Tax Strategies For The Trump/Ryan Plan

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This story appears in the December 30, 2016 issue of Forbes.

The tax roulette wheel is spinning. You have to place your bets now, before the marbles land. By making educated guesses about what will happen to the Internal Revenue Code you can save big-league.

It is very likely that the new president and his Republican legislative majorities will push through a statute that cuts tax rates but shrinks deductions. It is somewhat likely that they will refashion wealth transfer taxes with a similar give-and-take.

Those changes would make a shambles of existing tax-planning strategies, while creating opportunities. Your objective is to arrange your affairs to capture probable benefits while ducking probable tax bombs. In many cases you have to make your moves before Congress makes its moves.

Both the Trump plan and the one from House Speaker Paul Ryan include a 33% top individual income tax bracket and a repeal of the 3.8% ObamaCare surtax on investment income. What are the odds that this will get through? Very high, says Andrew Friedman, a Washington, D.C., tax expert who handicaps law changes for business clients. He puts at 75% the probability that a tax law like this will be enacted next year and be retroactively effective to January 1. Uncertain, he says, is whether the 2017 rate schedule will go full bore (down to 33% at the top) or be a blend of that and the 2016 rates (max: 39.6%).

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Strategy: Push income from 2016 into 2017 and be prepared, if the 33% kicks in only in 2018, to push income from 2017 into 2018. Push your deductions in the other direction. Trump would limit Schedule A deductions to $200,000 for a couple, making an incremental writeoff potentially worthless. Ryan would erase itemized deductions except for charity and mortgage interest.

Wealth taxes? The Trump plan calls for eliminating the estate tax but simultaneously eliminating a tax break called "step-up"--the tax basis of property held by a decedent is now stepped up, so that all appreciation before death escapes capital gains tax. The elimination of step-up would play havoc with just about any high-end wealth preservation scheme. It's not too soon to anticipate the damage and plan accordingly.

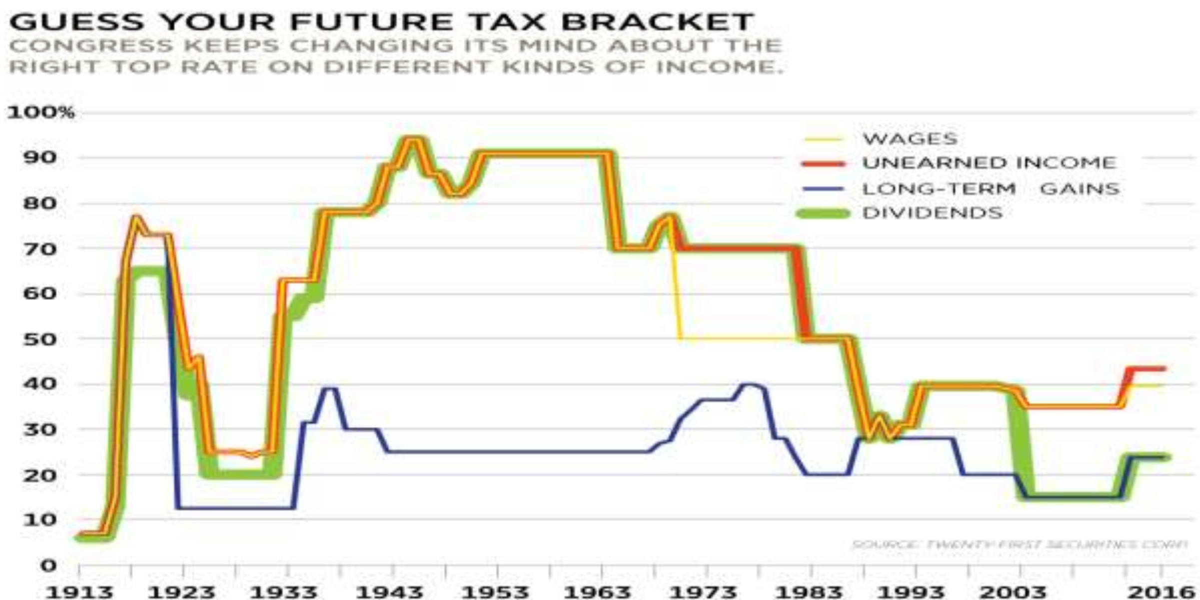
The most drastic repeal of step-up would put us on the Canadian system, which treats death as a sale of assets not going to a spouse. That's conceivable but unlikely; it would force survivors to liquidate family businesses, farms and homesteads in haste. Tears would be shed. More probable, says John Scroggin, a Roswell, Georgia, estate lawyer: a carryover system. Heirs would pick up Grandpa's tax basis on the 4,000 acres in Iowa but owe capital gains tax only when they sell.

Without providing details, the Trump plan calls for retaining a step-up on assets roughly the amount of the current estate tax exemption ($10.9 million for a couple). If you leave behind more than that, could your executor pick and choose which assets enjoy step-up? Maybe not, Scroggin speculates; a prorated exemption is possible. Careful planning will let your heirs extract the most from the exemption.

