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Temper Your Trump Tax-Cut Hopes

The wealthy should hope for a “temporary repeal of the estate tax” at best.

By Karen Hube, March 25, 2017

At best, notes a Brown Brothers Harriman advisor, the wealthy should hope for a temporary repeal of the estate tax.

President Donald Trump and most Republican lawmakers want the same thing: broad tax cuts that slash individual and corporate tax rates and provide a simplified tax code. But head-butting over details—such as how imports and exports should be taxed, and limits on itemized deductions for individuals—is raising questions about whether tax overhaul will happen this year, or even next.

“Even before you get Democrats engaged in the discussion, there’s enormous disagreement among Republicans,” says Howard Gleckman, a senior fellow at the Tax Policy Center. “That’s a big clue to how hard it’s going to be to get reform passed.”

What should you do? Be patient and temper your hopes, tax advisors say. While cuts are likely, they may not end up as deep and sweeping as current proposals suggest.

Separate tax plans laid out by Trump and House Republicans last year would lower the top individual income-tax rate from 39.6% to 33% and compress the current seven tax rates into three (12%, 25%, and 33%). Trump and the Republicans both want to eliminate the alternative minimum tax and taxes under the Affordable Care Act, including a 3.8% tax on investment income and a 0.9% tax on earned income for couples earning more than \$250,000 a year. The plans would also eliminate the estate tax. The Tax Policy Center estimates that the wealthiest taxpayers would save, on average, \$1.1 million after taxes annually; middle earners, \$1,010; and lowest earners, \$110.

But no one knows how those big cuts would be paid for—a necessity for such proposals to get through Congress. Trump’s position that economic growth resulting from the tax cuts would quickly pay for them, for example, has been pooh-poohed. The Tax Policy

Center estimates his proposals would cost the federal government \$6.2 trillion in lost revenue over 10 years, and add

\$7 trillion to the deficit in that time period. “The question is, just how big an increase in the deficit are deficit hawks in Congress going to swallow?” Gleckman asks. Best guess? Not very big, he says.

Congress will probably look to limit itemized deductions, using one of two prevailing tax plans as guides. The plan from House Republicans, known as the blueprint for tax reform, would eliminate all itemized deductions except for mortgage interest and charitable contributions. Trump’s plan would cap itemized deductions at \$200,000 for couples. “That cap means people making significant charitable contributions may not benefit from a tax perspective,” says Jody King, vice president and director of client services at Fiduciary Trust. Under current law, individuals can take deductions valued up to 50% of adjusted gross income for cash contributions and 30% for charitable gifts of stock and other assets. Excess contributions can be carried forward and deducted in future years.

Another area open to tinkering is how carried interest would be taxed. “There’s disagreement. Trump has shown willingness to tax carried interest at the income-tax rate, but many Republicans don’t agree,” says Pamela Villarreal, a senior fellow at the National Center for Policy Analysis. So another logjam there.

The president wants to repeal the 3.8% tax under the Affordable Care Act. Meanwhile, capital-gains tax rates—also applicable to dividends—would remain at 0%, 15%, and 20%, but correspond to the three new income-tax brackets. The GOP plan, meanwhile, allows for taxpayers to exclude half of their capital gains and dividend and interest income from taxes, then apply income-tax rates to the other half. The effective capital-gains rates would be 6%, 12.5%, and 16.5%.

Both Trump’s and the Republicans’ plans call for a repeal of the estate tax, which kicks in for married couples with more than \$10.98 million in assets—and affects 0.2% of households. Don’t get excited. President George W. Bush tried to permanently repeal the estate tax in 2006 and got nowhere—and he had 55 Republican senators watching his back.

Currently, your heirs inherit your estate’s assets with values reset at the date of your death. Trump proposes that in lieu of an estate tax, wealthy taxpayers should no longer get a step-up in that cost basis.

It's an impractical idea that's virtually impossible to implement. "Consider figuring out the cost basis for businesses that were started in the early 1900s, stocks held for 30 or 40 years," says Adrienne Penta, executive director of the Center for Women & Wealth at Brown Brothers Harriman. She believes the most that the wealthy should hope for is "a temporary repeal of the estate tax."

Which won't be happening anytime soon. Michael J. Graetz, Columbia Law School alumni professor of tax law, believes that changes to individual tax laws won't roll around until next year or even the year after. He argues that the clamor to cut corporate taxes has a better chance of bearing fruit first, and that such a cut would help, say, owners of small businesses. Trump says he wants to cut the current top corporate tax rate to 15% for "all businesses, big and small," while House Republicans have proposed a new, 20% top rate for corporations and 25% for small businesses. In either case, however, it isn't clear how this would affect owners of pass-through entities like S corporations, limited liability companies, and partnerships.

So hope and pray for tax relief—just don't hold your breath.