Comparing Trump's Tax Proposals with Current Law

By Ashley L. Spina

President Donald Trump has proposed significant changes to the current tax regime by way of changing income tax rates for both individuals and businesses; taxing un-repatriated foreign earnings; and eliminating the Affordable Care Act tax, alternative minimum tax, and estate tax (hereinafter "Trump's Proposal"). Trump states that the goals of his tax plan are the following: 1) tax relief for the middle class; 2) simplify the tax code; 3) grow the American economy; and 4) no additional debt added to the deficit. Given Republican control of the House and Senate, some of Trump's proposed changes could be implemented in 2017.

Changes to individual income tax rates

The current progressive tax system has seven tax brackets, pushing the taxpayer into a higher tax bracket when certain income thresholds are exceeded. Trump's Proposal will collapse the seven tax brackets into three (12 percent, 25 percent, and 33 percent). Additionally, the head-of-household filing category will be repealed, and unmarried taxpayers will instead be required to file as single.

While Trump would reduce the tax rate for the highest earners, his proposal would broaden the tax base by eliminating deductions. Trump proposes to cap itemized deductions at $100,000 for single filers and $200,000 for married taxpayers filing jointly, and eliminate the personal exemption amount. The current standard deduction for a single filer is $6,350, $12,700 for married filing jointly, and $9,350 for head-of-household. Trump's Proposal will increase these amounts to $15,000 for a single filer and $30,000 for married taxpayers filing jointly.

While these amounts are more than double the current standard deduction, Trump's Proposal would repeal the personal exemption amount of $4,050. Under the current tax system, a married couple with two children get a standard deduction of $12,700 and a personal exemption amount of $16,200 (4 x $4,050) for a total of $28,900 ($12,700 + $16,200). Under Trump's Proposal, the same married couple with two children would receive a $30,000 exemption. Under the current system, a family with more than two children, and no child-care deductions, receives a standard deduction and personal exemption amount of $32,950 ($12,700 + $20,250). Under Trump's Proposal, the same family would receive a standard deduction of $30,000.

In addition to changing the individual tax rates and standard deduction, Trump's Proposal would offer an above-the-line deduction, up to $5,000 per child, for qualifying child-care expenses. The deduction would be available for up to four children. This amount would be capped by the state's average cost of care, have income

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SINGLE FILER

2017 Tax Rates	
$0 – $9,275	10%
$9,275 – $37,500	15%
$37,500 – $91,900	25%
$91,900 – $191,650	28%
$191,650 – $416,700	33%
$416,700 – $418,400	35%
$418,400 +	39.6%

Trump's Proposed Rates	
$0 – $37,500	12%
$37,500 – $112,500	25%
$112,500+	33%

MARRIED FILING JOINTLY

2017 Tax Rates	
$0 – $18,650	10%
$18,650 – $75,900	15%
$75,900 – $153,100	25%
$153,100 – $233,350	28%
$233,350 – $416,700	33%
$416,700 – $470,700	35%
$470,700+	39.6%

Trump's Proposed Rates	
$0 – $75,000	12%
$75,000 – $225,000	25%
$225,000+	33%

STANDARD DEDUCTION

2017 Amount	
Single	$6,350
Head of Household	$9,350
Married Filing Jointly	$12,700

Trump's Proposed Amounts	
Single	$15,000
Married Filing Jointly	$30,000

Death Is No Excuse: Post-Mortem Income Tax Obligations

By Amy K. Kanyuk

A client's death brings with it a host of tax considerations, including the payment of income taxes after death.

Decedent's Final Tax Returns

The executor must file the decedent's final income tax return (Form 1040) for the period ending with the date of death. The final return is due April 15 of the year following the date of death. The decedent and his surviving spouse can file a joint tax return for the year of death, as long as the surviving spouse does not remarry before the end of the tax year. The final joint return will include the decedent's income through the date of death, and the surviving spouse's income for the entire year.

The executor should confirm that the decedent filed all of his prior tax income returns before the date of death. If the executor cannot locate copies of prior returns, he can request copies from the IRS. The executor should delay distributing estate assets until he is sure that all of the estate's tax obligations have been satisfied.

Estate's Income Tax Return

The decedent's estate is a separate taxpayer. Accordingly, the executor should obtain a taxpayer identification number for the estate, and file a Form 56 (Notice of Fiduciary Relationship) with the IRS.

The executor can choose a calendar or fiscal tax year for the estate. Choosing

a fiscal year can significantly defer the date of the first payment of income tax by the estate. If the executor chooses a fiscal year, the initial fiscal year must end no later than the last day of the calendar month before the month of the decedent's death. For example, if the decedent dies April 20, the fiscal year must end no later than March 31.

