



Income and Estate Tax
Planning in 2021 under
the Biden
Administration

INTRODUCTION

Following the 2020 general election and Georgia runoffs the Democratic Party has won the Presidency, maintained control of the House of Representatives, and ended up in a 50/50 split with Republicans in the Senate. A 50/50 Senate split means Vice President Kamala Harris will cast any tie-breaking vote, to the extent a filibuster does not apply, essentially giving Democrats voting control over Senate legislation. This makeup of Congress and the Presidency means the likelihood of enactment of new tax legislation soon is high.

How can Democrats pass such legislation without 60 votes to overcome a filibuster?

Under current Senate rules, a filibuster cannot be used for budget reconciliation acts, under which tax legislation can be passed, so Senate Democrats only need a simple majority with the tie-breaking vote of Harris to send such legislation to President Joe Biden for approval. It is therefore important to understand both President Biden's and the Democratic Party's recent tax policy proposals since there is a strong possibility of them coming to pass during Biden's first 24 months with unified control of the Federal Government.

Why act now when no new legislation has been put forth?

Congress has the legal authority to enact tax law changes with retroactive effective dates.¹ Many commentators believe that the chance of a retroactive effective date is low but that it could be more likely to occur with estate tax law changes than income tax. Although the timing and extent of tax law changes is uncertain, beginning or continuing to plan now will increase the ability to take advantage of certain tax laws and techniques that might soon become less favorable or vanish. However, precautions should be taken, and flexibility incorporated to address the potential impact of retroactivity so clients can make informed decisions on whether to proceed given the uncertainty and be able to change course to the extent possible if necessary.

Due to the high probability of tax-reform within the first 24-months of a Democratic-controlled Federal Government, high-net worth, high-income, and business clients are urged to consult with their tax, legal and financial advisors to consider the impact of possible new tax laws and begin or continue to plan accordingly and immediately.

General themes of Biden's and the Democratic Party's general tax policy proposals include:

- ***Increase tax on income*** for high-income earners through increasing payroll and self-employment taxes, raising the top marginal income tax rate as well as the top capital gains income tax rate or limiting itemized deductions.
- ***Increase tax on wealth*** for high-net-worth individuals through a wealth tax, increasing estate and gift taxes, eliminating the step-up in basis at death for capital assets or limiting various estate planning techniques.
- ***Increase tax on businesses*** through increasing corporate income taxes or limiting or eliminating certain deductions.

¹Retroactive tax legislation is possible if supported by a rational legislative purpose. See Pension Benefit Guar. Corp. v. R. A. Gray & Co., 467 U.S. 717; United States v. Carlton, 512 U.S. 26; and Quarty v. United States, 170 F.3d 961.

HIGHLIGHTS OF CURRENT TAX LAW VS. TAX POLICY PROPOSALS OF PRESIDENT BIDEN AND THE DEMOCRAT PARTY *(Not an exhaustive list)*

Tax Item	Current Tax Law <i>(as February 2021)</i>	Biden/Democratic Party Proposals
INDIVIDUAL INCOME TAXES		
Income Tax Rates	Top rate of 37% and top brackets of \$523,600 (single) and \$628,300 (married/joint).	Increase top rate to 39.6% on income over \$400,000.
Long-Term Capital Gain and Qualified Dividend Tax Rates	Top rate of 20% for taxable income over \$445,850 (single) and \$501,600 (married), plus the 3.8% Net Investment Income Tax (NIIT) for MAGI over \$200,000 (single) and \$250,000 (married/joint) ; a combined top rate of 23.8% ² .	Increase top rate to 39.6% plus 3.8% NIIT for taxpayers with income over \$1 million; a combined top rate of 43.4%.
Wealth Tax	No wealth tax.	Although some commentators suggest it is unconstitutional, recent Democrat proposals have included a wealth tax for ultra-high-net-worth taxpayers.
Itemized Deductions	Certain itemized deductions have been limited (e.g. SALT cap) or suspended (miscellaneous itemized deductions), and the Pease limitation was suspended. ³ Tax benefit is based on the participant's marginal rate, up to 37% for those in the highest brackets.	Limit the tax benefit of itemized deductions to 28%. Reinstatement of Pease limitation on itemized deductions for incomes exceeding \$400,000. Eliminate SALT deduction cap.
Retirement Plan Contribution Deductions	Tax benefit is based on the participant's marginal rate (up to 37%).	Tax benefit of the deduction will be limited to 28%.
Employment and Payroll Taxes	Social Security taxable wage base is capped at \$142,800 and subject to a 12.4% tax rate (split between the employer and employee). Medicare tax rate is 2.9% and split between employer and employee. Self-employed persons pay the full 15.3% tax. Additional 0.9% tax applies to wages over \$200,000 (single) and \$250,000 (married/joint).	Expand the Social Security taxable wage base subject to a 12.4% tax rate to include income over \$400,000.

