

## Proposed 2018 Tax Reform

As you have probably read, the Trump Administration has released its proposed framework for sweeping tax reform. While we applaud most of the basic parameters, we do not believe they will be approved by Congress. Keep in mind that the last time there was significant tax reform, Ronald Reagan was in the White House.

The proposal lacks important details, but we know it includes the elimination of Estate Taxes and the Alternative Minimum Tax, a compression to only three tax brackets, reduction in corporate taxes, elimination of many individual deductions, and changes in the way small business owners are currently taxed. There are winners and losers in the proposal, and tax cuts must be offset with a corresponding reduction in federal spending.

Eliminating the Estate Tax would benefit a small number of Americans, and it only raises \$20 billion in annual tax revenue. This is due to the higher exemptions for estates. However, eliminating the tax would not be popular in the current political environment, and an increase in the current estate exemption (instead of an elimination of estate taxes) would be the most favorable outcome.

Eliminating the Alternative Minimum Tax would have wide support as more Americans have fallen into this trap. However, some of the benefit would be reduced as certain deductions would be eliminated, including state and local taxes. Residents in states that have high state income taxes (California, New York, etc.), but who are not affected by AMT, would be hurt. Losing an important federal tax deduction will be very unpopular and primarily hits residents of Blue States.

A reduction in corporate taxes will be beneficial if it helps boost hiring activity, capital spending, research, or even quarterly dividends. The worst outcome would be corporations hoarding the tax savings in cash reserves or using the savings to repurchase shares of its stock. That would do nothing to spur the economy and would lead to a backlash from US taxpayers.

The Administration is also promoting a change in “pass-through” income that would lower personal taxes for small business owners. While it sounds good in theory, it would also lead to many gray areas in the way expenses are recognized by business owners. This would be hard to detect and enforced by the IRS. Keep in mind that tax reform is meant to simplify the process, not make it more complicated.

The Administration wants to reduce the number of tax brackets from seven to only three. Instead of the 10%, 15%, 25%, 28%, 33%, 35%, and 39.6% existing brackets, the rates would be reduced to 12%, 25%, and 35%. The proposed changes include doubling the standard deduction for singles and couples. Most itemized deductions would be eliminated unless it is a “tax incentive” – including mortgage interest, charitable giving, and deposits into retirement accounts. Deductions that would be eliminated include

state income taxes, local property taxes, home offices, and state/local sales taxes (in states that do not levy a state income tax).

Capital Gains and taxes on dividend-income were not mentioned in the proposed tax reform, and we do not expect the current rates to be adjusted. Senator Orin Hatch has proposed allowing corporations to expense quarterly dividends that are distributed to its shareholders. If approved, it would lead to higher dividend payouts in the future.

These bullet points are the extent of what we currently know. The changes are expensive and would have to be offset with a corresponding reduction in federal spending. The US Treasury is already facing major costs associated with the hurricanes that impacted South Texas, Florida, Puerto Rico, and the US Virgin Islands. Getting Republicans and Democrats to agree on what areas can be cut from the budget will be monumental. The President will have to be very active in the negotiation process, which we did not see when Obamacare was being addressed. Until we see major progress on bi-partisan negotiations, as well as agreement within the Republican Party, our outlook appears more like vanilla tax cuts and not landmark tax reform.

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