LIVE **WEBINAR**

Boyer & Ritter LLC

Post-Election Tax Planning & Strategies

December 1, 2020 | 1PM EDT

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Key Objectives of Webcast

- GA Senate Races will dictate how much control a Biden Administration has
- Address <u>potential</u> income and estate tax changes that Biden may focus on
- Planning steps to consider before 12/31/20
- Possible long-term impact on my business and wealth planning

Are my income taxes probably going up in 2021?

Answer: "It depends"

Key points from Joe Biden's Tax Plan:

- Rate increases
- FICA limit being eliminated after $400,000 of earned income
- Reduce the benefit of itemized deductions
- Possible elimination of preferential dividend and capital gain rate

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Control of Senate Will Dictate Momentum

- The November Election Results:
  - Biden is President
  - Democrats have retained control of the House
  - Republicans have 50 Senate seats
- There are two Senate “run-offs” in Georgia on January 5th to determine if Republicans can retain control of Senate (need 51 seats). If the Democrats win both “run offs”, they will control all 3 branches

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Control of Senate May Dictate Momentum

- With control of all 3 branches, the Democrats will look to be aggressive with
  - Repeal the tax relief Trump was able to procure
  - Increasing income tax burden on those "who can afford to pay more" and
  - Change the estate and gift laws to limit the generational transfer of wealth

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Control of Senate May Dictate Momentum

- No one knows what will happen on January 5th, but we do know what Biden and the Democrats have stated their goals are.
- Retention of control of the Senate by Republicans will probably mitigate the changes that Biden can make in 2021
- Many clients want to understand the larger changes that may be made and the proactive planning they may want to undertake.

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Potential Income Tax Changes

- Vice-President Biden Pledge:

  "Nobody making under 400,000 bucks
  would have their taxes raised, period, bingo."

- Raise marginal income tax rates and minimize other benefits enjoyed by those making more than $400,000

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Questions Being Asked

1. Are my income taxes probably going up in 2021?

- Proposals in Joe Biden’s tax plan:
  - Rate increases
  - FICA limit being eliminated after $400,000 of earned income
  - Reduction of benefit of itemized deductions
  - Possible elimination of preferential dividend and capital gain rate

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Potential Individual Income Tax Changes

Individual Income Taxes

	Current Law	Biden's Proposal
Top Rate	37%	39.6%
Top Long Term Capital Gains and Qualified Dividends Rate	20%	39.6%
Qualified Business Income Deduction (QBI)	No phase out for a qualified business	Phased out at incomes over $400,000

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Potential Income Tax Changes (cont.)

1. (Cont.) Are my income taxes probably going up?

Other ways Biden has stated he desires to raise income taxes:

- Phase out the preferential 20% qualified dividend and long-term capital gains rate for those with income greater than $1 million
- Modify the step-up of income tax basis at death and/or institute an income tax at death of appreciation of assets after a certain exclusion

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Questions Being Asked

1. (Cont.) Are my income taxes probably going up?
   - Planning point - Some are accelerating income back into 2020 under the belief that the effective tax rate will be higher and there will be lower favorable benefits.

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Potential Individual Tax Changes

Itemized Deductions

Current Law	Biden's Proposal
Taxpayers of any income may itemize eligible deductions against their income tax liability.	Cap the tax benefit of itemized deductions to 28% of their value and restore PEASE Limitation for incomes above $400,000.
State and Local Taxes (SALT) capped at $10,000	End SALT cap

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Expanding the Social Security tax base

Federal Insurance Contributions Act (FICA)

- Old-age, survivors, and disability insurance (Social Security) – 6.2%
- Hospital insurance tax (Medicare) – 1.45%

Old-Age, Survivors, and Disability Insurance (OASDI)	Current (2020 wage base)	Biden's Proposal (2021 wage base)
Wage base subject to tax	Up to $137,700	Up to $142,800; and over $400,000
Maximum tax for employee	$8,538	$8,854 + 6.2% * (Salary over $400k)

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Questions Being Asked

2. Can you explain the impact of the FICA limit going up?

Individual with a W-2 wage income of $700,000	Under Current Law	Biden's Proposed Plan	Increase
Social Security Tax 6.2%	$8,537	$27,137	$18,600
Medicare Tax 1.45%	$10,150	$10,150	$-0-
Medicare Surtax 0.9%	$4,500	$4,500	$-0-
Total Federal Payroll Tax for Employee	$23,187	$41,787	$18,600

– Watch out for deferred compensation and NQSOs

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Questions Being Asked

3. What impact could the phase out of the QBI and rate increase have on my S corporation business income of $1 million?

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Example for S Corp Owner

	Current Law	Biden's Proposal
W-2 Income	$300,000	$300,000
Long Term Cap Gains	$150,000	$150,000
Dealership K-1	$1,000,000	$1,000,000
Taxable Inc before Pass Through Deduction	$1,450,000	$1,450,000
Pass-Through Deduction	($290,000)	$-0-
Taxable Income	$1,160,000	$1,450,000

- Taxable income higher by $290k
- Additional taxes of $115k

Questions Being Asked

4. Could my charitable deductions be worth less in 2021?
   - Biden's proposed 28% cap on itemized deductions
   - "Bundling"
     - Example, Mr. and Mrs. Smith want to give $10,000 per year to their church and some other charities they support. They are going to gift $30,000 to a donor advised fund in 2020 and then grant the $10,000 to the charities over 2020, 2021, and 2022.
     - This will accelerate their $30,000 charitable contribution in 2020 without the potential limits that the same contributions may be subject to in the future.

