First Quarter 2017

Diversified Asset Management, Inc.

1113 Spruce Street, Boulder, CO 80302

phone: 303-440-2906

Seven Key Components Of Trump's Tax Reform Plan

On November 8, 2016, Donald Trump was elected the 45th president of the United States, culminating a two-year campaign. It is expected that it will take considerably less time for the former business mogul to push tax proposals through a Republican-led Congress. Although these provisions likely will be tweaked during congressional debate and negotiations, here are seven key items on Trump's tax agenda:

1. Individual tax rates. One cornerstone of Trump's tax plan is a restructuring of individual income tax brackets. The seven-bracket system now features a bottom tax rate of 10% and a high of 39.6%. Trump would replace the system with one having just three tax brackets: 12%, 25%, and 33%. Most taxpayers could pay less with this structure, but the largest benefits will be for those in the higher tax brackets.

2. Corporate tax rates. Another consistent theme in Trump's campaign was a pledge to reduce corporate income tax rates. Corporations currently pay tax at rates as low as 15% and as high as 35% (with a 38% bubble on some income). Under Trump's plan, all businesses would be taxed at a 15% rate, providing a tax cut to the majority of corporations. At the same time, Trump hopes to eliminate "double taxation" for C corporations, while preserving benefits such as liability protection.

3. Itemized deductions. Although Trump is offering tax relief to individuals with one hand, he would take it away with the other by eliminating some itemized deductions or limiting the total amount of itemized deductions. However, exceptions could be carved out for certain deductions, such as those for charitable donations and mortgage interest. The loss of the state income tax deduction could have an adverse effect on upper-income residents of states with high tax rates, such as California and New York.

4. Business write-offs. Under Section 179 of the tax code, a business currently may deduct up to $500,000 of the cost of assets placed in service during the year, subject to a phase-out threshold of $2 million. Plus, a business may be entitled to a bonus depreciation of 50% on qualified property. As part of his plan to boost business growth, Trump would double the Section 179 deduction to $1 million and provide an immediate deduction for business investments. This could be accompanied by a repeal or modification of the depreciation rules.

5. Estate taxes. Trump has proposed to repeal the federal estate tax. In addition, he has called for eliminating the tax rule allowing heirs

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What Are The Main Items On Trump's Tax Reform Agenda?

President Donald Trump is making tax reform one of the top priorities in the early days of his administration. Although there are no guarantees, some or all of his proposals may be approved by a Republican-led Congress, possibly with modifications. These are among the key items on the agenda:

- Replacing the seven-tier income tax rate structure for individuals with three brackets of 12%, 25%, and 33%.
- Eliminating some itemized deductions or limiting the dollar value of deductions claimed on personal returns.
- Reducing the top corporate income tax rate from 35% to 15%.
- Repealing the estate tax and replacing the step-up in basis for inherited assets with a carryover basis rule or income tax consequence at death.
- Repealing the 3.8% surtax on net investment income.
- Repealing the alternative minimum tax.
- Curbing the benefits of stretch IRAs.
- Providing immediate deductions for investments in businesses.
- Doubling the maximum Section 179 allowance from $500,000 to $1 million and revamping depreciation deduction rules.
- Revising tax benefits for child-care expenses, including a new deduction and tax-favored savings accounts.
- Implementing a one-time 10% repatriation tax for multinational corporations.

We will provide more details if and when any of these provisions are enacted into law.

Robert J. Pyle, CFP, CFA

This Type Of Trust Is A Failure

Trusts come in many shapes and sizes, but you could divide them into two broad groups—grantor trusts and non-grantor trusts. There's also a third type, however—the "intentionally defective grantor trust," or IDGT, that is designed to break tax rules for estate planning purposes.

With a grantor trust, the grantor—the person who creates it—retains considerable power over how it's administered, including the rights to amend, revoke, or terminate the trust. The grantor also maintains control over the trust assets. Typically, the grantor is a beneficiary of the trust income and principal. For instance, the grantor could be the primary beneficiary, with other family members entitled to the remainder. The grantor also can act as the trustee responsible for administering the trust.

With non-grantor trusts, however, grantors give up all of those rights. They aren't entitled to the income or the principal and, usually, payouts from the trust go to other family members. Also, the grantor cannot be the trustee of a non-grantor trust.

Now consider the tax implications. Because grantors retain control over grantor trusts, they're taxed for the income the trusts produce. For grantors in higher tax brackets—including the top bracket, with its 39.6% tax rate—the income tax consequences can be significant. In contrast, income earned by a non-grantor trust is taxed to the trust itself, not to the grantor.

But that can be a problem because trusts pay comparatively high tax rates. For instance, that top 39.6% rate kicks in when trust income exceeds $12,500 in 2017. Compare that to the $470,700 threshold for the top rate for a married grantor who files a joint return, or $418,400 for a single filer. That can translate into very high taxes for a non-grantor trust.

