

Tax Uncertainty: Should You Take Action Before 2021?

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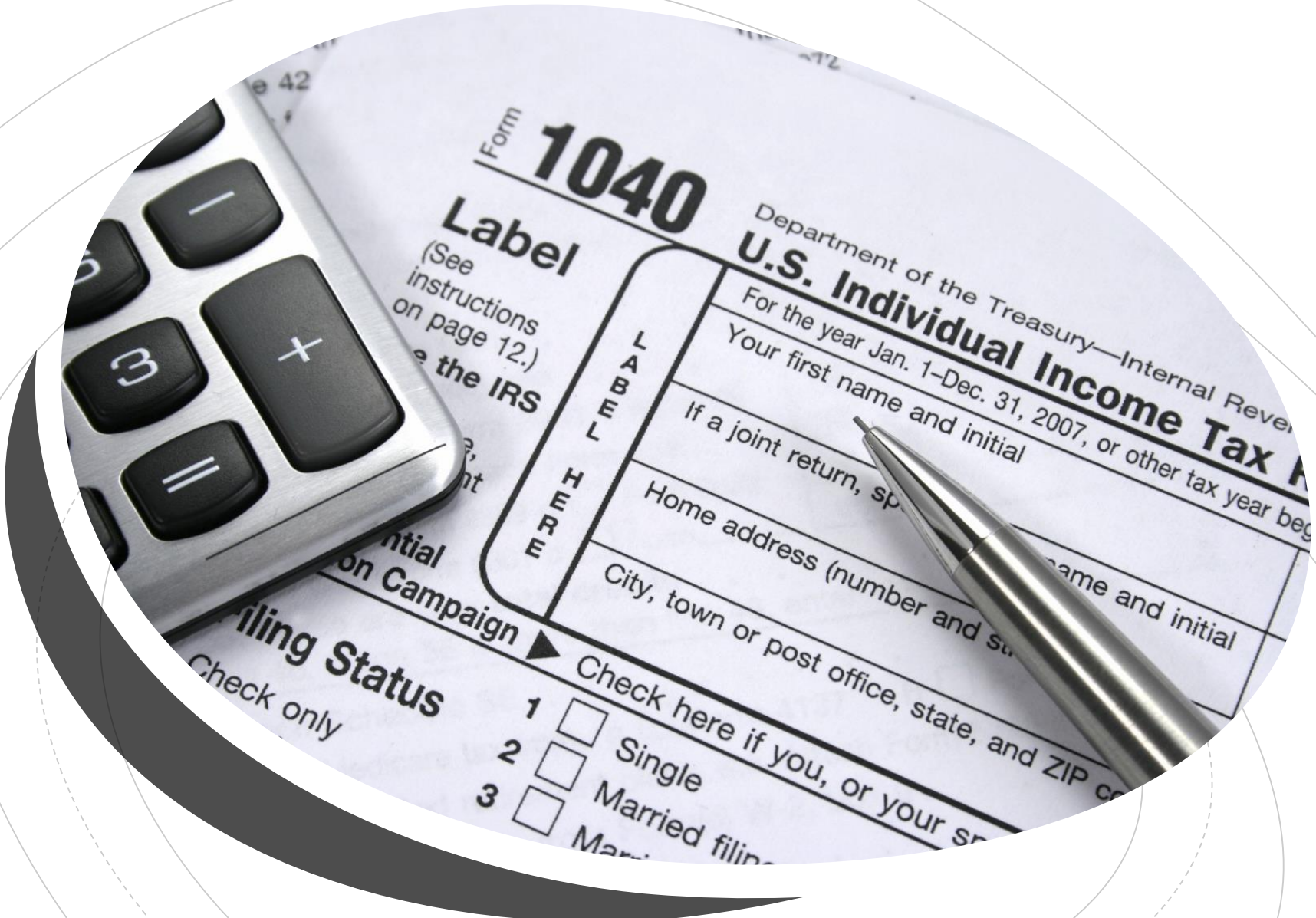
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Have you heard?



