As summer comes to a close, there continues to be a great deal of discussion among lawmakers in Washington, D.C. about potential changes to the U.S. tax code. It has been more than 30 years since the tax code was changed in any significant way, and congressional Republicans are hoping to enact policies that are built to last — though they may need to settle for temporary legislation that can be passed more easily through the budget reconciliation process. There are some significant proposals being considered, including eliminating the estate tax, doing away with most itemized deductions and reducing tax rates on corporations, partnerships and other pass-through entities.

However, given the recent struggles to unify the Republican congressional majority around a health care bill, it’s not certain whether they can come together on a tax plan that will satisfy everyone involved.

The uncertainty around what exactly a bill might include, when it might come into effect and how permanent it will be can make planning seem especially daunting. As recent events have made clear, we can’t rely too heavily on predictions and must be prepared for any outcome, no matter how unlikely it may seem.

What we can do is make an effort to understand the possibilities that lay ahead and what their implications might be so we are prepared to recognize any potential opportunities, should they arise.

What’s Being Proposed

While lawmakers have yet to settle on a list of priorities, the following represents some of the most prominent proposals made by President Trump and congressional Republicans.

Exhibit 1. Current Tax Law vs. Proposed Changes

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Corporate Tax Rate</td>
<td>Top rate of 35%</td>
<td>Top rate of 15%</td>
<td>Top rate of 20%</td>
</tr>
<tr>
<td>Partnership and Other Pass-Through Entities</td>
<td>Ordinary income tax rates</td>
<td>Top rate of 15%</td>
<td>Top rate of 25%</td>
</tr>
<tr>
<td>Ordinary Income Tax Rate</td>
<td>7 brackets: 10% - 39.6% (+3.8% NIIT)</td>
<td>3 brackets: 10%/25%/35% (eliminate NIIT)</td>
<td>3 brackets: 12%/25%/33% (eliminate NIIT)</td>
</tr>
<tr>
<td>Taxable Interest Income</td>
<td>Taxed as ordinary income</td>
<td>Not addressed</td>
<td>Taxed as ordinary income with 50% deduction²</td>
</tr>
<tr>
<td>Long-Term Capital Gains &amp; Qualified Dividends</td>
<td>3 brackets: 0%/15%/20% (+3.8% NIIT)</td>
<td>3 brackets: 0%/15%/20% (eliminate NIIT)</td>
<td>Taxed as ordinary income with 50% deduction²</td>
</tr>
<tr>
<td>Short-Term Capital Gains</td>
<td>Taxed as ordinary income</td>
<td>Not addressed</td>
<td>Not addressed</td>
</tr>
<tr>
<td>Carried Interest</td>
<td>Taxed at capital gains rates</td>
<td>Not addressed</td>
<td>Not addressed</td>
</tr>
<tr>
<td>AMT</td>
<td>Remain</td>
<td>Eliminated</td>
<td>Eliminated</td>
</tr>
<tr>
<td>Itemized Deductions</td>
<td>Various</td>
<td>Eliminate all except mortgage interest and charitable contributions</td>
<td>Eliminate all except mortgage interest and charitable contributions</td>
</tr>
<tr>
<td>Estate/Gift Tax</td>
<td>Top rate: 40% Exemption: $5,490,000 (2017)</td>
<td>Eliminate “death” tax Silent on basis step-up and gift tax</td>
<td>Eliminate “death” tax Silent on basis step-up and gift tax</td>
</tr>
</tbody>
</table>


²Under the house proposal, investment income will be taxed as ordinary income with families and individuals able to deduct 50% of their net capital gains, dividends, and interest income, leading to basic rates of 6%, 12.5%, and 16.5% on such investment income depending on the individual’s tax bracket.

³Specific details of proposal unclear, Director of NEC Gary Cohn stated the standard deduction for a married couple would be $24,000 in his press conference introducing proposal.
Repealing the Federal Estate Tax

In 2017, the estate tax exemption applies to individual estates that are valued up to $5.49 million—or $10.98 million for married couples. While Republicans have made clear that they intend to repeal the estate tax entirely, they’ve said little about what they would replace it with—or whether they would replace it at all.

Options include:

- **Continuing the “step up” in tax basis for inheritors.** This tax break currently allows heirs to “step up” the tax basis of their inherited assets to their current market value, which means that when they sell the assets, they don’t have to pay capital gains taxes on any appreciation that occurred between when the assets were originally purchased and when the decedent passed away.

- **Implementing a “carryover” tax basis system.** This would eliminate the step up in basis, meaning that when the inheritors sell the assets, they would pay capital gains based on the original basis of the assets rather than the value at the time of the decedent’s death. It’s possible that there may be an exemption that allows for a step up in basis for gains up to a certain amount. This is similar to rules that were in place when the estate tax was temporarily repealed in 2010.

