Biden Administration: Potential Changes to Tax Code

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Estate, Gift and Basis Step-Up Tax Proposals

- Elimination of Step-Up in Basis at Death
- Reduction to Estate, Gift & GST Tax Exemption
- Effective Date of Changes
- Planning for Retroactive Tax Change
- Disclaimers, QTIP(s) and Formula Clauses

Carryover or Recognition …. ?

- Step-Up Regime
  - Central feature of the code for a century.
- Carryover Regime
  - Enacted in 1976
  - Retroactively repealed in 1980
  - In December 2019 Sen. Mitt Romney, R-Utah, and Sen. Michael F. Bennet, D-Colo, made a joint proposals for a carryover basis system.
- Recognition Regime
  - Previously proposed, but never codified
  - Most recently in 2015 by President Obama

Death as a Realization Event

- Exceptions to Obama's 2015 proposal:
  - spouses and charities would receive carryover basis;
  - exclusions for gains from certain small business stock;
  - deferment of tax on certain family owned businesses with ability to choose a 15-year fixed rate payment plan;
  - $100,000/person exclusion;
  - $250,000/person exclusion for principal residence sales;
  - unlimited use of capital losses and carry-forwards on final income tax return;
  - deductions for costs of appraisals; and
  - deduction for tax on decedent's estate tax return.

Returning the Estate Tax to 2009 Levels

- "As President, Biden will work to provide the type of comprehensive 12 weeks of paid family and medical leave envisioned in the FAMILY Act sponsored by Senator Kristen Gillibrand and Representative Rosa DeLauro. *Biden will pay for this proposal by <u>returning the estate tax to 2009 levels</u>*."
  - JoeBiden.com, "Highlights of Joe Biden's plans to support women during the COVID-19 crisis," https://joebiden.com/plans-to-support-women-duringcovid19/

TABLE 1

Estate, Gift, and GST Tax Rates and Exemptions under Current Law
2007–2020

TPC

Year	Estate and Generation-Skipping Transfer (GST) tax rate	Gift tax rate	Estate and GST tax exemptions	Lifetime gift exemptions	Annual gift exclusion[a]
2007	45%	45%	$2 million	$1 million	$12,000
2008	45%	45%	$2 million	$1 million	$12,000
2009	45%	45%	$3.5 million	$1 million	$13,000
2010	0%[a]	35%	N/A[b]	$1 million	$13,000
2011	35%	35%	$5 million	$5 million	$13,000
2012	35%	35%	$5.12 million	$5.12 million	$13,000
2013	40%	40%	$5.25 million	$5.25 million	$14,000
2014	40%	40%	$5.34 million	$5.34 million	$14,000
2015	40%	40%	$5.43 million	$5.43 million	$14,000
2016	40%	40%	$5.45 million	$5.45 million	$14,000
2017	40%	40%	$5.49 million	$5.49 million	$14,000
2018	40%	40%	$11.18 million	$11.18 million	$15,000
2019	40%	40%	$11.40 million	$11.40 million	$15,000
2020	40%	40%	$11.58 million	$11.58 million	$15,000

Source: Internal Revenue Code.

(a) The exemption, which was $10,000 in 1998, is indexed for inflation in $1,000 increments.

(b) Executors can elect to apply the EGTRRA rules, which repealed the estate tax for 2010, but otherwise the 2011 parameters apply.

Effect Date of Changes - Retroactive (?)

- Generally, tax law changes are effective on date of enactment or prospectively to the beginning of the next tax year.
- Treasury Secretary Yellen has recently signaled that Congressional action related to the pandemic and economic stimulus should take priority over tax law changes, and other administration figures have signaled that retroactive tax increases are not preferred.
- 10 Republicans would be needed to end the filibuster.
- But, consider Budget Reconciliation (e.g. American Rescue Plan).

What about the Lifetime Exemption?

- Under case precedent, as long the law is rationally related to a legitimate legislative purposes, courts have upheld retroactive provisions. *Pension Benefit Guaranty Corporation v. R.A. Gray & Co.*, 467 U.S. 717 (1984); *United State v. Carlton*, 512 U.S. 26 (1994).
- Most likely provision to be retroactive is the reduction to transfer taxes
- Although unlikely, the possibility for a retroactive reduction necessitates planning.
- So, how do you structure a plan that is able to be unwound if the reduction to the transfer tax exemption is retroactive to January 1, 2021.