- CONTINUES NEXT PAGE -

²Modified Adjusted Gross Income (MAGI) is a household's adjusted gross income with any tax-exempt interest income and certain deductions added back. The Internal Revenue Service (IRS) uses MAGI to establish if you qualify for certain tax benefits.

³"SALT" is State And Local Tax, payments of which are deductible as an itemized deduction (limited to a \$10,000 cap through 2025).

Tax Item	Current Tax Law (as February 2021)	Biden/Democratic Party Proposals
INDIVIDUAL TRANSFER TAXES		
Transfer Tax Rates	Top rate of 40%.	Democrat proposals have included an increase in the transfer tax rate up to 77%.
Lifetime Exemption for Gift, Estate and Generation Skipping Transfer Taxes	Until 2026, the lifetime exemption is doubled from \$5,000,000 to \$10,000,000 indexed for inflation (\$11,700,000 for 2021).	Democrat proposals have included a reduction of the exemption to \$5,000,000 or \$3,500,000, indexed for inflation or not, and a limit on GST exemption to 90 years (i.e. a GST tax would be imposed on a trust after 90 years).
Annual Gift Tax Exclusion	\$15,000 per donee for 2021, indexed for inflation, and no per-donor limit.	Democrat proposals have included a per-donor annual total limit of \$20,000.
Step-Up in Basis at Death	Basis of property included in the decedent's estate, other than Income in Respect of a Decedent (IRD), is stepped up to the FMV as of date of death (or alternate valuation date).	Eliminate step-up in basis at death; replace it with a carryover basis regime or one that treats death as a realization event causing income taxation of unrealized gain.
GST Exemption and Rule Against Perpetuities	Many states have modified or abolished the Rule Against Perpetuities allowing GST exempt trusts to last for hundreds of years or forever without imposition of transfer tax.	Limiting the GST exemption to 90 years, or less, and assessing a GST tax after that time has been discussed by Democrats.
Grantor Retained Annuity Trusts (GRATs)	No minimum term of years or minimum value of the remainder interest for gift tax purposes.	Democrat proposals have included a minimum term of 10 years or minimum remainder value of 25%.
Estate Tax Treatment of Irrevocable Grantor Trust Property	Property held by an irrevocable grantor trust is not includible in the grantor's taxable estate for estate tax purposes nor subject to gift tax upon termination of grantor trust status during the grantor's lifetime.	Democrat proposals have sought to include irrevocable grantor trust property in the grantor's taxable estate at death or subject it to gift tax if grantor trust status terminates during the grantor's lifetime.
Valuation Discounts for Family- Controlled Entities	Discounts are available for lack of marketability and control.	Obama-era proposed Treasury regulations under § 2704, which severely limited the use of valuation discounts with family-controlled entities, may get resurrected.
BUSINESS INCOME TAXES		
Corporate Tax Rates	Top rate of 21%.	Tax rate of 28% with 15% minimum tax for corporations with book profit of \$100 million or more but paid \$0 or negative federal income taxes.
IRC § 199A Qualified Business Income (QBI) Deduction	Pass-through businesses (S-Corporations, partnerships, sole proprietorships) are eligible to receive a deduction up to 20% of QBI reducing the top effective income tax rate from 37% to 29.6%. ⁴	End special qualification rules, including those for real estate investors. Limit deduction for taxpayers with more than \$400,000 taxable income.

⁴Complicated qualification rules apply. Business owners in a Specified Service Trade or Business (SSTB) with taxable income in 2021 over \$164,900 (single) or \$329,800 (married/joint) get phased out of the deduction. Non-SSTB owners with taxable income over these thresholds do not get phased out but are subject to a separate wages and capital test that may limit the deduction.

PLANNING THEMES AND IDEAS TO CONSIDER FOR 2021⁵

Some planning themes and ideas that maybe beneficial to consider in anticipation of potential income tax changes include:

- **Accelerating taxable income** to avoid future taxation at higher proposed rates. Examples can include Roth conversions, capital gain harvesting, accelerating C-corp. shareholder dividends, exercising non-qualified or incentive stock options or accelerating gain under § 453(d) for installment sales.
- **Spreading out or deferring taxable income** to remain under proposed new thresholds for higher tax rates. Examples can include doing Roth conversions over multiple years, using § 453 installment sales, charitable remainder trusts, § 1031 like-kind exchanges or investing in Opportunity Zones.
- **Shifting taxable income** to other family members to remain under proposed new thresholds for higher tax rates. Examples can include using charitable remainder trusts and family limited partnerships.
- **Avoiding taxable income** to minimize or avoid exposure to higher proposed tax rates. Examples can include investing in Opportunity Zones, § 1202 Qualified Small Business Stock, using Incomplete Gift Non-Grantor Trusts to save state income taxes, or charitable lead trusts.
- **Carefully timing deductions** to maximize the resulting tax benefit of the deduction if income tax rates increase or certain limitations are imposed, or caps eliminated. Examples can include deferring business related expenses, delaying unrealized capital loss harvesting, or accelerating vs. deferring itemized deductions such as SALT and charitable donations.

