What you need to know

About the personal income and estate tax proposals in Biden's proposed 2022 budget and tax plans.

News continues to come out about the Biden administration's tax proposals. We are still waiting for the drafting of the legislation to begin. We won't know what the proposals will officially state until they are proposed and even then proposed legislation has a ways to go before it is law. At present, two pieces of legislation are being discussed.

There is a bipartisan "hard" infrastructure bill (roads and bridges) in the works which will require 60 votes in the Senate to pass and which does not include any tax increases. Second, the Biden Administration is expected to propose a piece of legislation containing numerous tax increases to fund the American Families Plan which can be passed by "Budget Reconciliation" which only requires 50 votes in the Senate. Part of this legislation is also likely to contain funding for the IRS so there can be increased tax enforcement. Keep in mind that if even one of the possible 50 Senators does not vote for the legislation, it will not pass.

Two key points to keep in mind:

- The Biden administration has pledged not to raise taxes on households earning $400,000 or less a year.
- The tax proposals, if passed, would likely increase taxes for higher-net-worth households and businesses.

As a result, we strongly recommend that you review your personal income and estate tax planning strategies. Consider contacting your tax and legal professionals and discuss these possible tax changes and see how they might affect you. Your Wealth Management team can also be part of the conversation. To the extent you do any planning, you may need extra time to implement before the end of 2021, particularly since the professionals who implement these plans (attorneys, CPAs and appraisers) are very busy helping many clients with these possible upcoming changes.

We strongly recommend that you review your personal income and estate tax planning strategies.

When will new tax changes take effect if they are passed?

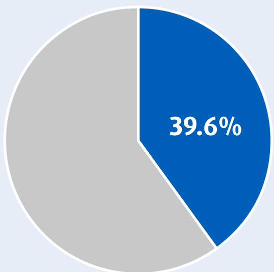
If any legislation is passed, it's very likely that all proposed changes will take effect Jan. 1, 2022, except for a new capital gains and qualified dividend tax rate which might apply retroactively to April 28, 2021. Retroactive tax increases actually are quite unusual. However, it's wise to be prepared for this possibility, just in case.

What changes to personal taxes are proposed?

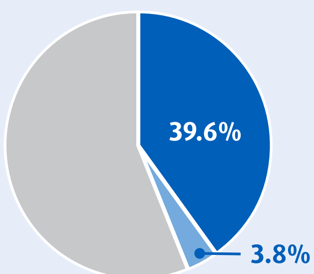
The American Families Plan along with the proposed Budget and Green Book look to:

- **Restore the top marginal rate to 39.6%** (up from today's 37%) for households with incomes above $400,000. It also proposes to lower the threshold of taxable income needed to hit this new rate to $509,300 for married couples and $452,700 for singles.
- **Raise long-term capital gains and dividend taxes from the current 20%** to the ordinary income tax rate of 39.6% for taxpayers in years when their annual adjusted gross income is above $1 million. However, there is speculation that this new capital gains rate will end up closer to 28% rather than 39.6%.
- **Tax carried interests (private equity and hedge funds) as ordinary income** instead of capital gains.
- **Repeal Section 1031 like-kind exchange rules for real estate.** This change would mean that investors could no longer defer taxes on gain from the sale of real estate by rolling profits into their next purchased property except for an annual $500,000 exclusion per taxpayer (married couples would have a $1 million exclusion).

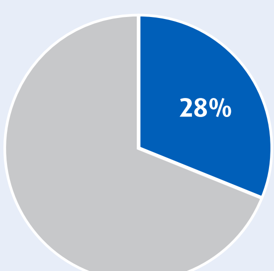
New tax proposals



Proposed top marginal personal income tax rate (up from **37%**)



Proposed long-term capital gains and dividend tax rate on those earning above **$1 million,** in addition to the **3.8%** medicare tax.



