



**THE WASHINGTON UPDATE**<sup>®</sup>  
FROM ANDY FRIEDMAN

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# 2016 Election



*“I remember when I was The Donald!”*

# Trump's Plan

- Increase economic growth through:
  - Lower taxes
  - Less government regulation of businesses
  - Protect U.S. businesses and workers

# Trump's Power

- Republican Congress
- Reverse Obama executive orders
- Checks on Trump power:
  - Senate filibuster rules (use of reconciliation procedure)
  - Deficit hawks in House

# Federal Spending – FY2018 Deadlines

- Government is funded through December 8, 2017.
  - Congress must pass appropriations legislation before that date to avoid a shutdown on December 9.
- Congress has authorized the federal government to borrow additional funds through December 8, 2017.
- Passage of appropriations and debt ceiling legislation requires 60 votes in Senate.

# House Republican Budget Proposal

- Increase in defense spending
- Significant cuts to discretionary spending on domestic programs
- Significant cuts to mandatory (entitlement) spending, particularly to “safety net” programs
- Trump seeks funding for Mexican border wall and down payment on infrastructure repair program.

# Tax Reform

“This [preparing my tax return] is too difficult for a mathematician. It takes a philosopher.”

Albert Einstein



# Tax Reform

“We have what it takes to take  
what you have.”

Unofficial Motto of the  
Internal Revenue Service

# Tax Reform - Enactment Process

- Senate can use reconciliation procedure to pass tax bill with 51 votes as long as:
  - Bill does not lose more than \$1.5T in revenue over 10 years
  - Bill does not lose any government revenue after 10 years.
- Must eliminate or cap some “sacred” deductions and exemptions to recoup at least some of the revenue lost from reduced tax rates.
- Tax reform will have winners and losers.

# Tax Reform - Enactment Process

- House Ways & Means Committee passes bill
- Senate Finance Committee passes bill
- Full House passes bill
- Full Senate passes bill
- Conference Committee resolves bill differences
- House and Senate pass identical bill

*Effective date: January 1, 2018*

# Tax Reform - Individual

- House: Top individual rate unchanged at 39.6%, but now applies to joint incomes > \$1M rather than > \$470K. Senate reduces top rate > \$1M to 38.5%.
  - No change to 20% maximum dividend / capital gains tax rate or to ACA 3.8% surtax on investment income.
  - House: Phase out of 12% rate for joint incomes > \$1.2M produces an effective rate of 45.9% up to \$1.4M income.

Source for this slide and following tax reform slides: *Tax Cuts and Jobs Act (November 2017)*

# Tax Reform - Individual

- Eliminate alternative minimum tax
- Wealth transfer
  - Increase unified lifetime estate / gift exclusion to \$11.2M.
  - House: Repeal estate tax and GST (but not gift tax) beginning 2024.
  - No change to stepped up basis.

# Tax Reform - Individual

- Double standard deduction to \$24K.
- Replace personal exemptions with:
  - House: \$1600 child credit and \$300 non-child credit through 2022 (phased out for joint incomes > \$230K).
  - Senate: \$1650 child credit only, no expiration (phased out for joint incomes > \$1M).
- Repeal limitation on itemized deductions claimed by high income taxpayers (Pease limit).

# Tax Reform - Individual

- Mortgage interest:
  - House: Reduce cap on mortgage loans for which interest is deductible from \$1M to \$500K. Eliminate deduction for interest on second home mortgage and home equity loans. Existing indebtedness grandfathered.
  - Senate: Eliminate deduction for interest on home equity loan only, including existing indebtedness.

# Tax Reform - Individual

- State and local taxes: Eliminate deduction for state and local taxes, other than state and local taxes incurred by a business.
  - House bill also allows individuals to deduct property taxes up to \$10K annually.
- Repeal deductions for medical expenses (House only) and casualty losses.
- Preclude catch-up contributions for worker earning > \$500K.



# Tax Reform - Business

- Reduce tax rate on C corporations from 35% to 20%.
  - Senate would apply lower rate beginning 2019.
- Lower tax on business income earned by pass-through entities.
  - House: Tax rate 25%. Passive investor applies lower rate to all income. For owner / employee, rate applies to 30% of income from non-service businesses, 0% of income from service business.
  - Senate: Deduct 17.4% of business income for non-service businesses up to 50% of wages paid, 0% for service business unless income < \$150K.

