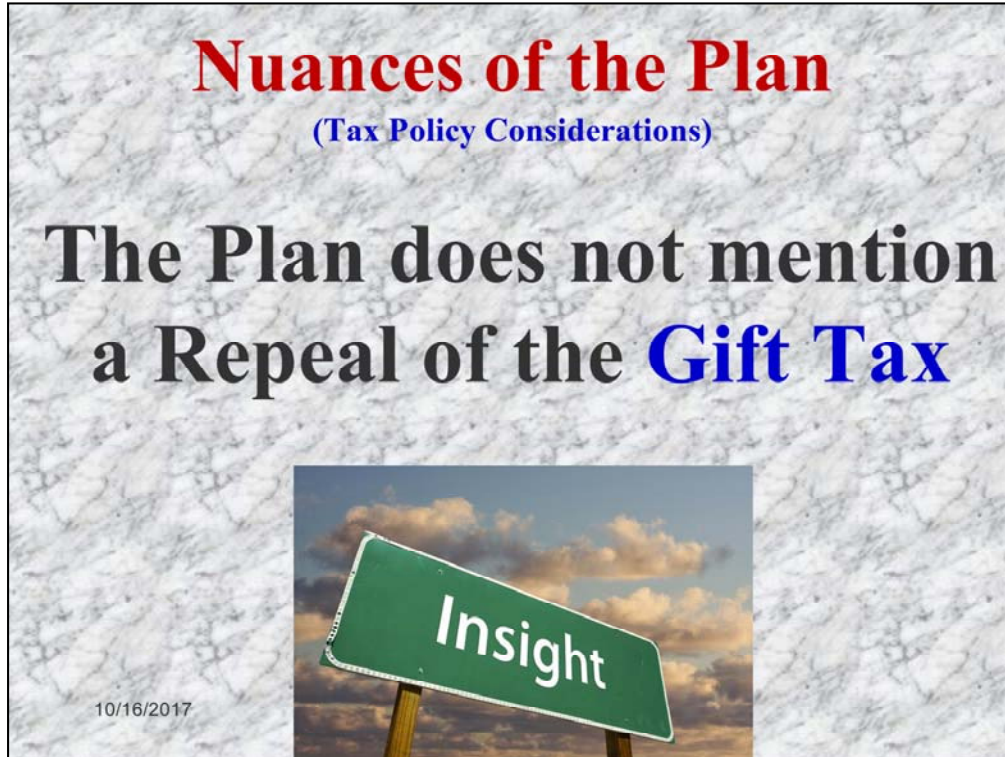


Rumors persisted in the weeks leading up to the issuance of the Plan that the White House in its overtures to Democrats was willing to drop a repeal of the estate and GST tax – but that could create problems with Republican support in the House.

Wall Street Journal October 6, 2017: *“Estate tax repeal would reduce federal revenue by about \$239 billion over the next decade, according to the Tax Policy Center.”*

Even the Republicans are fighting over whether to repeal the Estate Tax: See Wall Street Journal, October 5, 2017: *“Senate GOP Hits Resistance on Estate-Tax Repeal—From Republicans.”*

\*



The Plan, the House Plan and the Trump Plan did not mention any Elimination of the Gift Tax.

Possible Exemption Alternatives:

- No Gift Tax?
- \$1,000,000 exemption,
- \$5,490,000 exemption plus a inflation adjustment, or
- Something in-between?

**Query: Are there modifications in the gift tax rate (currently 40%)?**

**Query: Does tax reform retain the inflation increase in the Gift Tax exemption?**



Restoration of the Estate Tax and GST Tax will occur either:

- Automatically at the end of the reconciliation period provided for in the Congressional reconciliation bill (probably 10 years)
  - Remember that the reconciliation bill is essential to eliminate any filibuster in the Senate, but provides a limited life for any bill enacted under those rules.
- Or earlier, if the Democrats gain control of Congress and the White House.

Historic Context: In 2001, Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) which included significant phased-in increases in the federal estate, gift and generation skipping tax exemptions and lower transfer tax rates. Because the bill was adopted under the reconciliation rules, it was due to automatically expire on January 1, 2011. Section 901(b) of EGTRRA reads: “*The Internal Revenue Code of 1986... shall be applied and administered to years, estates, gifts and transfers described in subsection (a) [i.e., after 2010] as if the provisions and amendments described in section (a) **had never been enacted.***”

**Critical Point: There is NO assurance that the exemptions and tax rates under any restored Estate and GST taxes will reflect the current high**




**exemptions and historically low tax rates.**

\*

**Prediction**

**Estate Tax Repeal  
will cause  
Increased Audits  
of Trust & Estate  
Income Taxes**



10/16/2017

The image features a woman in traditional attire, possibly a fortune teller, looking into a glowing crystal ball. The background is a textured, light-colored surface. The text is prominently displayed in the center, with 'Prediction' in red and the main message in blue and black. A date '10/16/2017' is visible in the bottom left corner of the image area.

