

WILMINGTON TRUST

Emerald Family Office & Advisory

PROVIDING STRATEGIC TRANSITION PLANNING AND SOLUTIONS

Politics, Policy & Legislation

Overview of 2021 Tax Reform

House Ways & Means Committee Draft Legislation

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October 7, 2021



**WILMINGTON
TRUST**

MEMBER OF THE M&T FAMILY

Special Thanks

**“IF I HAVE SEEN FURTHER, IT IS BY
STANDING ON THE SHOULDERS OF
GIANTS.”**

-ISAAC NEWTON

Special Thanks to Bob Keebler, Jonathan Blattmachr, and Marty Shenkman who have developed some outstanding secondary source material that we reviewed as part of our presentation.

Odds of Passing in Current Form

The Serious/Technical Answer

- Odds on it passing in its current form are almost zero
- The proposal is still in the drafting phase with the committee staff, and even Senator Pelosi has conceded that the proposal will undergo changes.

Overview of the Legislative Process

The Procedure

- Must start in the House, and, if passed, goes to the Senate.
- Remember that Democrats need all Democratic Senators plus the two independent Senators who generally vote with them in order to pass the Legislation. Accordingly, at this time it is impossible to say what will actually pass.
- Senate Finance Committee also has their proposals.
- Also, remember that lobbyists have not really sank their teeth in yet (i.e., Section 1014).

What's In The Bill?

1	IRS Budget Increases	NOT COVERED
2	Additional Reporting Requirements and Compliance	NOT COVERED
3	Low Income Tax Credits	NOT COVERED
4	Individual Income Tax Provisions	COVERED
5	Estate Tax Provisions	COVERED
6	Valuation Discounts Under Attack	COVERED
7	Grantor Trust Tax Provisions	COVERED
8	Retirement Plan Rules/Limits	NOT COVERED
9	Corporate Income Tax Rates	NOT COVERED
10	Energy and Other Specialized Areas	NOT COVERED

Individual Income Tax Rates

Punchline: They Are Going Up at The Top End

Ordinary Income Rates – Bringing Back the Top Bracket (39.6%)

THE BRACKETS					
	S	MFJ/QW	MFS	HOH	T&E
10%	\$9,950	\$19,900	\$9,950	\$14,200	\$2,650
12%	\$40,525	\$81,050	\$40,125	\$54,200	-
22%	\$86,375	\$172,750	\$86,375	\$86,350	-
24%	\$164,925	\$329,850	\$164,925	\$164,900	\$9,550
32%	\$200,000	\$400,000	\$200,000	\$200,000	-
35%	\$400,000	\$450,000	\$225,000	\$425,000	\$12,500
39.6%	The Over				

S = Single

MFJ = Married Filing Jointly

MFS = Married Filing Separately

HOH = Head of Household

T&E = Trusts and Estates

Effective Date: After 12/31/2021

Source: House Ways & Means Committee Draft Legislation

Individual Income Tax Rates

Punchline: They Are Going Up at The Top End

Capital Gains Rates – Top Rate Goes to 25% (From 15%)

THE BRACKETS					
	S	MFJ/QW	MFS	HOH	T&E
0%	\$40,400	\$80,800	\$40,400	\$54,100	\$2,650
15%	\$400,000	\$450,000	\$225,000	\$425,000	\$12,500
25%					

Effective Date: Date Bill Is Introduced

Source: House Ways & Means Committee Draft Legislation

Individual Income Tax Rates

Punchline: They Are Going Up at The Top End

Net Investment Income (NIIT) Expansion – 3.8% “Obamacare Tax”

Proposed NIIT Threshold	
Married Filing Jointly (MFJ)	\$500,000
Head of Household (HoH)	\$400,000
Single	\$400,000
Married Filing Separately	\$250,000
Estates & Trusts	\$12,500

- **If above income thresholds are reached, proposal calls for NIIT to cover “income derived in the ordinary course of a trade or business”**
- **Caveat: Would not apply to income on which FICA is already imposed**
- **Strategy/Practical Application for Clients:**
 - **Strategy of paying S Corporation owners small salaries would be eliminated**

Effective Date: After 12/31/2021

Source: House Ways & Means Committee Draft Legislation

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Estates & Trusts	\$12,500

- **If above income thresholds are reached, proposal calls for NIIT to cover “income derived in the ordinary course of a trade or business”**
- **Caveat: Would not apply to income on which Federal Insurance Contributions Act (FICA) Tax is already imposed**
- **Strategy/Practical Application for Clients:**
 - **Strategy of paying S Corporation owners small salaries would be eliminated**

