goulston&storrs

Wealth Planning and the New Administration: Potential Individual Income & Transfer Tax Changes

May 12, 2021

On April 28, 2021, in an address to a Joint Session of Congress and a Fact Sheet published by the White House, President Biden introduced the "American Families Plan," the President's plan for spending and a series of tax changes to pay for it. The tax changes proposed by President Biden would include tax cuts and extended credits for certain taxpayers and increased tax rates and IRS enforcement for Americans earning over $400,000.

The changes proposed by the President are the latest in a series of proposals from Democratic lawmakers. Other plans have been proposed by Senators Bernie Sanders, Elizabeth Warren and Chris Van Hollen. It is likely to be several months before any of these proposals advance through Congress and, if legislation actually is enacted, the final details may look different than the ideas now being introduced.

Attorneys in the Private Client and Tax Groups at Goulston & Storrs PC will continue to monitor legislation in this area and will provide further insight as it becomes available. For now, the leading proposals are summarized below. If you would like to discuss how they may impact you if they were to become law, please contact your Goulston & Storrs attorney or any member of the Private Client and Tax Groups.

1. The American Families Plan, President Joe Biden

Tax Rate Increases. Under the American Families Plan, the top marginal tax rate would increase from 37% to 39.6% for taxpayers earning more than $400,000 annually. In addition, taxpayers earning over $1 million dollars would pay tax on capital gains at a rate of 39.6%. It is unclear how these thresholds apply to single taxpayers versus married couples that file jointly.

The American Families Plan would also more "consistently" apply the 3.8% Medicare tax to those earning over $400,000 per year.

President Biden's plan would close the "carried interest loophole" and require hedge fund partners to pay taxes on carried interest at ordinary income rates.

Taxes at Death. Under current law, the cost basis of an asset owned by a decedent becomes its date of death fair market value. This has the effect of eliminating any lifetime capital gain on an appreciated asset. The American Families Plan would eliminate this "step-up in basis" rule for capital gains in excess of $1,000,000 per taxpayer ($2,500,000 for married taxpayers, when combined with the existing capital gains exclusion for primary residences). The Fact Sheet states that the plan will ultimately include protections for heirs that will continue to operate family owned businesses, suggesting that death or transfer by gift would result in a deemed sale for capital gains purposes under Biden's plan. It is expected that the gain associated with any deemed sale at death would be reported on a decedent's final income tax return.

The current version of President Biden's proposal is silent on any changes to the federal estate, gift or generation-skipping transfer taxes – all of which are assessed based upon the fair market value of assets transferred and not on gains. A capital gains tax at death, therefore, could exist alongside the existing transfer taxes.

Enforcement. The American Families Plan would increase reporting requirements for financial institutions and increase investment of resources in IRS enforcement against taxpayers with more than $400,000 of income.

2. For the 99.5 Percent Act, Senator Bernie Sanders

Annual Exclusion. The current annual exclusion from the gift tax allows each donor to make gifts annually of up to $15,000 to an unlimited number of recipients free of gift tax. The Sanders plan would reduce the annual exclusion to any single recipient to $10,000 with an aggregate limit to all recipients in a year of $20,000.

Transfer Taxes. The current exemption from gift, estate and GST taxes is $11.7 million. The Sanders plan would reduce the gift tax exemption to $1 million and would reduce the estate and GST exemptions to $3.5 million. In addition the gift, estate and GST tax rates would increase and gift and estate tax brackets would be introduced. Currently, these taxes are assessed at a flat rate of 40%.

Proposed gift and estate tax brackets:

Over	But Not Over	99.5% Act
$3,500,000	$10,000,000	45%
$10,000,000	$50,000,000	50%
$50,000,000	$1,000,000,000	55%
$1,000,000,000		65%

Note: The GST tax is assessed at the maximum federal estate tax rate. Therefore, all GST taxes would be assessed at a flat rate of 65%, if corresponding brackets are not introduced to the GST tax.

Grantor Trusts and GRATs. New grantor trusts (trusts that for income tax purposes are treated as owned by the person who funded them) would be included in the grantor's taxable estate at death.

New gifts or sales made to existing grantor trusts would also be includable in the grantor's taxable estate. Older trusts would be grandfathered so long as no further contributions are made. This change would render several popular estate "freeze" techniques ineffective and would have a significant impact on even commonplace trusts such as irrevocable life insurance trusts.

The Sanders plan would also impose additional requirements on Grantor Retained Annuity Trusts ("GRATs"). A GRAT allows a grantor to shift outsized appreciation in the value of the funding assets to family members, often while making gifts with little to no value for gift tax purposes. The annuity paid by the GRAT would be required to be paid for a minimum of ten years and the remainder interest would be required to have a value equal to the greater of 25% of the contributed property or $500,000. This requirement would eliminate use of the "zeroed-out" GRAT.

GST Exempt Trusts. The Sanders plan would eliminate multi-generational "dynasty" trusts by requiring that any new trust must terminate no later than fifty years after creation to qualify as GST exempt. Existing GST exempt trusts would lose exempt status 50 years after date of enactment.

Valuation Discounts. The Sanders plan would eliminate valuation discounts for "non-business assets" if the transferee and family members will have control or majority ownership of the entity. Non-business assets are defined as any assets not used in the active conduct of a trade or business.

3. Ultra-Millionaire Tax of 2021, Senator Elizabeth Warren

Senator Warren's plan would introduce a wealth tax into the Internal Revenue Code. The plan would impose a 2% annual tax on net worth of households and trusts valued at over $50 million and an additional 1% annual surtax on households and trusts valued over $1 billion.

4. Sensible Taxation and Equity Promotion Act of 2021, Senator Chris Van Hollen

Senator Van Hollen's plan would treat any property transferred by gift, in trust or upon death as being sold for fair market value to the transferee on the date of such gift, death or transfer. The exemption for such gain would be $1 million.

* * *

President Biden's plan did not indicate the effective dates of any of his tax reform proposals. The effective date of any proposal enacted this year may likely be any date between enactment and January 1, 2022. While it is possible that enacted reforms could be made retroactive, such a step would be uncommon.

If you would like to discuss whether any of the proposals summarized in this advisory, please contact your Goulston & Storrs attorney or any member of the Private Client & Trust Group or Tax Group.