Estate & Gift Tax Reform: It's Going To Be Ugly

presented by
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2021 Professional Advisor Symposium

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BUSINESS PROVISIONS

- **Corporate Tax Rate**

Beginning after 2021, the corporate tax rate structure would generally return to a graduated format from the current flat 21% rate applicable as a result of the Tax Cuts and Jobs Act (TCJA).

The proposal would actually lower the tax rate on smaller corporations, while raising it to 26.5% on larger corporations.

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BUSINESS PROVISIONS

Proposed Tax Rate on Corporations Proposed by the Build Back Better Act:	
Taxable Income	Tax Rate
Not over $400,000	18%
Over $400,000 but not over $5,000,000	21%
Over $5,000,000	26.5%

- An additional 3% tax would be included on the taxable income of a corporation in excess of $10,000,000 with a maximum additional tax of $287,000.
- **COMMENT**: The additional 3% tax essentially eliminates the benefit of the 18% bracket for these larger corporations.
- Special rules apply to corporations using the normalization method of accounting to adjust for the change in tax rate.

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INDIVIDUAL PROVISIONS

- Ordinary Income Tax Rates

Under the proposed legislation, effective for tax years beginning after 2021, the highest ordinary income tax rate applicable to individual taxable income would be increased to 39.6%.

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INDIVIDUAL PROVISIONS

- Currently, individual ordinary income is taxed at seven graduated rates: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. For 2022, the 37% bracket is projected to begin at the following income levels, depending on filing status:

Projected 2022 37% Rate Bracket Threshold Amount:	
Filing Status	Projected 2022 Amount
Single	$539,900
Married Filing Jointly	$647,850
Married Filing Separately	$323,925
Head of Household	$539,900

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INDIVIDUAL PROVISIONS

- Under the proposal, the 37% rate bracket is eliminated and replaced with a 39.6% bracket, which also begins at a lower threshold amount:

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INDIVIDUAL PROVISIONS

Projected 2022 39.6% Rate Bracket Threshold Amount (CURRENT LAW)	
Filing Status	Projected 2022 Amount
Single	$400,000
Married Filing Jointly	$450,000
Married Filing Separately	$225,000
Head of Household	$425,000

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INDIVIDUAL PROVISIONS

- Additionally, for estates and trusts, the current 37% ordinary income bracket projected to begin at $13,450 for 2022 would be taxed at 39.6%.

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INDIVIDUAL PROVISIONS

- The current seven-rate tax structure was implemented in the TCJA and was subject to sunset after 2025 and revert to the seven-rate structure (10%, 15%, 25%, 28%, 33%, 35%, and 39.6%) in place prior to 2018.
- The proposed legislation makes the replacement of the top rate permanent, and eliminates the 35% rate bracket that would otherwise return in 2026.

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CAPITAL GAIN RATES (CURRENT)

- Under current law, graduated rates apply to individuals' long-term capital gains and qualified dividends depending upon the amount of taxable income.
- The "breakpoints" at which the rate increases from 0% to 15% to 20% are adjusted annually for inflation, and are projected to be as shown in the table on a following slide for 2022.

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THE PROPOSAL

- Under the proposal, the top 20% rate would be replaced with a 25% rate.
- Additionally, the "breakpoint" for the beginning of the new 25% bracket would be lowered to align with the income amounts applicable for the new 39.6% ordinary income bracket (discussed above).
- The low-end "breakpoints" for the 15% bracket would not be affected.

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WHEN EFFECTIVE

- The proposal to increase the top rate to 25% takes effect for tax years *ending* after September 13, 2021.
- However, a transition rule applies to tax years that include September 13, 2021 (for example, calendar year taxpayers) that makes the 20 percent rate applicable for sales and exchanges before September 13, 2021, and the 25 percent rate applicable to sales and exchanges after that date.