Effective Date: After 12/31/2021

Source: House Ways & Means Committee Draft Legislation

Individual Income Tax Rates

Punchline: They Are Going Up at The Top End

Proposed High Income Taxpayer Surcharge – 3.0%

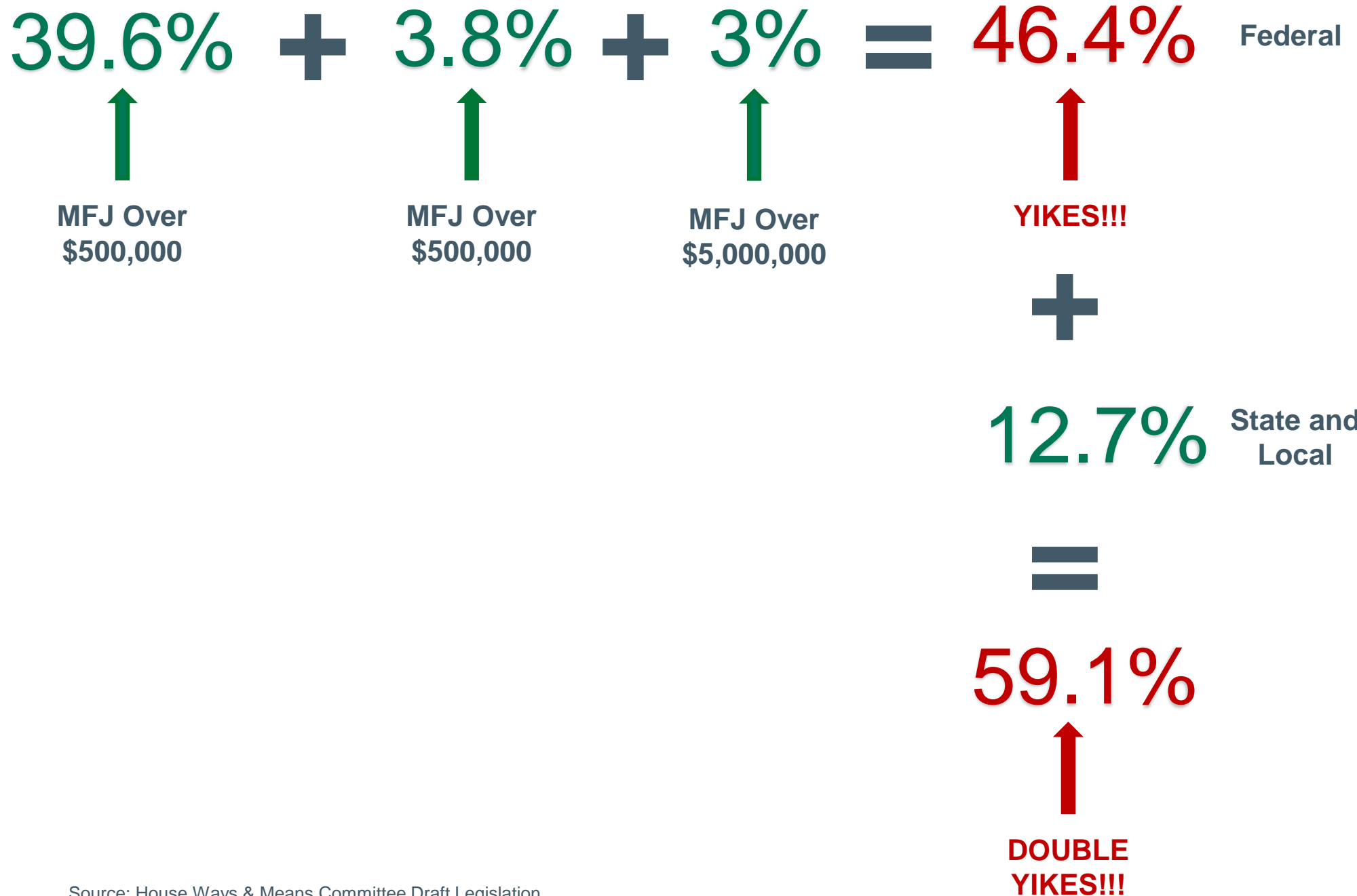
- **High Income Taxpayer Surcharge**
 - Equal to 3% of excessive Modified Adjusted Gross Income
 - Modified AGI threshold = \$5,000,000 generally (\$2,500,000 MFS)
 - Modified AGI threshold = \$100,000 for trusts & estates
 - Modifications to AGI include a reduction for investment interest

Effective Date: After 12/31/2021

Source: House Ways & Means Committee Draft Legislation

Individual Income Tax Rates

So What Really Is The Highest Proposed Individual Income Tax Rate?