Taxes are a significant issue in this election

Principal types of federal taxes

- ***Income taxes*** are taxes imposed on income generated by individuals, trusts, estates, and businesses and used to fund government operations and programs.
- ***Payroll taxes*** are taxes imposed on wages and self-employment income and used to fund Social Security, Medicare, and other social insurance programs.
- ***Estate, gift, and generation-skipping transfer taxes*** are imposed on the value of assets owned at death or given to other people.



Gross Collections by Type of Tax (FY 2019)



Where are
we now, and
where might
we go?

What's on the table

Item	Present Law	Trump	Biden
Business	<ul style="list-style-type: none">• 21% corporate rate• 20% QBI deduction through 2025• Territorial style regime with BEAT, 10.5% GILTI rate• Carried interest held at least three years is taxed as a capital gain	<ul style="list-style-type: none">• Make QBI deduction permanent• Eliminate carried interest	<ul style="list-style-type: none">• 28% corporate rate• Repeal 20% QBI deduction for taxpayers with more than \$400,000 of income• Double GILTI rate• 15% AMT on corporations with \$100 million or more of book income• Eliminate carried interest

What's on the table

Item	Present Law	Trump	Biden
Business			<ul style="list-style-type: none">• Repeal §1031 like-kind exchange for real estate• Repeal other real estate benefits (unclear)• Add tax credit for businesses that experience workforce layoffs or a major government institution closure

What's on the table

Item	Present Law	Trump	Biden
Business			<ul style="list-style-type: none">• Expand and make permanent the New Markets Tax Credit• Add tax credits to small business that adopt workplace retirement savings plans• Expands renewable-energy-related tax credits

What's on the table

Item	Present Law	Trump	Biden
Payroll	<ul style="list-style-type: none">• 12.4% social security tax on wages up to \$142,800 (2021)• 2.9% Medicare tax on all wages• 0.9% Medicare tax on wages above \$200,000 (\$250,000 for MFJ) (applies to employee portion only)	<ul style="list-style-type: none">• Forgive employee-side of payroll tax deferral under August 8, 2020 Executive Order (Notice 2020-65)• “Permanent cuts” to the payroll tax	<ul style="list-style-type: none">• 12.4% social security tax on wages above \$400,000

What's on the table

Item	Present Law	Trump	Biden
Individual	<ul style="list-style-type: none">• 37% maximum rate through 2025, reverts to 39.6%• 20% maximum rate on capital gains and qualified dividends• 3.8% rate on net investment income• No Pease limitation on itemized deductions through 2025	<ul style="list-style-type: none">• Make TCJA permanent• Cut capital gains rate to 15%	<ul style="list-style-type: none">• Repeal TJCA (including SALT limitation)• Increase maximum rate to 39.6% for taxable income above \$400,000• Increase capital gains and qualified dividends tax rates to 39.6% on income above \$1 million

What's on the table

Item	Present Law	Trump	Biden
Individual			<ul style="list-style-type: none">• Limit itemized deductions to 28% of value for taxable income above \$400,000• Restore Pease limitation for taxable income above \$400,000

What's on the table

Item	Present Law	Trump	Biden
Individual			<ul style="list-style-type: none">• Enhance current retirement tax breaks for low- and middle income workers• Equalize the various forms of retirement saving tax breaks

