Build Back Better: Will You Pay More if the Proposed Tax Changes are Adopted?

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This content does not constitute accounting, tax, investment or legal advice, nor is it intended to convey a thorough treatment of the subject matter.

Type of Client Situations

- Sophisticated estate planning
- Business succession strategies
- Executive benefit plans for closely held businesses

What We Do – Process

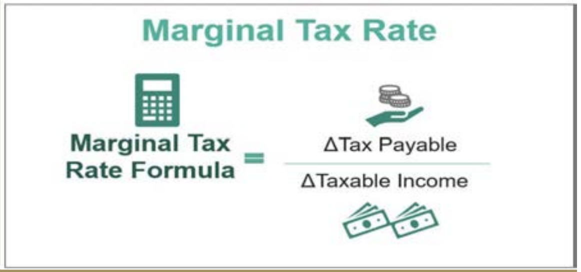
- Consult with clients to determine their goals and objectives
- Create comprehensive estate plan
- Consult with client's legal advisor
- Make modifications as necessary

Proposed Income Tax Changes

- Highest marginal rate increases to 39.6%
- 3% surcharge for incomes over $5M
- Highest capital gain rate increases to 25%
- Significant changes to mega IRAs
- 3.8% net investment tax applies to trade or business income
- Increase in highest C Corporation rate
- Reduction of use of 199A and 1202 for high income taxpayers

Marginal Rate Increases

- Highest marginal rate will increase to 39.6% for singles with incomes over $400K, and married couples over $450K
- Currently the highest marginal rate is 37% for single taxpayers over $518,000 and married taxpayers over $622,000
- Highest marginal rates would apply to Trusts and Estates for incomes over $13,050



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Increased Capital Gain and Dividend rates

$ Highest capital gains and dividend rates will increase to 25% for single taxpayers with over $400K of income, and married taxpayers with over $450K of income

Taxpayers subject to these higher rates who have appreciated gains and are not intending to hold those assets until death should consider selling and reinvesting to receive higher basis and shelter against higher tax rates

Taxpayers with capital losses should preserve those losses to offset higher rates in the future

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Three Percent Surcharge

There will be a 3% surcharge for individuals with incomes over $5M, and $2.5M for married couples filing separately

The surcharge will apply to trusts and estates with incomes over $100K

Trustees should either make distributions when income approaches $100K or, if not possible, invest in assets that do not produce annual income

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Changes in Net Investment Tax

The Net Investment Tax of 3.8% would apply to trade or business income unless the income would be subject to FICA tax

But this tax only applies to single taxpayers with incomes over $400K, and joint taxpayers with incomes over $450K

High income taxpayers who are owners of S corporations and are taking a low salary should consider changing their corporate or income structures

Mega IRAs

- Taxpayers with IRAs over \$10M can make no further contributions
- Taxpayers with IRA balances between \$10M and \$20M must take a 50% distribution of the excess
- Taxpayers with IRA balances over \$20M must take a 100% distribution until IRA is reduced below \$20M
- IRA investments can no longer include those where the taxpayer is an accredited investor

More IRA Changes

- IRA owner cannot invest in a business entity where he holds a 10% interest, and which is not offered on a national exchange. (This would include direct and indirect investments.)
- IRA owner and beneficiary of an inherited IRA are always disqualified persons
- These rules are designed to stop IRAs from getting too big and be more than purely retirement vehicles

C Corporation Tax changes

- For small taxpayers (those under $400K) the corporate rate would go down to 18%
- For taxpayers with incomes between $400K and $5M, the rate will remain at 21%
- For taxpayers with incomes over $5M, the rate will be increased to 26.5%

199A Deduction

- This bill would limit the amount an S corporation, partnership, or sole proprietor could take as a 199A qualified business deduction
- The deduction would be limited to $400K if single, and $500K if married
- The bill would not phase out the deduction at certain income limits, but rather limit the total deduction
- No other changes were made to 199A

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1202 Deduction

Under current law, a small C Corporation taxpayer who sells his stock may be able to exclude between 50%, 75%, or 100% of gain, based on when the corporation was started

The House proposal would limit the deduction to 50% for single taxpayers with incomes over $400K, and married taxpayers with incomes over $500K

This would limit a valuable business succession planning strategy

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Case Study I

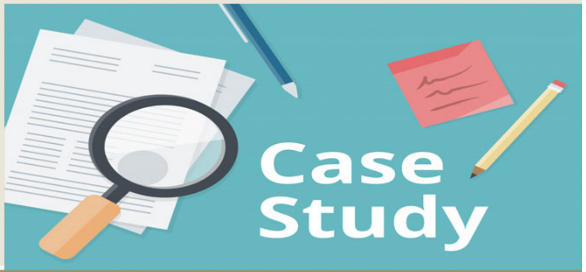
- Joe Smith funds an Irrevocable Life Insurance Trust (ILIT) for disabled son for $5M
- At Joe’s death, the death benefit goes into a Special Needs Trust (SNT) to provide supplemental payments the government does not provide
- Because the payments are supplemental to what the state and federal governments provides, it’s possible that the trust income will go over $100K, subjecting the trust to the 3% excise tax

Case Study I (Continued)

- Instead, at Joe's death the SNT should invest in an annuity which, because the trust is an agent for a natural person, will receive tax deferral
- When money is distributed to a special needs beneficiary, it will be taxed to him/her at a zero rate, or close to it
- The trust will get a distribution deduction, so no tax will ever be incurred and thus no 3% surcharge

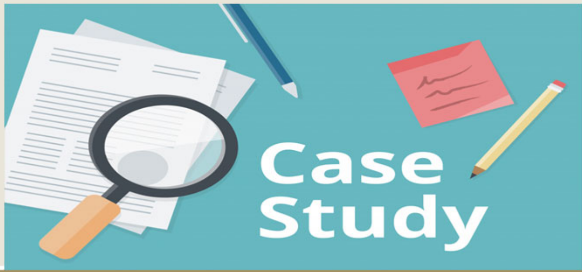
Case Study II

- Bill creates an Irrevocable Trust for the benefit of his 3 children—Ron, Debbie and George
- The trust was a “pot” trust for the benefit of all three children
- The distribution standard was totally discretionary to provide complete protection from his children’s creditors
- The intent was to benefit all equally, but the trust document allowed the amount each child receives to be different every year



Case Study II (continued)

- In 2021, there was $300,000 of trust income
- George was getting a divorce, so his share was distributed to Debbie and Ron
- The surcharge, as well as other trust taxes, was avoided
- The excess income received by the other two children would be made up in subsequent years



Case Study III

- Bill and Betty (both age 60) have a retirement worth $10M and own $5M of stock in a technology company, with a basis of $100K
- The company pays no dividends
- They were planning on selling the stock in 2024 and use the proceeds for retirement purposes
- Their current gross income is around $700,000
- They should consider selling the stock in 2021 and pay capital gain at 20% (instead of 25%) and invest the proceeds in a balanced portfolio


Q&A

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Thank You

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