2016 CANDIDATE AND PARTY TAX REFORM PLAN UPDATE

Details of the Tax Reform Plans

Suzanne L. Shier,
Wealth Planning Practice Executive and Chief Tax Strategist/Tax Counsel

Benjamin Lavin
Wealth Planner & Associate Tax Strategist

September 2016

As we have witnessed throughout the 2015-2016 Presidential campaign season and at the first presidential debate on September 26, 2016, tax policy and tax reform are major issues that will challenge the incoming President and new Congress no matter which candidate eventually moves into the Oval Office. Only time will tell how this process will evolve. In this *Wealth Planning Tax Update*, we will summarize the key issues of the tax reform plan proposed by Republican presidential candidate Donald Trump and vice presidential candidate Mike Pence; the tax reform blueprint presented by Speaker Paul Ryan and the House Republican GOP; and provide an update on the New Democratic Tax Plan. As always, we will continue to advise you as substantive developments occur.

UPDATE TO THE NEW DEMOCRATIC TAX PLAN

After the conclusion of the Democratic National Convention, we released a *Wealth Planning Tax Update* detailing the proposals of the New Democratic Tax Plan. In recent days, the Democratic presidential nominee tweaked her proposed changes to the federal estate tax. In addition to raising the estate tax rate from the current 40% to 45% and reducing the estate tax exclusion from $5.45 million to $3.5 million, the nominee proposes a progressive estate tax rate system, with rates upwards of 65% for estates valued at over $1 billion per couple. Additionally, the new plan proposes to tax accumulated capital gains at death by treating death as a realization event. For an in-depth review of the tax reform proposals, please see the *Wealth Planning Tax Update: The New Democratic Tax Plan* at Northerntrust.com/insights-research.

THE TRUMP TAX PLAN 2.0

Republican presidential candidate Donald Trump announced a revised version of his tax reform plan – "Tax Reform That Will Make America Great Again"[1] – that makes significant changes to his initial plan released in 2015. The Trump Tax Plan 2.0 would reduce marginal income tax rates for all individuals and businesses, impose a cap on itemized deductions, repeal the individual and corporate alternative minimum taxes (the "AMT") and repeal the federal "death tax." However, as detailed below, ambiguities still remain especially with regard to business income taxation. The following summarizes select proposed changes by the Trump Tax Plan 2.0:

Individual Income Tax Proposals

- Collapses the current seven ordinary income tax brackets into three brackets of 12%, 25% and 33%, maintaining the current capital gains tax rates of 0%, 15% and 20%.

Trump Tax Plan 2.0: Individual Income Tax Brackets

Ordinary Income Tax Rate	Capital Gains Tax Rate	Single Filers	Married Joint Filers
12%	0%	$0 to $37,500	$0 to $75,000
25%	15%	$37,500 to $112,500	$75,000 to $225,000
33%	20%	$112,500 +	$225,000 +

- Increases the standard deduction from $6,300 to $15,000 for single filers and from $12,600 to $30,000 for married couples filing jointly, eliminating personal exemptions.
- Caps itemized deductions at $100,000 for single filers and $200,000 for married joint filers.
- Repeals the individual AMT and the 3.8% net investment income tax.
- Taxes carried interest as ordinary income.

Transfer Tax Proposals

- Repeals the "death tax," which we interpret to mean the federal gift, estate and generation-skipping transfer taxes.
- Taxes capital gains held until death with the first $10 million tax-free as under current law to exempt small businesses and family farms. The plan does not state whether the $10 million exemption is applied per couple ($5 million per individual).
    - This provision could be interpreted as either (1) taxing capital gains at death by treating death as a realization event like a taxable sale, or (2) establishing a carryover basis on those gains, taxing beneficiaries on the gains when they dispose of the inherited property at a future time. Although this is unclear, establishing a carryover basis regime seems more consistent with Mr. Trump's intent to repeal the "death tax." This was also the regime that applied during the one-year repeal of the federal estate tax in 2010.
- Disallows contributions of appreciated assets into a private charity established by the decedent or the decedent's relatives with the stated purpose of preventing abuse.