What's on the table

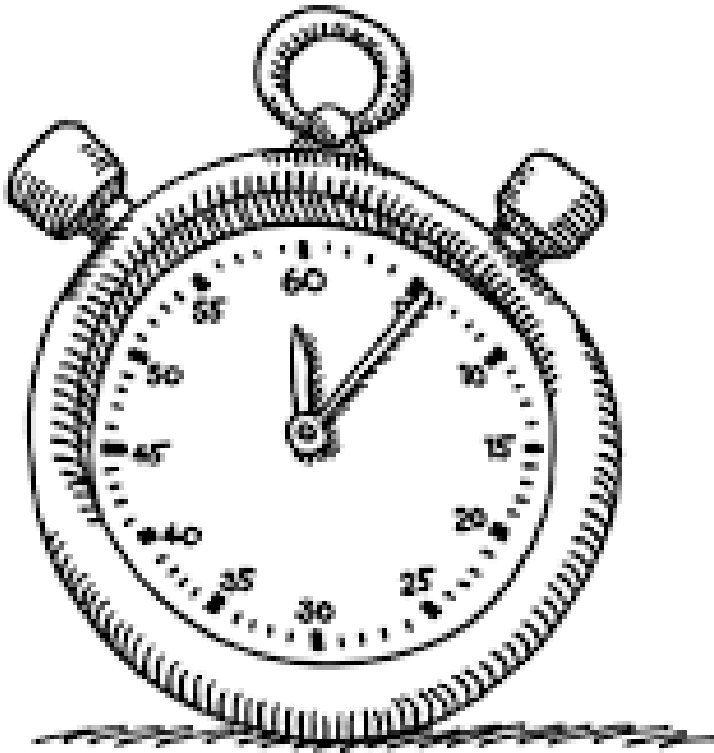
Item	Present Law	Trump	Biden
Estate and gift tax	<ul style="list-style-type: none">• 40% top rate with \$11.58 million combined basic and excess exclusion amount (2020) through 2025, reverts to \$5 million basic exclusion amount (indexed from 2011)• Basis adjustment for assets held at death	<ul style="list-style-type: none">• Make TCJA permanent	<ul style="list-style-type: none">• Eliminate basis adjustment for inherited assets• Capital gains tax on death• \$3.5 million exemption at death• \$1 million gift exemption• 45% tax rate

Potential outcomes

- Trump wins and
 - Democrats take control of Senate → no change likely
 - Republicans retain control of Senate → may have more temporary changes
- Biden wins and
 - Democrats take control of Senate → change likely (maybe)
 - Republicans retain control of Senate → no change likely



Timing?



- Retroactive taxation is possible if rationally related to a legitimate legislative purpose
- November 4, 2020—The day after the election
- January 6, 2021—Congress meets for swear in and to count electoral votes
- January 20, 2021—Presidential inauguration
- Later?
 - Bipartisan legislation
 - Contested election

What should
you do right
now?



“Anyone may so arrange his affairs that his taxes shall be as low as possible.” *Helvering v. Gregory*, 69 F.2d 809, 810, aff’d, 293 U.S. 465 (1935).



