For 3.8% Trump Tax Cut, Push 2016 Payments To 2017

What will Donald Trump and Congress do? President Elect Trump has made no secret of his view that our tax system needs reform. He blamed the tax laws for making it possible for him to manipulate the tax law to pay so little. Among other things, he may have been referring to that controversial $916 million net operating loss. Tax cuts are surely coming, though exactly what and when are much debated. Still, with a Trump Presidency and Republican control over the House and Senate, some tax cuts are inevitable.

Next year, the rates should be lower, but the critical effective dates of those cuts remain unclear. Under current law, we pay ordinary income tax at graduated rates up to 39.6%. Some people are allowing hopes of Mr. Trump’s tax plan to impact their 2016 year-end planning. Trump proposes cutting the tax brackets to 12%, 25%, and 33%. The top ordinary rate would be 33%, with the top capital gain and dividend rate 20%. Yet Trump’s tax plans call for eliminating personal exemptions. More important, itemized deductions would be capped at $200,000 for married couples.
Under Obamacare, high-income taxpayers pay an additional 3.8% surtax on net investment income. That means the top federal rate for individuals today is really 43.4%. Qualified dividends and long-term capital gains are taxed at 15% or 20%, depending on your income. Yet, that rate too gets hit with the additional 3.8% for Obamacare’s net investment income tax. And of all the coming tax cuts, the elimination of this 3.8% net investment income tax could be the most palpable for some high income taxpayers. It also could impact behavior this year-end.

After all, if you could save 3.8% by delaying a sale until January, wouldn’t you do it? There is no guarantee that the 3.8% tax cut will be effective in January, of course. Assuming this net investment income tax is repealed (that seems a safe bet), the effective date could be later in the year. For example, the effective date of the repeal might coincide with the date a bill is introduced. Conceivably, though, the elimination of the net investment income tax might be retroactive to January 1, 2017.

Even if that seems too much to hope for, the likelihood is that there will be some rate cuts. In turn, they are probably going to make future tax deductions worth less. These potential changes suggest paying state taxes before 2016 ends, and the same for charitable contributions. Businesses are also supposed to be in for big tax cuts. Perhaps the biggest target in the corporate tax law is that corporations currently pay 35%. President Elect Trump has said he would cut it to 15%, and eliminate most business deductions.

Even if that 15% rate gets bumped to 20% or more, that is still a big cut from 35%! Besides, LLCs, partnerships and S corporations could have changes too, possibly even paying the same 15% rate as corporations. Yet, the latter seems unlikely. It could mean someone taxed on flow-through business income at 39.6% or 43.4% could see their tax rate slashed to 15%. Of course, even if the only change in 2017 is the elimination of the 3.8% net investment income tax, it could really be worth waiting to sell assets until 2017.

There is a usual tax timing element to this too, which also suggests holding until 2017. If you sell in December of 2016, it is obviously 2016 income, taxed at 23.8%, 39.6% or even 43.4%. If you sell in January of 2017, there’s a good chance you will get lower rates. Besides, even if you are not expecting rate cuts, it is standard to defer income and to accelerate deductions. Even if rates are unchanged, selling in December of 2016 means taxes are due in April of 2017. In contrast, selling in January of 2017 means that taxes are due in
the following April, April of 2018! And these traditional incentives are underscored this year. Some taxpayers may even be able to strike a binding deal in 2016 that calls for payments in 2017 or later. Just be careful how you do it, since the details can matter a great deal.

Of course, the likelihood that tax rates will fall should make you accelerate tax deductions where you can. Moreover, if you have losses, they may be worth more in 2016 than in 2017. That suggests you may want to sell your losing investments now. While deferring income—pushing it off into the future—requires care, selling assets now is easy. Businesses, too, should accelerate deductions and defer income. If a business needs equipment, buying in 2016 is probably smarter than in 2017.

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