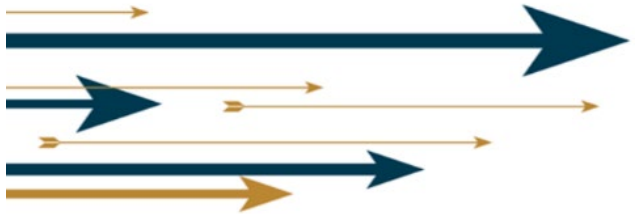

Welcome

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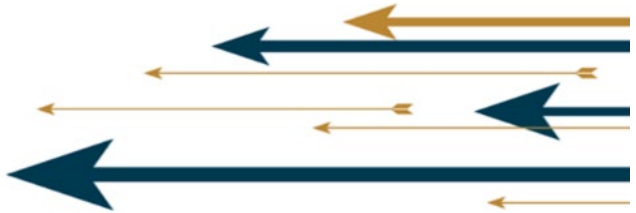

April Fool's Day
Taxes Are No Joke!

A Guide to Navigating Potential Tax Law Changes

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Hosted by:

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Thursday, April 1st 2021

President Biden
TAX REFORM

Eric McGraw, CPA

Senior Tax Manager

Eric joined the ADKF family in 2019. He is originally from Atlanta, Georgia and earned his Bachelors degree from the University of Georgia, and his Masters in Accountancy from Georgia State University. Eric is a Certified Public Accountant (CPA), and has been practicing accounting since 2009. Eric is a member of the American Institute of CPAs, the Texas Society of CPAs, the San Antonio CPA Society, and the Boerne Chamber of Commerce.

ADKF

with you
all the way

Sources Used for this Presentation

- Biden campaign whitepaper
- Biden press release on The American Jobs Plan
- KPMG
- EY
- Deloitte
- RSM
- Wolters Kluwer (CCH)
- Kiplinger Letter
- And numerous others…

Outline of Today's Presentation

- Overview
  - The Magic Number
    - Tax Increases
      - Tax Decreases
        - The Unknown
          - Well… what do we do?

Overview – Political

- The last major tax reform was enacted in 2017 when Republican controlled the House, the Senate, and the White House. Democrats are now in the same position and are expected to attempt major tax reform this year.
- Tax changes could be enacted in conjunction with additional Covid relief, or more likely in separate legislation.
- The Democratic majority is small, and moderate votes will be needed to pass legislation.
  - The recent buzz is that moderate Democrats are not keen on tax increases
- Senate Finance Committee Chairman Ron Wyden (D-Oregon) stated this week that Democrats are actively crafting tax legislation right now.
- The 2022 elections are already looming. Will Democrats press for legislative victory or hunker down to avoid defeat?

Overview – President Biden

- President Biden's general position on tax reform is that corporations and high-income individuals need to pay more taxes in order to fund various efforts:
  - Climate Change
  - Healthcare
  - Education
  - Infrastructure (The American Jobs Plan)
  - Wealth Inequality
  - Social Justice

$400,000

The Magic Number

Tax Increases

- Please note that many of these changes refer to an income threshold of $400,000 per year, a figure President Biden has referred to repeatedly. It is not clear whether his references to this figure assume an individual or household income of $400,000, but most experts assume the latter.

  - The top marginal tax rate (the maximum rate at the highest tax bracket) will increase from 37% to 39.6%, which was the top marginal rate prior to the Tax Cuts and Jobs Act (TCJA) put in place under the Trump administration. Note that the reduction of the top marginal rate provided by TCJA was written as a temporary chance ending in 2025. So, the top marginal rate will return to 39.6% at that time without further action being taken.

Tax Increases

- Continued…
  - Households making over $1,000,000 per year would pay tax on qualified dividends and long-term capital gains at their marginal rate (as high as 39.6%) rather than the modified rates currently levied against this type of income (as high as 20%). It is unclear what impact this would have on NIIT (3.8%).
  - Currently the social security portion of payroll taxes is levied only on the first $142,800 of wages. It has been proposed to also levy social security payroll tax on wages over $400,000. This would create a “donut hole” of wages between $142,800 to $400,000 in which social security tax would not be levied, but it would be levied on any amount of wages not in that range.

