Pending Tax Laws—What's the latest?

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The "Big 4"

1) **Accelerates the sunset of the lifetime gift and estate tax exemption** back to $5 million adjusted for inflation to now be effective December 31, 2021, rather than December 31, 2025. For 2022, estimated to be $6,020,000.

2) **Valuation discounts no longer available** when transferring entities holding "non-business assets" (passive assets not used in the active conduct of a trade or business), effective for transfers made after the date of enactment.

3) **Grantor trust assets now includible in grantor's estate**, applicable to trusts created on or after the date of enactment AND to any portion of a trust created before the date of enactment which is attributable to a contribution made on or after the date of enactment.

4) **Sales to grantor trusts no longer ignored** for income tax purposes and therefore subject to tax on the gain, whether it's a sale to an old grantor trust or a new grantor trust, effective the date of enactment.

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What do we do between now and the date of enactment?

- **Fund grantor trusts now**. Create grantor trusts if need to.
- If you have an Irrevocable Life Insurance Trust ("ILIT"), **contribute substantial assets** now to cover insurance premiums for coming years.
  - Contributions made after the date of enactment will cause a percentage of the trust to be includable in your estate.
- **Create a trust to benefit your children or grandchildren** as an Intentionally Defective Grantor Trust ("IDGT"). Assets held in the IDGT would be outside your taxable estate.
  - Creating as a grantor trust allows you to personally pay the income tax on the trust income rather than the trust paying its own income tax (and depleting trust assets to do so).
  - If you wait until after the date of enactment, the assets will be includable in the taxable estate. To avoid inclusion, will have to create as a non-grantor trust, meaning that the trust would have to pay the income tax on the trust income.

- **Each spouse create a Spousal Lifetime Access Trust** ("SLAT") to benefit the other. Assets held in the SLATs would not be included in either spouse's estate at death. Think of a SLAT as a "Lifetime Bypass Trust" for the benefit of a spouse.
  - Locks in the higher lifetime gift and estate tax exemption before it sunsets in half, yet the spouses continue to benefit from the assets removed from their estates.
  - The two SLATs must be substantially different to avoid the Reciprocal Trust Doctrine.
  - If you wait until after the date of enactment, the assets will be includable in the taxable estate. To avoid inclusion, will have to create as a non-grantor trust, which is hard to do.
- Put assets into a Family Limited Partnership ("FLP") and then **transfer the FLP interests to a IDGT or SLAT** to take advantage of valuation discounts and the higher exemption.
  - To transfer the FLP interests, make a <u>gift</u> to the trust equal to the balance of your lifetime exemption and then <u>sell</u> the rest to the trust in exchange for a promissory note.
  - Currently, valuation discounts for lack of marketability and lack of control are routinely applicable to limited partnership interests as they are less marketable than assets held outright or assets traded on an exchange, such as stock of public companies or bonds.
  - After the date of enactment, these valuation discounts will no longer be available when transferring entities holding passive assets not used in the active conduct of a trade or business such as FLPs.

Other Tax Proposals

- **Increases top income tax rate** from 37% to 39.6%, effective for 2022 tax year, and lowers threshold for highest bracket to $450,000 for joint filers, $400,000 for single, $425,000 for head of household, $12,500 for trust or estate. (Current threshold for top bracket is $628,300 for joint filers and $523,600 for single.)
- **Increases highest long term capital gains tax rate** from 20% to 25%, for gains realized after Sept 13, 2021. Also aligns income threshold to highest new ordinary income tax bracket ($450,000 for joint filers, $400,000 for single, $425,000 for head of household, $12,500 for trust or estate). For 2021, current income bracket applies.
- **Expands reach of the 3.8% Net Investment Income tax** to include income from active trade or business if taxable income is over $500,000 for joint filing, $400,000 for single, and for all trusts and estates, effective for 2022 tax year.
- **New 3% surtax** on modified adjusted gross income above $5 million for joint filers AND for single, above $100,000 for trusts and estates (excluding charitable trusts), effective for 2022 tax year.

- **Caps maximum allowable Section 199A 20% pass-through deduction** at $500,000 for joint filers, $400,000 for single, $10,000 for trusts and estates, effective for 2022 tax year.
- **Modifies carried interest rules** to increase holding period from 3 years to 5 years to be taxed as capital gain, effective for 2022 tax year.

  Exception: If adjusted gross income is less than $400,000, still get 3-year period.

  Exception: Real property trades or businesses still get 3-year period.
- **New graduated corporate tax rate structure**, effective for 2022 tax year, of 18% tax rate on first $400,000 of income, 21% on income $400,001–$5 million, 26.5% on income above $5 million.

  Exception: For corporations with income over $10 million, the amount of tax determined above is increased by the lesser of (i) 3% of such excess, or (ii) $287,000.

  Exception: Personal services corporations taxed at flat 26.5% rate.
- **Limits exclusion rate for Qualified Small Business Stock gains** for sales on or after September 13, 2021. For taxpayers with AGI over $400,000 and all trusts and estates, the 75% and 100% exclusion rates no longer available—only the 50% exclusion rate is available.

- **Restricts Roth conversions** beginning in 2032 if income is over $450,000 for joint filers, $400,000 for single, $425,000 for head of household.

- **Caps IRA size** if income is over $450,000 for joint filers, $400,000 for single, $425,000 for head of household. Cannot make additional contributions to Roth or traditional IRA if the combined value of IRAs and defined contribution plans exceeds $10 million, effective for 2022 tax year.

- **Increases minimum distribution from large IRA** if income is over $450,000 for joint filers, $400,000 for single, $425,000 for head of household. If combined value of IRAs, Roth IRAs, and defined contribution plans exceeds $10 million, new minimum distribution rules apply, effective for 2022 tax year.
  - If combined value is over $10 million, annual minimum distribution required of 50% of amount over $10 million.
  - If combined value is over $20 million, annual minimum distribution required of lesser of (i) amount over $20 million or (ii) the total balance held in Roth IRA and Roth defined contribution plans.

- **Prohibits IRAs from owning interests in Private Placement Investments**, effective for 2022 tax year. Subject to a 2-year transition period for IRAs already holding such investments.