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2022 PROJECTED (CURRENT LAW)

2022 Projected Long-Term Capital Gains and Qualified Dividends Rates for Taxpayers with Taxable Income in the Specified Ranges UNDER CURRENT LAW			
	0%	15%	20%
Married Filing Jointly	$0 - $83,350	$83,351 - $517,200	over $517,200
Married Filing Separately	$0 - $41,675	$41,676 - $258,600	over $258,600
Head of Household	$0 - $55,800	$55,801 - $488,500	over $488,500
Single	$0 - $41,675	$41,676 - $459,750	over $459,750
Estates and Trusts	$0 - $2,800	$2,801 - $13,700	over $13,700

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PROPOSED CAPITAL GAIN PUNISHMENT

Proposed Long-Term Capital Gains and Qualified Dividends Rates for Taxpayers with Taxable Income in the Specified Ranges Under Current Law			
	0%	15%	25%
Married Filing Jointly	$0 - $83,350	$83,351 - $450,000	over $450,000
Married Filing Separately	$0 - $41,675	$41,676 - $258,600	over $258,600
Head of Household	$0 - $55,800	$55,801 - $425,000	over $425,000
Single	$0 - $41,675	$41,676 - $400,000	over $400,000
Estates and Trusts	$0 - $2,800	$2,801 - $13,450	over $13,450

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INCOME TAX SURCHARGE

- The proposed legislation would apply a 3% tax on the modified adjusted gross income of individuals, estates, and trusts in excess of certain amounts. The 3% surcharge would be effective for tax years beginning after 2021.
- But, is there another marriage penalty?

Married Filing Jointly	$5,000,000
Married Filing Separately	$2,500,000
Head of Household	$5,000,000
Single	$5,000,000
Estates and Trusts	$100,000

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NET INVESTMENT INCOME TAX – 3.8%

- The proposed legislation expands the scope of taxpayers subject to the next investment income (NII) tax.
- Effectively, taxpayers who are S corporation shareholders, limited partners, and LLC members are not currently subject to the NII tax on income received from these entities, if they do not materially participate in the trade or business. Under the proposed law, lack of material participation will no longer exempt them from the 3.8 percent NII tax.
- The proposal is effective for tax years beginning after 2021.

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QUALIFIED BUSINESS INCOME DEDUCTION - LIMITED

- For tax years beginning after 2017 and before 2026, taxpayers are allowed a 20 percent deduction on the qualified business income from an S Corporation, partnership, or sole proprietorship, effective for tax years beginning after 2021. These amounts are not adjusted for inflation.

DEDUCTION LIMITS	
Married Filing Jointly	$500,000
Married Filing Separately	$250,000
Estates and Trusts	$10,000
All Other Taxpayers	$400,000

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EXCESS BUSINESS LOSSES

- Under the proposed legislation, the prohibition on the excess business losses of a non-corporate taxpayer, currently applicable through 2026, would be permanent.

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CHILD TAX CREDIT

- The American Rescue Plan Act (ARPA) significantly modified the child tax credit. The proposed legislation extends many of those modifications to 2022.
  - Increase in the age limit of a qualifying child to 17
  - Increase to $3,000 for ages 6-17 ($3,600 for children under 6)
  - Two-stage phase out of the credit amount and the increased credit amount
- Increase in the amount of the credit to $3,000 ($3,600 for children under 6).

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CHILD TAX CREDIT

INCOME THRESHOLDS		Fully Phased Out
Married Filing Jointly	$150,000	$400,000
Married Filing Separately	$75,000	$200,000
Head of Household	$112,000	$400,000

- Credit is fully refundable!!
- Zero income qualifies!!
- Advance payment of the credit (for a full year instead of six months)
- President Biden wants to make this permanent.

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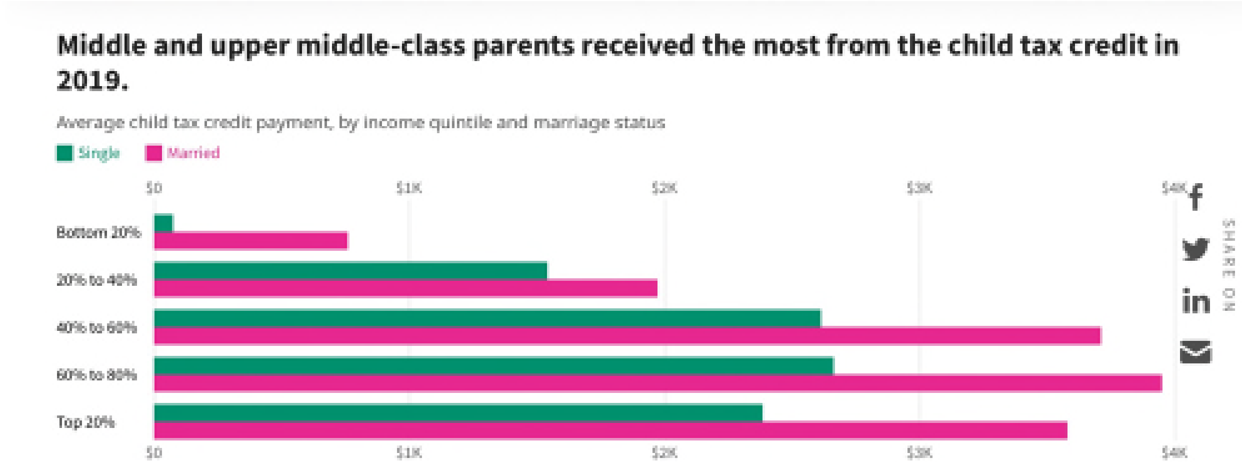
From USAfacts.org