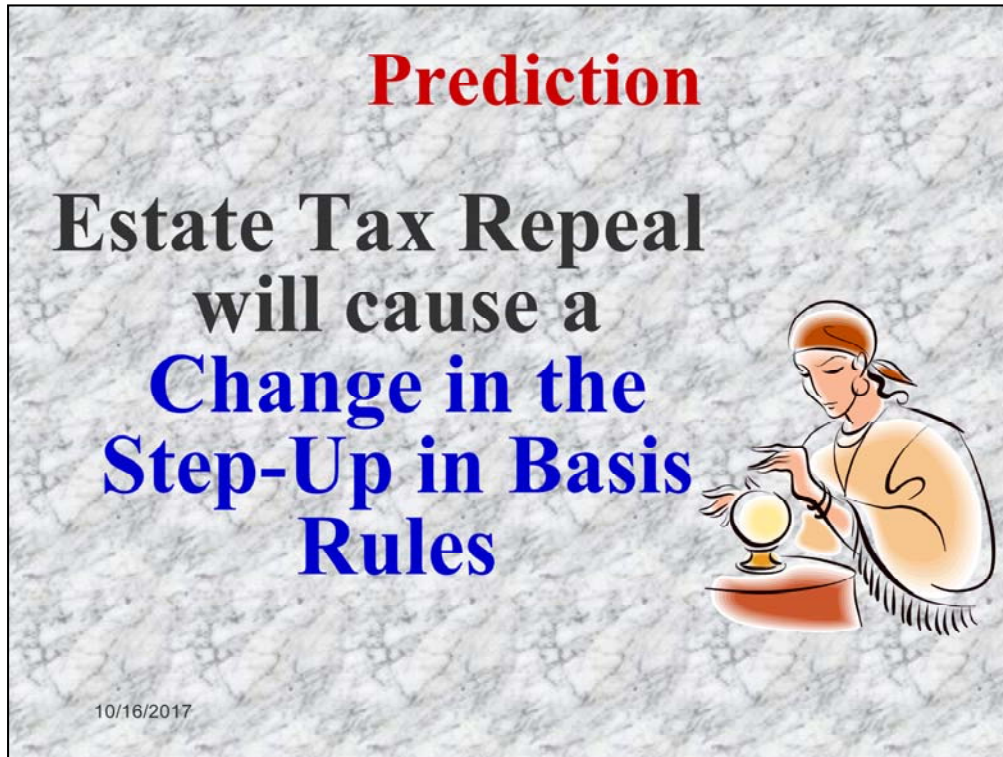
A movement of IRS estate and trust auditors from Transfer Taxes to Income Taxation of Trusts and Estates

**Audience Question:** Have any of you seen a stand-alone (i.e., not part of another audit, such as the audit of the grantor's personal income tax return) audit of a Trust or Estate income tax return?

*(Author's note: I have been asking this question of audiences for 3 years and so far only 4 hands have gone up).*

\*

##



#### **Reasons for Eliminating the Step-up in Basis rules:**

- **Rationale for Step up to FMV is gone** when the estate tax is gone
- **Additional revenue** to offset tax reform revenue losses – heirs tend to sell inherited assets quickly and the dead don't tend to complain
- The impact of high exemptions on tax basis and the resulting **loss of income tax revenue** from lower capital gains and higher depreciation of assets
- **Inherited Family farms and businesses** are not subject to a “death tax” until the business/farm is sold.

