McDonald & Kanyuk PLLC
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CLIENT ALERT

Preliminary Observations on the Prospects for Post-Election Tax Reforms and the Implications for Our Clients

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The election of Donald Trump as President, and the Republicans' control of Congress, creates a strong likelihood of significant changes to the Internal Revenue Code. It is too early to predict what will happen. Some information about possible reforms is, however, available on President-elect Trump's website. Some of the proposed changes, and our preliminary observations on what our clients might do (or not do) now to plan in this uncertain environment, are described in this Newsletter. We will follow this up with something more definitive when we get more concrete information, which we anticipate happening some time during the first quarter of 2017.

Federal Estate, Gift and Generation-Skipping Transfer Taxes

The Trump website proposes that the federal estate tax would be repealed. Current law now allows a fair market value basis "step-up" on death of all appreciated capital assets owned by a deceased taxpayer. The Trump reforms would eliminate that benefit and impose a capital gains tax at death on appreciated assets over $10 million, with an exemption for small businesses and family farms. No guidance is provided for what constitutes a small business or a family farm, and no detail is provided as to whether the $10 million is based on the value of assets or the amount of previously untaxed capital gain. In the case of married couples, there is no indication whether the tax would be imposed at the first spouse's death or deferred until the second spouse's death – something prior proposals for similar reforms provided to protect the financial security of a surviving spouse.

No information is provided on whether the gift and generation-skipping transfer taxes would also be repealed. However, in order to prevent avoidance of the capital gains tax at death, either some form of tax on lifetime gifts of appreciated assets would have to be imposed, or such gifts would have to trigger the capital gains tax. Many commentators believe that the capital gains at death proposals are borrowed from the Canadian experience when that country eliminated its estate taxes and substituted a capital gains tax at death regime. Canada now allows a blanket exemption for transfers of appreciated capital assets to the decedent's spouse, and imposes the capital gains tax on gifts of appreciated property.

If some or all of these proposals become law, we will be recommending substantial changes to the tax-driven provisions of our clients' estate planning documents. New strategies may be available to deal with the changes in the capital gains rules. We will follow-up this Newsletter with specific recommendations once we have a better idea of what will happen.

<u>What Estate-Planning Related Actions Should You Consider Now?</u>

Earlier this fall, we sent our clients a Newsletter describing the Treasury Department's publication of proposed regulations that would significantly restrict gift and estate tax valuation discounts for intrafamily transfers of business interests and other assets. Many of our clients were contemplating asset transfers in anticipation of a divided government after the election, no gift or estate tax repeal, and the issuance of the final "§2704 regulations" that many feared could become effective as early as next January. Given the surprising election results and the uncertainty about the fate of the wealth transfer tax system and possible capital gains tax reforms after Trump's inauguration, and in light of recent indications from IRS personnel indicating a rapidly diminishing likelihood that the §2704 regulations will become effective anytime soon, we recommend that you call us to discuss any pending or contemplated intrafamily transfers. There is a good chance that the wealth transfer tax elimination and any capital gains tax at death reforms will be phased-in over a transition period (*e.g.*, 10 years). Some intrafamily sales and gifts of discounted assets, particularly those involving flexibly-designed irrevocable trusts established by one spouse to a marriage, may still make sense depending on specific goals. This may be particularly true for clients who reside or own significant real estate in a state other than New Hampshire that imposes an estate tax, or there is a strong possibility that death might occur before any gift and estate tax repeal becomes law.

<u>Income Taxes</u>

The President-elect's website also contains some information on his plan for income taxes. He would seek to reduce the highest marginal income tax rate on individuals to 33%, from its current 39.6 % rate. Married couples filing a joint return would pay this rate on their taxable income in excess of $225,000, and unmarried individuals would pay this rate on their taxable income in excess of $112,500.

The proposals would retain the current capital gains tax rate of 20% and repeal both the 3.8% Medicare tax on net investment income and the alternative minimum tax. Itemized deductions would be capped at $200,000 for married couples filing joint returns, and $100,000 for unmarried individuals. Tax subsidies would be provided for childcare and eldercare.

These proposals would give the lion's share of the benefits of individual income tax reduction to the wealthy. Citizens for Tax Justice projects that 44% of those benefits will go to the top 1% of income earners, and 68% will go to the top 5%.

The corporate income tax rate would be reduced to 15% from its current level of 35%. The corporate alternative minimum tax would be eliminated. Although most business deductions would be eliminated, manufacturing businesses located in the United States would also be able to elect to deduct all of their capital expenditures in the year incurred in exchange for giving up the interest deduction on their indebtedness.

The website actually refers to the "business tax rate" being reduced to 15%, for "all businesses, both small and large, that want to retain profits within the business." This may mean that S corporations and partnerships (including limited liability companies treated as S corporations or partnerships for federal income tax purposes) could elect to retain profits and pay only the 15% tax. Presumably the owners of those entities would not be taxed until the retained profits were distributed. We will watch this carefully, as most of our small business-owner clients operate their businesses as LLCs or S corporations.

It will be interesting to see whether some or all of these proposals find their way into legislation, and the details when they emerge. We expect that some or all of the proposals will be priorities that will be pushed during the much-anticipated first 100 days of the Trump presidency. We will of course continue to keep you posted on all tax-related developments that might affect your planning. Feel free to call your McDonald & Kanyuk, PLLC contact at (603) 228-9900 with any questions that you may have in the interim.

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