The elections are finally over. We are now waiting to see what tax legislation will be proposed, likely this Fall. To date, nothing concrete has been put forward so we can only look at the Biden campaign’s campaign proposals for ideas on what may be forthcoming. We do know that tax legislation has a fair chance of passing since Democrats control the House and have the needed 50 votes in the Senate plus a tie-breaking vote by Vice President Harris. It is possible we may also see some tax provisions contained in any one (or more) of President Biden’s administration’s four priorities: COVID Relief, Economic Recovery, Racial Justice and Climate Change.

One thing we do expect is that taxes will go up. It can’t be emphasized strongly enough that now is the time to reach out to your Wealth Management team, CPA and Estate Planning attorney to discuss what you should be considering for both income tax and estate tax planning this year.

Retroactivity of new tax legislation
Will any changes be retroactive to 1/1/2021 or instead take effect on January 1, 2022 (or any date in between)? This won’t be known until legislation is proposed and passed. Recent comments out of the Biden Cabinet seem to be leaning towards an acknowledgment that it would be bad for economic recovery if the legislation was retroactive. Numerous commentators have also expressed the belief that it will not be retroactive. This, of course, is no guarantee.

Estate taxes
The current amount you can transfer tax-free to the individuals of your choosing (usually spouse, family) is $11.7 million. This exemption can be given away during your lifetime, at death, or some combination of both. The anticipated proposal is to reduce this amount to $3.5 million. Even if this proposal is not enacted, the estate & gift tax exemption is already slated to be reduced in 2026 to $5 million (adjusted for inflation). Note: a surviving spouse would still be permitted to use any part of their deceased spouse’s remaining exemption by electing “portability” on the deceased spouse’s estate tax return. There is no proposal to change the current rule that charitable gifts at death are tax-free.

Let’s quantify what all this means if you have significant assets and don’t take advantage of your ability to make a gift tax free transfer now. The difference between the current estate tax exemption amount and the possible proposed amount is a staggering $8.2 million. Multiply that by the 45% possible new estate tax rate and you may be leaving $3.69 million on the table for the government at death based on today’s values (with future appreciation, that number can be substantially higher). Double this if you are married.

With proper estate tax planning, these assets could instead go to the beneficiaries of your choosing—not the government. Lifetime gifts can be outright or in trust; most people choose the latter in order to continue to exert some control over those assets. If you use the strategy known as a Delaware Directed Trust, you can even continue to be the Investment Adviser for the trust and manage the assets, if you choose.

If you are married, there is an interesting strategy known as a “SLAT” (spousal lifetime access trust) to lock in your estate tax exemption. This involves creating trusts for each spouse and gifting your lifetime
exemption into each trust. The children will receive the assets from each spouse upon their respective passing. Using this strategy, a couple might be able to move a significant amount of wealth out of their estate but still have access to all of their wealth as beneficiaries of each other’s trusts. It is important to work closely with your estate planning attorney to make sure you fully understand the ramifications and the rules.

Could the benefits of making large lifetime gifts now be retroactively taken away at death if the estate tax exemption is reduced? In 2018, the Internal Revenue Service issued a ruling reassuring taxpayers that it would not “clawback” large gifts if the estate tax exemption ever reverts to the old, lower threshold.

**Stepped-up basis**

The Biden campaign proposal included elimination of a capital gains tax break known as “stepped-up basis”. It allows the person who inherits an appreciated asset to sell the asset and only pay capital gains tax on post-death appreciation, not the appreciation that occurred during the deceased’s lifetime. Some have speculated whether this elimination might be partnered with some type of stepped-up basis allowance that you could allocate to the inherited assets of your choosing so you would get at least a partial capital gain tax break when the asset is sold, in order to make it more middle-class taxpayer friendly.