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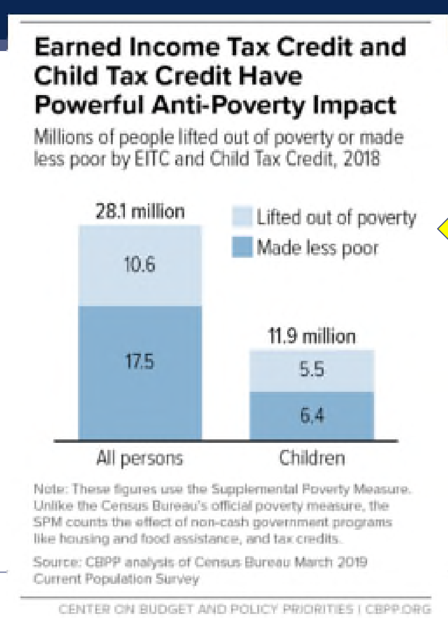
From Center on Budget and Policy Priorities: cbpp.org



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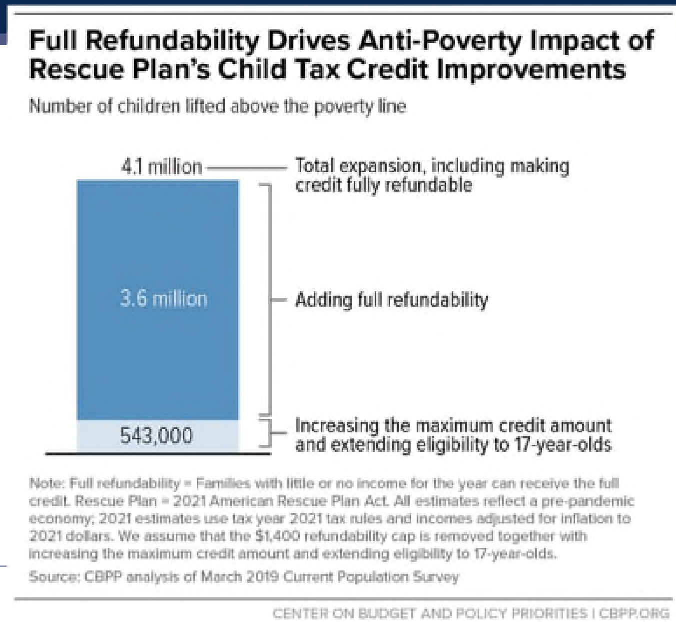
From Center on Budget and Policy Priorities: cbpp.org



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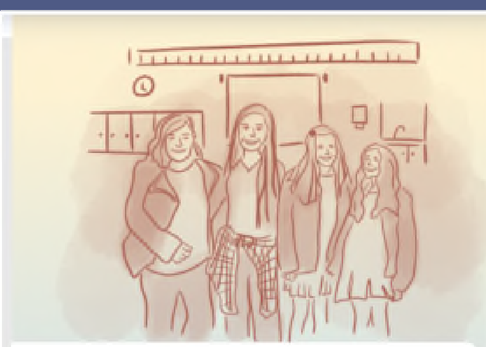
Examples from WhiteHouse.gov



Jamie

Occupation: Teacher
Income: $55,000
Filing Status: Head of Household (Single Parent)
Dependents: 3 children over age 6

Jamie

Jamie filed a tax return this year claiming 3 children and will receive part of her payment now to help her pay for the expenses of raising her kids. She'll receive the rest next spring.