Tax Increases

- Continued…
  - Reinstate the Pease limitation that was temporarily suspended by the TCJA. The Pease limitation phases out itemized deductions with a maximum cap of 28%. For example, an individual would only receive a deduction for 28% of their itemized deductions. Biden would alter the Pease limitation to only affect households making more than $400,000 per year. The temporary suspension of the Pease limitation provided by the TCJA will expire in 2025, so it will return at that time without further action.
  - The qualified business income deduction would be phased out for all households with income over $400,000 per year. This deduction was introduced by the TCJA and provides a 20% deduction for business income and some real estate investments.

Tax Increases

- Continued…
  - Elimination of 1031 like-kind exchanges, which are currently used to defer income tax generated on the sale of real estate.
  - The estate tax exemption (the value an estate can be before estate taxes are generated) would be lowered from $10,000,000 (not including indexed inflation) to $3,500,000.
  - The estate tax rate would increase from 40% to 45%.

Tax Increases - The American Jobs Plan

- The corporate tax rate would increase from 21% to 28%. Note this would apply to c-corporations. S -corporations are passthrough entities and do not pay federal income tax at the entity level.

- Various additional changes targeting large corporations, such as enhancing the global intangible low-tax income (GILTI) tax related to corporate offshoring of taxable income.

- New 15% minimum tax on book income over 100m.

In this world
nothing is certain
but death and taxes.

Benjamin Franklin

Tax Decreases

- President Biden would use some of the revenue generated by tax increases on corporations and high-income individuals to provide targeted tax relief to lower- and middle-class families. Below are some of the changes that have been suggested:
  - The child tax credit would be increased from $2,000 per child to $3,000 per child ages 6 to 17, and $3,600 for children under the age of 6.
  - The childcare tax credit would increase from $3,000 for one child and $6,000 for two or more children to $8,000 for one child and $16,000 for two or more children.
  - A new caregiver tax credit of $5,000 would be created for individuals caring for elderly or ill family members.

Tax Decreases

- Continued…
  - The first-time homebuyer tax credit would return, this time for an amount up to $15,000.
  - A tax credit for low-income renters would be created that would cap housing costs at 30% of income.
  - Various energy-saving tax credits would be restored and/or expanded, such as the electric vehicle tax credit.

The Unknowns

- Timing?
- Retroactive?

Well… What Do We Do?

- In General
  - Accelerate Income into 2020 and 2021
  - Decelerate Deductions into 2022 and later
  - Meet with Estate Planner
  - Meet with Investment Advisor
  - Meet with CPA

Well… What Do We Do?

- More specific
  - Increase retirement contributions
  - Shift investments into tax-exempt interest
  - Defer harvesting tax losses
  - Investment in real estate
    - Depreciation!
      - Beware passive losses!

Well… What Do We Do?

- More specific… continued…
  - Like-kind Exchanges (1031)
  - Farm and Ranch
  - Double check business deductions
    - Hiring family members
    - Bundle personal and business travel

LANGLEY & BANACK

INCORPORATED

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Admissions and Certifications

- Admitted to the State Bar of Texas, 2019

Professional Involvement

- Member of the San Antonio Estate Planners Council
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Basic Exclusion Amount

- **Basic Exclusion Amount:** the amount that any person may transfer without imposition of gift or estate tax
  - Currently – $11.7 million per individual / $23.4 million per married couple
    - Sunsets on December 31, 2025 - $5 million per individual / $10 million per married couple (adjusted for inflation)
  - Proposed reduction – as little as $3.5 million per individual / $7 million per married couple
      - If this goes into effect, when will it happen?
- The estate and gift tax rate is 40%

Timing of Reduction

- Could it be applied retroactively?
  - Congress is currently focusing on other issues so retroactive reduction is unlikely, but still possible
- What if Congress passes a new law that reduces the exclusion amount and it is silent in terms of retroactivity?
  - Would this affect gifts made prior to the date of enactment?
    - Yes, potentially.