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Questions Being Asked

5. Should I be considering a ROTH conversion of some or all of my IRA in 2020? What are the benefits of doing this?

- A Roth Conversion is essentially pulling tax deferred assets (IRA and 401k) into income and placing those assets in a Roth IRA wrapper.
- The three primary advantages are that Roth grows income tax-free, comes out income tax free if conditions are met and is not subject to Required Minimum Distributions.
- Reality is that you are accelerating taxable income and paying income tax to lessen the burden in the future (most likely to your heirs).

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Questions Being Asked

5. (Cont.) Should I be considering a ROTH conversion of some or all of my IRA in 2020? What are the benefits of doing this?

- Why might this be a time for a Roth Conversion?
  - Many believe their 2020 income will be down as result of Covid-19 and/or 2020 marginal tax rates will not get lower in the future
  - Additionally, accelerating the income tax on the Roth conversion, you may be removing that income tax burden from your estate.
  - Example, if you convert $1m of traditional IRA to a Roth IRA, that may trigger $370,000 of income tax liability in 2020. Your estate is then $370,000 less
  - Address higher marginal tax rates and potential lower estate exclusion

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Questions Being Asked

6. We have a C corporation and understand the rates may go from 21% to 28%. What are some planning ideas to consider for 2020?

- Many clients are re-evaluating the conversion to an S corporation in 2021 when corporate rates may spike up the income taxes on them. The corporate taxes going up coupled with the potential elimination of the preferential qualified dividend rate, could significantly increase the effective tax rate to an investor.
- Clients are also exploring the ownership of holding companies that may not allow a conversion to an S corporation. They are looking at gifting minority interests at a discount realizing that they can leverage the transferred value and/or the benefits to trigger an estate freeze on the holding company assets.

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Potential Estate and Gift Changes

- Lower Estate Exclusion
  - Under Tax Cuts and Jobs Act (TCJA), the estate exclusion was doubled and stands at $11.6 million per person ($23m for couples).
  - This is due to sunset in 2026 and revert to pre TCJA levels of about $5 million per person.
  - Biden has indicated he desires to accelerate this sunset and dramatically cut this exclusion (to maybe $3.5 million per person)
- Increase the Estate Tax Rate
  - Under TCJA, the highest the estate and gift tax rate was lowered from 45% down to 40%.
  - Biden has often stated that this rate might need to be as high as 55% for some.

Potential Estate and Gift Changes

	Current	Biden's Proposal
Estate Exemption	$11.58 million per person ~$23 million for couples	$3.5 million per person $7 million for couples
Estate and Gift Tax Rate	40%	Increase to 45%
Expiration	Sunsets in 2025	Accelerate the sunset

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Potential Estate and Gift Changes

A husband and wife have a $15 million estate.

	Current	Biden's Proposal
Total estate value	$15,000,000	$15,000,000
Lifetime combined exemption	($23,160,000)	($7,000,000)
Taxable estate value	$-0-	$8,000,000
Tax rate	40%	45%
Estate tax	$-0-	$3,600,000

The same estate could owe $3.6 million more in taxes

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Potential Estate and Gift Changes (Cont.)

- Elimination of Basis Step Up
  - There have been comments that the elimination of the current basis step up of appreciated property beyond a certain level (say $1 million) may be a way to capture additional income taxes at death without increasing the estate tax
- Decouple the Gift Exclusion
  - Under TCJA, the estate exclusion and gift exclusion are set at the same rate meaning you can use it during your lifetime or at your death.
  - By decoupling the gift exclusion to a lower rate than the estate tax, this could provide disincentive to do lifetime gifting

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Questions Being Asked

7. I have been reluctant to consider the benefits of lifetime gifting. Are these changes something that should inspire me to change that thinking? What are the reasons I should reconsider?

- In 2020, the Federal exclusion is $11.58m per person for gifting and estate purposes ($23.16m per couple). Under TCJA, this is scheduled to revert to $5m per person in 2026 (increased for inflation from 2017-2026) or $10m per couple.
- Vice-President Biden has indicated a desire to accelerate this reduction to limit the transfer of wealth within families. In this same discussion, he also talked about moving this back to $3.5m per person ($7m per couple).

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Questions Being Asked

7. (Cont.) I have been reluctant to consider the benefits of lifetime gifting. Are these changes something that should inspire me to change that thinking? What are the reasons I should reconsider?