Proposed corporate tax rate (up from **21%**)

- **Tax capital gains when assets are gifted or transferred to people at death.** Traditionally you only pay capital gains tax when you sell an appreciated asset. The proposal would trigger capital gain tax purely because the asset has been transferred by gift or at death. To be clear, the gift-giver or the estate of the deceased would owe the tax, not the person who received the appreciated asset. Exceptions have been discussed for a transfer to a spouse, a revocable trust, charity, and for small businesses and family farms; however, we don't know the details of these yet. This proposal, if passed, would have a dramatic impact on estate tax planning.
- **Tax capital gains when assets are transferred to or from an irrevocable trust or partnership.** Again, this is another proposal to trigger capital gains on appreciated assets that are transferred. This also would have a dramatic impact on estate tax planning.
- **Tax capital gains on unrealized appreciation of assets held in trust** if capital gains have not been paid on a property for 90 years. The intent of this provision is to tax appreciated assets held in generation-skipping trusts. The measuring period of time begins in 1940 or the date of acquisition, whichever is later. So, property acquired in 1940 would have its appreciation taxed in the year 2030.
- **To offset the new provisions triggering capital gains upon certain types of transfers, there would a one-time (not annual) exclusion.** The exclusion is $1 million per taxpayer plus $250,000 for a personal residence. For married taxpayers, these numbers are doubled.
- **All pass-through income would be subject to either the 3.8% Medicare Investment Income Tax or the 15.3% self-employment tax,** if taxable income is greater than $400,000. Pass-throughs include S corporations, partnerships and LLCs. The 15.3% self-employment tax would be imposed on active income earned from the pass-through; otherwise the 3.8% tax would be imposed.
- **Note: Changing the $10,000 "SALT" (state and local income tax deduction tax deduction) cap was not addressed.** However, it's possible that this cap could change once legislation is drafted.
- **Also: no increase in the estate & gift tax rate has been proposed** nor has a reduction in the current $11.7 million allowance been proposed. However, the $11.7 million allowance is already scheduled to be cut in approximately half effective 1/1/2026.

What personal tax strategies should be discussed this year?

Your Wealth Management team will have more ideas to share with you as legislation begins to take shape, keeping in mind it may not pass at all. Here are the considerations to consult with your tax and legal advisers if any of these proposals would pass:

- **Accelerate any gifts of appreciated property** you were thinking of making. Between now and year end you can still transfer appreciated assets without triggering capital gains tax.
- **Get any estate tax planning involving transfers of appreciated assets finished by year-end** to avoid triggering capital gains tax upon the transfer that may occur if you do the transfer next year.
- **Review any sophisticated estate tax planning strategy involving irrevocable trusts or partnerships** already implemented. The strategy should be reviewed to see if it calls for appreciated assets to be contributed or distributed in the future which may trigger capital gains tax beginning in 2022. These will need to be reviewed to determine whether those contributions or distributions can be accelerated to this year, or otherwise deferred or eliminated.
- **Sell appreciated capital assets sooner rather than later.** If you already planned to sell certain appreciated capital assets in the near future, think about doing so before year-end. There is always a chance that the new increased capital gains tax rate is not retroactive.

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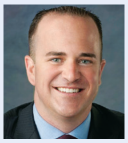

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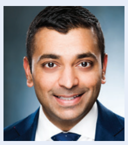

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- **Cash out carried interest positions.** Investigate whether it is possible and beneficial to have your interest in private equity or hedge funds redeemed this year while they're still taxed as capital gains.
- **Reposition investment real estate.** If you plan to sell a property and buy a replacement under Section 1031 exchange rules, you might consider doing so before 2022.
- **Transfer partial interests in real estate to your children** in anticipation of future investment real estate sales. If you expect to have gains of more than $500,000 on investment real estate sales in future years, consider whether transferring partial interests to children should be part of your wealth planning strategy to maximize the use of potential future capital gains allowances.
- **Maximize retirement contributions and Roth IRA conversions.** Ask your tax professional whether it makes sense to fund a Roth 401(k) or Roth IRA (if you're eligible) in order to have tax-free income when you later take plan distributions. If you plan to convert some or all of your existing retirement accounts to a Roth, you may want to do so at today's lower tax rate.
- **Review your other tax-deferred sources of retirement income**. You may have annuities or life insurance policies with aggressive cash value build-ups. Consider whether there are different options that might result in lower future tax bills.

Bottom line: What these proposals mean for you

We're already more than halfway through the 2021 tax year. Although we won't have exact information about the tax changes until legislation is drafted and then ultimately passed, possible tax changes are a hot topic of conversation.

Take time now to talk with your Wealth Management team. They can help you review your overall financial plan, and also suggest questions you might ask your tax professional and estate attorney.

Be proactive. Smart financial planning starts today.

BMO Wealth Management