Internal Revenue Code

- **§2010(c)(3):** defines the "basic exclusion amount"
- **§2505(a):** describes how a gift or estate tax is computed
  - "In the case of a citizen or resident of the United States, there shall be allowed as a credit against the tax imposed by §2501 for each calendar year an amount equal to – the applicable credit amount in effect under **§2010(c)** which would apply **if the donor died as of the end of the calendar year**…"
    - **Not** the law that's in effect at the time of the gift
- If a change to the exclusion is made effective on or before December 31, 2021, **§2505(a)** may result in a reduced exclusion for a gift made at any time during 2021
- Are there any estate planning strategies to avoid retroactive application?

Disclaimer Trust

- **Disclaimer Trust:** allows the trustee or other recipient of property the opportunity to disclaim the gift **within 9 months of receiving it**
- Any disclaimed property reverts to the grantor
- Potential issues with this strategy:
  - Conflict of interest
  - Trust with multiple beneficiaries
  - Disclaimant changes his or her mind
- Resolution: gift does not revert to grantor if disclaimed
  - Example: trust that provides for outright distribution to spouse, but if disclaimed by spouse, continues in trust for benefit of spouse and grantor's descendants

QTIP-able Trust

- **QTIP-able Trust:**
  - Irrevocable
  - Income to grantor's spouse for life
  - Option to make QTIP election
- **QTIP Election:**
  - Qualified terminable interest property
  - Gift to trust covered by unlimited gift tax marital deduction
- Advantages:
  - Avoid any gift tax by making QTIP election
  - Grantor retains control over whether to make QTIP election
- Disadvantage:
  - Trustee **must** pay all trust income to the beneficiary spouse for life

