



L. Roy Papp & Associates, LLP
Investment Counsel

2201 East Camelback Road
Suite 227B
Phoenix, Arizona 85016
(602) 956-0980
FAX: (602) 956-7053

VIEWS FROM CAMELBACK MOUNTAIN

The Good and The Bad About U.S. Taxes

We have all heard a great deal of commentary from businesses and politicians that the U.S. tax system is broken. In particular, corporate taxes contain numerous provisions, which we believe create inappropriate and destructive incentives for U.S. businesses. Without entering a political or philosophical debate about whether America would be better off if the government collected more or less tax from corporations, we do believe that the government could collect the same, more, or less in tax from corporations, but do so in a way that avoids damage to the U.S. economy. U.S. corporate tax law dates back to a time when most American businesses were involved in manufacturing, extraction or creation of commodities. Business was largely conducted within the United States or goods and products were manufactured in the U.S. for sale overseas. Today, most U.S. businesses are in the service, information and technology sectors. In many of these important sectors, business is substantially globalized. This has rendered the current U.S. tax system archaic and inefficient.

It is true that U.S. corporate taxes at 35% are among the highest in the world. In addition, the U.S. is also an outlier for taxing profits made by American companies in foreign locations. When corporations bring profits back into the United States, they are heavily taxed at rates as high as 35%. This has caused a large number of U.S. based companies to leave their accumulated profits and cash overseas to avoid paying what they feel is an exorbitant tax rate to bring their profits back to the United States. Whether we believe the rates are exorbitant or not, the result is the same, which is corporations leaving accumulated profits in the trillions of dollars parked outside of the U.S. This, in turn, causes companies to build new plants, hire more workers, conduct research and make acquisitions outside of the United States. This is a real drag on the potential growth of the U.S. economy. Our politicians can continue to fight about this and university researchers can debate what is fair or appropriate, but the results are the same; the cash sits abroad and new jobs and business expansion occur abroad instead of here in the U.S.

In the long-term, we think it would be a great idea for the Republicans and Democrats to get together and remodel the corporate tax structure to bring it into the 21st century so that it can efficiently and effectively deal with the kinds of businesses that are operating today. If that is not possible, a short-term solution such as a one or two year temporary reduction in the tax rate applied to foreign profits brought back to the United States, possibly 10%, would work much like a “fine-free” day at a library. We believe businesses would bring back hundreds of billions of dollars and thus would stimulate the growth of business and employment here in our country. This is not an entirely new strategy. We have done it before and it has been very effective, but our current leadership seems unwilling to pursue this. Let’s hope that the next Congress and Administration are more open to reasonable ideas.

Now, let’s focus on gift and estate taxes. These taxes have declined dramatically over the last fifteen years. As of January 1, 2016, a husband and wife in a traditional family will be able to leave \$10.9 million to their children and grandchildren without any gift or estate taxes. Fifteen or twenty years ago, couples had to work and plan carefully to be able to pass \$2 million to their

heirs without estate taxes. Currently, only the very rich pay estate taxes and this has greatly simplified planning for all but the very wealthy.

If we had to guess the outcome of the November 2016 elections today, we think it is most likely that Hillary Clinton will be elected President with a 50-50 Republican/Democrat Senate, or perhaps a small Democratic majority in the Senate. The House is likely to remain strongly Republican. This could well be the political scenario that could help bring about a “grand bargain” on tax reform. We might get a long-term remodel of the corporate tax system or we might get a short-term fix as addressed above. Those changes could come with major changes to the estate tax laws in order to balance out the “grand bargain” and not to overly benefit the wealthy. If this were to happen, some of our very wealthy clients might be well advised to take steps to make gifts or make other changes to their estate plan prior to December 31, 2016. We won’t know for sure the outcome of the election until November. Therefore, depending on how the election is shaping up, very wealthy clients might consider a visit with their estate planning attorneys and/or accountants earlier in the year so they are prepared to act based on the outcome of the election.

Finally, let’s focus on what is positive with American taxation, which is charitable deductions. Our firm has specialized for the last 30 years in advising clients on how to maximize the tax benefits from charitable contributions. Straightforward techniques include gifts of highly appreciated securities and the recently approved “charitable IRA rollover” that is now permanent. More complex gifts may include contributions to donor advised funds such as the Arizona Community Foundation or a variety of donor advised funds offered through popular investment custodians. We also have clients that have made gifts through charitable gift annuity programs. Some of the even more complicated arrangements include charitable trusts of all shapes and sizes and even the creation of family charitable foundations. We have arranged for our clients to make bequests at their passing to charities. Some have gifted a portion or all of an IRA account or insurance policy. Others have gifted securities or just a flat cash amount at their passing. We have also helped clients create complex, inter-generational family foundations which kick in on the passing of the older generation. Politically and philosophically, many of us might disagree on taxes. Relative to charitable gifting, I think most would agree that gifts to religious organizations, educational groups, arts and culture, social service or health organizations all work to make our community a better place. Our goal is to help our clients maximize the tax benefits available in conjunction with smart charitable gifting. In many cases, this allows our clients to make greater gifts than they might have imagined when they factor in the tax benefits available to them. If you have an interest in making a charitable gift, either now or at your passing, please contact one of our portfolio managers and they will help you to understand the opportunities and tax advantages available to you for your generosity.

All of us here at L. Roy Papp & Associates, LLP wish you and your family, a healthy, happy and prosperous new year.

Best regards,



Harry Papp
Managing Partner
December 31, 2015