Income tax planning ideas

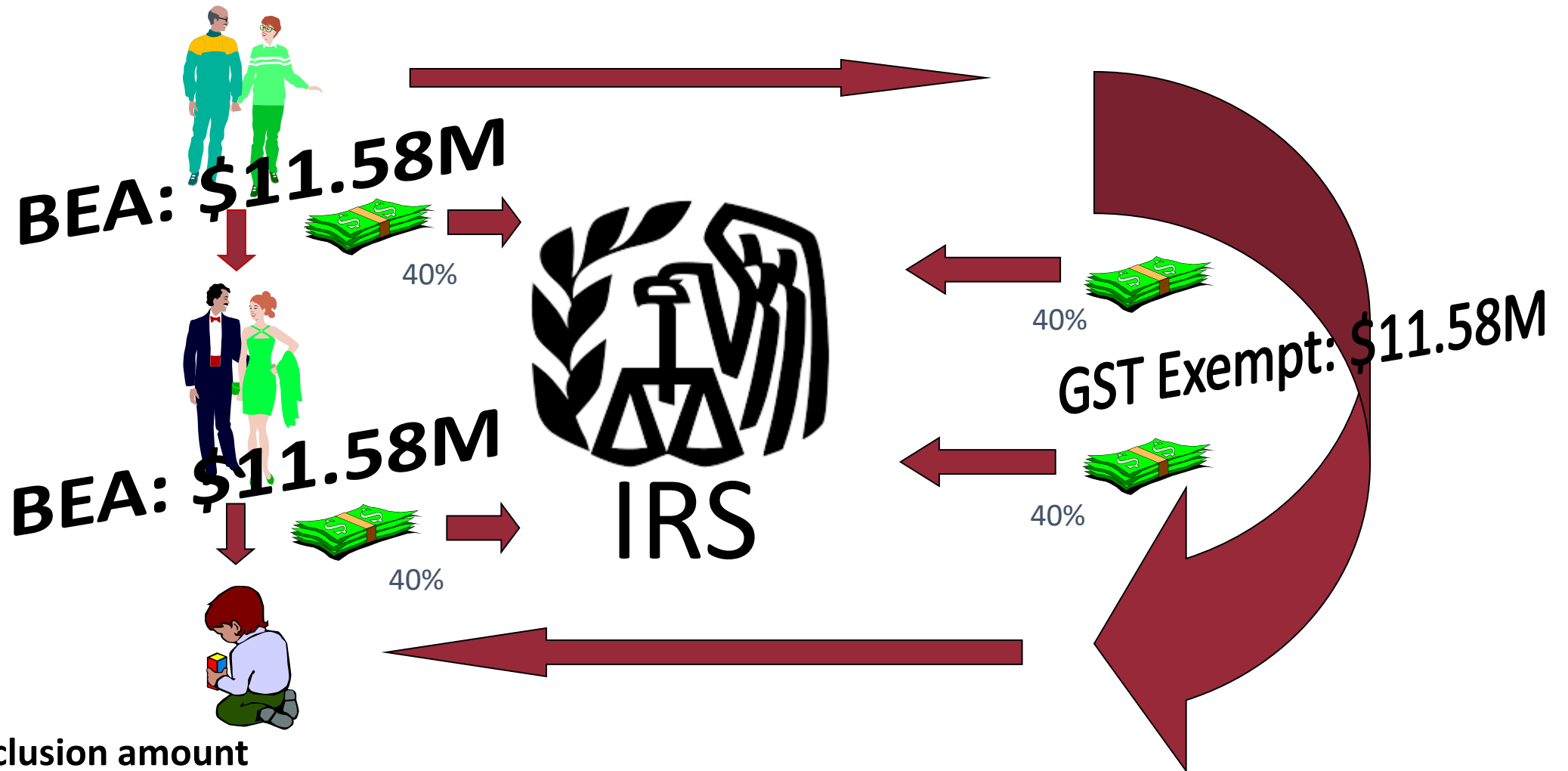
- Accelerate income
 - Harvest capital gains
 - Retirement plan withdrawals
 - Accelerate compensation and deferred compensation, if possible
 - Traditional IRA/401(k) to ROTH IRA conversion
- Defer deductible expenses (e.g., business expenses, no payments in excess of SALT cap)
- Accelerate Schedule A deductions (e.g., charitable donations)
- Accelerate 1031 transactions (consider effective date concerns)
- Fund 529 plans (maybe)

Payroll tax planning idea

Restructuring business operations

- Use a pass-through entity (S corporation or limited partnership)
- Pay “reasonable” compensation to yourself—aiming at or below the doughnut hole (\$142,800 to \$400,000)
- Pay the excess out as a dividend/distribution

Transfer Tax (2020)



BEA = Basic exclusion amount

Transfer tax strategies

- Utilize annual exclusion gifting
- Utilize tax-free gifting through direct payment of tuition and medical expenses
- Freeze the value of assets now so that future growth will not be subject to transfer tax
- Utilize available discounts when assets are transferred
- Pay income tax for your family without treating those payments as gifts
- Utilize favorable interest rate environment

Transfer tax planning ideas

Make gifts—use it or lose it!

- Determine gift necessity, suitability, and tolerance
- Utilize all existing transfer tax strategies
- Use formula gift clauses (*McCord, Wandry, etc.*)
- Outright or in trust
 - Irrevocable grantor trusts
 - Irrevocable non-grantor trusts
 - Spousal lifetime access trusts (SLATs)
 - Non-reciprocal SLATs
 - E-GRITs, GRIPs

Appendix

Bibliography

- <https://www.andersen.com/2020-presidential-candidates-tax-proposals>
- Bloomberg Tax & Accounting, *Trump, Biden Tax Plan Comparison* (last updated September 16, 2020)
- <https://www.kiplinger.com/taxes/601307/election-2020-president-trump-tax-plans>
- <https://www.kiplinger.com/slideshow/taxes/t055-s001-2020-election-joe-biden-s-tax-plans/index.html>
- <https://taxfoundation.org/president-trump-tax-plan-2020/>
- <https://taxfoundation.org/joe-biden-tax-plan-2020/>