- Because of the uncertainty that this exclusion may be changed as soon as 2021, many wealthy American's are accelerating estate gifting back into 2020.
- Year End Planning - Those with estate's over $10m realize that this 2020 window may to allow them to transfer assets estate tax free where they may not have this opportunity in the future. We are seeing a number of estate plans being accelerated because of this uncertainty.

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Potential Estate and Gift Changes

Husband and wife with the $15 million estate decide to gift $10,000,000 in assets to their children prior to 12/31/2020. Assuming Biden's proposed plan to reduce estate exclusion to $7 million took effect after 12/31/2020. The couple dies in 2022 with assets worth $17 million:

	No Gift Made	Gift Made
Total estate value	$17,000,000	$17,000,000
Gift made prior to 12/31/2020	($-0-)	($10,000,000)
Remaining estate value	$17,000,000	$7,000,000
Lifetime combined exemption under Biden's proposal	($7,000,000)	($-0-)
Taxable estate value	$10,000,000	$7,000,000
Tax rate	45%	45%
Estate tax	$4,500,000	$3,150,000

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Questions Being Asked

8. What if I have done or do aggressive gifting while the gift exclusion is $11.58 million and it gets changed to a much lower level (say $3.5 million in 2021)? What would happen to those gifts?

- In 2019, the IRS clarified that there will be no "clawback" on gifts made while the exclusion is greater (now $11.58m per person) compared to the exclusion at death.
- So, the IRS is saying if you gift $10m in 2020 under the current exclusion and then you pass away when the exclusion is significantly less, there is no clawback. Effectively saying "use it while you can because it could go away".

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Questions Being Asked

8. (Cont.) What if I have done or do aggressive gifting while the gift exclusion is $11.58 million and it gets changed to a much lower level (say $3.5 million in 2021)? What would happen to those gifts?

- Currently, a taxpayer is allowed to elect "portability" of unused exclusion at the death of a spouse.
- Example, Jim dies in 2020 while the current exclusion is $11.58m but only passes $3m of assets in his individual name to heirs while the balance of the marital assets revert to his spouse Jane. Jane can elect to have the $8.58m of remaining exclusion ($11.58m - $3m) be portable to her estate. If she dies when the exclusion is $3.5m, she gets her $3.5m plus the $8.58m from her late husband.

Questions Being Asked

8. (Cont.) What if I have done or do aggressive gifting while the gift exclusion is $11.58 million and it gets changed to a much lower level (say $3.5 million in 2021)? What would happen to those gifts?

- Planning Points - There is significant incentive to make any portability election even if you believe the surviving spouses net worth is below current exclusions and the IRS has said they will not clawback on any gifts made when the exclusion was greater than death.
- If there are assets you want to pass to heirs, like a vacation home, it may make sense to accelerate the transfer of these assets during lifetime as opposed to waiting until death.

Questions Being Asked

9. I have done some lifetime gifting but always assumed the basis step-up would be favorable to my heirs. Are these changes something that should change that thinking? What are the benefits I should better understand?

- When a U.S. citizen dies, the tax basis of most of the assets in their estate is restated to the FMV at death. This "step-up" means the unrealized gains go away for the heirs.
- The exceptions: IRAs, 401ks, annuities and some other assets do not get to eliminate the built-in gain a death and will be taxed to the heirs.

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Questions Being Asked

9. (Cont.) I have done some lifetime gifting but always assumed the basis step-up would be favorable to my heirs. Are these changes something that should change that thinking? What are the benefits I should better understand?

- The Biden administration has discussed eliminating the step-up benefit either partially (setting some threshold) or totally. This would effectively trigger an income tax when the assets are disposed of over and above the potential estate tax.
- Additionally, there has been talk that Biden would like to implement a “Wealth tax” to subject unrealized appreciation to capital gains tax at death.

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Questions Being Asked

9. (Cont.) I have done some lifetime gifting but always assumed the basis step-up would be favorable to my heirs. Are these changes something that should change that thinking? What are the benefits I should better understand?

- Tax Planning Point- many clients are reevaluating the timing of transferring assets since the step-up may not be available.
- Example, we know the beach house is worth significantly more than its cost basis. If this is gifted during 2020, the heirs assume the tax basis of the donor but this gain is not expected to be triggered in the future (because heirs have no plans to sell) and it is possible that this step up may not happen in a post 2020 death.

Basis Step-Up Example

Gary Sr. invested $50,000 into Amazon (AMZN) on January 1, 2009. Gary Sr. passed away on October 13, 2020, leaving the Amazon shares to Gary Jr.

Gary Jr's Basis under Current Rules		Impact to Estate/Gary Jr. under Biden Proposal	
Step-up in basis	$2,927,086	Basis	$50,000
Unrealized gain	$-0-	Unrealized gain	$2,877,086

Is Gary Sr.'s death the triggering event or does Gary Jr. receive assets that don't have a step-up in basis?

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Review: Control of Senate Is Key

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- Many clients want to understand the larger changes that may be made and the proactive planning they may want to undertake.

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Questions?

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