Income in Respect of a Decedent. Income in respect of a decedent (IRD) is income that the decedent earned, but didn't receive, before death. A common example of IRD is income attributable to distributions from a decedent's IRA or 401K. IRD received by the decedent's estate or a beneficiary is taxable to the estate or beneficiary when the estate or beneficiary receives it. IRD also is an asset of the decedent's estate for estate tax purposes. If the decedent's estate was subject to federal estate tax, the estate or beneficiary can take an income tax deduction against the IRD for the estate tax attributable to the inclusion of the IRD in the decedent's gross estate.

Taxation of Distributions

Distributable net income (DNI) is, in general, the estate's or trust's taxable income, excluding capital gains. DNI provides a ceiling on the amount an estate or trust can deduct for distributions to beneficiaries; a ceiling on the amount a beneficiary must account for on his income tax return with respect to distributions from an estate or trust; and DNI identifies the character of the income distributed to the beneficiary (e.g., taxable interest, dividends, etc.).

DNI and fiduciary accounting income (FAI) usually are not the same in a given year because the rules for determining DNI and FAI are different. DNI deals with determining the appropriate amount of tax to be borne by the trust or estate and its beneficiaries. FAI deals with equitable concepts of allocating the amount of income and principal between income beneficiaries and remaindermen. An item that may be subject to federal income tax will not necessarily be "income" for FAI purposes (e.g., capital gains), and an expense that may be deductible for income tax purposes may not be chargable in full against "income" for FAI purposes (e.g., fiduciary fees). Although capital gains are taxable as income for income tax purposes, they usually are not included in DNI because they are considered principal for fiduciary accounting purposes.

Distributions from an estate or trust to a beneficiary are taxable to the beneficiary, and deductible by the estate or trust, only to the extent of the estate's or trust's DNI. Taxable income is not allocated to beneficiaries who do not actually receive distributions from the estate or trust.

Specific Bequests. The payment of a specific bequest (money or specific prop-

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by the shareholders, and therefore do not qualify as performance-based under Section 162(m). While non-equity plans are often similar to bonuses and tied to performance, they are typically pursuant to a written plan, which can be designed to meet the requirements of 162(m).

> A written plan will not qualify as performance-based if the plan allows compensation to be paid in the event of termination, regardless of whether the conditions were met.

It is important to note that a written plan will not qualify as performance-based if the plan allows compensation to be paid in the event of termination, regardless of whether the performance conditions were met. So if the written plan allows the employee to achieve the performance-based compensation, even after the employer terminates without cause, the plan fails under 162(m) and no deduction will be allowed. Similarly, if the employee resigns for good reason, and the plan allows that employee to receive the performance reward, then no deduction for the employer.

Grants of stock options, stock appreciation rights (SARs) and restricted stock will qualify as performance-based compensation for purposes of Section 162(m) as long as the following requirements are met: The grant is made by the compensation committee; the plan provides for the maximum number of shares that may granted to an employee during a specified period; and in the case of stock options and SARs, the compensation received is based solely on an increase in the value of the stock after the grant date.

In the case of stock options and SARs, if the above requirements are met, neither the grant nor vesting of the award must be tied to attaining a qualifying performance goal. Conversely, stock grants must be designed with vesting occurring only upon achieving a performance-based goal, in order to meet the deductibility requirements of Section 162(m). Stock grants vesting based on the passage of time alone will not qualify.

There are two other areas worth mentioning when it comes to executive compensation, and while this article will not cover them in detail, a good compensation plan should explore both. One is profits interests; the other is pensions and deferred compensation.

Profits interests are yet another way to provide equity to executives. Recently, in May 2016, the IRS issued temporary regulations clarifying that an individual cannot be both a partner of a partnership and an employee of the partnership's subsidiary, if that subsidiary is taxed as a disregarded entity. For example, if an individual employed by a disregarded entity is granted a profits interest in the entity's parent, the individual must be considered a partner. The consequences of being a partner instead of an employee is significant (see regulations effective Aug.1, 2016).

Briefly, pensions and deferred compensation will be fully deductible if the plans meet the requirements of Section 409(A) of the Code. Generally, if the compensation is deferred until after retirement, it will be fully deductible. A good compensation plan must include a thorough review of the Section 409(A) requirements.

Code Section 162(m) was intended to put limits on executive compensation. However, seemingly tax-sophisticated corporations have figured out ways around this, mostly through performance-based pay. For those companies making cash payments over the $1 million mark, the disallowed deduction results in decreased profits and diminished returns for the shareholders. Finally, did Section 162(m), with all its good intentions, potentially establish $1 million as the base salary for CEOs? It will be interesting to see if a major reform to Section 162(m) will happen under this new administration and if all forms of compensation will once again be deductible expenses.