# Tax Reform - Business

- Permit immediate deduction of capital expenditures made through 2022.
- Eliminate deduction for business net interest expense exceeding 30% of business income.
  - Exemption for businesses with gross receipts < \$25M (House)  
\$15M (Senate).
- Eliminate deduction for business entertainment expenses.
- Curtail special tax provisions for insurance companies.

# Tax Reduction - International

- Eliminate tax on repatriated future earnings.
- Deemed repatriation of existing overseas earnings, with cash taxed at 14% (Senate 10%) and illiquid assets at 7% (Senate 5%), payable over 8 years.
- Curtail “base erosion” arrangements where U.S. business holds i/p in tax haven jurisdiction and claims U.S. tax deduction for payments made for i/p use.

# Tax Reform - Revenue Effects (\$billion)

## *Individual*

Tax rate reduction (1,089.4)

Repeal AMT (695.5)

Estate tax (171.5)

Revenue raisers 1475.2

*Total individual* (481.2)

## *Business*

Rate reduction (1,461.5)

25% pass through (448.0)

International 285.4

Revenue raisers 645.0

*Total business* (979.1)

**Total revenue loss (1,460.3)**

Source: *Estimated Revenue Effects of H.R. 1 (Joint Committee On Taxation (November 2017)).*

# Tax Reform

## *Individual*

## *Business*

Winners	Losers	Winners	Losers
AMT Payers	High W-2 Earners	Retail	Technology/ Pharmaceutical
Large Estates	Large Mortgages High State Taxes	Capital Intensive Businesses	Builders/Mortgage/ Real Estate
Non-Service Pass- through	Personal Service Pass- through	U.S.-Based Multi- National Businesses	Insurance companies

*Note: State tax liability may increase as federal tax base increases.*

# Trump Foreign Relations

- “America First” policy: “peace through strength”.
  - Focus on Defense Department rather than State (diplomacy).
- Rejection of globalism, which has hurt American workers.
- Focus on domestic growth, not foreign involvement to spread democracy.
- Support nation’s right to protect borders.
- Bilateral rather than multinational treaty negotiations.

# Trade

“[The problem is] more and more of our imports are coming from overseas.”

President George W. Bush (2000)

# Trade

- Tariffs on imported goods
- Push back from House Republicans
- Executive action:
  - Counter currency manipulation
  - Correct balance of payments
  - Protect domestic industries injured by imports
  - National emergency or national security
- Negative effect on economic growth?



# Trade

“Simply put, any policy proposal which drives up costs of Corona, tequila, or margaritas is a big-time bad idea. Mucho Sad.”

Senator Lindsey Graham (R-SC)  
(February 2017)

# Obamacare – Replacement Challenges

- Republican effort to replace ACA failed.
  - Elimination of penalty for non-purchasers of insurance and changes to subsidies for purchasers caused 20% projected increase in premiums and pushed more costs onto insureds through higher deductibles, etc.
  - Elimination of federal funding for Medicaid expansion would have taken away insurance from 22M people.

Source: *Congressional Budget Office Cost Estimate, Better Care Reconciliation Act of 2017 (June 26, 2017); CBO Letter to Representative Mike Enzi (July 20, 2017).*

# Obamacare – Adverse Trump Administration Actions

- Cease payment of cost sharing reduction subsidies.
- Do not enforce penalty for failure to purchase insurance.
- Expand use of unregulated association health plans.
- Expand use of non-compliant short-term limited duration health insurance.

# Obamacare – Adverse Trump Administration Actions

- Expand use of employer health reimbursement arrangements to pay employee medical expenses, not just ACA policy premiums.
- Cut open enrollment period in half.
- Drastically reduce federal assistance for individuals looking to purchase insurance on ACA exchanges.

# Financial Services

- Filibuster prevents full Dodd-Frank repeal.
- Trump executive order calls for sweeping review of Dodd-Frank regulations and enforcement with an eye toward removing impediments to “economic growth and vibrant financial markets and enabling American companies to be competitive.”

# Financial Services

- Treasury report sets out proposed changes to reduce regulatory burden on financial services industry, including:
  - Reduce burdensomeness of “living will” requirement and stress tests.
  - Reduce scope of the Volcker rule (limiting proprietary investments).
  - Increase bank asset threshold for strict oversight from \$50B to \$200B.

Source: *A Financial System That Creates Economic Opportunities Banks and Credit Unions*, U.S. Department of the Treasury (June 2017).

