# Initial 2021 Tax Considerations

## With the swearing-in of a new President and Vice President, plus convening of the next Congress, affluent Americans are weighing how changes in federal government may financially impact them.

Given that Democrats hold the Presidency and control both Houses of Congress by a slim margin, it now seems likely that tax reform could be passed as a budget reconciliation bill and then signed into law. While there is a remote chance that expected tax changes will be retroactive, it is more probable that they would take effect immediately upon becoming law or even at the start of 2022.

Since 2021 may be a last opportunity to capitalize on favorable income, capital gains and transfer tax laws, families are considering financial & estate planning adjustments, where appropriate.

### Income & Capital Gains Tax Proposals[1]

- Repeal income tax cuts for people making over $400,000 annually, raising the highest personal income tax rate from a current 37% back to 39.6%
- Cap the value of itemized deductions at 28% for taxpayers with incomes of over $400,000 per year, instead of valuing those deductions at the taxpayers' higher ordinary income tax rate
- Reinstitute the PEASE limit on itemized deductions, lowering the value of those deductions by 3% of taxable income which exceeds $400,000
- Replace the deduction for retirement account contributions with an estimated 26% refundable credit, limiting the tax benefit of those contributions for people who pay higher ordinary income tax rates
- Subject long-term capital gains and qualified dividends to ordinary income tax rates for people with yearly income exceeding $1,000,000
- Close the "loophole" which taxes private equity & hedge fund managers' carried interest at 20% capital gains rates by taxing that carried interest at a recipient's higher ordinary income tax rate
- Collect Social Security tax on earned income over $400,000 subjecting both the first $142,800 of earned income & earned income above $400,000 to the tax, using numbers for 2021; however, the "Byrd Rule" should require 60 Senate votes to implement this particular change[2]
- Implement a refundable 1st-time homebuyer credit of up to $15,000 which is advanceable to provide funds that are needed when purchasing the home

### Gift & Estate Tax Proposals[1]

- Raise the top estate & gift tax rate to as high as 45% and reduce the lifetime exemption for gift and estate tax from $11,700,000 back to either $5,000,000 where it was set in 2011 or even $3,500,000 where it was set in 2009
- Tax unrealized capital gains at death, even if none of the deceased's appreciated assets are sold; thus, eliminating the untaxed basis "step-up" to fair market value at death

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## Business Tax Proposals[1]

- Phase out the 20% pass-through deduction on qualified business income for people with annual income exceeding $400,000
- Eliminate capital gain deferral through like-kind exchanges of business & investment real estate for people whose yearly income exceeds $400,000
- Increase the highest corporate income tax rate from 21% to 28% and subject corporate book income of $100,000,000 or more to a 15% alternative minimum tax
- Double the tax rate on global intangible low tax income (GILTI) earned by foreign subsidiaries of American businesses from 10.5% to 21%
- Impose a 10% surtax for U.S. companies that move manufacturing & service jobs to another country and then provide services or products for sale back to the American market
- Create an advanceable 10% "Made in America" credit for manufacturers' revitalizing, re-tooling and hiring costs

## Responsive Planning

Given the above proposals, there is great uncertainty surrounding future tax policy. Even if some of the more benign tax provisions now in effect are not repealed, many of them are scheduled to sunset at the end of 2025 already.

One provision that will automatically sunset is today's gift & estate tax exemption of $11,700,000 per person or $23,400,000 for married couples which will revert to pre-2018 levels in 2026, unless Congress chooses to lower the exemption before then. With tax reform likely coming sometime this year, wealthy Americans see 2021 as perhaps their last chance to make further gifts which lock-in the extra lifetime exemption they now have before a large part of the exemption sunsets or is repealed.

Though there are many ways we can help maximize the delivery power of your lifetime exemption, a common concern when doing so in 2021 will be the remote possibility of retroactive tax change. Below, are a few strategies that could provide flexibility to clients wishing to freeze or reduce their taxable estates, while guarding against the risks of retroactive tax reform.

- Trust documents can allow gifts in-trust to be disclaimed within 9 months, causing trust assets to revert to the grantor & unwinding the gift in the event of retroactive tax change.
- Gifts of fractional ownership interests in-trust can be subjected to a formula clause in the trust document which directly ties the value given to a client's remaining lifetime exemption, thus automatically adjusting for retroactive tax change.
- Funding trusts that can elect to be Qualified Terminable Interest Property Trusts ("QTIP Trusts") on a timely filed gift tax return will only use any lifetime exemption if no QTIP election is made.

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1 These Biden campaign tax proposals were derived from a 10/22/2020 article, entitled "Details and Analysis of Democratic Presidential Nominee Joe Biden's Tax Plan," posted online at taxfoundation.org.

2 This statement about 60 Senate votes being required to pass legislation that changes Social Security was derived from a 1/21/2021 article, entitled "The Biden Tax Plan," posted online at kelleydrye.com.



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