

TNU-2017-5  
MAY 2, 2017



# Meridian Client Update

## President Trump Unveils Proposed Tax Plan

**President Trump's proposed tax plan is largely similar to the plan he proposed during the presidential campaign—large cut in corporate tax rate, reduction in individual tax rates with consolidation of tax brackets, elimination of most deductions and increase in the standard deduction.**

The proposed tax plan represents a broad-brush proposal rather than a detailed tax plan. Significant work lies ahead for the Trump administration to iron out the key points of the tax proposal so that it will be acceptable to the various (and often differing) factions of the Republican Party. Democratic support is likely to be minimal regardless of the detailed terms of the tax proposal. No realistic prediction on the likelihood of passage or effective dates can be made at this time.

### Proposal on Corporate Income

The following are the key elements of the President's corporate tax proposal.

- **Substantial reduction in corporate tax rate.** The tax rate on corporate income would fall to 15% from 35%.
- **Move to territorial tax system.** Income subject to tax would be limited to U.S.-derived income. Currently, U.S. corporations are taxed on worldwide income.

The proposal is silent on the imposition of a border adjustment tax and on the treatment of repatriated foreign profits.

**Meridian Comment.** The proposed dramatic changes in corporate tax rates and the move to a territorial tax system could profoundly affect companies' performance plans linked to net income, earnings per share or any other post-tax measure. According to a Wall Street Journal article, a Bank of America Merrill Lynch study concluded that S&P 500 companies would see a 12% increase in earnings per share **based on a 20% tax rate** and the U.S. moving to a territorial tax system.<sup>1</sup> The proposed 15% corporate tax rate should further increase earnings per share.

Often performance awards expressly provide that the determination of achieved performance exclude the effect of substantial change in tax laws. Depending on the specific plan design, these awards would not be affected by enactment of President Trump's proposed tax plan. However, where a plan is silent, Boards and Compensation Committees will need to evaluate whether, and to what extent, any positive (and, in some cases, negative) effect of tax law changes on achieved performance should be considered. For companies developing performance metrics for annual incentive plans and long-term performance awards, care should be taken on setting performance metrics related to net income, earnings per share and other post-tax measures in light of the tax proposal and its potential enactment.

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<sup>1</sup> Francis, Theo and Rubin, Richard, *Companies Dig Into Details of Proposal*, Wall Street Journal, April 27, 2017, p.A4.

## Proposal on Individual Income

The following are the key elements of the President's individual tax proposal.

- **Reduces number of tax brackets and top marginal rate.** The number of tax brackets would fall to three from seven and the top marginal rate would fall to 35% from 39.6%. The three marginal rates would be 10%, 25% and 35%. However, the proposal does not identify income levels for each tax bracket.
- **Eliminates most itemized deductions.** Except for deductions for mortgage interest and charitable contributions, the tax proposal would eliminate all other itemized deductions (e.g., real estate taxes paid, State and local taxes paid, casualty and theft losses, etc.).
- **Increases standard deduction.** The standard deduction for a married couple filing jointly would almost double to \$24,000 from \$12,700. However, the proposal does not address the fate of personal exemptions.
- **Eliminates alternative minimum tax (AMT).** AMT would be repealed entirely.
- **Eliminates estate tax.** The estate tax would also be repealed.
- **Eliminates health care tax on investment income.** Enacted as part of Obamacare, the health care tax of 3.8% imposed on investment income would be repealed.
- **Introduces special tax on pass-through business income.** Currently, income from pass-through entities (e.g., partnership income, Sub S income) is treated like wages for tax purposes. That is, such income is subject to the same marginal tax rates applicable to W-2 wages. Under the tax proposal, a special 15% flat tax would apply to "business income" derived from a pass-through entity. The notion is to apply the same tax rate to all business income regardless of the legal structure of the underlying business entity.

**Meridian Comment.** The proposed 15% tax rate on pass-through business income appears to be among the more controversial and complex aspect of the President's tax proposal. Although not specifically outlined in the White House one-page summary of the tax proposal, presumably a portion of pass-through income would be treated as compensation income, which would not be eligible for the special 15% flat tax rate. Rather, the 15% flat tax rate would kick-in solely with respect to "business income," amounts earned in excess of paid compensation. This would require pass-through entities to determine the extent to which pass-through income constitutes compensation or business income. Currently, the tax laws provide little guidance on delineating between compensation and business income derived from a pass-through entity.

The proposal does not address whether the 15% flat tax rate would also apply to income earned by an independent contractor.

The follow page shows a side-by-side comparison of the Trump campaign and Trump administration tax proposals against current tax law.

## Side-By-Side Comparison of Trump Campaign and Trump Administration Tax Proposals Against Current Tax Law

### Corporate Tax Proposal

Tax Provision	Current Tax Rates/Policy	Trump Campaign Tax Proposal	Current Trump Tax Proposal
Corporate Tax Rate	35.0%	15.0%	15.0%
Income Subject to Tax	Worldwide Income	No proposal	U.S. Income

### Individual Tax Proposal

Tax Provision	Current Tax Rates/Policy	Trump Campaign Tax Proposal	Current Trump Tax Proposal
<b>Income Tax Brackets (Married Filing Jointly)</b>			
\$0 to \$18,550	10.0%	12%*	10.0%**
\$18,551 to \$75,300	15.0%		
\$75,301 to \$151,900	25.0%	25%*	25.0%**
\$151,901 to \$231,450	28.0%		
\$231,451 to \$413,350	33.0%	33%*	35.0%**
\$413,351 to \$486,950	35.0%		
\$486,951	39.6%		
<b>Standard Deduction (married filing jointly)</b>	\$12,600	\$30,000	\$24,000
<b>Certain Pass-Through Income</b>	Added to other taxable income, which is subject to above rates	No proposal	15.0%
<b>Itemized Deductions</b>	6 categories <ul style="list-style-type: none"> <li>• State &amp; Local Taxes</li> <li>• Medical &amp; Dental</li> <li>• Mortgage Interest</li> <li>• Charitable Contributions</li> <li>• Casualty &amp; Theft Losses</li> <li>• Job Expenses &amp; Certain Misc. Expenses</li> </ul>		2 categories <ul style="list-style-type: none"> <li>• Mortgage Interest</li> <li>• Charitable Contributions</li> </ul>
<b>Capital Gains</b>	20.0%	6.0% to 16.5%	20.0%
<b>Health Care Tax on Investment Income</b>	3.8%	Repealed	Repealed
<b>Alternative Minimum Tax</b>	28.0%	Repealed	Repealed
<b>Estate Tax</b>	40.0%	No proposal	Repealed

\*Under the Trump campaign tax proposal, the second and third income brackets slightly differed from existing income brackets.

\*\*The Trump proposal does not specify income levels for each tax bracket.

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The **Client Update** is prepared by Meridian Compensation Partners' Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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