

Taxes and Investments

There is one thing that we know about the new administration; it will bring change. Specifically, we believe that the tax code will change and that taxes on investment income will change. These changes will have a profound impact on our investment decision making now and well into the future. Below, we provide a brief analysis of what has been proposed.

There are currently two plans that have been floated to date:

- The Ryan Plan [A Better Way](#)
- The Trump Plan at DonaldJTrump.com

Here is the relevant language from the Ryan Plan:

"SIMPLICITY AND FAIRNESS

Our plan makes the tax code simpler, fairer, and flatter, so that it's not only easier to do your taxes, but it's also easier to have peace of mind at critical moments, whether it's going to school, getting a job, raising a family, or planning for retirement. Save time and money by making it so that most Americans can do their taxes on a form as simple as a postcard.

- *Consolidate the system down to three tax brackets, and lower the top individual income tax rate to 33%.*
- *Simplify tax filing for families by creating a larger standard deduction and a larger child and dependent tax credit.*
- *Make it easier to pay for college by streamlining the maze of education tax benefits.*
- *Eliminate the alternative minimum tax so you don't have to do your taxes twice a year.*
- *Reward work by improving the EITC.*
- *Encourage charitable giving by providing a real tax incentive.*
- *Help families plan for retirement by reforming savings provisions.*
- *Stop overtaxing "Made in America" products so that our manufacturers can compete.*
- *Repeal the death tax so that the loss of a family member will no longer be taxable.*

JOB'S AND GROWTH

Our plan will make it easier to create jobs, raise wages, and expand opportunity for all Americans.

Cut taxes on small businesses by creating a separate, low tax rate of 25 percent for many on Main Street.

Cut taxes on savings and investment by allowing families and individuals to deduct 50 percent of the dividends, capital gains, and interest received from stocks and mutual funds.

Provide a tax-free return on new investment by allowing, for the first time ever, full and immediate write-offs.

Restore American competitiveness by lowering our corporate tax rate from the highest in the industrialized world to 20 percent and shifting to a "territorial" system with more competitive rates.

Create more certainty by eliminating the death tax, which can take up to 40 percent of a family business's assets if the owner passes away."

Under Representative Ryan's plan, the impact would be to:
Reduce the number of brackets to three with a reduction in the top tax rate to 33% from 39.6%.

Allow families and individuals to deduct 50 percent of the dividends, capital gains, and interest received from stocks and mutual funds. While not explicitly mentioned in the Ryan Plan, it is assumed that the intent is to also eliminate the Obamacare tax of 3.8% on passive income (dividends and interest), based on the stated commitment to repeal Obamacare.

There is a question as to how interest from bonds and other debt related instruments would be taxed under the Ryan Plan. Under the most liberal interpretation of the proposal, all investment income would be taxed at the same rate. If so, a taxpayer in the top bracket would see a 62% reduction on the effective tax rate for interest income (implied, not specifically proposed) and a 30.7% reduction on the effective tax rate for qualified dividends and long-term capital gains (see the chart below). The proposal makes no specific reference to non-qualified dividends or short-term capital gains, but refers to cutting taxes on savings and investments in general. Therefore, we assume that all investment income would be taxed at the same lower rate.

This plan, if adopted, would result in lower overall rates, significant reductions on taxes for investment income and a normalization of tax rates across investments at 50% of the tax rate for ordinary income.

The Trump plan offers less generous treatment for investment income, specifically calling for retention of the 20% rate on long-term capital gains. Further, it makes no reference to interest income. In the table below, we assume that the rate on short-term capital gains and interest income (currently taxed at the same rate as ordinary income) will be taxed similarly, but at a lower rate and exclusive of the Obamacare tax. We also assume that qualified dividends (currently taxed at a maximum rate of 20% plus the 3.8% Obamacare tax) will remain unchanged, except for the elimination of the Obamacare tax. The Trump Plan explicitly states the intent to repeal the Obamacare tax.

Here is the language from the Trump Plan:

"Income Tax

Tax rates

The Trump Plan will collapse the current seven tax brackets to three brackets. The rates and breakpoints are as shown below. Low-income Americans will have an effective income tax rate of 0. The tax brackets are similar to those in the House GOP tax blueprint.

*Brackets & **Rates** for Married-Joint filers:*

*Less than \$75,000: **12%***

*More than \$75,000 but less than \$225,000: **25%***

*More than \$225,000: **33%***

**Brackets for single filers are ½ of these amounts*

The Trump Plan will retain the existing capital gains rate structure (maximum rate of 20 percent) with tax brackets shown above. Carried interest will be taxed as ordinary income.

The 3.8 percent Obamacare tax on investment income will be repealed, as will the alternative minimum tax."

Proposals for Changes to the Top Tax Rates on Investment Income

	Current Tax Law	Ryan Proposal*	Trump Proposal**	Change Under Ryan Proposal	Change Under Trump Proposal
Top Income Tax Rate	39.6%	33.0%	33.0%	-16.7%	-16.7%
Top Tax Rate on Interest	39.6%	16.5%	33.0%	-58.3%	-16.7%
Obamacare Tax	3.8%	0.0%	0.0%	-100.0%	-100.0%
Effective Top Tax Rate on Interest	43.4%	16.5%	33.0%	-62.0%	-24.0%
Top Tax Rate on Short-Term Capital Gains	39.6%	16.5%	33.0%	-58.3%	-16.7%
Obamacare Tax	3.8%	0.0%	0.0%	-100.0%	-100.0%
Effective Top Tax Rate on Short-Term Capital Gains	43.4%	16.5%	33.0%	-62.0%	-24.0%
Top Tax Rate on Qualified Dividends	20.0%	16.5%	20.0%	-17.5%	0.0%
Obamacare Tax	3.8%	0.0%	0.0%	-100.0%	-100.0%
Effective Top Tax Rate on Qualified Dividends	23.8%	16.5%	20.0%	-30.7%	-16.0%
Top Tax Rate on Long-Term Capital Gains	20.0%	16.5%	20.0%	-17.5%	0.0%
Obamacare Tax	3.8%	0.0%	0.0%	-100.0%	-100.0%
Effective Top Tax Rate on Long-Term Capital Gains	23.8%	16.5%	20.0%	-30.7%	-16.0%
* As detailed in Speaker Ryan's "A Better Way"			** As detailed at DonaldJTrump.com		

How Likely Are These Changes?

Given that Republicans will control both houses of Congress and the White House, it is highly likely that one of these plans will be the blueprint for inevitable change. Given the reality of the deficit and the national debt, it will probably be closer to the Trump plan than the Ryan plan. The markets have already reacted. The result has been a rally in the equity markets and a sell-off in the bond market.

The Trump/Ryan alliance is almost certain to reduce taxes on all types investment income. The final rates, however, will be determined through intense negotiation and will balance the desire for growth against the reality of debts and deficits. The ultimate determination will provide greater insight on relative value as it becomes clearer which investments will be taxed at what rates and over what time horizon.