Transfer taxes

Transfer Tax

- Gift Tax—Imposed on any gratuitous transfer of property (IRC §§ 2501-2504)
- Estate Tax—Imposed on the value of assets owned at death (IRC §§ 2001-2210)
- Generation-Skipping Transfer (GST) Tax—Imposed on any generation-skipping transfer (IRC §§ 2601-2664)

Transfer Tax

- Transfer taxes driven by value—the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts
- 40% federal gift, estate, and GST tax rate

Transfer Tax

- \$11.58 million gift and estate tax basic exclusion amount (Chained CPI adjusted)
- \$11.58 million GST tax exemption (C-CPI adjusted)
- Unlimited marital deduction for transfers to a U.S. citizen spouse
- \$15,000 annual exclusion (C-CPI adjusted)
- Unlimited exclusion for direct payment of qualified educational expenses and qualified medical expenses

Transfer Tax

- Carryover basis for transfers by gift
- Fair market value basis adjustment for transfers at death
- Portability – deceased spousal unused exclusion amount (DSUE)
 - Must file a Form 706
 - DSUE is not C-CPI adjusted
 - Higher DSUE should be preserved after 2025
 - GST exemption is not portable

Transfer Tax

- December 31, 2025 sunset
 - Basic exclusion amount reverts to \$5 million (C-CPI adjusted)
 - Clawback should not be an issue per Prop. Reg. § 20.2010-1(c)
- C-CPI adjustment does not sunset

Transfer tax function

Aside from raising revenue, the estate tax has been defended as a ***means of increasing the overall progressivity of the tax system***. The tax falls on those with the greatest wealth, and wealth is widely regarded as a good measure of an individual's ability to pay.

Molly F. Sherlock, *Overview of the Federal Tax System*, Congressional Research Services, November 21, 2014

Transfer tax function

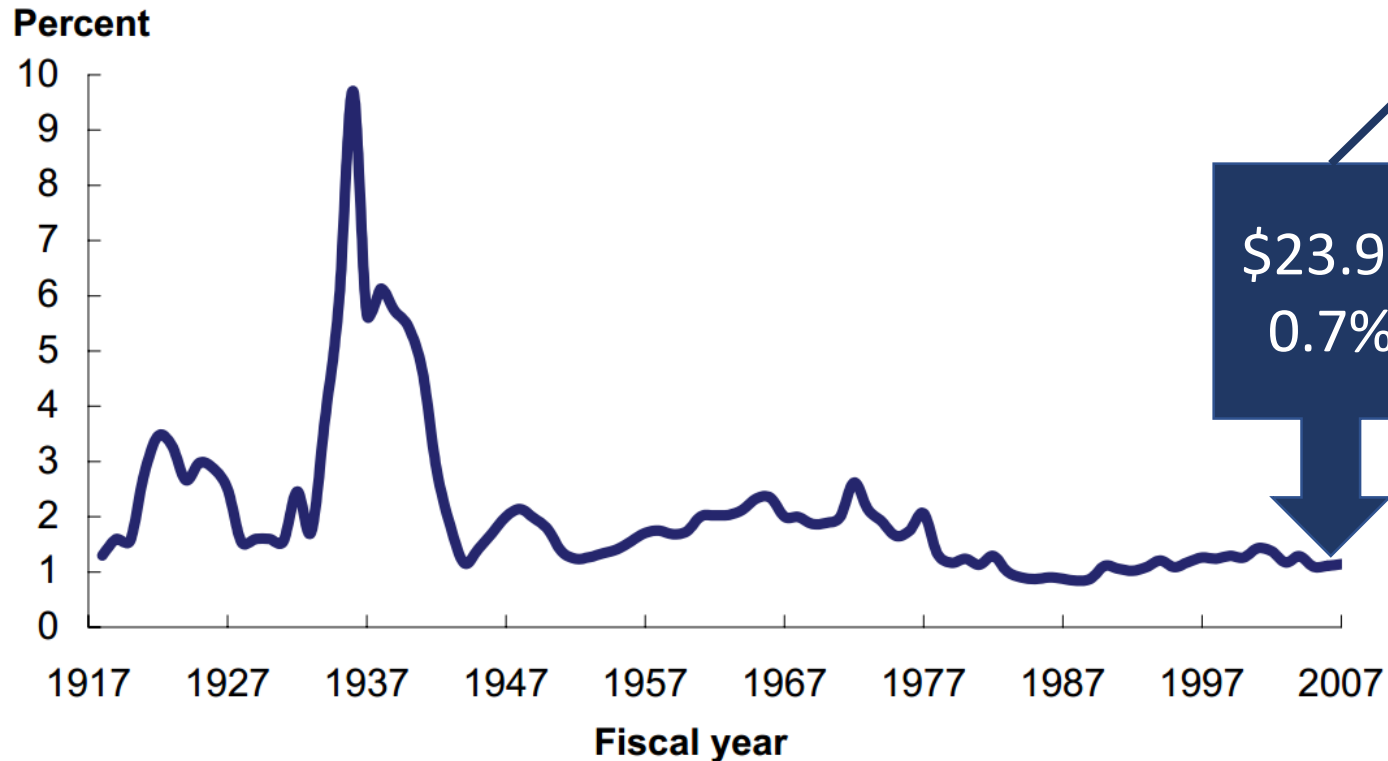
The U.S. transfer tax system is ***designed to erode the concentration of multigenerational wealth*** to reduce economic disparities within society.