Disclaimer Provisions

- Under IRC Sec. 2518, taxpayers have 9 months from the date of gift.
- Include disclaimers for spouse to disclaim, or for beneficiary to disclaim on behalf of the class of beneficiaries.
- Should result in exemption not being used and assets reverting to Settlor.
- Be certain none of the beneficiaries (spouse or descendants) accept any benefit from the trust assets in the interim.

QTIP(able) Trust

- Make transfer to Trust with intention of using remaining gift tax exemption;
- Trust should qualify for marital deduction if QTIP election is made;
- If the election is not made, assets pass to non-qualifying trust for surviving spouse that would use exemption.
- If the exemption is reduced retroactively, then a QTIP election can be made for portion above the exemption, which would receive the marital deduction.
- Spouse has to be a U.S. Citizen.
- Election must be made on a timely filed Form 709 Gift Tax Return (October 15, 2022)

Formula Clauses

- Make Formula Gift
  - similar to standard testamentary trust provisions for dividing Qualified and Non-Qualified Shares
- Fractional Share of Assets
  - Numerator = TP Available Gift Tax Exemption *Taking Future Code Amendments into Account*
  - Denominator = Full Value of the Gift *As Finally Determined For Gift Tax Purposes*
- Concept based upon *Wandry v. Commissioner*, T.C. Memo 2012-88.

Assignment

I, [DONOR NAME], in consideration of $10 cash received from [TRUSTEE NAME], as Trustee, of the trust dated [TRUST DATE] (known as [TRUST NAME]) and its successors and assigns, the receipt of which is hereby acknowledged, and $10 cash received from [SPOUSE'S NAME], my spouse who is a United States citizen, the receipt of which is hereby acknowledged, hereby make the following assignments of all of my right, title and interest in [PROPERTY DESCRIPTION] ("the Property") as follows:

(x) Alternatively, ***this gift of the amount, if any, in excess of the donor's gift tax exemption, could pass to a trust for the spouse which is designed to qualify for the QTIP election, or to an "incomplete gift" trust created by the donor***.

To the Trustees of [TRUST NAME] that fractional share of the Property (a) the numerator of which is the lesser of (i) the entire fair market value of the Property as finally determined for Federal tax purposes as of the date of this instrument, or (ii) the amount of my Remaining Gift Tax Exemption, and (b) the denominator of which is the fair market value of the Property as finally determined for Federal tax purposes as of the date of this instrument.

To [SPOUSE'S NAME] the remaining fractional share, if any, of the Property not assigned above to the Trustees of [TRUST NAME];

I authorize [SPOUSE'S NAME], individually as assignee of any interest in the Property and as the principal beneficiary of [TRUST NAME] to renounce and disclaim any of the Property assigned above and to the extent, if any, my spouse makes any such renunciation and disclaimer the property so renounced and disclaimed that otherwise would pass to my spouse directly or to the trust ***shall be revested in me***.

For purposes of this instrument, the following terms shall have the following meaning:

(i) The "Gift Tax Exemption" shall mean an amount equal to the maximum fair market value of property which, if transferred by gift (within the meaning of Section 2501 of Code) as of the date of this instrument, would generate a tax equal to the amount allowable as a credit under Section 2505 of the Code, ***taking into account any amendments to the Code made by legislation enacted after the date of this instrument but which is applicable to transfers made on the date of this instrument***.

(ii) My "Remaining Gift Tax Exemption" shall mean an amount equal to the Gift Tax Exemption reduced by the amount of such Gift Tax Exemption I have used or been deemed to have used by any prior transfers by me before this transfer including those made earlier this calendar year.

(iii) The "Code" shall mean the Internal Revenue Code of 1986, as amended.

Credit to InterActive Legal,
Martin Shenkman and Jonathan Blattmachr

Possible Challenges to Strategy

Formula Clauses.

- Language which accounts for subsequent legislative changes.
- State Law governs property rules

Disclaimers with Reversion to Settlor.

- The IRS may overlook *Wandry* and challenge provisions that theoretically create a reversionary interest.
- In *Nelson*, the IRS argued that "A donor's retention of an interest that is dependent upon the occurrence of an event beyond the donor's control will not cause the transfer to be incomplete." A disclaimer that reverts assets back to the Settlor could be challenged in the same way.

QTIP(able) Trusts.