- Total Child Tax Credit: increased to $9,000 from $6,000 thanks to the American Rescue Plan ($3,000 for each child over age 6).
- Receives $4,500 in 6 monthly installments of $750 between July and December.
- Receives $4,500 after filing tax return next year.

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Examples from WhiteHouse.gov

Alex & Casey

Occupation: Lawyer and Hospital Administrator
Income: $350,000
Filing Status: Married
Dependents: 2 children over age 6

Alex & Casey

Alex & Casey filed a tax return this year claiming 2 children and will receive part of their payment now to help them pay for the expenses of raising their kids. They'll receive the rest next spring.

- Total Child Tax Credit: $4,000. Their credit did not increase because their income is too high ($2,000 for each child over age 6).
- Receives $2,000 in 6 monthly installments of $333 between July and December.
- Receives $2,000 after filing tax return next year.

CHILD AND DEPENDENT CARE

- ARPA also expanded the child and dependent care credit, but only for 2021.
- The amount of the credit was increased to $8,000 for taxpayers with one qualifying individual and $16,000 for those with two or more, and it was made fully refundable.
- Similar to the child tax credit, the amount of the credit phases out in two stages.

CHILD AND DEPENDENT CARE

- The proposed bill makes these changes permanent. It also makes the $8,000 and $16,000 amounts subject to inflation adjustments, as well as the first stage of the two-stage phase out.
- The credit begins to phase out or decrease by 50% when household income reaches $125,000 to $183,000. After $183,000 the credit is 20%. The 20% lasts until income reaches $400,000.
- Any amount over $438,000 and above will reduce the credit to zero (0).

HEALTH CARE CREDITS

- ARPA reduced the share of premiums that individuals or households must contribute towards the cost of health insurance in calculating the amount of their premium assistance credit. It also generally expanded eligibility for the premium assistance credit to individuals and families with household incomes above 400% of federal poverty level for a family of the size involved.
- These provisions in ARPA were for 2021 only, but the proposed legislation makes the changes permanent.
- Other changes to the premium assistance credit are also proposed.

HEALTH CARE CREDITS, cont.

- The health coverage tax credit, set to expire for months beginning on or after January 1, 2022, is also made permanent under the proposed bill. The amount of the credit is also increased to 80% of qualified health insurance premiums from the current 72.5%.
- So, $2,500 monthly premium for a family of 5 – you pay $500.

Family Size	400% of FPL
1	$51,520
2	$69,680
3	$87,840
4	$106,000
5	$155,200

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ESTATES AND TRUSTS

- **Unified Credit**

PROJECTED: Current Law	**2022**	**$12,060,000**
PROPOSED LAW	**2022**	**$ 6,000,000**

- TCJA increased the unified credit applicable to estate and gift taxes after 2017, effectively doubling the amount exempted from estate and gift taxes.
- For 2022, this increase in the credit is projected to effectively shield $12,060,000 from estate and gift taxes. This increase in the unified credit is scheduled to expire after 2025.
- Under the proposed legislation, the expiration of the increase would be accelerated to 2022. However, the current amount could still be used for farming property, at the election of the estate's executor (wait and see).

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GRANTOR TRUST CHANGES

Changing Estate & Gift Tax Rules that Apply to Grantor Trusts

- Make the rules similar to income tax rules for grantor trusts, making assets held in a grantor trust taxable in a person's estate.
- These rules would apply to future trusts and to future transfers to existing trusts.
- The House also proposes to tax sales between grantors and grantor trusts the same way a normal sale of assets are taxed.
- These proposals make it much more difficult and expensive to transition family businesses.
- Opposition to these proposals is expected to be strong, stay tuned to see who prevails.

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EXPECTED TIMING & EFFECTIVE DATES

Majority Vote

- Many expect the ultimate enactment of comprehensive tax changes in November or December of 2021. Only a simple majority of votes are needed in the House and Senate to pass a budget reconciliation bill.

Effective Date

- The effective date of most provisions will be January 1, 2022. Certain provisions, especially hated by the Democratic majority, may have effective dates tied to the date of announcement, committee action or enactment of the actual legislation.

