Post-election US Tax Outlook

November 2016

Trump victory and GOP Congress could pave the way for significant tax changes, though important details are yet to be determined

Surprising the vast majority of pollsters and many political pundits, Donald J. Trump prevailed in the US election on November 8, and will be inaugurated as the country's 45th president on January 20, 2017. Among his policy priorities, Trump has outlined a range of tax measures that could result in substantive changes for US taxpayers, including Canadian residents who file tax returns with the IRS.

What will these changes mean for you? After reviewing the Trump campaign's tax plan, there are some early indications of the path ahead. Of course, in assessing the impact of any tax measures, the details are essential, but few political campaigns bother to burrow too deep into specifics. This means that while the broad outlines of the tax proposals are known, many of the details are yet to be determined. Still, we can draw some important conclusions, and these are outlined below.

Trump plan silent on tax and reporting issues specific to expats

US citizens and permanent residents residing in Canada are subject to a number of IRS reporting requirements, such as the Foreign Account Tax Compliance Act (FATCA), and the Report of Foreign Bank and Financial Accounts (FBAR). While these can be a significant concern for affected individuals, the Trump tax plan and campaign were silent on these matters.

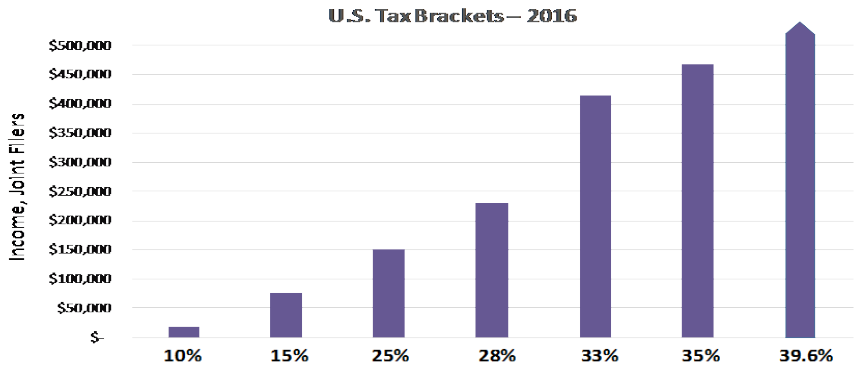
While it is possible that the incoming administration will ask for changes to these rules at some point, its first priority will be to push for those measures that have a domestic impact.

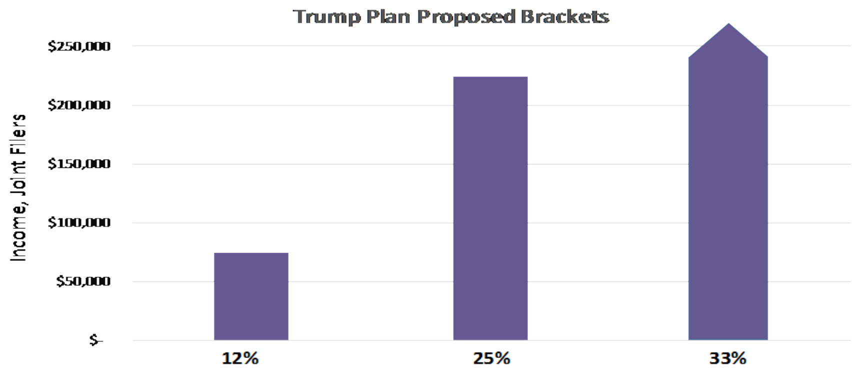
For individuals, a plan that seeks to reduce complexity and lower overall rates

Simplifying the system and reducing individual tax burden are the principal goals of Trump's tax proposals. To meet these objectives, the plan outlines a number of changes to current law:

- **Shrink the number of tax brackets from seven to three.**

- **Reduce top-line tax rates across all brackets**—the new rate for married couples filing jointly would be 33% for income over $225,000 (down from the current 39.6%); for joint income between $75,000 and $225,000 the rate would be 25%, while the lowest rate for income below $75,000 would be 12%.





