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Use It or Lose It?
Year-End Wealth Planning Strategies

Presented by:

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ATTORNEYS AT LAW

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Imperative Planning Issues

- <u>Potential</u> for New Federal Tax Legislation – “Biden Plan”
  - Change in Federal Income Provisions for Individuals and Businesses
  - Potential Reduction in the Estate and Gift Exemption Amount
  - Loss of basis adjustments to fair market value (FMV) at death
- California Constitutional Amendment
  - Proposition 19 – approved by 51.09% of voters on November 3, 2020
  - Partial Repeal of Parent-Child Reassessment Exclusion for Property Tax Purposes
  - Effective February 16, 2020

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Current Tax Laws versus "Biden Tax Plan" Corporate Tax

Present Law	Biden Tax Plan
• 21% corporate rate	• 28% corporate rate
• 20% pass-through deduction for QBI	• Repeal 20% pass-through deduction for QBI for taxpayers >$400K in income and for REIT dividends
• Territorial style regime with BEAT, 10.5% GILTI rate	• Double GILTI rate
	• 15% minimum global book income tax
	• Repeal like-kind exchange deferral for real estate
	• Impose 6.2% tax on wages >$400K (both employer and employee), wages between $137,700 and $400,000 not taxed

Current Tax Laws versus “Biden Tax Plan” Individual Income Tax

Present Law	Biden Tax Plan
• 37% maximum rate through 2025, reverts to 39.6%	• 39.6% maximum rate

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Current Tax Laws versus "Biden Tax Plan"
Long Term Capital Gains

Present Law	Biden Tax Plan
• 20% maximum capital gains rate	• Tax long-term capital grains at 39.6% for taxpayers with income > $1 million
• 3.8% net investment income tax	• Keep 3.8% net investment income tax

Current Tax Laws versus "Biden Tax Plan"
"Step-Up" in Basis

Present Tax Law	Biden Tax Plan
• IRC 1014 – Basis to FMV at death	• "Eliminate" the "step-up" in basis • Possible carry-over basis, modified carry-over basis, or tax event on death

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Current Tax Laws versus "Biden Tax Plan"
Transfer Tax

Present Law	Biden Tax Plan
• Estate, gift and GST tax rate at 40%	• Restore to "historical norms"
• Exclusion of $10.0 million (indexed for 2020 at $11.580 million) through 2025, reverts to $5 million (indexed from 2011)	

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USE IT OR LOSE IT?
Understanding the Timing Issues

- Basic Exclusion Amount is $10 million
- Indexed for inflation at $11.580M for transfers in 2020
- Sunsets in 2026
- In 2026 Basic Exclusion Amount becomes $5M
- Expected to be indexed for inflation at approximately $6.5M
- Without new tax legislation, exclusion is reduced by 1/2

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USE IT OR LOSE IT?
Understanding the Timing Issues

- Biden estate tax provisions are unclear
- Historical norms could mean $3.5M
- Gift and Estate De-unification

Year	Exclusion	Tax Rate
2004	$1.5M	48%
2009	$3.5M	45%
2010	$5.0M	35%
2017	$11.180M	40%

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USE IT OR LOSE IT?
Understanding the Timing Issues - Questions

- Democratic Senate? January elections in Georgia
- New Tax Legislation in 2021?
- Estate and Gift Tax Provisions Included?

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USE IT OR LOSE IT?
Understanding the Math Issues

- Enhanced Exclusion Amount Could be Lost
  - Excess over new exclusion amount

- Example 1: Donor gifts \$15M in 2020. Exclusion of \$11.580M is applied. Taxable gift, assuming no prior gifts, is \$3.420M. Tax at 40% is \$1,368,000.
- Example 2: Instead, Donor waits and gifts \$15M in 2021. Exemption of \$3.5M is applied. Taxable gift, assuming no prior gifts, is \$11.5M. Tax at 40% is \$4,600,000.
- This donor was wise to make a large gift in 2020!

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USE IT OR LOSE IT?
Understanding the Math Issues

- Enhanced Exclusion Amount Could be Lost
  - Excess over final exemption amount

- Example 1: Donor gifts $1M in 2020. Exclusion of $1.0M is applied. Taxable gift, assuming no prior gifts, is $0. Tax is $0.
- Example 2: Donor makes an addition gift of $14M in 2021. Exclusion of $2.5M is applied. Taxable gift, assuming no prior gifts, is $11.5M. Tax at 40% is $4,600,000.
- It did not help this donor to make a $1M gift in 2020!

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USE IT OR LOSE IT?
Understanding the Math Issues

- Enhanced Exclusion Amount Could be Lost
  - Excess over final exemption amount

- Example 1: Donor gifts $6M in 2020. Exclusion of $6M is applied. Taxable gift, assuming no prior gifts, is $0. Tax is $0.
- Example 2: Donor makes an addition gift of $9M in 2021. No remaining exclusion is available. Taxable gift, assuming no prior gifts, is $9M. Tax at 40% is $3.6M.
- This donor used only $2.5M of the enhanced exclusion. The rest was lost!