Brian Layman, *Perpetual Dynasty Trusts: One of the Most Powerful Tools in the Estate Planner's Arsenal*, Akron Law Review, Vol. 32:4, 1999

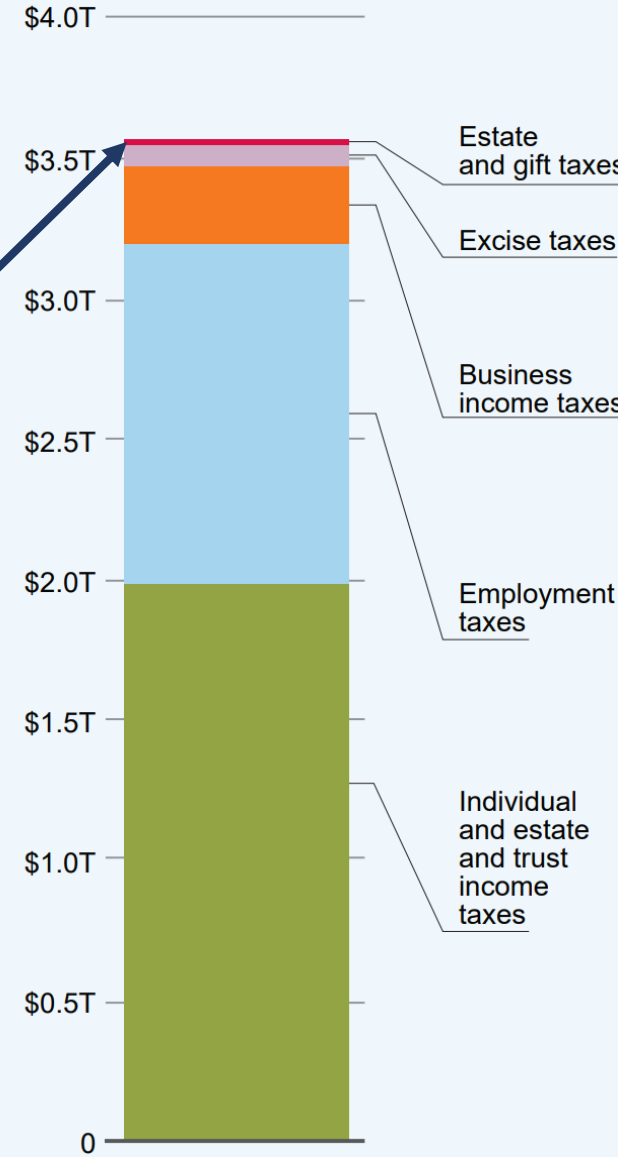
Show me the money—not!