- **Retain the existing rate structure for capital gains** (maximum of 20%) within the simplified three brackets noted above; carried interest will be taxed as ordinary income.

- **Increase standard deductions and cap itemized deductions**:
  - Proposed increase in the standard deduction for joint filers to $30,000, (from $12,600) and the standard deduction for single filers to $15,000.
  - Eliminate personal exemptions and the head-of-household filing status.
  - Cap itemized deductions at $200,000 for joint filers or $100,000 for single filers.

- **Repeal the 3.8% Medicare tax on investment income** levied on taxpayers in the higher income brackets as part of Obamacare.

- **Repeal the alternative minimum tax** (AMT). Under current tax law, US taxpayers are subject to the AMT, which was established to limit the total benefits from certain deductions and tax credits that higher-income taxpayers can receive. Though initially intended to target only the ultra-wealthy, over time the percentage of taxpayers subject to the AMT has grown, ensnaring those with more modest incomes and catching many families by surprise. Canadian residents can be subject to the US AMT under certain circumstances, so an AMT repeal would remove the burden of having to calculate—and perhaps pay—this levy.

- **Allow families to deduct the average cost of childcare** from their taxes, including stay-at-home parents.
- **Establish Dependent Care Savings Accounts** (DCSAs) that families can set up for specific individuals, with total contributions of up to $2,000 per year.

While the specific implications of these measures vary from person to person—and efforts by independent analysts to model those impacts have been cause for debate—their cumulative effect would be to lower the US tax liability for most individuals. Of course, if you are a Canadian resident and required to file a US tax return, calculating your US tax liability is only one part of your tax equation, but again the net impact could be a simplified return and the potential for a lower total tax bill.

It's also important to bear in mind that new tax-free savings accounts on either side of the border have the potential to create unexpected tax liabilities if they are not covered under bilateral tax agreements. As a US taxpayer residing in Canada, you should investigate new savings plans such as the proposed DCSAs carefully before proceeding.

Plans for business taxes could mean significant savings for certain partnerships, S corporation owners, and sole proprietors

One of Trump's proposed changes to business tax rates could end up greatly reducing the US tax liability for a number of individuals. Under current law, certain businesses do not pay corporate income tax; rather, the owners of S corporations, principals in a partnership and sole proprietors pay taxes on their business income on their individual returns. This is known as "pass-through" taxation, and it means that business income is subject to the applicable individual tax rates and brackets—up to the maximum 39.6% top rate.

The Trump plan, however, envisions two big changes for business tax rates and treatment. First, rates would be lowered from 35% to 15%. In addition, this rate would apply to the pass-through income, meaning that some business owners and partners could see a significant reduction in the effective rate they pay on this income.

An elimination of the estate tax, with a new provision to tax capital gains

Current US law requires that estates with combined assets valued over a certain threshold—$5,450,000 in 2016—file an estate tax return with the IRS and pay taxes on amounts above that threshold. Canadian residents that own property in the United States, as well as all US citizens and permanent residents, are subject to this tax.

The tax plan outlined by Donald Trump envisions a repeal of the existing estate tax altogether. In its place, two new measures would be enacted, a tax on capital gains valued over $10 million and held until death, and a ban on contributions of appreciated assets into a private charity.

What happens next

At this stage, all of these changes are merely proposals—realizing them will require changes in law. The US Constitution requires that any changes to the tax code must originate in the House of Representatives, and the Senate must agree to them as well. The new administration will need to work with Congress next year in order to achieve these goals. As in all tax matters, details can be very important, and the details of any changes are likely to be debated, negotiated and re-shaped during the legislative process.

The bottom line for American citizens (and those with US tax filing obligations) is that you have an idea of where the next administration wants to go with tax policies, and GOP majorities in the House and Senate make it more likely—though not inevitable—that the incoming president will be able to make progress on his ambitious agenda. The specifics will evolve over the coming months, but once they are set, you will benefit from a review of your tax strategies to ensure the most favourable position when any new rules take effect.

Don't hesitate to contact your Grant Thornton advisor, who can help you determine how future US tax reforms might benefit you, and suggest ways to maximize your tax efficiency.

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