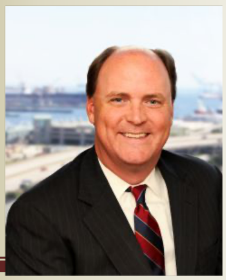
April 2021

Business Signals – Tax Alert

An alert about the legal implications of issues affecting businesses and business owners in the Central Gulf Coast region.



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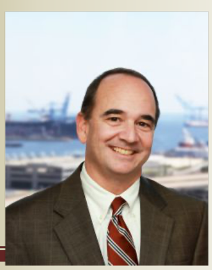

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Tax Alert 2: Update on 2021 Tax Proposals

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In January of this past year, we released our first tax alert on the impact of the federal election results on tax planning. At that time, all we had to go on were the tax proposals from President Biden that he released through his campaign literature. See Tax Alert: Impact on Federal Election Results on Tax Planning, January, 2021. While those proposals were somewhat vague (most likely intentionally given that these were election proposals), they did provide some interesting details of what to expect from President Biden and his administration in the 2021 legislative year. This included such items as an increase in corporate tax rates, and a brand new “minimum tax” concept for major corporations, which would mandate that the largest corporations in the U.S. pay a minimum of 15 percent tax on their book income, rather than taxable income. There were also indications in the campaign literature of major changes in the estate and gift tax area, although at that time there were no specifics other than repeated statements that the Biden administration would raise rates, lower exemption amounts, and eliminate the step-up in basis at death.

As of the date of drafting of this tax alert, we now have some more general details as to the upcoming proposals by President Biden, but no specific legislation from the President (although we now know it is coming soon!). However, two specific items of tax legislation have now been proposed by Congress members in both the Senate and the House, both of which are currently working through Congress. This tax alert will provide a quick summary of these updated proposals.

I. President Biden's Proposals

President Biden has made numerous speeches since the inauguration indicating his desire to raise taxes in a variety of areas, including corporate, individual and estate and gift tax. However, he has now released some specifics

regarding at least some of those tax changes, in two specific documents. The first, entitled "Fact Sheet: The American Jobs Plan," was released on March 31, 2021, and outlines President Biden's specific proposals relating to targeted expenditures and new programs in the upcoming year.

As part of that release, President Biden included a provision called "The Made in America Tax Plan", which focuses on proposed corporate tax changes, both domestic and foreign. He states that the purpose of the Made in America Tax Plan is to fund the "American Jobs Plan," and that his goal is to raise over two trillion dollars over the next 15 years to pay for the American Jobs Plan and thereafter to reduce the deficit. In the fact sheet, President Biden mentions the new 28 percent corporate tax rate and the new proposed 15 percent minimum tax on book income for large corporations that he had previously proposed during the campaign. The remainder of the release focuses on tax provisions relating to offshore taxation of domestic corporations. This includes increasing and strengthening the global minimum tax for U.S. multinational corporations; negotiating global agreements to avoid corporations from taking advantage of tax havens; denying various expense deductions relating to offshore jobs; eliminating deductions for foreign derived intangible income ("FDII"); and many other proposed changes targeting corporations minimizing taxation by moving their assets offshore. President Biden also suggests ramping up enforcement against large corporations by providing a significant boost in funding to the IRS to allow them to audit all major corporations each year.

On Wednesday, April 28, President Biden addressed a joint session of Congress and announced details relating to his "American Families Plan." As part of that address, the White House released a second document, entitled "Fact Sheet: The American Families Plan," which provided details regarding some major new programs, including such things as primary and secondary education reform, child care, paid leave, and many others. As part of that release, the Fact Sheet outlines additional proposed "tax reform" measures, which they claim will raise more than $1.5 trillion in additional taxes when combined with the tax proposals in the American Jobs Plan. The specific details listed in the Fact Sheet are as follows:

- Increase funding to the IRS for enforcement and audits, and require additional reporting of financial information from corporations;
- Increase top tax rate for individuals to 39.6 percent;
- Increase top tax rate on capital gains for taxpayers making over $1 million to 39.6 percent;
- Require that there be a "deemed sale" for decedent's owning property with potential capital gains in excess of $1 million, or $2.5 million per couple when combined with existing real estate exemptions;
- Eliminate carried interest for hedge fund partners;
- Eliminate the use of 1031 exchanges to avoid capital gains greater than $500,000;

- Make permanent the limitation on restrictions of deductions for large excess business losses;
- Close loop holes relating to the 3.8 percent Medicare tax for all taxpayers making more than $400,000.

President Biden has still not specifically released any details on changes in the gift and estate tax area, other than the new “deemed sale” rule, but he has mentioned it in various press conferences, so we do expect that there will be some proposed changes. We expect that actual legislation will be forthcoming soon, so stay tuned for further updates!