Business and International Tax Proposals

- Reduces the corporate income tax rate from 35% to 15%, with the reduced tax rate "available to all businesses, both big and small, that want to retain the profits within the business."[2] It is unclear whether to interpret this to mean that the 15% tax rate would apply to all business income or only to businesses that are organized as C corporations, with the ordinary individual tax rates applying to the income of pass-through businesses, such as partnerships and S corporations.
    - If the 15% rate were to apply only to C corporations, there would be potential to try to game the rate differential, but don't forget that a distribution from a C corporation would be taxed a second time as a dividend at the proposed 20% tax rate, for an effective tax rate of 32%. Alternatively, if the 15% rate applies to all business income, pass-through businesses would benefit significantly, as its income would only be subject to one level of tax at the 15% rate.
- Eliminates most corporate tax expenditures except for the Research and Development credit.
- Imposes a one-time 10% deemed repatriation tax on corporate profits held offshore, ending the deferral of tax on profits held offshore, which under current law are not subject to U.S. tax until they are repatriated.

HOUSE GOP TAX PLAN

Republican leaders of Congress have also chimed in on tax reform, releasing a consensus blueprint for comprehensive pro-growth tax reform announced on June 24, 2016 by Speaker

Paul Ryan (the "House GOP Tax Plan"). The House GOP Tax Plan would overhaul major components of the current tax code, lowering taxes across the board for individuals and businesses. The key details of the House GOP Tax Plan are summarized below:

Individual Income Tax Proposals

- Consolidates the current seven tax brackets into three brackets with rates of 12%, 25% and 33%, replacing the current capital gains tax rates with a 50% income tax deduction for net capital gains, dividends and interest income (currently subject to ordinary income tax rates), resulting in equivalent reduced capital gains tax rates of 6%, 12.5% and 16.5%.
- Increases the standard deduction from $6,300 to $12,000 for single filers and from $12,600 to $24,000 for married couples filing jointly.

House GOP Tax Plan: Individual Income Tax Brackets

Ordinary Income Tax Rate	Capital Gains Tax Rate Equivalent	Single Filers	Married Joint Filers
12%	6%	$0 to $37,650	$0 to $75,300
25%	12.5%	$37,650 to $190,150	$75,300 to $231,450
33%	16.5%	$190,150 +	$231,450 +

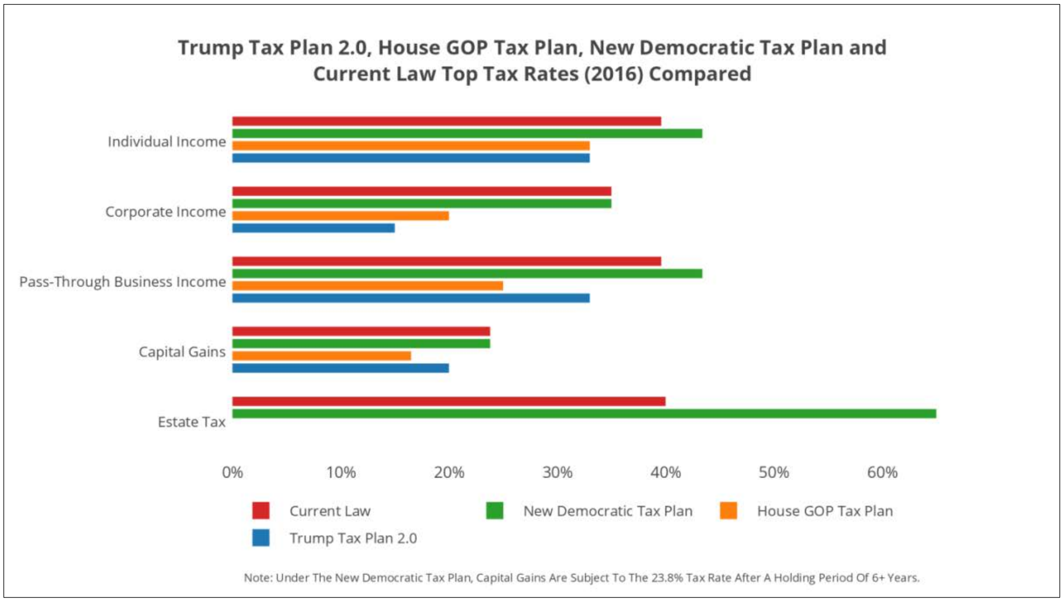
- Eliminates the personal exemption and all itemized deductions except for the mortgage interest deduction and the charitable contribution deduction.
- Eliminates the 3.8% net investment income tax, the additional 0.9% payroll tax, the medical device tax, the health insurance tax and the individual AMT.