**Counter-Argument:** The complexity of calculating the tax basis of a long-owned asset. The Tax Reform Act of 1976 included a new Code section 1023 which eliminated the fair market value basis at a taxpayer's death and replaced it with a modified carryover basis. The Revenue Act of 1978 postponed the application of 1023 for three years. Congress considered making significant changes to section 1023, but ultimately decided the implementation of the statute was too complex. The Crude Oil Windfall Profit Tax Act of 1980 retroactively repealed the carryover basis rules to the date of original enactment (October 4, 1976). See the Joint Committee's General Explanation of the Crude Oil Windfall Profit Tax Act of 1980. At page 120, the explanation says: “*Congress believed that the carryover basis provisions are unduly complicated and should be repealed.*”

**Query:** What happens when you cannot determine the basis of an inherited asset?

Interestingly, the elimination of the current step-up in basis and replacement with some form of a carryover in basis plan, could raise significantly more taxes than the \$17-19 billion per year that is currently generated by transfer taxes – thus helping to balance the books.

New York Times (Sept 22, 2017): ***“The Congressional Budget Office estimates that the exclusion [the step-up in tax basis] will cost the Treasury \$644 billion from 2014 to 2023.”***



*Memorable Quotes*

*“The purpose of the stepped-up basis rule was to avoid double taxation.”*

Congressional Research Service, 2003

## **Impact of Potential Changes**

### **IF ESTATE TAXES ARE REPEALED:**

- **Step-up at Death – moderate likelihood**
- **Carryover Basis – low likelihood**
- **Modified Carryover Basis – Probable**
  - **Use of the 2010 Modified Carryover Rules (§1022)?**
  - **Special Exemptions for Family Businesses?**
  - **Note: Even with a carryover tax basis, family businesses and farms would effectively avoid a tax until the business/farm is sold**

There have been speculation that the elimination of a step-up in tax basis might only occur once the value of the assets in the estate exceeded the current estate tax exemption amounts.

In 2010, Code section 1022 permitted a basis step-up of up to \$1.3 million applicable to non-spousal transfers and an additional basis adjustment of up to \$3.0 million for qualified spousal transfers. Would a similar approach work in new legislation?

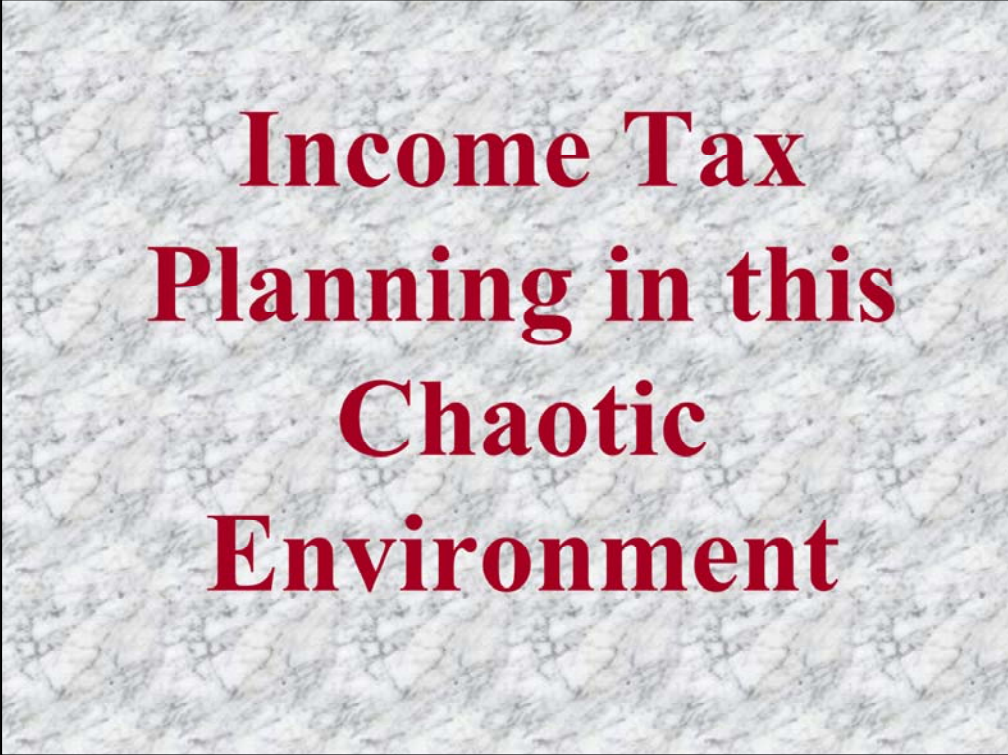
Final section 1022 regulations were issued effective as of January 19, 2017.

*Memorable Quotes*

*“Tax reform is  
absolutely, totally,  
completely impossible,  
until 15 minutes before  
it happens.”*

Ron Wyden, Democratic Chairman of the Senate Finance Committee, as  
reported in the New York Times, November 7, 2014

10/16/2017

A square area with a marbled, stone-like background in shades of grey and white. The text is centered within this area.