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EXPECTED TIMING & EFFECTIVE DATES

Capital Gain

- For example, the Biden administration indicated capital gains would apply to gains required to be recognized after the date of announcement, which would have been April 2021. The legislation proposed by the House Ways and Means Committee is effective for gains required to be recognized after September 13, 2021.
- Historically, proposed effective dates for capital gains increases have slipped to the date of enactment of the legislation. It is possible the same will occur this year.

WHAT ELSE MIGHT HAPPEN

Tax on Capital Gains at Death and Required Carryover Basis at Death

- Both seem to lack sufficient support and will likely be dropped from the reconciliation process. However, stealth death taxes on certain techniques to help keep control of the family business may still be in play.
- Changes to the Grantor Trust rules and discounts for closely held businesses such as minority interest and marketability discounts.
- Allows Certain S corporations to convert to partnerships.
  - The House proposes to allow S corporations that were taxed as S corporations on May 13, 1996 (prior to the publication of the check the box regulations), to reorganize as partnerships with no tax consequences between a two year period beginning December 31, 2021.

SALT DEDUCTIONS

- The House proposal does not include any specific relief for the $10,000 cap on SALT deductions. However, Ways and Means Chairman, Richard Neal, committed to including "meaningful" SALT relief in any final package.
- The leading proposals being discussed include raising the SALT cap (perhaps to $40,000) and eliminating the SALT cap for some period (perhaps two years).
- Question: In excess of standard deduction or in addition to the standard deduction?

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OTHER POTENTIAL ESTATE & GIFT TAX INCREASES AND CHANGES

- Is the $15,000 per donee gift tax annual exclusion ($30,000 if spouses agree) going away?
- The March Senate Bill limited annual exclusion gifts for trusts to $30,000 (two per taxpayer). Presumably outright gifts would continue as currently authorized.
- The current estate tax rate is 40% - Bernie wants it to go to 55%.
- Portability exemptions among spouses is generally expected to continue.

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IMPROVEMENTS

- How about codify Crummey?
- Makes tooooo much sense.
- Make GST Exemption portable between spouses like estate tax exemption?

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THE SLAT DIES?

- Appears can still make gift to trust (non-grantor) not taxable in estate, just have to treat as complex trust.
- What about QSST? Will Democrats attack?
- What happens when a non-grantor trust is created by spouses and assets are invested in an LLC that that makes an S-election?
- Beneficiary spouse disregarded and taxed on all income earned by trust.
- 80% as good as SLATs structured as grantor trusts.
- Look to non-grantor trusts.
- Can you say "The MaxProtect Plan©" !!

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BERNIE SANDERS – GRATs

- Will Grantor Retained Annuity Trusts change?
- 2 or 10 year GRATS?
- Heightened interest in opportunity shifting.
- Create non-grantor trust or QSST or ESBIT for all new business opportunities.

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SALQSST: Spousal Access Lifetime QSST: Step 1

- Paula creates irrevocable non-grantor trust. Income does not flow through to grantor's 1040.

THOMAS C. HOFFMAN II 2021
IRREVOCABLE TRUST
(non-grantor trust)

Trustee: Thomas C. Hoffman, II

- Paula, as Grantor, makes gift to trust and files a gift tax return, reporting gift and allocating GST exemption.

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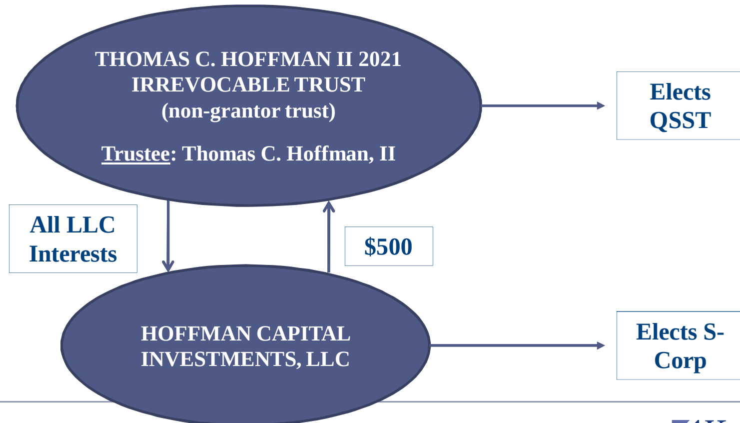
Step 2

- Thomas C. Hoffman, II, as Trustee, forms Hoffman Capital Investments, LLC



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Result

- One Form 1120S – reporting all income for LLC
- Trust Form 1041
  - Passes all LLC K1 income directly through to QSST beneficiary (Thomas C. Hoffman, II)

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What We Have Accomplished

- Settlor has vehicle to which funds can be transferred for gift and estate planning
- Beneficiary is responsible for paying tax on all income (but that is me, Paula's spouse). Sounds a lot like a SLAT?
- Family members can act as trustee

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Accomplishments, cont.