# Financial Services – DOL Fiduciary Rule

- Rule nominally went into effect on June 9, 2017. But DOL will not begin to enforce rule until July 1, 2019.
- During transition (before July 1, 2019), broker-dealer is not required to establish compensation system that curtails differing FA compensation.
- During transition, DOL “will not pursue claims against fiduciaries who are working diligently and in good faith to comply.”

# Financial Services – DOL Fiduciary Rule

- DOL is considering changes in three areas:
  - Contract requirement and enforcement mechanism
  - Rollovers from 401(k) plans
  - Treatment of annuities
- DOL also is considering a new “streamlined” exemption from the rule, presumably for certain classes of products.

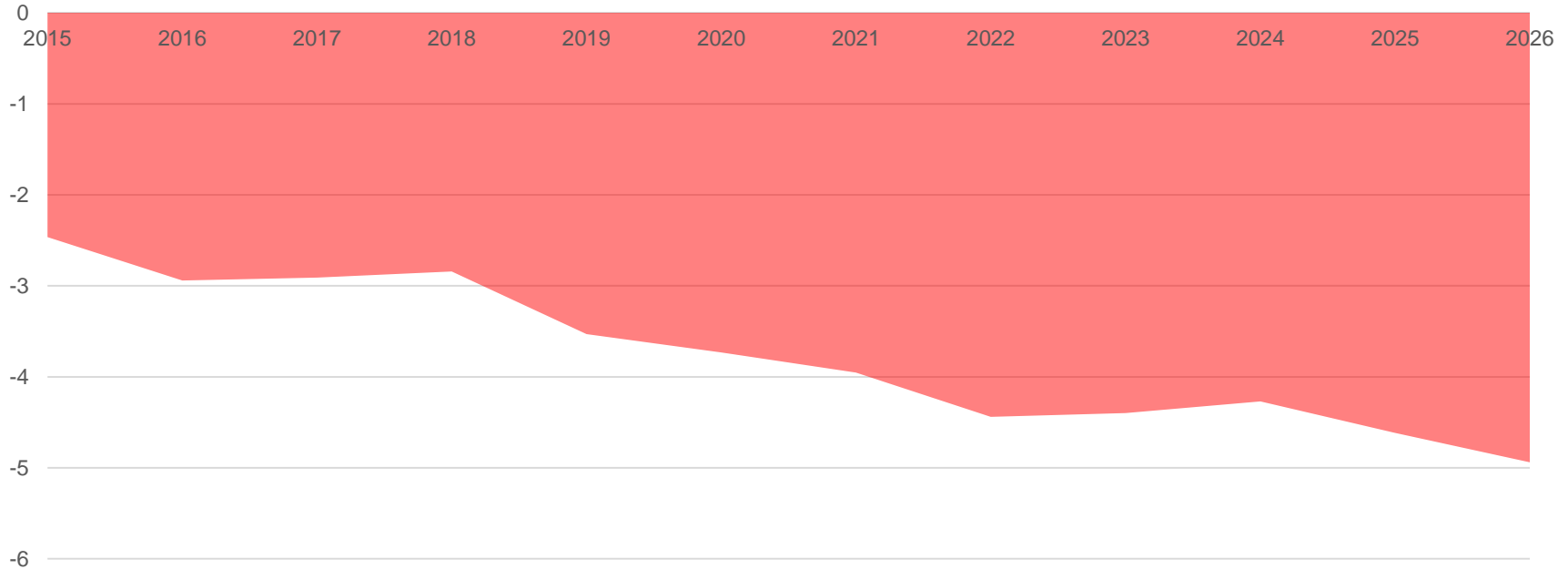


# Energy

- Goal: U.S. energy independence.
- Expanded exploitation of conventional energy sources. Climate change is not a concern.
- Repeal Obama environmental regulations limiting fracking; carbon emissions on power plants; and oil, gas, coal extraction.
- *Boost for fossil fuels:* oil, natural gas, coal, shale.
- *Boost for domestic production:* offshore drilling, drilling on federal lands, stalled pipeline projects.