Defined-Value Clause

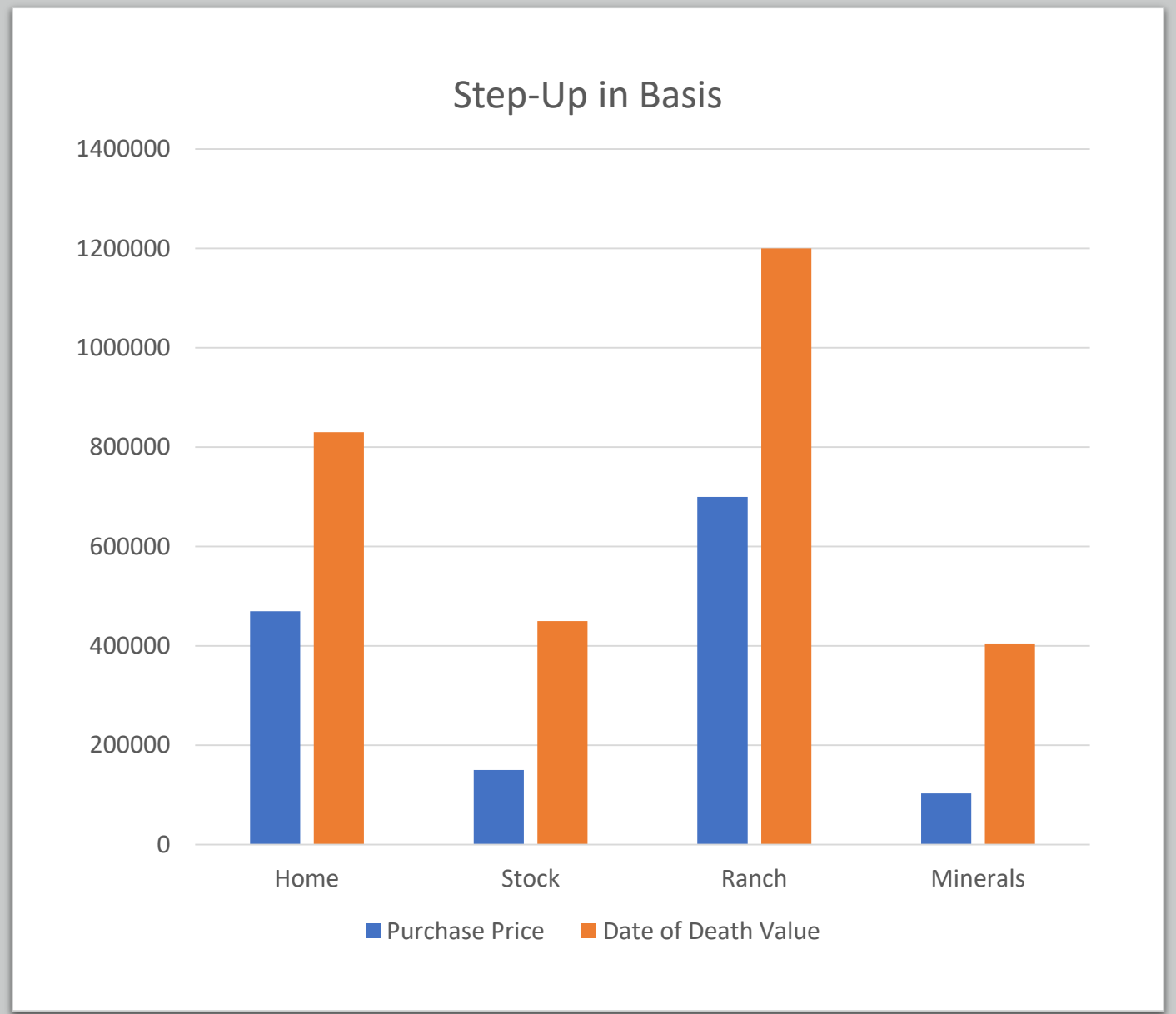
- Gift subject to a defined-value clause: any portion of gift in excess of basic exclusion amount passes to a recipient (other than grantor) without being subject to gift tax
- No portion of the gift may revert to grantor
  - The gift of the excess portion should result in little to no gift tax
  - Recipient should be eligible for exclusion from gift tax
- Advantages:
  - Simple
  - Allows for anticipation of future tax law changes
- Disadvantage:
  - Risky

Installment Sale or Conditional Gift

- **Installment Sale:** sell assets to an irrevocable grantor trust in exchange for a promissory note
  - If exclusion reduced retroactively –
    - Assets sold not subject to gift tax
  - If exclusion not reduced retroactively –
    - Grantor has the option to forgive the debt and complete the gift
- **Conditional Gift:** gift made conditioned on the fact that certain basic exclusion amount in effect as of the date of the gift
  - Gift isn’t made if law changes and is applied retroactively

Step-Up in Basis

- **Basis:** generally, the cost of property with certain adjustments
- However, a special rule applies if property is acquired from a decedent
- Property passed down in a will has generally appreciated over time
- In most cases, the basis in property inherited from a decedent is the value of that property for federal estate tax purposes (regardless of whether an estate tax return is filed)



Step-Up in Basis Continued

- Currently: the step-up in basis has been a major consideration in some decisions to retain highly appreciated assets
  - Given potential elimination of step-up in basis, this consideration may deserve less weight in the future
- Investment considerations should continue to be given significant weight in decisions regarding when to liquidate appreciated assets

Estate Planning for Future Reductions

- If Congress does nothing, the temporary doubling of the basic exclusion amount will still sunset on December 31, 2025 and revert to the pre-TCJA amount of $5M (adjusted for inflation).
- The potential early reduction under the Biden administration is causing acceleration of estate planning strategies but not fundamentally changing them in most cases.
- There are potential advantages to making lifetime gifts sooner rather than later.