Trump's tax plan is expensive. Misgivings by fiscally conservative legislators might cause them to look for revenue enhancements (as well as spending cuts), imperiling some classic tax-minimization gimmicks listed in the box on the left.

Democrats don't care for tax cuts benefiting high-incomers. Their 48 votes in the Senate will allow them to impede a Trump/Ryan bonanza, up to a point. But the Republicans can bypass a threatened filibuster by using a procedural shortcut ("budget reconciliation") that is available if the new tax law sunsets in ten years. That's how George Bush got his tax cuts in 2001 and 2003.

What the budget and the politics tell you: You should take advantage of a low rate or a tax trick available now, because it might not be around for long. But be skeptical of a tax ploy that banks on a low rate in the distant future. **"When you defer tax you're deferring into a black hole," warns Robert Gordon, president of Twenty-First Securities, which specializes in tax strategies for wealthy investors. "You don't know what the rate will be when you retire. It could be 70%. It could be 20%." He proves the point with this chart:**



With that in mind, we offer a series of defensive steps to take--some now, some in 2017 and the rest over the next three years. After that? Let's just say that elections can deliver surprises.

DO IT NOW

Postpone income. Push business receipts, bonuses and other controllable income into the new year.

Accelerate deductions for state and local taxes. You could send in your January 15 estimated-tax payment a month early or prepay property taxes. Proviso: Don't do this if it puts you within reach of the federal AMT (alternative minimum tax). Have your accountant run what-if scenarios on 2016 income taxes with different income and deduction numbers.

If you are likely to be doing a Roth conversion next year and if you're clear of the AMT, consider overpaying your 2016 state income taxes now and applying the refund against your large 2017 state tax bill.

Accelerate charitable deductions. The big brokerage firms make this easy. You can transfer appreciated stocks into a charitable pool, get a deduction for their market value while escaping capital gains tax, then take your time disbursing the money to worthy causes. Typical annual fee: 0.6% plus expenses on mutual funds.

If you have a giant sum, open a foundation.

Undo, then redo a Roth conversion. If you converted pretax IRA money to aftertax Roth money earlier this year (that made total sense when Hillary Clinton was favored to win), you can reverse the transaction by "recharacterizing" the move. In 2017 reinstate the Roth conversion, using different IRA assets.

Maximize retirement savings. If you don't have the income to fully fund your 401(k), consider boosting your contribution this year (if your payroll department will tolerate a last-minute catch-up) and then slacking off next year, when the deduction will be worth less.

Take capital losses. A net $3,000 loss on your Form 1040 this year is potentially worth 44.6 cents on the dollar this year (depending on how it interacts with other income) but only 33 cents next year.

DO IT IN JANUARY

Exercise employee options. If you are itching to exercise "incentive stock options," wait a month. These create AMT income equal to the bargain element in the option. (If you buy a share at $10 when it's trading at $70, you have $60 of AMT income.) It would be very painful to pay AMT on $60 this year and then have the stock crash to $15 next year.

See where you are in December 2017. If the stock stays up, you can hang on to it, hoping for a low-taxed capital gain when you eventually sell. Alternatively, if the new tax law repeals the AMT (as Trump and Ryan propose), then you're off the hook. If neither of these is true, you'd sell the shares. Existing law gives you an AMT dispensation if you liquidate the shares within the same year you exercise the option.

Rothify. Prepaying income tax on retirement assets is a good move when your tax bracket is destined to remain constant over time, because it enhances the tax-free compounding. It's an especially good move if tax rates are likely to creep up over the next decade or two. (Recall that the 28% rate in Ronald Reagan's 1986 tax reform has crept up to 39.6%.)

Roth conversions should be done in measured doses, says Green Bay, Wisconsin, tax expert Robert Keebler, with attention paid to when you are crossing the boundary into a higher bracket. Also keep an eye on Congress. If rates are to come down only in 2018, you could undo the 2017 Roth and then resume the converting later.

DO IT IN 2018-20

Liquidate clunkers. Certain bad investments create ordinary income on your way out. Don't leave until that 33% rate is in place. Two in this category: tax-deferred annuities and energy partnerships.

You can get a boomerang tax bill for ordinary income when you sell a master limited partnership, even when you're selling at a loss. MLPs, that is, are an exception to the usual rule that it pays to take capital losses sooner rather than later.

Shrink your estate. See what comes out of any death tax overhaul, which may or may not include a repeal of gift taxes and limits on step-up. You may want to reduce your assets with gifts during your retirement years. One trick is to park money in Section 529 college plans with grandchildren as beneficiaries and you as owner. You get the money out of your estate but retain some ability to retrieve it if you get in a financial bind.

Exploit new loopholes. Republican tenderheartedness to "small business" may create an opportunity to replace a salary with a mix of salary and low-taxed proprietorship income. Stay plugged in.