Transfer Tax Proposals

- Repeals the gift, estate tax and the generation-skipping transfer taxes, establishing in their place a carryover basis for appreciated property, subjecting beneficiaries to income tax on the gains when the property is disposed of by the beneficiaries at a future time.

Business and International Tax Proposals

- Reduces the corporate income tax rate from 35% to a flat rate of 20%, eliminating the corporate AMT.
- Taxes income of sole proprietorships and pass-through businesses at a maximum rate of 25%.
- Allows the cost of capital investment to be fully and immediately deductible, eliminating the net interest expense income tax deduction.
- Allows net operating losses to be carried forward indefinitely and increased for inflation, but disallows net operating losses to be carried back.
- Moves from a worldwide tax system to a fully territorial tax system, exempting 100% of dividends from foreign subsidiaries from U.S. tax.
- Enacts a deemed repatriation of currently deferred foreign profits, at a tax rate of 8.75% for cash and cash-equivalent profits and 3.5% on other profits, payable over an eight-year period.



ESTIMATED REVENUE IMPACT (in billions)[3]

Tax	Static Revenue Impact (2016-2025)		Dynamic Revenue Impact (2016-2025)	
	Trump Tax Plan 2.0	**House GOP Tax Plan**	**Trump Tax Plan 2.0**	**House GOP Tax Plan**
Individual Income Taxes	-$2,192	-$981	-$1,058	$566
Payroll Taxes	$0	$0	$520	$683
Corporate Income Taxes	-$1,936	-$1,197	-$1,958	-$1,324
Gift and Estate Taxes	-$240	-$240	-$240	-$240
Other Revenue	$0	$0	$96	$68
TOTAL	**-$4,368**	**-$2,418**	**-$2,640**	**-$191**

CONCLUSION

Although not unified around a single plan, the revamped Trump Tax Plan 2.0 and the House GOP Tax Plan are moving in the same direction: lower tax rates with a broader tax base and repeal of the gift, estate and generation-skipping transfer taxes. The Trump campaign and Republican Party leaders will continue work on developing a comprehensive “Tax Reform That Will Make America Great Again.” What will happen come November 8 is uncertain. What is certain, however, is that the outcome of the 2016 Presidential and Congressional elections will affect the prospects for tax reform come 2017. As always, we will continue to keep you informed of any substantive developments.

FOR MORE INFORMATION

As a premier financial firm, Northern Trust specializes in life-driven wealth management backed by innovative technology and a strong fiduciary heritage. For over 125 years we have remained true to the same key principles – service, expertise and integrity – that continue to guide us today. Our Wealth Planning Advisory Services team leverages our collective experience to provide financial planning, family education and governance, philanthropic advisory services, business owner services, tax strategy and wealth transfer services to our clients. It is our privilege to put our expertise and resources to work for you.

If you'd like to learn more, contact a Northern Trust professional at a location near you or visit us at northerntrust.com.

[1] "Tax Reform That Will Make America Great Again," https://www.donaldjtrump.com/positions/tax-reform, (Sept. 23, 2016).

[2] Id.

[3] Tax Foundation, Details and Analysis of the Donald Trump Tax Reform Plan, September 2016 (Sept. 19, 2016); Tax Foundation, Details and Analysis of the 2016 House Republican Tax Reform Plan (July 5, 2016).