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USE IT OR LOSE IT? Understanding the Math Issues

- Anti-Clawback Provisions – if you use it, it is yours forever

- Benefits of Gifting Beyond Using Exemption
  - Estate Freeze
  - Income Shift
  - Proposition 19 issues

- Issues to Consider When Gifting
  - Carryover Basis
  - Property Tax Reassessment
  - Debt Issues
  - Use of Funds
  - Structure

Estate Planning Team

- Attorney
- CPA
- Financial Planning Professional

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Annual and Tuition Exclusion Gifts

- Annual Exclusion
  - $15,000 each per year to each of an unlimited number of donees without consuming any of your exemption amount
  - Direct to donee or through “Crummey Trusts”

- Tuition Exclusion
  - Unlimited for direct gifts to an educational institution (rather than the student) and must be for tuition expenses of a full-time or part-time student.
  - The exclusion does not apply to amounts paid for books, supplies, dormitory fees, board, or other similar expenses
- Too Small To Help?

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Spousal Lifetime Access Trusts (SLAT)

- A Spousal Lifetime Access Trust ("SLAT") is an irrevocable trust created by one spouse for the benefit of the other as well as additional family members, most commonly children and/or grandchildren
- SLATs offer the opportunity to take advantage of "freezing" the value of the assets transferred to the SLAT and of utilizing one's gift and estate tax exemption while providing for access to those funds by the donor's spouse
- Lifetime Bypass Trust

Qualified Personal Residence Trust (QPRT)

- Irrevocable trust for personal residence or vacation home
- Donor is beneficiary for term of years
- When the trust terminates, residence is distributed to the remainder beneficiaries.
- If donor dies during the term of the QPRT, the residence will be included in donor’s gross estate
- Donor must lease property back to use it after trust term
- Value of gift is leveraged: “taxable gift” portion is the present value of the remainder interest
- Value of the remainder interest is based on the length of the trust, the value of the retained interest, and the federal discount rate (based upon the applicable federal rate) which discounts the value of annuities, life estates, and remainder interests to present value

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Grantor Retained Annuity Trust (GRAT)

- Irrevocable trust for a stated term of years
- Donor retains fixed annuity payment for a fixed term
- Like QPRT, “taxable gift” is value of remainder interest only
- The present value of the remainder interest is determined by the length of the trust term, the amount of your retained annuity, and the federal discount rate
- Mortality risk issues like QPRT
- Low interest rates make this option attractive right now

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Large Gifts to GST Trusts/Intentionally Defective

- Simplest option: make a large gift of assets your children
- Consider use of an irrevocable trust for their benefit
- An intentionally defective grantor trust (“IDGT”)
  - Considered a “defective” transfer for income tax purposes
  - Assets in the IDGT will not be included in your estate for estate tax purposes.
- Loan/sale to the IDGT
- Perpetual or generation skipping style trusts
- Creditor protective
- Sales to IDGT

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Charitable Planning Options: Lead Trust

- A CLT is a trust for a stated term of years that pays a fixed annuity amount or percentage to designated charities
- After the trust term expires, the trust terminates and the remaining trust property is transferred to the remainder beneficiaries
- Gift of the remainder interest is valued actuarially based on the term of the trust, the amount of the annuity or unitrust, and the federal discount rate, as with a QPRT

Navigating The Process

- Do you have an estate tax problem? Answer: Depends…
- Can you “comfortably” gift $11.580M now? Use it!
  - IDGT Trust
  - GRAT
  - Charitable Lead Trust
  - QPRT
- Can you “comfortably” gift something above $3.5M/$6.5M now?
  - SLAT if married
  - GRAT or QPRT
- If you cannot gift now, continue other gifting strategies
  - Annual and tuition exclusion gift
  - Sales and loan transactions – estate freezes
  - Life insurance planning
  - IRC 6166 deferrals

Proposition 19 – Property Tax Problems?

- Partial repeal of "Prop 13" exclusions for transfer of real property between parents and children
  - Residence unlimited assess valued
  - Other real property limited to first million of assessed value
- Enacts constitution amendment
- Effective for transfers between parents and children after February 15, 2021
- Not a "wealth tax" issue but impacts all that own real property covered under Prop 13

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Proposition 19

- Exclusion now limited only to parent-child transfers of personal residence if property continues as family home of transferee and family farms
- Personal residence exclusion limited to $1M
- Exclusion no longer applies to other types of real property transferred between parent and child

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Proposition 19

- Property tax re-assessment could have real fiscal impact
- Consider strategies to transfer before February 16, 2020
  - Transfers that are complete for property tax purposes as parent-child transfer but, if there is no other incentive to make a taxable gift, have strings that cause inclusion for possible basis step up
    - Irrevocable trusts with general powers of appointment?

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Conclusion

- Gift now if you can
- Consider property tax issues under Prop 13

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Thank you, Gina Lera

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For more information about the
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Family Business Trivia Night

December 3

5:30-7:30 PM