FAMILY & CLOSELY HELD

BUSINESS SUMMIT

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Proposed Wealth Tax Changes Under the Biden Administration

Presented by:

Jacqueline L. Messler,
Corporate; Tax; and Trusts, Estates and Succession Planning Attorney
jmessler@dkattorneys.com
262-792-2409

Mark J. Andres,
Corporate; Tax; and Trusts, Estates and Succession Planning Attorney
mandres@dkattorneys.com
262-792-2414

DAVIS KUELTHAU
attorneys at law

1) **Summary of Current Tax Rules**
   a) Income Tax
      i) Top tax rate 37%
   b) Capital Gains Tax (long term)

FILING STATUS	0% RATE	15% RATE	20% RATE
Single	Up to $40,400	$40,401 – $445,850	Over $445,850
Married filing jointly	Up to $80,800	$80,801 – $501,600	Over $501,600

   c) Corporate Income Tax
      i) 21%
   d) Gift Tax
      i) Basic Exclusion amount (Unified with Estate Tax) - $11.7 million, indexed for inflation
      ii) Tax Rate – 40%
      iii) Annual Exclusion Gifts - $15,000 per person per year
   e) Estate Tax
      i) Exclusion – (Unified with Gift Tax) - $11.7 million, indexed for inflation. If no change, current exemption will sunset at end of 2025, back to $5 million, indexed for inflation
      ii) Tax Rate – 40%
   f) Generation-Skipping Tax
      i) Exclusion – Separate from Estate Tax Exemption - $11.7 million, indexed for inflation
      ii) Tax Rate – 40%
   g) Basis Step Up
      i) When certain assets are included in an estate at death, the basis "steps" to the date of death value, usually a "step up"
      ii) Main exclusions to rule are retirement accounts and annuities. Beneficiary pays income tax as income is received after death of owner
   h) Taxation of Unrealized Appreciation at Death
      i) Inherited capital assets are not considered to be "sold" at death, and with basis step up, no capital gains taxes are due as a result of death

2) **American Families Plan**
   a) Sponsor/Proponent – President Biden
   b) Objectives of Legislation
      i) Universal, no-cost preschool to 3 and 4 year-olds
      ii) Two years of free community college
      iii) Provide direct support to families to ensure that low- and

iv) middle-income families spend no more than 7% percent of their income on childcare
v) Create a national comprehensive paid family and medical leave
vi) Provide nutrition assistance to families
vii) Expand access to healthy meals to students
viii) Extension of Child Tax Credit, the Earned Income Tax Credit, and the Child Dependent Care Tax Credit
ix) Extension of credits for health insurance premiums

c) Proposed Tax Changes
   i) Income Taxes
      (1) Top rate increased to 39.6% from 37%
   ii) Capital Gains
      (1) 39.6% for high income earners. 3.8% Net Investment Income Tax will continue to also apply
      (2) AFP would require financial institutions to report information on account flows so that earnings from investments and business activity are subject to reporting more like wages already are
   iii) Corporate Taxes
      (1) Increased to 28% from 21%
   iv) Gift Tax
      (1) Basic Exclusion – No change announced as part of AFP Funding. Prior comments reflected desire to reduce to $5M or $3.5M
      (2) Annual exclusion gifts – N/A
      (3) Tax of accumulation appreciation recognition when making gifts – N/A
   v) Estate Tax
      (1) Exclusion - No change announced as part of AFP Funding. Prior comments reflected desire to reduce to $5M or $3.5M
      (2) Tax Rate – N/A
   vi) Generation-Skipping Tax
      (1) No change announced as part of AFP Funding. Prior comments reflected desire to reduce to $5M or $3.5M
   vii) Basis step up
      (1) Eliminated to extent exceeds $1M per person. Mechanics unclear
      (2) Includes protections so that family-owned businesses and farms will not have to pay taxes when given to heirs who continue to run the business
      (3) No forced recognition if property is donated to charity
   viii) Taxation of Unrealized Appreciation at Death

(1) Unclear. President calls for "ending the practice of stepping up the basis for gains in excess of $1 million . . . and making sure the gains are taxed if the property is not donated to charity."

ix) Limitation on Valuation Discounts – N/A

x) Effective date

(1) Unclear, but "Green Book" signals no changes until 2022

3) The 99.5% Act

a) Sponsor/Proponent – Senator Bernie Sanders

b) Objectives of Legislation

i) "Strengthen the federal estate tax, create a fairer tax system and help prevent the accumulation of dynastic wealth. It would raise $430 billion over 10 years to invest in working families and rebuild our communities."

c) Proposed Tax Changes

i) Income Taxes – N/A

ii) Capital Gains – N/A

iii) Corporate Taxes – N/A

iv) Gift Tax

(1) Basic Exclusion – Reduced to $1M. Not indexed for inflation

(2) Annual exclusion gifts – Limits aggregate annual exclusion gifts. $20,000 limit per donor. $10,000 limit per donee