Source: House Ways & Means Committee Draft Legislation

Individual Income Tax

Punchline: 199A Deductions Will Be Capped

Section 199A Deduction Limitation

199A Maximum Deduction	
Married Filing Jointly (MFJ)	\$500,000
Head of Household (HoH)	\$400,000
Single	\$400,000
Married Filing Separately	\$250,000
Estates & Trusts	\$10,000

- Imposes a cap on the amount that may be claimed as a deduction

Effective Date: After 12/31/2021

Source: House Ways & Means Committee Draft Legislation

Individual Income Tax

Punchline: Excess Business Loss Limitations to Extend Permanently (Beyond 2025)

Excess Business Loss Limitation

- Originally added as part of the “Trump Tax Cuts” (TCJA), and, accordingly, was set to sunset in 2025
- Limitations on amount of pass-through business net losses that can offset non-business income (Section 461(I))
- Losses limited to \$250,000 (\$500,000 MFJ)
- Proposal would make the limitation permanent

Effective Date: Technically, already in effect, but makes permanent (extends past 2025)

Source: House Ways & Means Committee Draft Legislation

Estate/Gift/GST Tax Exemption

Punchline: It Will Be Cut Approximately in Half (\$11.7M to \$6M (2022))

Estate/Gift/GST Tax Exemption Amount

- **Current Exemption (2021) = \$11,700,000**
 - **Proposed Change = Brings exemption amount back to 2010 (\$5,000,000), and then adjusts for inflation; This would put 2022 Exemption = ~\$6,020,000**
-
- **This is why our lives will be miserable between now and year end; clients with a net worth above \$12 million should consider doing planning before 12/31/2021**
 - **Clients on the high end may be facing a potentially enormous lost opportunity**

Effective Date: After 12/31/2021

Source: House Ways & Means Committee Draft Legislation

Valuation Discounts Under Attack

Punchline: Non-Business Assets (i.e., Family Limited Partnerships (FLPs) with Marketable Securities) Will Not Be Able To Get the Benefit of Valuation Discounts

Valuation Discounts for Non-Business Assets

- **No Valuation Discounts for Non-Business Assets** – Proposed legislation would amend Section 2031 – assets of the entity transferred would be valued as if grantor transferred underlying assets owned by the entity directly to the transferee
 - **Non-business assets:** assets not used in the active conduct of a trade or business; specifically: (i) held for the production or collection of income, and (ii) Not used in the active conduct of a trade or business.
 - **Potential Exception: “Passive assets”** can be treated as business assets if used active conduct of a trade or business
 - **Example:** Real property trades or business in which the transferor materially participates
- **Business Assets Can Still Obtain Benefits of Valuation Discounts**
 - **Business Assets:** assets used in the active conduct of a trade or business
 - **Real Estate Businesses** where grantor materially participates would still qualify
 - **Non-business assets** would need to be subtracted out (except for “reasonably required working capital”)

Effective Date: After Date of Enactment

Source: House Ways & Means Committee Draft Legislation

Grantor Trust Rules Eliminated

Punchline: Non-Business Assets (i.e., FLPs with Marketable Securities) Will Not Be Able To Get the Benefit of Valuation Discounts

Valuation Discounts for Non-Business Assets

- **New Sections Added Through Proposed Legislation**
 - **Section 2901:**
 - Causes grantor trusts to be included in the gross estate of the grantor
 - Deemed gifts for transfers during the life of the owner
 - Deemed gift if grantor trust status is “turned off”
 - Deemed gift if terminated during lifetime (unless returned to the grantor)
 - **Section 1062 would cause transactions between grantor trusts and grantors (or Section 678 Trusts and their deemed owners) to be recognized for income tax purposes**
 - **Note: This effectively overrules Rev. Rul. 85-13**
 - This would eliminate the ability to make installment sales to grantor trusts and Grantor Retained Annuity Trusts (GRATs)
- Existing trusts will be grandfathered so transfers prior to enactment would be allowable.