- Assets held within LLCs in Trust are removed from settlor's AND beneficiary's federal taxable estate
- Assets held within LLCs in trust are protected from most creditors

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Accomplishments, cont.

- Assets held within LLCs in trust are protected from bankruptcy of both spouses
- Assets held within LLCs in trust are not subject to marital division (future former blood sucking spouse of widow/widower)

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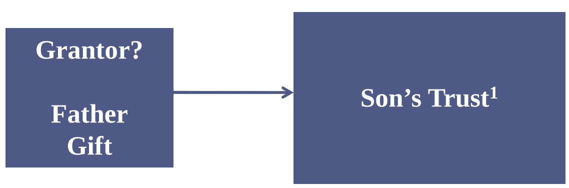
Additional Case Study: Opportunity Shift

- Step 1



NOTES:
1. Beneficiaries – Son and issue.

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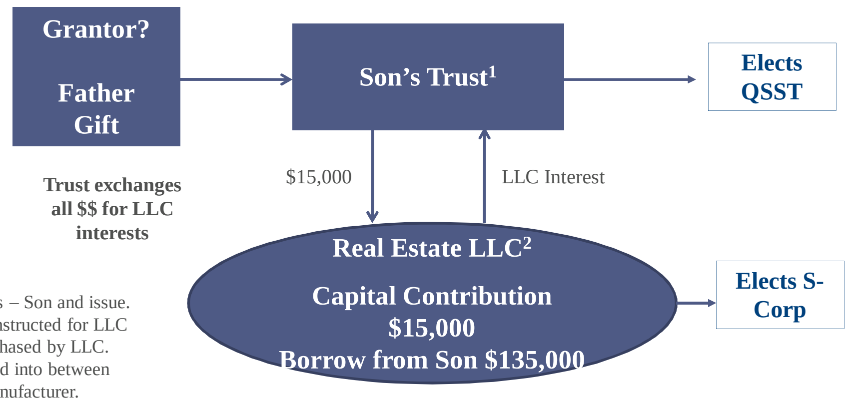
Additional Case Study

- Step 2



NOTES:
1. Beneficiaries – Son and issue.
2. Building constructed for LLC on land purchased by LLC. Lease entered into between LLC and manufacturer.

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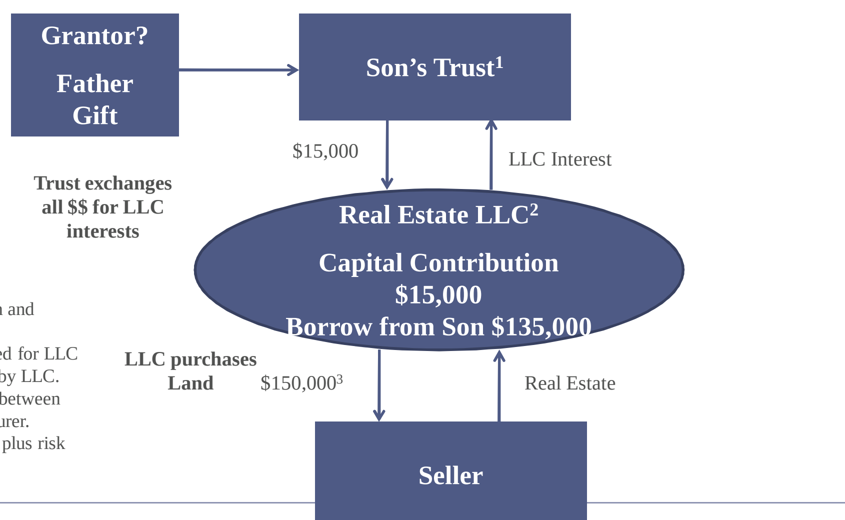
Additional Case Study

- Step 3



NOTES:
1. Beneficiaries – Son and issue.
2. Building constructed for LLC on land purchased by LLC. Lease entered into between LLC and manufacturer.
3. Loan, with interest plus risk premium.