**Income Tax  
Planning in this  
Chaotic  
Environment**



## **PLANNING OPPORTUNITY**

**Year End Income Tax Planning**

**Defer Income into 2018** (examples)

- ✓ **Push Sale Transactions into 2018**
- ✓ **Defer Fiduciary Fees?**
- ✓ **Estates: consider a 2018 Year End**

**Always do the Math (e.g., AMT)**

**Note:** Deferring fiduciary fees could increase the taxes on the estate/trust and/or the taxes to beneficiaries.

# **PLANNING OPPORTUNITY**

**Year End Income Tax Planning**

## **Accelerate Deductions**

- ✓ **Increase Itemized Deductions in 2017**
  - ✓ **Charitable Deductions (to DAFs?)**
  - ✓ **State & Local Taxes**

**Always do the Math (e.g., AMT)**

Normally you cannot accelerate medical expenses and tax a deduction in the year of payment. But there is an exception. The entrance fee to a “life-care” facility could be deductible in 2017 even if the person doesn’t enter the facility until 2018. This is a complex area and clients should not take this action without first running the numbers (e.g., the itemized deduction limitation for medical expenses) and seeking competent tax advice.


“DAF” stands for Donor Advised Fund

The background of the slide is a square with a marbled pattern in shades of grey, white, and light brown. The text is centered within this square.

**Estate Planning  
in this Chaotic  
Environment**

## **Predictions**

- ✓ **More Estate Planning Work**
- ✓ **More Income Tax & Basis Planning**
- ✓ **More Use of GST Trusts**
- ✓ **Planning becomes more Personal**



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**Query:** Would GST trusts created during this gap period (i.e., from repeal to reinstatement of GST taxes) be exempt as “grandfathered” trusts?



## Planning as We Wait for new Rules

- ✓ Flexible Powers of Attorney
- ✓ Flexible Dispositive Documents
- ✓ Medical Directives in Place
- ✓ Plan for Repeal and Reinstatement of the Estate Tax as a Contingency

It may be a bit macabre, but do you advise family of wealthy clients to try and **KEEP THE WEALTHY CLIENT ALIVE INTO 2018?** There have been suggestions that it happened at the end of 2009 because of the one year (2010) elimination of estate taxes.

Example: Sumner Redstone? Estimated estate = \$5.0 billion at 40% a tax savings of \$2.0 billion.

**Problem:** The lack of information on the final tax bill and its effective dates

## **Planning as We Wait for new Rules**

- ✓ **Continue to File Estate Tax Returns for Portability**
- ✓ **Keep Life Insurance in Place**
- ✓ **Consider Gifts that don't Impact the Transfer Tax Exemptions**

## **Probable Long Term Planning**

(Expect the return of Estate Taxes)

### **Planning for Affluent Clients**

- ✓ **Greater use of Lifetime Gifts –  
Using By-Pass Trusts**
- ✓ **Greater use of Sales to Defective  
Grantor Trusts**
- ✓ **Generation Skipping Trusts**
- ✓ **Move Appreciating Assets out of  
Taxable Estate**

**Query:** Will GST trusts created in this gap period be **grandfathered** from any restoration of the GST Tax?

# **Probable Long Term Planning**

(Expect the return of Estate Taxes)

## **Benefits of Trusts**

- ✓ **Discretionary “Spray” Trusts**
  - ✓ **Asset Protection**
  - ✓ **Income Shifting**
- ✓ **Use of Defective Trusts for Income Tax Planning**
  - ✓ **Asset & Divorce Protection**



## **Probable Long Term Planning**

**(Tax Basis and Income Tax Planning)**

- ✓ **Strategies designed to:**
  - ✓ **Reduce Income Taxes**
  - ✓ **Increase the Tax Basis**
- ✓ **Drafting Documents to Equalize Estates on a Expected Net-After-Tax Value (i.e., taking account of the Tax Basis of Assets)**

**Prediction:** If there the step in basis rules are replaced with a modified carryover tax basis, it will create **significant conflicts** over how the carryover tax basis is applied to the inherited assets (i.e., which heir(s) get the benefit of the tax basis adjustments?)

**A THOUGHT TO REMEMBER**

According to Benjamin Franklin, only **death**  
and **taxes** are inevitable.

So live your life **accordingly**.



10/16/2017