- **Requiring that capital gains be paid upon death.** Under this plan, capital gains tax would be due on the assets at death, whether or not they are sold, before they are transferred to the inheritor. This rule would likely be paired with the step up in basis, meaning that after the transfer, the tax basis of the assets would be the value at the time of transfer.

It’s possible that the gift tax or the generation-skipping transfer tax (a tax on transfers made to related persons more than one generation younger or unrelated persons 37½ years younger than the donor) may also be under discussion, but neither the April 2016 House Republican proposal nor President Trump’s April 2017 proposal addressed the subject.

Eliminating Itemized Deductions

Both President Trump and House Republicans have proposed eliminating all itemized deductions, except for the mortgage interest deduction and deductions for charitable contributions. To offset this, they both suggest effectively doubling the standard deduction which, in 2017, is $6,350 for single filers and $12,700 for joint filers. Right now, about 25% of taxpayers itemize their charitable deductions. It’s believed that the increase in the standard deduction would lead fewer taxpayers to itemize at all, and could reduce the percentage of taxpayers who claim an itemized charitable deduction to just 5%.

If enacted, this provision would have an impact on taxpayers in high income tax states, and would potentially offset some of the benefits of the lower overall federal income tax rate.

Reducing Corporate Tax Rates

President Trump’s most recent proposal calls for a 15% top tax rate for corporations and pass-through entities such as partnerships. That corporate rate is much less than the top income tax rate for individuals, now at 39.6%, and there is concern that this could spur individuals to form pass-through entities in order to take advantage of the tax break.

Maintaining Discounts for Family Limited Partnerships

Prior to the election, the U.S. Treasury proposed new regulations that aimed to eliminate valuation discounts for family limited partnerships and family LLCs. However, the Treasury received more than 10,000 comments against the proposed regulations, and President Trump’s executive orders have all but ensured that they will not be enacted. That said, increased litigation challenging deathbed partnership planning may create some new ways for the IRS to challenge poorly planned partnerships.

Don’t Let Uncertainty Paralyze Planning

It’s impossible to know exactly how the debate over changes to the tax code will play out. Individuals and families should continue to review their plans to ensure enough flexibility to handle whatever might come out of Washington, D.C. Properly drafted trusts and estate plans allow families to address changing circumstances far into the future. We recommend the following steps:

**Factor in the Possibility of a Carryover Basis System**

The potential of a switch to a carryover tax-basis rule for inherited assets could have a big impact on existing plans. Families should consider giving executors the ability to make funding decisions based on any changes to tax laws, and allow trust protectors to swap assets in and out of trusts to maximize their tax basis.
Re-Evaluate Charitable Bequests

If the estate tax is repealed, charitable bequests will no longer be beneficial from a tax planning perspective. Families should review their estate plans to make certain they still make sense even if there’s no estate tax. For instance, it’s common for trusts to calculate the amount of their charitable bequests as the maximum amount possible that would not incur estate taxes — under a tax code with no estate tax, this would be the entire estate, which is most likely not what was originally intended.

Avoid Making Large Gifts

We recommend temporarily holding back from making large individual gifts, which run the risk of incurring significant gift taxes. If a gift is made under the current tax laws, consider stipulating that the assets will be returned if the recipient “disclaims” the gift. If the recipient gives it back within nine months of receiving it, the assets can then be regifted under the new tax laws. Gifts to grantor trusts are also an option, as they could be structured to provide tax-free gifts to a beneficiary, so long as the grantor is willing to pay the income tax on the trust assets.

Remember That There's More to Planning Than Taxes

Some people hit pause on their planning after the election in hopes there would be more immediate clarity on what Republicans had in store for the tax code. Though that hasn’t come about yet, there are still reasons to continue planning amid this uncertainty, many of which are unrelated to taxes. These include the need to manage and protect assets, to plan for disability or incapacity, or to develop business succession strategies. In the same vein, long-term goals should remain the driving force behind any estate plans, regardless of what changes may come in the near term.

Instead of focusing too narrowly on the tax aspects of planning, families can take a step back and ensure that their primary wealth-transfer goals are clearly articulated in the estate planning documents, and should consider a statement of intent or letter of wishes to better guide those entrusted with administering the estate.

Prepare for Near-Term Opportunities, but Maintain a Long-Term Vision

Savvy investors may find opportunities amidst the current uncertainty. For instance, with lower tax rates a possibility, it might be wise to consider deferring realized capital gains until next year, or claiming deductions this year, when they may make more of an impact. However, there is always the possibility that tax rates could remain the same — or even increase for some of the wealthiest taxpayers.

In this new political landscape, it’s hard to know what’s coming next week — much less next month or year. And whatever happens, we can’t be sure that some future Congress or presidential administration won’t decide to change things again. But those who review their plans and keep their goals and the big picture in mind will be prepared no matter what changes occur.