Michelle Radie-Coffin is an associate at Shaheen & Gordon. She is a member of its Business, Real Estate, Immigration, Employment and Estate Planning Group.

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erty) is not taxable to the beneficiary, as long as the bequest is: 1) paid all at once, or in no more than three installments; and 2) ascertainable under the governing instrument as of the date of the decedent's death. Interest paid on pecuniary bequests is interest income to the beneficiary.

Distribution of Property In-Kind. Distributions in kind generally don't result in the recognition of gain or loss. However, if the fiduciary distributes appreciated property to a beneficiary to satisfy a pecuniary bequest (i.e., a bequest that has a fixed dollar amount), the distribution is treated as a taxable sale or exchange, and any gains or losses must be recognized by the estate or trust.

> The executor can choose a calendar or fiscal tax year for the estate. Choosing a fiscal year can significantly defer the date of the first payment of income tax by the estate.

If the will or trust leaves bequests to multiple beneficiaries, and the beneficiaries agree to take specific assets of equal value, rather than receive a fractional interest in every asset, there is a taxable exchange, unless the fiduciary is authorized (under state law or the governing instrument) to make non-pro rata distributions. Drafting attorneys therefore should ensure that their wills and trust agreements authorize the fiduciary to make non-pro rata distributions.

Basis Adjustments at Death. The basis of property acquired from a decedent generally is the property's fair market value on the date of death. This rule can either "step up" or "step down" the basis of property. However, the step-up rule does not apply to items of IRD; the basis of an item of IRD equals the decedent's basis at the time of death.

The 65-Day Rule. Generally, for an estate or trust to take a distribution deduction for a particular tax year, the entity actually must make the distribution to the beneficiary during that tax year. However, Section 663(b) of the Internal Revenue Code allows fiduciaries to elect to treat all or any portion of a distribution made to a beneficiary within the first 65 days of the estate or trust's subsequent tax year, as if the entity had made the distribution on the last day of the preceding tax year. This 65-day rule provides flexibility to fiduciaries with respect to timing distributions for tax purposes, and allows the fiduciary to base those distributions on the entity's actual income for a given year.

The 645 Election

During the grantor's life, the IRS ignores a revocable trust's existence for federal income tax purposes, and the grantor reports the trust's income, deductions and credits on his individual income tax return. After the grantor's death, the trustee must wind up the trust's affairs before distributing its assets to the beneficiaries. During this wind-up, the decedent's revocable trust is a separate taxpayer for income tax purposes. The trustee must obtain a taxpayer identification number for the trust and file income tax returns for it.

The Code treats the decedent grantor's revocable trust and estate differently for federal income tax purposes. In some cases, the Code affords more favorable tax treatment to the estate than to the trust (for example, an estate can elect to be a fiscal year taxpayer, but a trust cannot). Code Section 645 levels the playing field between trusts and estates by allowing the trustee to elect to treat the trust as part of the grantor's estate (rather than as a separate entity) for income tax purposes. If the 645 election is made (on IRS Form 8855), all items of income, deduction and credit are combined and reported on one income tax return (Form 1041) filed under the name and taxpayer ID number of the estate. The 645 election is effective as of the date of the decedent's death. The fiduciary should determine and calendar the ending date of the 645 election period. See Treas. Reg. Section 1.645-1(f).

Planning for Subchapter S Corporations

Maintaining S Status. Estates are permitted S corporation shareholders during the period of administration. A decedent's revocable trust is an eligible S shareholder during the person's life. When the decedent dies, new rules apply with respect to the eligibility of the trust to hold the S stock. If the decedent's revocable trust owned S stock at the time of the death, the trustee should determine and calendar the time period during which the trust will be an eligible S shareholder, and plan for the disposition of the S stock at the end of that period. See Code Section 1361(c)(2)(A).

Any trust that continues in existence beyond the grace period after the decedent's death, and that will continue to hold S stock, must elect to be treated either as a "qualified subchapter S trust" (QSST), or an "electing small business trust" (ESBT). QSSTs and ESBTs differ with respect to how income and principal may be distributed, and how the income from the S corporation is taxed. Although ESBTs provide more flexibility with respect to the dispositive provisions of the trust, QSSTs may be more efficient for income tax purposes.

Conclusion. Regardless of the size or complexity of an estate, fiduciaries and their advisors must address income tax obligations after a person's death, to ensure they are satisfied before distributing assets to the beneficiaries.

Amy Kanyuk is a founding member of McDonald & Kanyuk, in Concord, NH. She is licensed to practice law in New Hampshire, Massachusetts and South Dakota. She concentrates her practice on estate, gift and generation-skipping planning for individuals and families of high net worth.