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Family Business Succession: Ad Hoc

Unscientific observations from 60 years of Knox Law business succession planning:

- 1/3 of family business successions to the next generation are successful
- 1/3 … are mediocre to below average
- 1/3 … are family and business disasters

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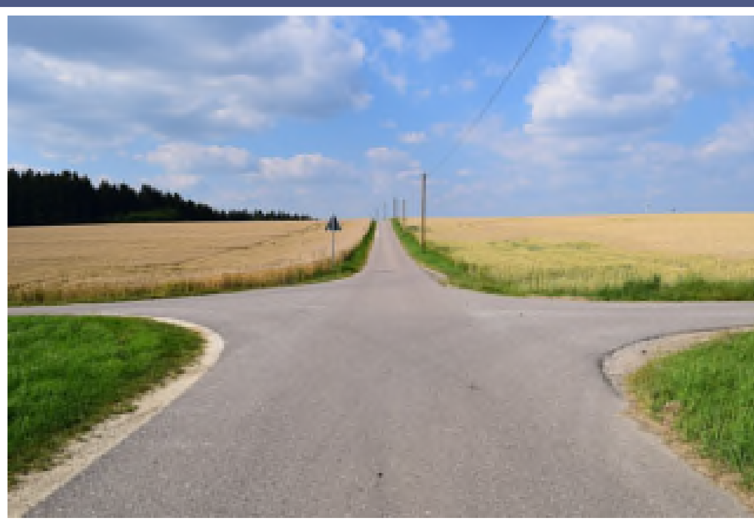
The Journey



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What Business Owners Want: TIME!

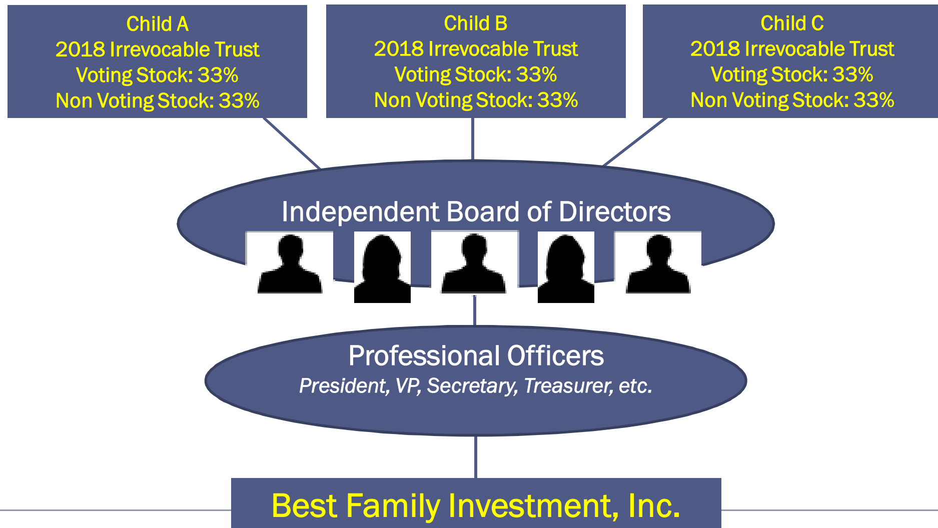
The Family Private Equity Model Epiphany

The light bulb goes on!

- Owner treats his/her company as an operating company; something that spins off cash.

- The epiphany is when the owner treats the company as a financial vehicle, which has many alternatives.

Family Private Equity Model Platform



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Family Private Equity Model Options

Profile the President

Attributes

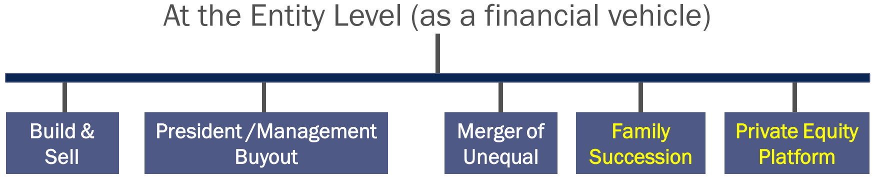
Skills

Experience

Behavioral Profile

Define the Potential Outcomes

At the Entity Level (as a financial vehicle)



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Thank You!

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