Jacobson D., Raub, B., and Johnson, B., *The Estate Tax: Ninety Years and Counting*

Estate and Gift Receipts as a Percentage of Total Revenue, 1917-2007



Gross Collections by Type of Tax Fiscal Year 2019



2019 IRS Data Book

Collections by type of tax in FY 2019

	Billions	Percentage
Business income taxes	277.1	7.8%
Individual and estate and trust income taxes	1,981.7	55.6%
Employment taxes	1,207.6	33.9%
Estate and gift taxes	17.6	0.5%
Excise taxes	80.8	2.3%
Total	3,564.8	100.0%



2019 IRS Data Book (Publication 55B)

Forms 706 filed in 2018

	All taxable returns	All nontaxable returns	All returns	Percent of taxable estates	Taxable estates per 10,000 deaths
Gross Estate					
Under \$5MM	483	477	960	0.02%	1.7
\$5MM < \$10MM	2,654	5,060	7,614	0.09%	9.1
\$10MM < \$20MM	1,413	1,722	3,136	0.05%	5.0
\$20MM < \$50MM	722	595	1,316	0.03%	2.6
\$50MM or more	313	188	500	0.01%	1.1
Total Returns	5,484	8,042	13,526	0.19%	19.5

2017 U.S. Deaths 2,813,503

IRS, Statistics of Income Division, Estate Tax Returns Study, January 2020.

Examination coverage in FY 2019

Gross Estate	Returns filed in 2018	Returns examined in FY 2019			
		Total	Percentage covered	Field	Correspondence
Under \$5MM	19,035	385	2.0%	385	-
\$5MM < \$10MM	8,837	815	9.2%	815	-
\$10MM or more	4,975	1,082	21.7%	1,082	-
Total*	32,847	2,282	6.9%	2,282	-
Gift tax returns	244,570	1,839	0.8%	1,839	-

*Forms 706, 706GS(D), 706GS(T), and 706-NA
2019 IRS Data Book—Table 17b (Publication 55B)

Gift tax return audit rates

FY	Filed*	Audited	Percent
2011	226,241	2,623	1.2%
2012	223,090	3,164	1.4%
2013	260,426	2,775	1.1%
2014	371,747	3,098	0.8%
2015	267,600	2,539	0.9%
2016	238,324	1,843	0.8%
2017	244,974	1,886	0.8%
2018	242,426	2,090	0.9%
2019	244,570	1,839	0.8%

*Returns filed in calendar year before fiscal year noted while audit is in fiscal year noted.

SOI Tax Stats - Examination Coverage: Recommended and Average Recommended Additional Tax After Examination
- IRS Data Book Table 17b

Estate and gift tax returns

	All gift tax returns	All estate tax returns*
2017	242,426	33,690
2018	244,000	33,100
2019	245,600	31,200
2020	247,300	27,000
2021	248,900	25,900
2022	250,500	24,200
2023	252,100	23,100
2024	253,700	22,000
2025	255,300	21,500

*Forms 706, 706GS(D), 706GS(T), and 706-NA

Publication 6186, *Calendar Year Projections for the United States and IRS Campuses: 2018-2025 (2018 Update)*

Basis basics

Assumes basis adjustment at death

Basis basics

- Basis reflects the capital investment in property
- Basis is used to figure depreciation, amortization, depletion, casualty losses, and any gain or loss on the sale, exchange, or other disposition of property
- Gain is measured by the excess of the amount realized from the disposition of property over the taxpayer's adjusted basis in that property (IRC § 1001)

Basis basics

- Property acquired by purchase
 - Purchase price, plus improvements, minus depreciation and amortization (IRC §§ 1012, 1016)
- Property acquired by gift
 - Carryover basis unless gifted property is sold for a loss, in which case the donee's basis cannot exceed (nor will it be less than) the FMV of the property as of the date of gift (IRC § 1015(a))
 - The donee's basis in gifted property is increased (but not above the FMV of such property) by the amount of gift tax paid by the donor (IRC § 1015(d))
- Property acquired from a decedent
 - FMV on the date of death or alternate valuation date (IRC § 1014(a))

Basis basics

Property acquired from a decedent (IRC § 1014(b))

- Property acquired by bequest, devise, or inheritance
- Property acquired from a trust over which the decedent had the power to revoke, alter, amend, or terminate
- Property passing under a GPOA
- Surviving spouse's one-half share of community property
- Property included in the decedent's gross estate for estate tax purposes
- QTIP property