# Fiscal Realities

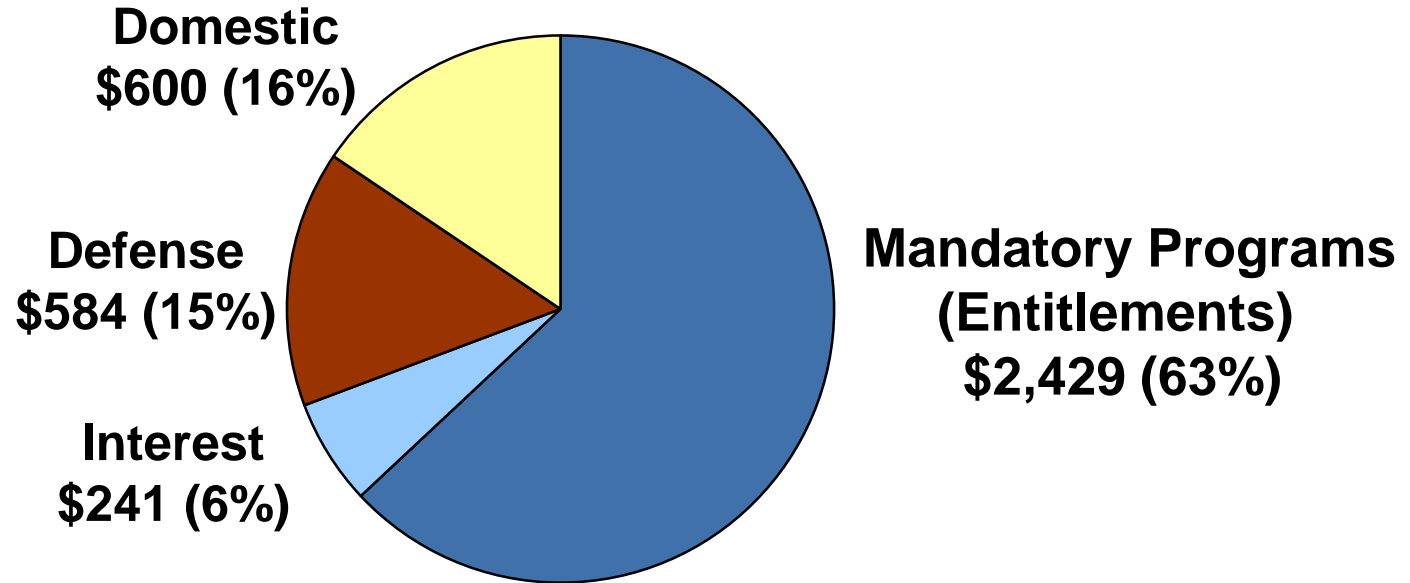
## Annual Deficit as a % of GDP



Source: *The Budget and Economic Outlook: Fiscal Years 2017 to 2027*, Congressional Budget Office (Jan 2017)

# Fiscal Realities

*2016 Federal Spending (\$3.9T) (in billions of dollars)*



Source: *The Budget and Economic Outlook: Fiscal Years 2017 to 2027, Congressional Budget Office (Jan 2017)*

# Economic and Market Consequences

- Fiscal stimulus, tax reform, reduced regulation should be favorable for economy and markets. Modulating effects:
  - Congressional curtailment of spending or tax cuts
  - Trade policy (tariffs)
  - Inflation concerns prompting higher interest rates
  - War
  - Special counsel investigation on Russia and Trump unpredictability
- Longer term deficit growth could cause over-borrowing.

# Investigations

“I don't believe Trump colluded with the Russians. I don't think he even colludes with his own staff.”

Sen. Lindsey Graham (R-S.C.)  
(June 2017)

# Favorable Market Sectors

- Domestic industrials (infrastructure, expensing)
- Traditional energy (oil, coal, pipelines)
- Defense (defense build-up, expensing)
- Retail (lower tax rates)
- U.S.-based multinationals (tax reform)
- Financial services (less regulation, higher interest rates)

# Uncertain Market Sectors

- Technology (international tax changes)
- Real estate / builders (reduced tax deductions)
- Pharmaceutical (ACA changes, international tax changes)
- Health care (ACA changes)
- Insurance (ACA changes, tax reform)

# Tax Planning

- Protect against future tax volatility with flexibility to withdraw from taxable and tax-deferred accounts and investments.
  - Asset location as well as asset allocation.
  - Three buckets: taxable, tax-free and tax-deferred.
- Diversify sources of income generation.
  - Municipal bonds, annuities, life Insurance, MLP's, tax-efficient mutual funds, pre- and post-tax retirement plans.



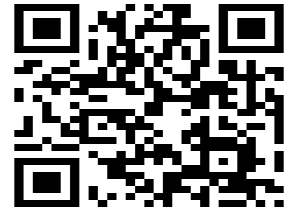
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