I. For the 99.5 Percent Act

Senator Bernie Sanders has introduced a major tax package every year since 2010. This year is no exception, as he has now introduced the “For the 99.5 Percent Act”, along with Congressmen Jimmy Gomez in the House of Representatives. Unlike President Biden’s proposals, Senator Sanders’ proposed legislation focuses almost exclusively on estate and gift taxation changes, and would be a drastic change from the current law, including many items that have been on the IRS’s wish list for many years. These include the following:

- $3.5 million dollar estate tax exemption, not indexed for inflation, with a $1 million dollar gift tax exemption;
- Increase of marginal estate and gift tax to forty-five percent from $3.5 million to $10 million, fifty percent from $10 million to $50 million, fifty-five percent from $50 million to $1 billion and sixty-five percent for estates over $1 billion. The Act would retain portability of the exemption between spouses;
- Generation Skipping Tax would effectively adopt the new changes in the estate tax, both for exemption amounts and rates;
- Disallowance of step-up in basis but only for certain grantor trusts;
- Elimination of valuation discounts for non-business assets, and for business interests where the transferor and family members have control or own a majority interest in the company;
- A provision for a minimum term of ten years for grantor retained annuity trusts for the annuity interests, and a maximum term of life expectancy for ten years, with the remainder interest of the GRAT to have a value equal to or at least twenty-five percent of the value of the assets or 500,000, whichever is greater;
- Elimination of favorable grantor trust rules for intentionally defective grantor trusts;
- Prohibition of the allocation of GST exemption to any dynasty trust with a term of over fifty years (effectively eliminates dynasty trusts)
- Limitations on annual exclusion for gifts in trusts, transfers of interest in pass through entities and other gifts to include an annual per-donor limit of twice per done (currently $30,000), but with a elimination of the present interest requirement;

- Increase in the cap of reduction in value for the special use valuation rules in Section 2032A for farm property to $3 million dollars;
- Increase in maximum exclusion for conservation easements to the lesser of $2 million or sixty percent of the net value of the land.

These proposed changes would eliminate many of the common estate tax planning techniques currently utilized by estate planners, especially in the area of grantor trusts and GRATs. Again, Senator Sanders has proposed many of these same changes each year since 2010, so it is highly unlikely that the bill will pass as currently drafted, but they do provide a rather extreme starting position for Democrats in the area of estate and gift taxation. As of today, the Act has not been proposed to be made retroactive, with an effective date of December 31, 2021, so even if some form of the Act passes there is still time in this year to avoid most of the most deleterious effects of the tax package.

II. The STEP Act

Another package of legislation that has been proposed is called the “Sensible Taxation and Equity Promotion Act of 2021” or “STEP Act.” As noted earlier, President Biden has proposed eliminating the step-up in tax basis for *estate and gift taxation*. The STEP Act goes even further, by providing that any property transferred by gift or at death shall be treated as sold for its fair market value on the date of the gift or death. This is an *income tax provision*, and would effectively require all assets transferred at death or by gift to be taxed at the date of death or transfer. This tax would be reportable on the Decedent’s final tax return (or for a gift on the Donor’s annual tax return). There are exceptions for certain transfers, such as tangible personal property, spousal transfers and for transfers to charities.

The STEP Act also provides that assets which are held in trust cannot escape income taxation forever. Specifically, the Act provides that assets held in non-grantor trusts property for thirty years without taxation will be deemed sold at that date. Current trusts will be exempted from this new rule, but only for thirty years from the date of enactment.

The STEP Act will exclude annual exclusion gifts and up to $1 million of net capital gain at death, and will allow for netting with capital losses. It will also allow for installment payments just like estate taxes, allowing for ten payments beginning no later than five years after death.

Finally, the STEP Act includes yet another IRS wish list provision, by requiring information reporting by the donor or executor regarding transferred properties, including fair market value and basis. There are some differences in House Act and the Senate Act regarding the information reporting, but regardless you can expect that this will be a hotly contested provision.

Unlike Senator Sanders’ proposal, the Senate version of the STEP Act would be made retroactive to December 31, 2020, although the House version is effective on December 31, 2021. Given the immensity of these changes, this would be an extraordinary and unprecedented step for the Congress, were it to make these changes retroactive, so you can expect this particular issue will also be hotly contested. Note that President Biden has now specifically referenced his desire to pass some form of legislation that would tax capital gains for assets held on death, so this legislation may receive the backing of the White House as it proceeds through Congress.

IV. Republican Responses

Although it has no chance of passing in this current Congress, it is worth noting that the Republicans have proposed a complete repeal act of estate taxes, appropriately entitled “The Death Tax Repeal Act of 2021.” This is the same type of bill that has been introduced for decades by Republicans, and would effectively repeal estate taxes and GST taxes for all estates. It would retain a gift tax, but with a thirty-five percent rate for gifts over $500,000 and with an exemption of $10 million indexed for inflation.

V. Conclusion

This Tax Alert is simply an update of the items that have been proposed thus far. We know that there will be substantial increases in taxation this year, and these are the first salvos fired in what will be a war in Congress over the issues. All estate planners and financial professionals should keep in mind that this type of legislation can be passed through reconciliation, which would avoid the filibuster in the Senate and would allow passage on a simple majority vote. There are some Democrats who have expressed reservations about many of the proposed tax increases, including especially Senator Joe Manchin of West Virginia and Senator Kyrsten Sinema of Arizona, so it is unlikely that the current extreme proposals will pass in their current form, but we can expect that there will be some compromises reached and that some form of a tax package will pass.

We will continue to post updates to keep you posted as this develops.

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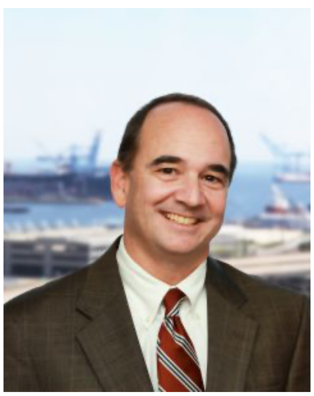

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