But that's where an IDGT may come to the rescue. As long as the grantor retains certain powers, the grantor, rather than the trust, will be taxed on trust income—even if none of that income goes to that person. An IDGT trust is set up so that it will purposely fail to qualify as a non-grantor trust, thus avoiding the higher taxes that come with the non-grantor designation.

What about estate and gift taxes? Money you transfer to an IDGT is treated as a taxable gift, but there's a current individual exemption of $5.49 million in 2017 that could reduce or eliminate your tax liability for the gift. (There also are other ways to structure this transfer so that it's not considered a gift at all.) In addition, the assets you transfer into the trust are no longer in your taxable estate, whose value will be reduced further by the annual taxes you pay on trust assets.

But IDGTs are complex arrangements, and you'll need the help of an experienced estate planning professional to create a trust that fits your needs. Seek expert assistance. ●

Why Would You Take Your RMDs Sooner?

Is it time for you to begin taking required minimum distributions (RMDs) from your retirement plans? The rules for 401(k)s, other employer-sponsored plans, and traditional IRAs generally call for these payments to start after you reach age 70½ and to continue each year. But you don't actually have to begin RMDs until the "required beginning date" (RBD) of April 1 of the year *after* you turn 70½.

Nevertheless, you might bypass this respite. Why would you do that? Because you still must take another RMD later that year. Thus, you would be doubling up on payouts and have to pay more tax.

Although your savings in 401(k)s and traditional IRAs grow without being taxed along the way, you eventually must start receiving RMDs, taking one each year by December 31. These RMDs generally are taxed at ordinary income tax rates.

If you're still working and don't own the company you work for, you may be able to postpone withdrawals from an employer-sponsored plan with that company until you retire. But this exception doesn't apply to traditional IRAs.

The amount of the RMD is based on IRS life expectancy tables and the value of your accounts on the final day of the previous tax year. Your financial advisers or the financial company holding your account can provide assistance in computing the amount.

The penalty for failing to take an RMD is equal to 50% of the amount that should have been withdrawn (or the difference between the required amount and any smaller amount you did withdraw). For example, if you're required to take $20,000 and you're in the 28% tax bracket, the penalty for failing to withdraw is $10,000, plus you'll owe $5,600 in federal income tax on the distribution.

Five 401(k) Options When You Leave A Job

If you have participated in a 401(k) plan where you work, you may have accumulated a tidy nest egg for retirement. But what happens to those funds if you switch jobs or retire? Typically, you will have at least five options:

1. Take a lump-sum distribution. If you have a pressing need for the money, you can arrange to have your investments sold and the proceeds paid to you in a single sum. However, beyond depleting your savings, this also may have negative tax consequences. Most or all of the money may be taxed at ordinary income rates, which can reach as high as 39.6%, and a large payout may result in other tax complications, including a 3.8% surtax on net investment income (NII).

And if you're younger than age 59½, you also may owe a 10% early withdrawal tax, unless an exception applies. You might not have to pay this penalty if you need the money for a divorce settlement or medical expenses, for example.

2. Arrange a series of payments. If your plan allows it, you might set up a system of periodic payments you receive on a monthly, quarterly, or annual basis. You also can simply withdraw money when you need it.

By taking distributions gradually, you spread out your tax payments and may pay less. For example, suppose that a lump-sum distribution would push you into the top 39.6% bracket —whereas with a series of payments, you may be taxed at a 35% rate or lower. This also could reduce your exposure to the NII surtax.

3. Roll over to an IRA. Another option is to transfer funds from a 401(k) to a traditional IRA in your name. As long as the rollover is completed within 60 days, you won't owe tax on the distribution, and you also won't be subject to the 10% penalty tax. In effect, you can take an interest-free loan from your savings for two months, although 20% of any money you withdraw will be withheld for potential taxes. If you repay the funds on time you can recoup that money when you file your tax return. If you miss the 60-day deadline, however, you'll owe income tax on the full amount.

A safer approach may be to use a trustee-to-trustee transfer, in which your funds go directly from the 401(k) to the IRA—your hands never touch the money—and there are no taxes.

If you roll over funds from your 401(k) to a Roth IRA instead of a traditional IRA, you'll owe tax on the amount of the conversion, just as if you'd transferred money from a traditional IRA to a Roth.

4. Roll over to a new 401(k). If you're changing jobs and your new employer provides a 401(k), you may be allowed to transfer your savings into a 401(k) account sponsored by the new employer. Your new company also might offer the option of converting to a Roth 401(k)—here, too, you would owe income tax on the amount you convert to a Roth account.

This kind of rollover also must be completed within 60 days to avoid tax liability. A trustee-to-trustee transfer may be your simplest choice.

In deciding where or whether to move your savings, you may want to compare the investment offerings of the various possibilities. For instance, you might opt to use an IRA if it provides more investment flexibility or better selections than you'd get in the new employer's plan.

