Tax Reform Moves to Next Stage

Release of reform framework bring tax debate to the forefront

President Trump and Congressional Republicans took the next step in trying to enact a series of tax reforms by releasing their latest summary of proposed changes, titled "Unified Framework for Fixing Our Broken Tax Code". This framework, which can be found at fairandsimple.gop, is very similar to what was previously released in May and was championed by the President during the 2016 campaign. It's also a long way from a final bill, and instead represents a template to be used by the various tax-writing committees in Washington to ultimately craft the detailed legislation that will become our tax code.

Consistent with prior announcements around tax reform, this plan can be summarized as a combination of lower tax rates and fewer deductions, exemptions and credits. One of the stated goals of this framework is to allow American workers to keep more of their income by reducing their tax burden. However, the President has said that higher-income taxpayers should not expect much of a cut at all, and may even end up paying more.

Below are some of the key points of this tax reform framework. The effective date of most provisions was not addressed in the framework, so it's unknown if these changes are expected to be retroactive to the beginning of 2017 or not take effect until 2018.

Individual Tax Changes

The framework document repeated the President's goals of making tax reporting as simple as completing a postcard-size form, providing tax relief for middle-class families and maintaining a progressive tax system, all while also broadening the overall tax base. The strategies to achieve those goals include the following:

- The current system of seven different tax brackets would be reduced to just three – 12%, 25% and 35%. This is a slight change from previous announcements that had quoted a bottom tax bracket of 10%, like we have today. The framework left open the possibility of an additional top rate for the highest-income taxpayers in order to avoid shifting the overall tax burden from high-income taxpayers to those with less income. This could become an important negotiating point between Republicans and Democrats.
- To offset these rate reductions, all itemized deductions would be eliminated with the exception of mortgage interest and charitable contributions. This means that medical expenses, state income taxes, property taxes and other expenses would no longer be deductible.
- The current standard deduction would be nearly doubled. The amount for married couples would increase from $12,700 to $24,000. For single taxpayers it would increase from $6,350 to $12,000.
- On the other hand, personal exemptions would be eliminated, along with the additional standard deduction amount for those age 65 or older or who are blind.

- The Child Tax Credit would be significantly increased, although we don't know to what level, and the income level at which the credit is phased out would be greatly increased, making the credit available to more taxpayers.
- A new $500 tax credit would be available for those caring for non-child dependents.
- The Alternative Minimum Tax would be repealed, although the impact on remaining AMT credits is unknown.
- The framework would retain the tax benefits for higher education and retirement savings.
- The estate tax and generation-skipping tax would be repealed, although there was no mention of the gift tax or the current basis adjustment rules for assets held at death.

Business Tax Changes

President Trump has long advocated a 15% tax rate for businesses, including pass-through entities such as sole proprietorships, partnerships and S Corporations. While this framework backs off that amount somewhat, tax cuts on businesses are a primary pillar of this reform plan.

- The tax rate on C Corporations would be reduced from effectively 35% to a flat 20%, and the corporate AMT would be repealed.
- The tax rate on pass-through entities would be reduced to 25%. The tax committees were instructed to adopt measures that would prevent abuse of this lower tax rate by those looking to convert personal income to business income.
- Business would be allowed to immediately deduct the cost of any investments in depreciable property made after September 27, 2017.
- The current deduction for interest expense by C Corporations would be limited, and other deductions and special exclusions would be repealed or restricted.
- US companies would no longer have to pay tax on income earned overseas, even when that income is repatriated back to the US. However, accumulated foreign earnings currently sitting overseas would be subject to tax, albeit possibly at a lower rate and spread over multiple years.

Planning Strategies

With the effective date of these changes uncertain, not to mention the uncertainty of them becoming law at all, tax planning for the rest of 2017 is complicated. The general rule of thumb on tax planning – delay income, accelerate deductions – likely continues to hold here. That's especially true if these changes are enacted but aren't effective until next year.

One thing to watch closely is the possibility of most itemized deductions being eliminated. If that appears likely to happen, effective in 2018, taxpayers should accelerate as many deductible expenses into 2017 as possible. Charitable contributions would be the exception as those would still be deductible in 2018, but only for those over the new larger standard deduction amount.

As always, though, any tax strategy should be evaluated based on each taxpayer's own personal situation, and by preparing a multi-year analysis to see the true impact of moving items between tax years.

Robert W. Baird & Co. 777 East Wisconsin Avenue, Milwaukee, Wisconsin 53202. 1-800-RW-BAIRD. www.rwbaird.com
First Use: 9/2017.