Basis basics

But there is no basis adjustment for property acquired from a decedent

- If such property constitutes an IRD item (IRC § 1014(c))
- If such property was given to the decedent within one year of death and then passes back to the donor or the donor's spouse as a result of the decedent's death (IRC § 1014(e))
- To the extent such property was excluded from estate tax under IRC § 2031(c) as a result of a qualified conservation easement (IRC § 1014(a)(4))

Our planning paradigm has changed—so long as we keep basis adjustment on death

The old paradigm

- Utilize estate, gift, and GST exemption during lifetime
- Utilize annual exclusion gifting
- Utilize tax-free gifting through direct payment of qualified educational expenses and qualified medical expenses
- Freeze the value of assets now (through gifts or sales) so that future growth will not be subject to transfer tax

The old paradigm

- Utilize available discounts when assets are transferred
- Pay income tax for your family without treating those payments as gifts
- Utilize favorable interest rate environment
- Defer tax through transfers to a spouse
- Charitable gifting

The new paradigm

- Basis, basis, basis
 - Combined ordinary income tax rates that equal or exceed the estate and gift tax rate
 - Basis step-up may out-weigh estate tax savings
 - Carryover basis for transfers by gift
 - FMV basis adjustment for transfers at death
- Portability

A few examples

Example #1—nontaxable estate

- D owns a single asset worth \$1 million with a basis of \$0
- D will not have a taxable estate
- D's heirs will sell the asset
- D wants to know whether he should give the asset to his children now or let it pass to his children under his will

Example #1—nontaxable estate

	Gift	Death
Sale Price	1,000,000	1,000,000
Basis	-	1,000,000
Tax Rate	23.8%	23.8%
Income Tax	238,000	-
Net Cash	762,000	1,000,000

Example #2—taxable estate

- D owns a single asset worth \$1 million with a basis of \$0
- The asset is expected to appreciate at 9.46% per year
- D will have a taxable estate
- D's heirs are expected to sell the asset after his death
- D wants to know whether he should give the asset to his children now or let it pass to his children under his will

Example #2—taxable estate

	Gift	Death [^]
Value at Transfer	1,000,000	2,469,135
Tax Rate	40.0%	40.0%
Estate Tax	400,000	987,654
Sale Price*	2,469,135	2,469,135
Basis	-	2,469,135
Tax Rate	23.8%	23.8%
Income Tax	587,654	-
Total Tax	987,654	987,654
NPV Total Tax[†]	637,995	987,654

[^]D lives ten years

*Sale ten years after death

[†]9.46% discount rate

Example #3—taxable estate (depreciable asset)

- D owns a single depreciable asset worth \$1 million with a basis of \$0
- The asset is expected to appreciate at 9.46% per year
- D will have a taxable estate
- D's heirs are expected to sell the asset after his death
- D wants to know whether he should give the asset to his children now or let it pass to his children under his will
 - Does the growth rate affect your answer?

Example #3—taxable estate (depreciable asset)

	Example #3A		Example #3B	
	Gift	Death [^]	Gift	Death [^]
Value at Transfer	1,000,000	2,469,135	1,000,000	2,469,135
Tax Rate	40.00%	40.00%	40.00%	40.00%
Estate Tax	400,000	987,654	400,000	987,654
Depreciable Basis	-	2,469,135	-	2,469,135
Tax Rate	37.00%	37.00%	37.00%	37.00%
Tax Shelter ^Δ	-	(913,580)	-	(913,580)
Sale Price*	6,096,762	6,096,762	2,779,896	2,779,896
Basis	-	-	-	-
Tax Rate‡	37%/20%	37.00%	37%/20%	37.00%
Income Tax	1,389,352	2,255,802	725,979	1,028,561
Total Tax	1,789,352	2,329,876	1,125,979	1,102,636
NPV Total Tax[†]	962,676	1,326,616	1,044,823	1,044,823

Example #3—taxable estate (depreciable asset)

Assumptions:

^D lives ten years

ΔS/L depreciation for ten years

*Sale ten years after death

‡Recapture at 37% and 1231 gain at 20%

†9.46% discount rate (Example #3A) / 1.19% discount rate (Example #3B)