Some planning themes and ideas that maybe beneficial to consider in anticipation of potential estate tax changes include:

- **Making large gifts** to take advantage of the \$11.7MM transfer tax exemption before it is reduced. Examples can include gifting to irrevocable grantor trusts, dynasty trusts, and pre-funding life insurance trusts.
- **Preserving accessibility** when making gifts in case the laws or circumstances change and the donor needs or wants access to the gifted money or property. Examples can include provisions in the trust allowing the grantor to borrow from it, using Spousal Lifetime Access Trusts (SLATs) or Special Power of Appointment Trusts (SPATs).
- **Preserving flexibility** to reverse course in response to a retroactive tax law change. Examples can include a qualified disclaimer provision in the trust instrument, using a "QTIP-able" trust or making formula gifts.
- **Preserving insurability** by acquiring life insurance now to provide liquidity for increased estate taxes from proposed higher tax rates or lower exemptions, or increased income taxes from repeal of the step up in basis at death. Examples can include buying a term policy and converting to permanent later or a minimally-funded permanent policy now.
- **Make use of other estate planning techniques** that may become limited or unavailable. Examples can include irrevocable grantor trusts, GRATs and valuation discounts with family-controlled entities.

⁵ Many ideas listed are oversimplified references to complicated financial, tax and legal strategies that may not be applicable for all individuals. For discussion purposes only and meant to highlight various topics for individuals to discuss with their financial, tax and legal professionals.

More about Retroactive Effective Dates

Although it may seem unusual, Congress does have the legal authority to enact a retroactive tax law if it is supported by a rational legislative purpose. Raising tax revenue to offset the historic stimulus spending during a global pandemic could certainly meet this standard. That said, income taxes are generally paid on a quarterly estimated basis or periodically through withholding so retroactive changes to income tax laws could cause administrative problems for taxpayers, such as potential interest and penalties on past amounts paid based on prior law, and certain changes can easily be made applicable to income recognized after a specified date, such as the tax on capital gain from the sale of property. Estate taxes, conversely, are generally due within nine months after the taxpayer's death so retroactive changes could be less problematic to administer. Therefore, although possible for both, many commentators believe if new tax legislation includes a retroactive effective date it may be more likely with estate tax changes than those for the income tax.

CONCLUSION

High-income, high-net-worth and business clients may see higher income and transfer taxes come their way soon because of unified control of government by the Democratic Party. Accordingly, they should work with their financial, tax and legal professionals and immediately begin or continue planning in 2021 to maximize the ability to take advantage of current tax laws before changes come. While the chances of retroactive effective dates may be seen as low by many commentators, the possibility exists. Clients should be advised of the uncertainty as to timing and the impact on planning so they can make informed decisions about what to do and the flexibility to change or reverse course once new legislation is proposed, and effective dates are known, are critical planning components to consider.

If you have any questions, please reach out to your financial professional.

ABOUT EXECUTIVE BENEFIT SOLUTIONS, LLC

EBS is an independent executive benefit consulting firm which provides total plan management services with respect to programs specifically designed for key employees and professionals. Those services include:

- Consulting with respect to plan design,
- The structuring of related financing and benefit security arrangements,
- The design and management of the participant communication, education and enrollment processes,
- Management of any informal funding assets and,
- On-going plan administration and technical support.

More information about the firm can be found at:

www.executivebenefitsolutions.com



CONTACT INFORMATION:

EBS-Boston

75 Arlington Street, Suite 500
Boston, MA 02116

Phone:

Fax: 866.903.9927

617.904.9444

Christopher Rich

Managing Director

Chris Wyrzten

Managing Director

National Administration Center

801 East Plano Parkway, Suite 216
Plano, TX 75704

Phone: 972.422.8298

Bonnie Barnes

Vice President of Plan Administration

crich@ebs-boston.com

cwyrzten@ebs-boston.com

bbarnes@ebs-boston.com

ABOUT LION STREET

Lion Street is comprised of an elite national network that connects high-net-worth and business clients with sophisticated insurance and financial planning solutions. It is among the largest life insurance distributors in the nation, through its premier independent firms and top-tier point-of-sale planning specialists. Our network has a broad range of industry experience and works collaboratively to deliver custom financial solutions to the clients they serve.



515 Congress Ave., 25th Floor - Suite 2500 | Austin, TX 78701 | (512) 776-8400

www.LionStreet.com

Copyright © Lion Street 2021.