Effective Date: Trusts Created and Transfers Made After Date of Enactment

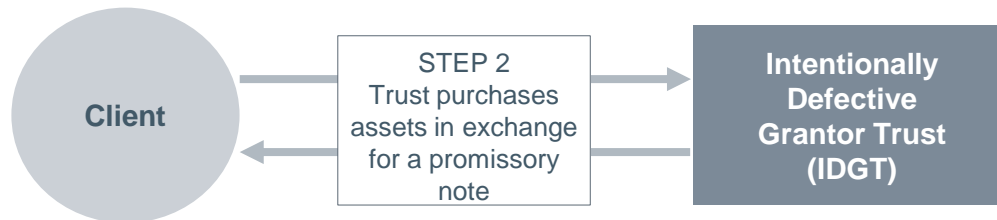
Source: House Ways & Means Committee Draft Legislation

Gift and Sale to Intentionally Defective Grantor Trust (IDGT)



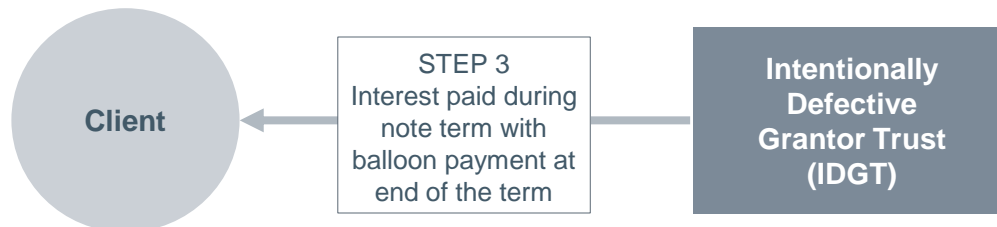
STEP 1: GIFT SEED MONEY

- Use available federal estate tax exemption
- Allocate available GST exemption to the transfer
- Pays no transfer taxes
- Structured as a Grantor Trust; Client pays income tax on all the trust income.



STEP 2: TRUST PURCHASES ASSETS

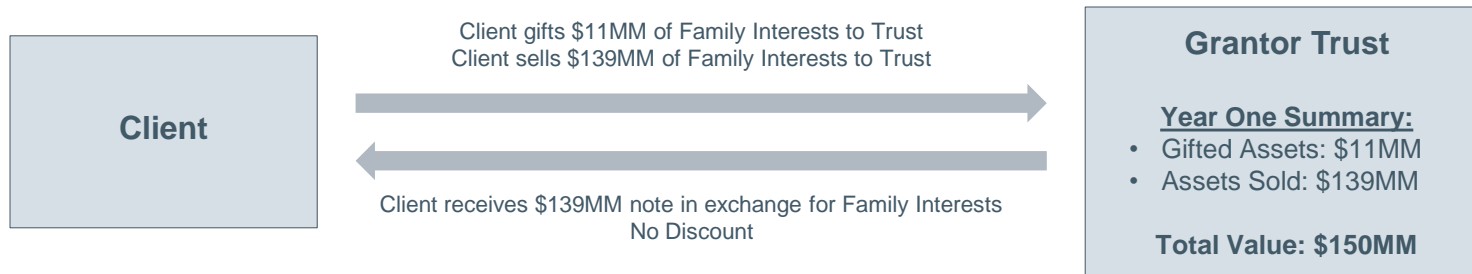
- Sell non-voting interests to trust in exchange for a promissory note
- Gifted seed money secures the Trust's ability to make the note payments
- Valuation discount may be applied for lack of marketability, minority interest and lack of voting control; which may further leverage benefits of strategy



STEP 3: PROMISSORY NOTE

- Trust will pay Client interest on the promissory note for the note term
- All appreciation grows tax free outside of Client's estate.
- At the end of the note term, Client receives a balloon principal payment.
- Assets remain in trust for future generations.

Gift and Sale to IDGT – No Discount Example



	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9
Beginning Trust Value	150,000,000	163,735,100	178,843,710	195,463,181	213,744,599	233,854,159	255,974,675	280,307,242	307,073,067
Income/Growth	15,000,000	16,373,510	17,884,371	19,546,318	21,374,460	23,385,416	25,597,467	28,030,724	30,707,307
Note Interest Payments	-1,264,900	-1,264,900	-1,264,900	-1,264,900	-1,264,900	-1,264,900	-1,264,900	-1,264,900	-1,264,900
Note Balloon Payment									-139,000,000
Year-End Trust Value	163,735,100	178,843,710	195,463,181	213,744,599	233,854,159	255,974,675	280,307,242	307,073,067	197,515,473

Assumptions:

- Client uses basic exclusion and allocates GST exemption to gift
- No transfer taxes paid on gift to trust
- Client is responsible for income taxes
- Calculation assuming an annual growth rate of 10.00% (net of trust fees and expenses)
- Mid-term Applicable Federal Rate (AFR) of 0.91% for October 2021
- Based on an interest only balloon principal note
- Actual trust administration fees depend on structure, value, and applicable fee schedule at such time, and returns will be reduced by such fees.

