PERSPECTIVE

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Tax Changes Are Just Around The Corner, But What Will They Be?

By Robert W. Wood

Tax changes are on the horizon, and they could be extensive. When President Elect Trump takes office in January, he will have a Republican-controlled Senate and a slimly Republican-controlled House. Even without Congressional action, the tax changes that were passed under Trump in 2017 (and that took effect starting in 2018) are scheduled expire at the end of 2025. In large part, Trump has proposed making these cuts permanent but with some tweaks as we will see.

Unless Congress takes action, the end of 2025 will bring numerous tax changes. Top individual tax rates will go from 37% to 39.6%. The $10,000 cap on deducting state and local taxes would also expire, making all such taxes deductible again. Estate taxes will go up, too. If the current law expires, the exemption in 2026 will be about $14.3 million for a married couple, compared with $28.6 million if the 2017 law is extended.

If Trump's 2017 tax law expires, the standard deduction for a married couple will be approximately $16,525 in 2026, and the personal exemption will be about $5,275. In contrast, if the current law is extended through 2026, the standard deduction will be approximately $30,725, and the personal exemption will be zero. Trump wants the higher standard deduction.

People in California pay very high state taxes, and for generations, it was possible to deduct your state taxes on your federal tax return. But effective starting in 2018, Trump's 2017 tax law slashed the so-called SALT deduction to a cap of $10,000. As many businesspeople know, a workaround has developed since then to claim additional state tax deductions through passthrough entities, but not everyone can use that workaround, and it doesn't help you on personal tax returns. So what is the future of the state and local tax deduction?

In a campaign flip-flop, Trump vowed to restore this classic tax deduction. The deduction matters a lot to millions of middle- and upper-class Americans in many states, not just high tax states like New York and California. While Democrats were quick to point out Trump's change on the SALT issue, raising the deduction also may face GOP pushback, including from Senator Mike Crapo of Idaho, who views it as regressive. This could make it challenging for Trump to fulfill his promise, even with a Republican-controlled Congress.

Trump famously slashed the corporate income tax rate from 35% to 21% in 2017. He has proposed lowering it *again* from 21% to 20%. He also wants to lower the corporate income tax rate to 15% for companies that produce products in the U.S. How this suggested criteria would be measured is not yet clear, but it fits nicely with his other protectionist economic plans, such as increased tariffs, which might be used to offset the cost of tax cuts.

Trump said he would eliminate taxes on tips for service and hospitality workers, although it is unclear whether this would apply to income tax or payroll tax. As a candidate, Vice President Kamala Harris embraced this idea too, so perhaps it will enjoy relatively bipartisan support. Unfortunately, numerous experts, including those at the Brookings Institution, have cautioned against making this change. They argue that the vast majority of low-income workers would not benefit.

Trump even floated the idea of eliminating income taxes on overtime. While the exact details are unclear, some have suggested that such a change might invite employees to seek out more overtime work from employers who may need to adjust to accommodate the new incentives. Experts say such a tax exemption could create new complications in the tax code, requiring verification from employers and employees of the exact hours worked in order to calculate the portion of wage income that could be excluded.

Trump also vowed that Social Security recipients would no longer have to pay taxes on their benefits if he were elected. This would be a welcome change for seniors relying on Social Security, but it could also place additional strain on an already-overburdened program, putting benefits at risk for future retirees. The Social Security trust funds could be insolvent by 2034, leading to a 23% cut in benefits. Experts say that cutting taxes on benefits will hasten this process unless an offset is provided.

Trump has proposed imposing a universal baseline tariff on all US imports of 10% to 20%. He proposed a 60% tariff on all US imports from China. He is also considering replacing personal income taxes with increased tariffs, and many of his proposed tax cuts (including Trump's plan to make 2017 changes permanent) will be supposedly offset by revenue generated with tariffs. A 10% universal tariff could raise approximately $2 trillion over the next ten years.

Notably, experts at the Tax Foundation have cautioned against using tariffs in this way. They say tariffs run the risk of foreign retaliation and can be unpredictable. The Tax Foundation says the reduction in other tax revenue and economic output expected from a universal tariff has the potential to offset any revenue it would generate in the long run, severely diminishing its ability to pay for tax cuts.

Trump has also called for bringing back 100% bonus depreciation. Currently, the bonus rate is at 40% and scheduled to go down to 20% in 2025. Since a higher rate can help reduce a company's tax liability, 100% would be a boon to business.

As part of his efforts to incentivize U.S. innovation, Trump has said that he would like to see Research & Development expenses currently deductible again. This would be walking back changes he made in 2017, which phased out existing R&D tax credits and required business to amortize R&D costs over five years.

Trump called for eliminating the 1% stock buyback excise tax for public companies that buy back their own shares of over $1 million in a taxable year. Critics of this proposal say this could lead many corporations to prefer buybacks over dividends. Since dividends already have a tax of their own, the revenue reduction could be larger than expected. That is, existing stock buybacks would skip the 1% tax *and* shareholder rewards that once took the form of taxable dividends might be transformed into buybacks.

Families are not totally left out of Trump's tax plans. He has called for other tax breaks, such as tax credits for family caregivers who take care of their parents or loved ones, and allowing those who buy an automobile made in the U.S. to write off the interest on their car loans.

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