

A Guide to Potential Tax Law Changes

A look into changes the Biden Administration might propose and what you can do now to prepare

Prior to the Presidential election, we created the content piece, [Presidential Candidate's Tax Policy Review](#) that outlined the differences in tax policies between the then President Donald Trump and Joe Biden. Since then we have had an election and our office of the President is in Democratic hands, with that comes changes, some definite and others potential. Many legal and tax professionals are predicting sweeping changes and repeals to tax laws under President Biden's administration. We outline here some potential changes that may occur and ones we feel are important for you, as a business owner to consider acting on.

Corporate Income Tax

Clients have different levels of wealth and business complexities, so the potential tax law changes will have varying impacts on estate and income tax planning. The goal of this piece is to give a high level explanation of the more relevant changes that impact most of our lending customers.

With regard to your business, here are a few potential changes that could have an impact:

- Corporate Income Tax Rate increase from 21% to 28%. This would affect C-Corporations. Some say the rate could go as high as 35% if the Tax Cuts and Jobs Act is fully repealed.
- Elimination of the 20% deduction for Qualified Business Income
- Elimination of the 1031 Exchange which is used frequently by real estate developers or those with real estate portfolios to postpone capital gains tax by buying qualified replacement property to replace the property they sold
 - Coupled with the increase in capital gains tax rates to 39.6% plus a 3.8% surtax for those earning \$1,000,000 or more, this could play a significant role in decision making

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Personal Income Tax

President Biden has proposed a number of initiatives during his presidential campaign surrounding tax increases for individuals with high income. More specifically, for individuals with income over \$400,000 will be greatly affected. Below are some key items from the President's income tax proposals:

- Increase top marginal tax rate from 37% to 39.6%
- Long-term capital gains/qualified dividend income for individuals with income over \$1 million will be taxed at the ordinary income rate instead of the lower capital gain tax rate, which will result in an additional 19.6% tax
- Social security payroll tax will be imposed on wages above \$400,000
- Itemized deductions will be capped at 28% for individuals earning more than \$400,000

While the actual timing and extent of the tax legislation is uncertain, it is still prudent to take advantage of tax planning opportunities that are available now to hedge against potential future tax hikes. If you are a high-income earner, consider accelerating income and harvest capital gains in 2021 and defer expenses and losses to 2022. For those who may be subject to a higher tax rate on their capital gains, consider gifting stocks instead of cash to avoid the capital gain tax while still being able to take a deduction on the charitable donation. Also, to capitalize on the current low tax rate environment, consider doing a Roth conversion to fill up your current tax bracket. For those who inherited an IRA from a non-spousal decedent who passed away in 2020, don't forget that new distribution rules from the SECURE Act enacted end of 2019 may now apply. The ability to stretch an inherited IRA over a non-spouse beneficiary's lifetime has been eliminated and instead it must be withdrawn within 10 years. For sizable inherited accounts, this accelerated depletion will certainly increase an heirs' income taxes significantly in the near future years.

What's raising even more eyebrows is the proposed elimination of the "Step Up In Basis" so that all capital gains taxes will be paid at death. Currently, assets held until death receive a "Step Up In Basis" (heir's cost basis becomes the market value of the asset at death avoiding capital gains tax). This portion of the tax reform would create significant taxation to your heirs, especially on assets above the lifetime exemption. In this scenario, inherited low basis assets that are over the lifetime estate tax exemption could be taxed at a 40% (or higher) Estate Tax Rate. In addition, a capital gains tax rate may be imposed at the highest income tax bracket which will likely increase to 39.6% with an additional 3.8% surtax for individuals with an income over \$1,000,000. For example, a decedent's asset with \$1,000,000 in basis and a fair market value of \$10,000,000

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at death will be subject to capital gain tax of \$3,906,000 at the combined 43.4% rate. This capital tax would then reduce the overall market value of the asset which is included in the estate and the remaining portion of \$6,094,000 in this example would then be subject to estate tax. With an estate tax payable of \$2,437,600, this leaves \$3,656,400 for the heirs and \$6,343,600 is paid to our favorite uncle...Uncle Sam!

Proposed capital gains tax changes are not the only federal tax changes that may affect your heirs. A reduction in the lifetime gift and estate tax exemption amount and an increased estate tax rate are also on the horizon.

Federal Estate and Gift Tax

Decrease in the Lifetime Exemption Amount and Estate Tax Rate Increase

The federal lifetime gift tax exemption amount is the amount individuals can gift away during their lifetimes without having to pay any gift taxes on the transfer to the individuals. The lifetime gift tax exemption is unified with the federal estate tax exemption amount, which is the total amount that can be excluded from estate taxes at death.

In 2021, the lifetime federal exemption amount is \$11.7 million per person or \$23.4 million per married couple. It was increased from \$5.5 million per person in 2018, and will sunset at the end of 2025 to the pre-2018 levels, indexed for inflation. It is anticipated that President Biden will propose legislation to lower the lifetime exemption amount to pre-2018 levels, approximately \$5.5 million per person or lower.

Additionally, the federal estate tax, which is a tax imposed on the portion of an estate that exceeds the lifetime gift and estate tax exemption, is expected to be increased by the Biden administration from the current top rate of 40% to 45% or 50%, but could go even higher.

The following are several different methods for removing existing wealth from the transfer tax base:

- Outright gifts
- Gifts to grantor trusts
- Gifts of fractional interests in properties
- Sales of assets for lifetime annuities
- Transfer of property expected to produce a significant investment return
- Loans at low interest rates

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One of the most effective ways of removing wealth from the transfer tax base, is to make annual exclusion gifts. Currently an individual can make annual gifts up to \$15,000 to any number of people without any gift tax on the transfer. Simple cash gifts, or gifts of appreciated property, can generate a significant federal estate tax savings. In substantial estates, cash gifts of \$15,000 can generate a federal estate tax savings of at least \$6,000 for every transferee.

For example, an individual has a significant estate and three children (two of whom are married), and five grandchildren. If the individual has an estate that would be taxed at the 40% bracket, gifts of \$15,000 to each of the three children, to the spouses of the two married children, and to each of the five grandchildren would entail transfers of \$150,000. These transfers would result in a federal estate tax savings of \$60,000. If this gift program continues for ten years, his taxable estate will be reduced by \$1,500,000 saving \$600,000.

In addition to annual exclusion gifting, individuals can pay education or medical expenses. Tuition payments made directly to an educational organization and payments for a person's medical care made directly to the provider are not treated as taxable gifts.

The reduction in the lifetime estate tax exemption is a major change that will bring many more estates into the estate tax target range. Every dollar above the lifetime exemption is currently levied a 40% tax, but that rate could go as high as 50% with tax reform supporting gift strategies as discussed above.

It is difficult to know what the comprehensive tax package will include, but it is important to be prepared by understanding the potential changes and proactively discussing planning ideas with your financial consultant. Rockland Trust Investment Management Group's team includes several experts who are very knowledgeable on these topics and who can work closely with you and your other professional advisors to help you make the best decisions for your current and future situations.

Contributing insights from Rockland Trust Investment Management Group's Jack Gates, Vice President & Advanced Insurance Specialist; Kathleen Callahan, CTFA, First Vice President & Senior Fiduciary Officer, Relationship Manager; Bonnie Loedel, MPH, JD, First Vice President & Senior Fiduciary Officer, Relationship Manager; Rita Yeung, CPA, Vice President, Manager of Tax Services.

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