- IRC Sec. 2519 Attack.

Types of Trusts and Strategies to Consider

- Trust Instruments
  - Self-Settled Domestic Asset Protection Trust ("DAPT") and Hybrid DAPT
  - Spousal Lifetime Access Trust ("SLAT")
  - Special Power of Appointment Trust ("SPAT")
  - Grantor Retained Annuity Trust ("GRAT")
- Other Techniques
  - Gifts of Promises
  - Gifting Borrowed Assets
  - Valuation Discounts for Fractional Interests in Assets
  - Note Sale Transactions
  - Intentionally Defective Gift of Deferred Interest

Individual Income Tax Proposals

- Increase Top Marginal Tax Rate
- Reinstate Payroll Tax on Top 1%
- Increase Cap. Gain and Qualified Dividend Rate
- Limit on Itemized Deductions
- Pease Limitation
- Phase Out QBI Deductions for Top Earners
- Retirement Plan Contributions
- Child Tax Credits
- Reinstatement of SALT

Increase Top Marginal Tax Rate

- "He won't ask a single person making under $400,000 per year to pay a penny more in taxes."
  - JoeBiden.com, "A Tale of Two Tax Policies: Trump Rewards Wealth, Biden Rewards Work," https://joebiden.com/two-tax-policies/

2021 Income Tax Rates						
Tax Rate	Single Individual			Married Filing Jointly		
10%	Up	to	$ 9,950	Up	to	$ 19,900
12%	$ 9,951	to	$ 40,525	$ 19,901	to	$ 81,050
22%	$ 40,526	to	$ 86,375	$ 81,051	to	$ 172,750
24%	$ 86,376	to	$ 164,925	$ 172,751	to	$ 329,850
32%	$ 164,926	to	$ 209,425	$ 329,851	to	$ 418,850
35%	$ 209,426	to	$ 523,600	$ 418,851	to	$ 628,300
37%	$ 523,601	and	Over	$ 628,301	and	Over

Potential Income Tax Rates Under Biden						
Tax Rate	**Single Individual**			**Married Filing Jointly**		
10%	Up	to	$ 9,950	Up	to	$ 19,900
12%	$ 9,951	to	$ 40,525	$ 19,901	to	$ 81,050
22%	$ 40,526	to	$ 86,375	$ 81,051	to	$ 172,750
24%	$ 86,376	to	$ 164,925	$ 172,751	to	$ 329,850
32%	$ 164,926	to	$ 209,425	$ 329,851	to	$ 418,850
35%	$ 209,426	to	$ 400,000	$ 418,851	to	$ 480,000
39.6%	$ 400,001	and	Over	$ 480,001	and	Over

Reinstitute Payroll Tax on Top 1%

Currently –

- 12.4% Social Security is on the first $142,800 of wages;
- Tax split evenly between employer and employee.
- Self-employed people pay both portions

"Doughnut Hole"				
TP with $1 million in Self Employment income				
	Earned Income		Rate	Tax Liability
Dough	$	142,800	12.4%	$ 17,707.20
Hole	$	257,200	0.0%	$ -
Dough	$	600,000	12.4%	$ 74,400.00
				$ 92,107.20

Increase Capital Gain and Qualified Dividend Rate

- "Joe Biden will not raise taxes on anyone making less than $400,000. Period. But he will ask wealthy Americans … to pay their fair share, including by … Asking those making more than $1 million to pay the same rate on *investment income* that they do on their wages."
  - JoeBiden.com, "A Tale of Two Tax Policies: Trump Rewards Wealth, Biden Rewards Work,"
    https://joebiden.com/two-tax-policies/

Increase Capital Gain and Qualified Dividend Rate

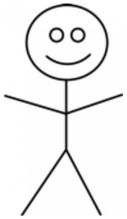
2021 Cap. Gains & Qualified DIV Rates				
If Table Income Is:				The Tax Is:
Over	$ -	but not over	$ 40,400	Zero
Over	$ 40,400	but not over	$ 200,000	15%
Over	$ 200,000	but not over	$ 445,850	15% + 3.8% NII
Over	$ 445,850			20% + 3.8% NII

Projected Cap. Gains & Qualified DIV Rates (not adjusted for inflation)				
If Table Income Is:				The Tax Is:
Over	$ -	but not over	$ 40,400	Zero
Over	$ 40,400	but not over	$ 200,000	15%
Over	$ 200,000	but not over	$ 445,850	15% + 3.8% NII
Over	$ 445,850	but not over	$ 1,000,000	20% + 3.8% NII
Over	$ 1,000,000			39.6% + 3.8% NII