**Personal income taxes**

Democratic lawmakers have long been critical of the Tax Cuts and Jobs Act of 2017. Many of Biden’s tax proposals take direct aim at some of the law’s key provisions. Some of his proposals include:

- **Restoring the top marginal rate** to 39.6% from today’s 37% for those with incomes above $400,000 (not sure if that is $400,000 per person for married couples, or $400,000 whether single or married).

- **Imposing a 12.4% payroll tax on high earners** (wages above $400,000). Currently, this tax is imposed only on the first $142,800 of wages. The wages between these two numbers would not be subject to payroll tax. Please note there is some question on whether this is permissible for tax legislation using the Budget Reconciliation process.

- **Capping the value of itemized deductions to 28%**, which could reduce the benefit for taxpayers in higher brackets.

- **Raising the tax on long-term capital gains and dividends** on those earning above $1 million to the ordinary income tax rate of 39.6%, in addition to the 3.8% Medicare investment income tax.

- **Taxing carried interests at ordinary income tax rates** instead of capital gains rates.

- **Repealing Section 1031 like-kind exchange rules** for real estate.

According to the nonpartisan Tax Foundation, these proposals would increase taxes on the top 1% of taxpayers by 7.8%.

**Individual income tax strategies to consider implementing this year:**

- **Sell appreciated capital assets sooner rather than later.** If you had intended to sell appreciated capital assets in the relative near future, you may want to consider doing so in 2021 to take advantage of potentially lower capital gains rates. This has to be balanced against the possibility of retroactive tax legislation.

- **Repositioning investment real estate.** If you have been thinking about selling a property and purchasing a replacement property under the tax-deferral rules of Section 1031, you might want to accelerate those plans, assuming new tax legislation is not retroactive.

- **Starting a new business.** If you have set up a business as a C corporation in recent years, or anticipate setting up a new one, talk to your CPA about whether your investment can qualify as Section 1202 Qualified Small Business stock. If it does and you do business as a C corporation and hold the stock for at least 5 years, the first $10 million of capital gains (or 10 times your investment, whichever is greater) is exempt from Federal income tax (but not state tax) when you sell. This break is limited to companies with $50 million or less of gross assets prior to your purchase of the stock.

- **Maximize contributions to retirement accounts and Roth conversions.** Make sure to fully fund all retirement plans, and IRAs where applicable. Evaluate whether it makes more sense to fund a Roth 401(k) or Roth IRA going forward in order to get tax free income when you take distributions in the future. If you are planning on converting part or all of your existing retirement accounts to a Roth, it might make sense to do so at today’s lower tax rate. In addition, you need to consider what your retirement tax bracket will be before deciding on a Roth conversion.

- **Other retirement planning assets.** Look at tax-deferred sources of retirement income such as life insurance with aggressive cash value build-up or annuities.

- **Determine whether to postpone some 2021 itemized deductions until 2022.** The value of deductions for property taxes and charitable contributions might be greater in a higher tax regime, but everyone’s tax situation is unique. It is imperative you speak with your CPA to determine what is best in your specific situation.
Corporate taxes

The Biden proposal is to raise the corporate tax rate to 28% (up from the current 21%) as well as impose a 15% minimum tax on companies with book income over $100 million.

**Corporate strategies to consider implementing this year:**

**Shift income and expenses.** Moving income you might earn in 2022 into 2021 could help you reduce the total taxes you end up paying. Business owners may have some leeway in when they choose to claim income and it might be worthwhile to think through how to do this now. By the same token, consider shifting expenses for which you will receive a tax deduction into 2022, when they can help you lower your taxable income in a higher tax year.

**Rethink business structure.** Biden’s proposals also include phasing out the IRC 199A 20% business income deduction for business owners who earn more than $400,000 (no indication whether this is per person, or a flat $400,000 whether single or married). Work with your tax advisors to determine the optimum entity structure for you for tax purposes.

Bottom line: Understand your options

Work closely with your BMO wealth management team to become aware of the proposals being discussed so you are prepared for what comes next.

We will work with your CPA and estate planning attorney to identify areas to focus on address any impact.

Let’s start planning!