Select Lifetime Estate Planning Techniques

- Family Limited Partnerships
- Lifetime Gifts to Utilize Exemption: SLATs and Other GST Trusts
  - **SLAT:** spousal lifetime access trust
- Take Advantage of Low Interest Rates: GRATs, Sales to IDGTs, CLTs, and More
  - **GRAT:** grantor retained annuity trust
  - **IDGT:** intentionally defective grantor trusts
  - **CLT:** charitable lead trust

Lifetime Estate Planning Techniques Continued

- Certain lifetime gifts do not reduce a taxpayer's estate and lifetime gift tax exclusion amount and are not subject to gift tax:
  - A person may give the annual gift tax exclusion amount ($15K for 2021) directly to each recipient without reducing the giver's exclusion amount.
  - A person may make tuition payments for any individual without incurring gift tax. Such payments must be made directly to a qualifying educational institution for education or training purposes.
  - Subject to limitations, a person may exclude from gift taxes all payments made directly to medical providers on behalf of another individual.

Family Limited Partnership

- Advantages:
  - Donees of limited partnership interests do not own the underlying assets outright
  - Variety of assets can be transferred to and held by a family limited partnership
  - Centralization of management and decision-making over family assets
  - The partnership may be valued for transfer tax purposes at a discounted rate of 30-65%
- Disadvantages:
  - Additional complexity
  - Partnership must abide by annual record keeping regulations

Generation Skipping Tax Trusts (GST Trusts)

- The TCJA also temporarily doubled the generation-skipping transfer (GST) tax exemption. Like the estate and gift tax exclusion amount, the increased GST exemption amount is scheduled to sunset on December 31, 2025 and revert to the pre-TCJA amount of $5M (adjusted for inflation).
- If sufficient GST exemption is allocated to an irrevocable trust, the trust can continue for multiple generations and be excluded from the estates of the beneficiaries for transfer tax purposes until the trust's termination.
- Income and principal can be distributed for the benefit of current generation and/or subsequent generation as needed. After current generation has passed, assets pass free of transfer taxes to subsequent generation (outright or in trust).

Spousal Lifetime Access Trust (SLAT)

- Irrevocable trust established for the benefit of grantor's spouse
- Advantages:
  - Taxable gift that removes assets, and future appreciation of the assets, from grantor's taxable estate
- Disadvantages:
  - "Reciprocal Trust Doctrine"
  - Assets in SLAT will not obtain a step-up in basis upon grantor's death because they are permanently removed from taxable estate
  - Cannot fund with assets jointly owned by both spouses

Select Estate Planning Techniques for Low Interest Rates

- Grantor Retained Annuity Trust (GRAT): an irrevocable trust for a term of years
  - During the "GRAT term," the grantor receives an annuity payment (value of total annuity payments typically adds up to the value of the property used to fund the GRAT)
  - After the GRAT term is over, the GRAT terminates and any remaining property may be held in a continuing trust for the benefit of family members
- Charitable Lead Trusts (CLT): a form of split-interest trust that benefits both a charitable recipient (as the initial or "lead" beneficiary) and a noncharitable beneficiary (who receives the trust remainder).
- Sales to Intentionally Defective Grantor Trusts (IDGT): a type of transaction in which a person sells an asset that is likely to appreciate to a grantor trust in exchange for promissory note.

How to get started

- Discuss which strategy works best for your circumstances with an estate planning attorney
  - Important to be thoughtful about which strategy you use
  - The most important consideration in both lifetime and testamentary planning is retaining flexibility
- Review testamentary plan and confirm it will produce the desired outcome under current tax laws and in the event of a substantial decrease in the exemptions
- Preparing for gifts in late 2021 or subsequent years
  - Establish and fund family limited partnership(s)
    - Draft and execute agreement
    - Fund (fully)
  - Establish any trust(s) –
    - Draft and execute agreement
    - Fund (minimally)
  - This will facilitate the implementation of gifting strategies once a final decision is made

Thank you!