5. Keep the funds where they are. Finally, your existing 401(k) might let you leave your money where it is. This option has been discouraged in the past, because you no longer work for the employer and might have concerns about access to your account, but recently it has become more common.

Once again, your preference may depend on the investment choices available through your plan. If you've had good success with the investments in your old employer's plan, you might decide to stay the course. At the very least, you can retain the status quo until you decide on your next step.

Of course, everyone's situation is different. Your financial advisor can help you analyze the particulars of each option so that you can make an informed decision. ●

If you postpone your first RMD until the following year, you'll have to take two RMDs in that year. If you remain in the same tax bracket, that will double the tax you owe, or the extra payment may push you into a higher tax bracket. Going back to our example of an annual $20,000 RMD, you'll have to take two RMDs for a total of $40,000 in the following year. Suppose that $10,000 of the extra amount is taxed at the 33% rate. Your total tax bill on RMDs for that year comes to a whopping $11,700 (28% x $30,000 + $10,000 x 33%).

Furthermore, doubling up on RMDs increases the possibility you'll have to pay the federal surtax on "net investment income," and it could hike your state income tax liability as well.

As you approach your RBD, consider your options. In many cases, you'll be better off taking your first RMD in the year in which you turn age 70½, rather than the following year. ●

Tax Rewards For Charitable Trusts

Are you thinking of giving a large gift to charity? A charitable trust can help you satisfy your philanthropic goals, preserve wealth for your heirs, and collect tax breaks, all at the same time. One of the most popular of these is the charitable remainder trust, or CRT.

A CRT requires you to give up control over the assets that you transfer into the trust and it's irrevocable. There's no going back, so make sure this charitable vehicle suits your needs before you commit to it.

Typically, you will set up a CRT with a particular charity you want to support. The charity must be approved by the IRS as a tax-exempt entity. During its term, you (or another income beneficiary or beneficiaries that you specify) receive regular payouts. The CRT may last for terms of years or for your lifetime. Finally, when the trust ends, whatever is left—the remainder—goes to the charity.

There are three main tax advantages to this setup:

1. Regular income tax: You're entitled to a current tax deduction for the projected value of the remainder that will go to the charity at the end of the trust's term. Your tax adviser and charity officials can help determine the amount of your deduction.

2. Capital gains tax: If you transfer appreciated assets into the trust you won't owe any tax on the appreciation. And if the charity sells property from the trust and turns it into cash, you don't have to worry about capital gains tax then, either. But you pay income tax on the annual payments you receive.

3. Estate tax: When the remainder eventually goes to the charity at the end of the trust, those assets are removed from your taxable estate. So there aren't any estate tax concerns with a CRT.

Let's not forget that you'll be receiving annual income from the CRT. It can be structured in one of two ways, which must be determined when you set up the trust. You can't change your mind later. Here are the two ways:

- **Fixed annuity method:** The CRT pays out a fixed dollar amount each year. So even if trust earnings fall, you'll still receive the same amount of money.
- **Percentage of assets method:** Another version, which is more common, is to base the annual payment on a percentage of assets. For instance, you might arrange to receive 6% of the value of the trust assets each year. Accordingly, your annual 6% payments generally will provide larger payouts over time, assuming the assets go up in value, but the amounts are based on market conditions.

In any event, the IRS requires you to receive at least 5% of the value of the trust each year and the charity's remainder value must be at least 10% to preserve the tax breaks.

This is just a brief overview of CRTs. For more information about this rewarding tax planning technique, reach out to your advisers. ●

Trump's Tax Reform Plan

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to adjust the taxable basis of inherited property to its value at the death of the person making the bequest. This so-called step-up in basis may reduce capital gains taxes on inherited assets. The proposed changes could cause income tax complications for some taxpayers.

6. Repatriation tax. Tax revenue has shrunk in recent years due to so-called "tax inversions," through which multinational companies relocate their headquarters in a foreign country to avoid paying higher U.S. taxes. Trump has advocated a one-time tax repatriation holiday rate for corporations that would let them pay a tax rate of 10% on income brought back to the U.S.

7. Child care. The current tax law attempts to help beleaguered parents through a child tax credit (CTC) and a dependent-care credit for certain child-care costs. Low-income families may benefit from the earned income tax credit (EITC). Trump would overhaul the rules and institute a new deduction for child-care expenses, increase the EITC, and create tax-favored dependent care savings accounts, among other changes.

Many more changes could be in the works. For instance, Trump has advocated repealing the alternative minimum tax (AMT), the benefits for "stretch IRAs" that let inheritors spread out distributions over their life expectancies, and the 3.8% surtax on "net investment income" authorized by Obamacare. ●

Robert J. Pyle Diversified Asset Management, Inc. 1113 Spruce Street, Boulder, CO 80302
Phone: (303) 440-2906 Fax: (303) 539-9880 E-mail: rpyle@diversifiedassetmanagement.com www.DiversifiedAssetManagement.com