TPC

The Peninsula Center
for Estate and Lifelong Planning
Attorneys and Counselors at Law

461 McLAWS CIRCLE, SUITE 2
WILLIAMSBURG, VIRGINIA 23185
Telephone: (757) 969-1900
Facsimile: (757) 969-1903
www.tpcestate.com

Tax Law Changes Are Right Around the Corner

With a new administration often comes changes in the tax laws, and it is no secret that the Biden administration intends to make sweeping changes which, if passed, will increase taxes – income, estate, gift and generation-skipping transfer taxes – across the board. Most of the changes are targeted toward early termination of the 2017 Tax Cuts and Jobs Act (TCJA) which significantly raised the threshold for the imposition of income, estate, and gift taxes for individuals and entities. But that's not all. Also on the chopping block are several estate tax planning strategies and the imposition of an entirely new concept of taxing unrealized gain at death.

As estate planners, we are most concerned with the changes that would materially subject more American families to additional taxes upon the death of a loved one. This includes not only the estate tax itself, but also income tax resulting from the imposition of a capital gains tax on the *unrealized gain* in assets included in the decedent's estate as well as the loss of the basis step-up at death.[1] Only 1,900 of the estates of decedents who died in 2020 – less than 0.1% – paid estate tax,[2] but 100% of the estates received a step-up in basis for all of the assets included in the decedent's estate. This means that an asset purchased for $100 which was worth $200 at death, would receive a basis adjustment to $200, which consequently results in less, or no capital gains tax being incurred upon later sale of the asset. Changing the capital gain tax rules will affect more individuals and bring in more tax revenue than simply lowering the amount of the estate tax exemption.

1 With a $1 million exemption which is portable to a surviving spouse.
2 Estimate per the Urban-Brookings Tax Policy Center.

Although the President's revised plan does not call for a reduction in the estate tax exemption from $10 million (indexed for inflation),[3] as originally planned, those estates which are large enough to incur estate tax will also be subject to a capital gains tax. Combining both taxes would result in a total tax liability of $61.1 million on an asset valued at $100 million, which results in an effective tax rate of 61 percent[4] instead of simply 40%, which is the current estate tax rate.

Additional tax revenue will come from increased income tax on higher-income individuals and certain business entities through higher marginal tax rates[5] while lower-income taxpayers will see more refundable tax credits. The plan will also increase the tax on long-term capital gains and qualified dividends by taxing them at ordinary income rates instead of the much lower capital gains tax rates of 15% to 20% currently.[6] All in all, the plan is estimate to bring in $661 billion in additional taxes.[7]

The plan also seeks to increase funding for the Internal Revenue Service by $80 billion over the next 10 years with a specific focus on increasing tax collections. According to the National Bureau of Economic Research, "36% of federal income taxes unpaid are owed by the top 1% [of income earners]" and "collecting all unpaid federal income tax from this group would increase federal revenues by about $175 billion annually"[8] thus easily paying for the increase in funding.

From a valuation standpoint, the Biden proposal also seeks to curb some and totally eliminate other estate tax planning techniques which are used to reduce the value of assets gifted during lifetime or remaining in an estate at death. These techniques include marketability, fractional interest, and lack of control valuation discounts for the non-business portions of an entity, dynasty trusts, intentionally defective grantor trusts, and the Crummey annual exclusion withdrawal powers, as well as imposing a mandatory minimum term for grantor retained annuity trusts.

[3] The exemption is $11.7 million for 2021.
[4] Biden Tax Plan: Estate Tax Change Means Forced Asset Sales | National Review.
[5] The top marginal income tax rate would be increased to 39.6% on income over $452,700 for single taxpayers and $509,300 for joint filers. Currently the top rate is 37% and applies to taxable income above $500,000 for single taxpayers and $600,000 for joint filers.
[6] Applies to taxpayers with over $1 million in income.
[7] American Families Plan Tax Proposals | Details & Analysis (taxfoundation.org).
[8] Three False Narratives Being Used in the IRS Funding Push (msn.com).

There are other proposals out there, so we won't know until a bill is finally passed, which may not occur this year. Additionally, Democrats have tried to pass a capital gains tax for years but have faced stiff opposition from Republicans and even some moderate Democrats. So, the end result remains to be seen. Normally a tax legislation bill requires 60 votes to pass the Senate, but, for many years, the Budget Reconciliation Process has been used as an end-run around the 60-vote rule. Under the Congressional Budget Act of 1974, the reconciliation process was established to allow lawmakers to change policies on spending or taxes with only 51 votes so long as the changes are necessary to maintain the budget. In the past, the reconciliation process has been used to both increase and cut taxes.

The process can only be used once per fiscal year, or two per calendar year since there are two overlapping fiscal years within one calendar year. Recently, however, it was determined that the Senate can *repeatedly revise* the budget resolution for the current fiscal year to create additional reconciliation bills, so long as it has first passed a budget resolution.

Reconciliation bills are limited to 20 hours of debate and not subject to filibuster, meaning they can pass with a simple majority vote. However, the Senate can only consider three basic subjects – spending, revenue, and the federal debt limit – and it can only consider each of these once per year unless Congress passes a second budget resolution.[9]

The budget reconciliation process was used in March to enact the American Rescue Plan which provided for an additional $1.9 million in spending as additional aid to families and workers who have been impacted by the COVID-19 health crisis. The American Rescue Plan passed the Senate with only 51 votes.

This publication is intended for general information purposes only and is not to be construed as providing legal advice. You must consult an attorney to discuss how the laws apply to your specific situation and how to best implement a plan that will meet your individual goals and objectives. If we can be of assistance in that regard, please call us at (757) 969-1900 to schedule a consultation appointment.

[9] What is reconciliation in Congress? (brookings.edu).