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***THE TAX-CONSCIOUS ADVISER***

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# Taking a closer look at tax reform

*Rep. Camp's overhaul of the IRS code could mean some unwelcome surprises for the rich*

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House Ways and Means Committee Chairman Dave Camp, R-Mich., has proposed sweeping changes to the Internal Revenue Code.

And while many of the ideas — such as a top tax rate of 35% and changes to the way derivatives are taxed — have been reported and dissected, there are new proposals that could have a major impact on ultrahigh-net-worth taxpayers.

Although few expect these proposals to be enacted this year, they will be discussed in future sessions of Congress, so they bear examination.

Here are the highlights:

- The following deductions for individuals would be eliminated: state and local income taxes, real estate taxes, medical deductions, casualty losses and tax preparation fees. This would increase the after-tax cost of state taxes by anywhere from 50% to 100%.

- To the extent that deductions were allowed, they would be limited to a 25% benefit, with an exception to the rule for charitable contributions. Such contributions could get a benefit of 35%.

- The alternative minimum tax would be eliminated, but with all these deductions being eliminated, you wonder if it would matter.

- For those in the highest income brackets, municipal bond income would be taxed at 10%.

- There would be a number of changes regarding charitable contributions. Currently, cash contributions to public charities are limited to 50% of a taxpayer's adjusted gross income, and contributions of appreciated securities are limited to 30% of the taxpayer's AGI. Instead, both of these types of contributions would be limited to 40% of the taxpayer's AGI.

  Fair market value would be used to determine the amount of the deduction for publicly traded equities held for at least one year, as well as tangible property such as art given to a museum. The amount of the deduction for most other property would be limited to the taxpayer's basis in the property. As an example, the deduction for a donation of private-company stock would be the taxpayer's cost basis, not today's fair market value.

- Long-term gains would be taxed at 20%. The Camp proposal would exclude 40% of any long-term gains or qualifying dividends from income instead of having a special preferential tax rate as is the case now. In effect, this would raise the rate on long-term capital gains from 20% to 21% (60% taxed at 35%). Also, the proposal suggests that collectible gains wouldn't get the exclusion and thus would be taxed as ordinary income.

- Regarding homeownership, only interest incurred on mortgages up to $500,000 could be deducted, and no deduction would be allowed for interest on home equity loans.

Up to $500,000 of gain from the sale of a principal residence could still be excluded from income. However, this exclusion would be reduced dollar for dollar for taxpayers with an AGI in excess of $500,000. Therefore, if a taxpayer had $1 million or more in AGI, none of the gain from the sale of a principal residence would be excluded from income

- Section 1031 would be repealed. Like-kind exchanges that are exempt from tax would become subject to tax. This could have a large impact on investors in real estate.

- Contributions to both deductible and nondeductible traditional individual retirement accounts wouldn't be permitted. Instead, the income eligibility requirements for Roth IRAs would be repealed. Therefore, only contributions to Roth IRAs would be permissible.

The ability to re-characterize a Roth IRA contribution back into a regular IRA after a conversion would be eliminated.

We will keep you apprised as to the status of these proposals as they wend their way through Congress. We have found that once these ideas are formally proposed and “scored” for revenue impact, the possibility that they will become law increases substantially.

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