(3) Tax of accumulation appreciation recognition when making gifts – N/A

v) Estate Tax

(1) Exclusion - Reduced to $3.5M. Indexed for inflation

(2) Tax Rate

(a) $3M - $10M will be taxed at 45%

(b) $10,000,0001 - $50M taxed at 50%

(c) $50,000,0001 - $1B will be taxed at 55%

(d) Over $1B will be taxed at 65%

vi) Generation-Skipping Tax

(1) Exclusion reduced to $3.5M. Dynasty trusts essentially limited to 50 years at which time GST exclusion would expire. 50-year rule applies to existing trusts

vii) Basis step up

(1) N/A (other than narrow circumstances of intentionally defective irrevocable grantor trust where basis step-up was planned)

viii) Taxation of Unrealized Appreciation at Death – N/A

ix) Limitation on Valuation Discounts

(1) Disallowance of valuation discounts for lack of control or marketability for non-active business interests if the transferor, the transferee, and “members of the family” have control of the entity, or own majority interest (by value). Marketable securities and real estate generally considered passive

d) Effective Date – Tax years after 12/31/2021

4) Sensible Taxation and Equity Promotion (STEP) Act

a) Sponsor/Proponent – Senators Chris Van Hollen, Bernie Sanders, Sheldon Whitehouse, and Elizabeth Warren

b) Objectives of Legislation

i) “This legislation would close the stepped-up basis loophole by taxing unrealized capital gains when heirs inherit huge fortunes on which the original owner never paid income taxes.”

c) Proposed Tax Changes

i) Income Taxes – N/A

ii) Capital Gains – N/A

iii) Corporate Taxes – N/A

iv) Gift Tax

(1) Basic gift tax exclusion amount – N/A

(2) Annual exclusion gifts – N/A

(3) Tax of accumulation appreciation recognition when making gifts

(a) Gift transfers generally treated as sale of gifted asset triggering recognition of capital gain

(b) Limited exceptions for tangible personal property (other than collectibles), for sale of principal residence, for transfers to spouses and charities, and for certain charitable trusts, qualified trusts, and cemetery trusts

(c) An annual exclusion of up to $100,000 in capital gain for appreciation included in gifted assets is provided, with aggregate lifetime gain exclusion capped at $1M

v) Estate Tax

(1) Exclusion – N/A

(2) Tax Rate

(a) No rate change. Capital gain tax paid on deemed sale occurring at death may be deducted when determining estate tax due. This is not explicitly addressed in Step Act

vi) Generation-Skipping Tax

(1) Assets held in non-grantor trusts deemed sold every 21 years thereby triggering capital gain tax on unrealized appreciation. Trusts created in 2005 or earlier deemed to have gain triggered in 2026

vii) Basis step up

(1) No change but significance of step up limited given imposed gain recognition at death. Exceptions for bequests to charity and U.S. citizen spouses (outright or via Marital Deduction)

viii) Taxation of Unrealized Appreciation at Death

(1) Transfers at death treated as a sale of assets with resulting capital gain recognition. Tax can be paid over period of up to 15 years for transfers at death (not applicable to lifetime transfers).

ix) Limitation on Valuation Discounts – N/A

x) Effective Date – Tax years after 12/31/2020

5) Planning to Consider Now

a) Retroactivity

i) STEP Act would be retroactive to 1/1/21

ii) Questionable constitutionality

(1) No ruling on retroactivity of estate tax legislation, but there are rulings in other contexts

(2) Retroactive taxation of transactions is possible if rationally related to a legitimate legislative purpose. Pension Benefit Guaranty Corporation v. R. A. Gray & Co., 467 U. S. 717 (1984); United States v. Carlton, 512 U.S. 26 (1994).

iii) Many planners and clients are hesitant to make large gifts to utilize current $11.7 million exemption

b) Gift/Estate Tax

i) Make Gifts to Utilize Current $11.7 exemption

(1) Make transfers to utilize exemption, lock in discounts, etc. but seek to minimize risks, although there is no assurance that these techniques, especially for income tax purposes, will be effective

(2) Gift only cash (can borrow) to avoid gain recognition if STEP Act or similar bill is enacted.

(3) Utilize a swap power to swap in other assets (and then repay the loan).

ii) Basic tools

(1) Annual exclusion gifting

(2) Payment of direct tuition

(3) Payment of medical expenses

(4) Contribution to 529 account

c) Capital Gains Tax

i) Consider selling this year and recognizing capital gains at current rate (Biden's plan doubles capital gains rates)
    (1) Tax paid at lower rate, but paid sooner
ii) Charitable Remainder Trusts (CRT)
    (1) What is it?
        (a) A CRT is a split interest trust consisting of an income interest and a remainder interest
        (b) During the term of the trust, the income interest is usually paid out to the donor (or some other named beneficiary)
        (c) At the end of the trust term, the remainder (whatever is left in the trust) is paid to the charity or charities that have been designated in the trust document
        (d) Generally the donor will not realize gain or loss when property is transferred to the trust (exceptions for if property transferred subject to debt or donor receives property in exchange)
    (2) Charitable remainder trusts can be used to reduce or avoid surtax and incremental capital gains tax by smoothing out income when Taxpayer has a large capital gain
    (3) Strategy:
        (a) Taxpayer contributes the appreciated asset(s) to a CRT
        (b) The CRT sells without recognizing gain
        (c) The gain is recognized as annuity (or unitrust) payments are made
        (d) This defers the tax liability for years and or reduces the total tax liability by avoiding higher income and a higher rate
iii) Installment Sale
    (1) An installment sale is a type of sale in which the seller sells an asset to another person in exchange for a promissory note paid over time
    (2) If executed correctly, the taxable gain recognized by the seller will be deferred until payments are made on the principal of the note

d) Basis Step up
    i) Near-death exercise of grantor trust swap power
e) Other