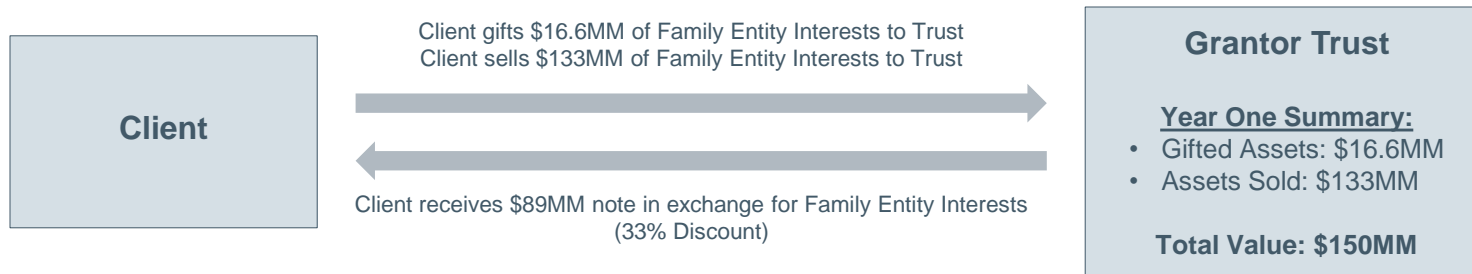
Potential Federal Estate Tax Savings after 9 years:

\$74,606,189

Based upon amount of appreciation that passes free of additional federal gift, estate, and GST taxes (less \$11MM seed gift)

For illustrative purposes only. Calculations from Leimberg's NumberCruncher software

Gift and Sale to IDGT – 33% Discount Example (Using Lack of Control and Lack of Marketability Discounts)



	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9
Beginning Trust Value	150,000,000	164,190,100	179,799,210	196,969,231	215,856,254	236,631,980	259,485,277	284,623,905	312,276,396
Income	15,000,000	16,419,010	17,979,921	19,696,923	21,585,625	23,663,198	25,948,528	28,462,391	31,227,640
Note Interest Payments	-809,900	-809,900	-809,900	-809,900	-809,900	-809,900	-809,900	-809,900	-809,900
Note Balloon Payment									-89,000,000
Year-End Trust Value	164,190,100	179,799,210	196,969,231	215,856,254	236,631,980	259,485,277	284,623,905	312,276,396	253,694,135

Assumptions:

- Client uses basic exclusion and allocates GST exemption to gift
- No transfer taxes paid on gift to trust
- Client is responsible for income taxes
- Calculation assuming an annual growth rate of 6.00% (net of trust fees and expenses)
- Mid-term AFR of 0.91% for October 2021
- Based on an interest only balloon principal note
- Actual trust administration fees depend on structure, value, and applicable fee schedule at such time, and returns will be reduced by such fees.

Potential Federal Estate Tax Savings after 9 years:

\$97,077,654

Based upon amount of appreciation that passes free of additional federal gift, estate, and GST taxes (less \$11MM seed gift)

For illustrative purposes only. Calculations from Leimberg's NumberCruncher software

The Value of Discounting – The Real Lost Opportunity

Punchline: Larger Exemption is Great, but Elimination of Discounting/Grantor Trust Rules Packs a Bigger Punch

Exemption Savings

Discounted Gift/Sale Savings

Exemption Amount
\$11,700,000

Current Exemption

Potential Federal ~~Estate Tax~~ Savings after 9 years:
\$5,974,970
Based upon amount of appreciation that passes free of additional federal gift, estate, and GST taxes (less \$11MM seed gift)

Savings From Straight \$11M Gift



\$2,272,000
(\$4,544,000 if Two)

Estate Tax Savings Differential

\$91,101,684
(\$182,203,368 if Two)

Estate Tax Savings Differential



Exemption Amount
\$6,020,000

Proposed Exemption

Potential Federal ~~Estate Tax~~ Savings after 9 years:
\$97,077,654
Based upon amount of appreciation that passes free of additional federal gift, estate, and GST taxes (less \$11MM seed gift)

Discounted Gift/Sale

Effective Date: After 12/31/2021

Values obtained from slides 16 and 17.

Estate/Gift/GST Tax Exemption

Planning Opportunities

What should clients be doing?

- **DO: Have one spouse utilize full \$11.7mm exemption now before the second spouse uses exemption.**
 - **DO: Do discounted gift and gift/sale transactions involving non-business assets before year-end and discounted gift/sale transactions with business assets prior to year-end.**
 - **DO: Consider using SLATs for at least one spouse, or non-reciprocal SLATs for two spouses**
 - **Note: Reciprocal Trust Doctrine should be considered**
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- **DON'T: Make gifts if amount of gift is not above \$5.5 or \$6 million**

Disclosures

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