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Impact of Potential Biden Administration on Estate and Wealth Transfer Planning

Although the November 3rd general election is months away, the ballot for the presidential race has essentially been set for some time, with former Vice President Joe Biden and President Donald Trump each poised to become the official nominee of his respective party this August. While the economic impact of the COVID-19 pandemic is the major focus of fiscal conversation, a potential Biden administration could also result in sweeping changes to the existing income and transfer tax landscapes.

While tax legislation necessarily originates in Congress, Biden has laid out a number of tax reforms that he would make a priority if he wins in November. Many of those proposals would significantly impact current estate and wealth transfer planning opportunities.

Current Law

Under current law, each individual has $10 million of unified credit exemption, which can be used to transfer wealth during life (gifts) and at death (estate) without paying a 40 percent gift or estate tax. As of 2020, this $10 million exemption has been adjusted for inflation to $11.58 million per person.

Prior to the Tax Cuts and Jobs Act (TCJA) enacted at the end of 2017, the exemption was $5 million per person, as indexed for inflation. The doubled exemption under the TCJA is scheduled to revert to $5 million per person as of January 1, 2026 (again, as indexed for inflation). It is expected that the $5 million exemption will be adjusted for inflation to approximately $6.5 million per person at that time. This means that regardless of who is elected president in November, additional legislation will be needed to extend the $10 million exemption beyond December 31, 2025.

The TCJA also decreased personal income tax rates, reducing statutory tax rates at almost all levels of taxable income. For example, prior to the TCJA, personal income of $480,050 and over for a married couple was taxed at 39.6 percent. The TCJA moved the top tax bracket from $480,050 to $600,000, and lowered the top tax rate to 37 percent. The favorable individual income tax brackets are also set to expire at the end of 2025 and revert to pre-TCJA law for 2026 and beyond.

Unlike ordinary income, which is taxed at the personal income tax rates discussed

POSTED:

Aug 3, 2020

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above, capital gains have historically been taxed at much lower rates. For example, long-term capital gains and qualified dividends are taxed at either 0, 15 or 20 percent depending on the individual's level of income.

In addition, capital gain property receives a stepped-up basis if inherited at death, which greatly reduces and often eliminates any capital gain tax paid by the individuals who inherit the property. For example, if Mom paid $500 for shares of Apple stock that have increased in value to $3,000, she would pay tax on $2,500 of capital gain if she sold the stock during her lifetime. If Mom instead leaves the Apple shares to Son at Mom's death, Son receives a stepped-up basis of $3,000 and can sell the shares at Mom's death for no gain at all. If Son holds the shares after Mom's death and subsequently sells them for $3,500, he would pay capital gain tax on the $500 of appreciation occurring between Mom's death and the sale of the shares. Note that the stepped-up basis rule applies even if Mom's estate is not subject to estate tax.

Biden's Tax Proposals

Estate Tax: Biden has not officially endorsed a policy aimed at increasing the estate tax, however, the estate tax is often seen as "low hanging fruit" for any administration looking to tax the wealthy to fund policy initiatives. For example, Senator Bernie Sanders has proposed reducing the unified credit exemption from its current level of $11.58 million to $3.5 million per person, which was the amount last seen in 2009. From a planning perspective, this means that any transfers in excess of $3.5 million ($7 million per married couple) would be taxed at 40 percent (or possibly a higher rate depending on the specifics of a future proposal).

Individuals and families who may be subject to an estate tax in the future (by virtue of the 2025 TCJA unified credit exemption sunset or post-election tax law changes) should strongly consider making lifetime gifts to trusts now to ensure that the amounts can be transferred tax-free. Under current law, if a donor makes a gift of $11.58 million in 2020 and consumes all of her or his available unified credit exemption, the "bonus exemption" provided under the TCJA cannot be taken away from the donor even if the exemption amount drops in 2026 (or earlier). In addition, any post-transfer appreciation occurs outside of the donor's taxable estate and can pass tax-free to future generations in perpetuity. Several creative solutions are available to families who wish to use this bonus exemption this year or in early 2021 to lock in the current exemption regardless of future tax law changes. Reinhart’s Trusts and Estates Team is well versed in these tax-planning strategies.

Wealth Transfer: Biden has suggested that he will seek to eliminate the favorable income tax rules that currently apply to capital gain property inherited at death. The specific details of his plan remain to be seen, however, Biden has proposed: (a) ending the basis step-up rule currently in effect; or (b) taxing unrealized capital gains at death (unless the assets are left to a surviving spouse or charity). While both of these proposals take aim at the current rules, they do so in slightly different ways.

Eliminating the basis step-up rule means that a beneficiary of an asset would receive the same basis in the asset as the prior owner. In the example above, Son would receive Mom's Apple shares with a basis of $500 and a value of $3,000. If Son subsequently sells the shares for $3,500, he would pay capital gains tax on the $3,000 of appreciation. Alternatively, taxing unrealized capital gains at death treats an individual's death as a deemed sale of an appreciated asset. For example, at Mom's death, she would be treated as selling her Apple shares for $3,000 and her estate would realize $2,500 of capital gain. This appreciation might be taxed at ordinary income rates, rather than capital gain rates, under the proposed capital gain tax rate changes (see below).

Individual Income Tax: Biden has also called for increasing personal income taxes by rolling back the TCJA rate reductions for taxpayers with incomes in excess of $400,000. A Biden administration would also aim to tax capital gains and dividends at ordinary income tax rates for taxpayers with incomes above $1 million, a significant increase from the current 0, 15 and 20 percent brackets in effect now.

Importance of Planning Now

While the specifics of Biden's tax proposals remain to be fleshed out and the post-election composition of Congress is far from certain, there is a risk that the tax laws will be less taxpayer-friendly under a Biden administration. Even if President Trump wins a second term, the favorable estate and some of the income tax laws described above will sunset at the end of 2025, absent further legislation. With these legislative changes on the horizon, and the opportunity to transfer wealth at depressed values and low interest rates, it is more important than ever to consider additional planning.

If you would like more information regarding estate planning opportunities and strategies, now is the time to contact your Reinhart attorney or a member of Reinhart's Trusts and Estates Practice. As an additional resource, our colleague, Greg Monday, has posted further thoughts on this subject on his family business blog.

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