Planning for New Cap. Gain Rates

- Accelerate Gains on appreciated assets - keep in mind state income taxes in high taxing jurisdictions though.
- Defer capital losses to later years;
- Rebalance portfolio to include more tax-exempt securities instead of dividend income;
- Donate Appreciated Stock to Charitable Remainder Trust

Planning with Charitable Remainder Trust



1. Gift of Appreciated Assets in 2021

Charitable Remainder Trust

2. Charitable Income Tax Deduction in 2021

3. Annual Income Stream for term of years or life.

IRS

4. Donor defers capital gains tax over term of years or life and pays when income is received. Donor also pays tax on any income generated by CRT

5. At death of donor, or after term of years, remainder to charity

Limit Itemized Deductions

- Cap the tax benefit of itemized deductions at 28% of value for taxpayers with income above $400,000.

- Biden's Plan does not address whether the increase to the standard deduction ($24,000 for married couples) under the TCJA would remain.

Pease Limitation

- Restore "Pease" limitation on itemized deductions.
  - reduce the value of certain itemized deductions by 3% for every $1 of a taxpayer's taxable income above $400,000,
  - with a maximum reduction equal to 80% of the value of the taxpayer's itemized deductions.
  - Standard deduction available if greater

Phase Out QBI Deductions for Top Earners

- QBI Deduction phased out for taxpayers with taxable income over $400,000.
  - However, we do not know how much of the deduction is phased out above the threshold.

- Currently, QBI deduction can lower the effective tax rate for flow-through income from 37% to potentially 29.6% (20% * 37%),

- No income limit currently in place for this deduction.

Retirement Plan Contributions

- Provides a refundable tax credit rather than a deduction for contributions to retirement accounts.
- 26% tax credit for each $1 contributed.
- Roth tax treatment would be unaffected.
- Higher income taxpayers may benefit from a shift to more Roth-style plans.

American Rescue Plan – Tax Credits for Families

- Childcare Tax Credits
  - Credit up to 50% of spending on child care for children under 13, up to $4,000 for one child, or $8,000 for two or more children.
  - Full 50 percent credit for families making less than $125,000/year;
  - Partial credit for families making $125,000 to $400,000,
- Child Tax Credits
  - Credit to $3,000 per child ($3,600 for a child under age 6) and make 17 year-olds qualifying children for 2021.
  - Fully refundable for 2021

American Rescue Plan – Tax Credits for Families

- Earned Income Tax Credit
  - Raise Credit for childless adults from $530 to close to $1,500;
  - Raise the income limit from $16,000 to $21,000; and
  - Expand the age range eligibility by eliminating the age cap for older workers and expanding eligibility for younger workers.

American Rescue Plan – Reinstate SALT (?)

- House Ways and Means Committee member Thomas R. Suozzi, D-N.Y., said he hopes that repealing the SALT cap will be one of the provisions that will make its way into the package.
- Suozzi said its reinstatement will depend largely on Majority Leader Schumer
- If enacted, consider
  - Timing of tax payments;
  - 28% Cap;
  - Pease Limitation

Corporate and Business Tax Proposals

Corporate Tax Rates

- The current corporate income tax rate is 21%, reduced from 35% by the TCJA.
- Biden Plan:
  - Increase the corporate income tax rate to 28% (estimated 10-year revenue increase: $727 billion).
  - Impose a 15% minimum tax rate on book income for corporations that report net income in excess of $100 million for financial statement purposes but owe no U.S. income tax (estimated 10-year revenue increase: $109 billion).
  - Establish a financial risk fee on certain large financial institutions (estimated 10-year revenue increase: $84 billion).

Real Estate

- Carried Interest – elimination of capital gain treatment on income in excess of $1.0 million *(see* previous discussion).
- Section 1031:
  - Proposed closing "loopholes" for real estate investors with the possible elimination of like-kind exchange treatment for taxpayers earning more than $400,000.
  - Taxpayers earning less than $400,000 would still be eligible for like-kind exchange treatment.
- Qualified Opportunity Zones – no current plans to eliminate QOZs, however, Biden would like increased regulations to ensure economic, social, and environmental benefits.

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