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Tax Changes Coming? Planning Strategies for High Net Worth Households That Could Benefit You Now

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The House Ways and Means Committee has proposed new tax legislation related to the potential **new infrastructure** plan. The changes result in increased taxation on high-income earners and corporations.

The most significant potential changes for ultra-high net worth families are focused on gift and estate tax laws and strategies. **In this column, we'll cover the lifetime exemption, grantor trusts, valuation discounts, income tax changes, and changes that could affect your retirement planning.**

Lifetime Exemption

The maximum amount which an individual can pass free of gift and estate taxes is currently $11.7 million, or $23.4 million for a married couple. This amount is called the lifetime exemption and is scheduled to revert to $5 million, indexed for inflation, in 2026. Under the legislation put forward, this amount will reduce to $5 million plus inflation effective January 1, 2022. The simple example below may better illustrate the impact:

Current Tax Law		Proposed Tax Law	
Total Net Worth	$25,000,000	Total Net Worth	$25,000,000
Lifetime Exemption	($23,400,000)	Lifetime Exemption	($12,000,000)
Taxable Estate	$1,600,000	Taxable Estate	$13,000,000
Federal Estate Tax Liability (40%)	**$640,000**	**Federal Estate Tax Liability (40%)**	**$5,200,000**

Ultra-high net worth families may wish to consider using their lifetime exemption before it is reduced at the end of the year, should legislation pass.

Grantor Trusts

In addition to the reduced lifetime exemption amount, many estate planning **strategies common** among ultra-high net worth families will be impacted**. Under the proposed legislation, grantor trusts will be included in the taxable estate if the deceased is deemed an owner of the trust. The provision also treats the sales between grantor trusts and their owner as sales to a third party.**

The tax advantages of Grantor Retained Annuity Trusts (GRATs) would be eliminated under the planned legislative changes. GRATs allow the grantor to place assets in a trust, receive distributions based on the contributed value for at least two years, then pass the remaining growth tax free. Under the proposed law, assets will either fall back into the grantor's taxable estate and be subject to estate taxes or pass to beneficiaries and be deemed a taxable gift.

Intentionally Defective Grantor Trusts (IDGTs) would also lose their tax advantages if the new legislation is passed. IDGTs allow the grantor to remove an asset from their taxable estate while still maintaining the income tax liability. The income tax payments made by the grantor reduce the tax drag typically associated with non-grantor trusts.

Other grantor trusts whose benefit may be limited include:

- Spousal Lifetime Access Trusts (SLATs)
- Irrevocable Life Insurance Trusts (ILITs)
- Qualified Personal Residence Trusts (QPRTs)

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You may wish to talk with your client advisor about your grantor trusts in light of these potential changes.

Valuation Discounts

Ultra-high net worth families often transfer assets into a family limited partnership (FLP) before gifting a non-voting, minority interest to their children at a discounted value. The non-controlling interest is often discounted between 15-35% depending on the assets transferred. Under the proposed legislation, valuation discounts are disallowed for passive, non-business assets.

Most of the potential changes to grantor trusts and valuation discounts begin on the date that the new law is enacted, likely before the end of the year. With this in mind, ultra-high net worth families that would like to utilize grantor trusts or valuation discounts may wish to consider immediate implementation.

Corporate, Individual and International Income Taxes

Other proposed changes focus on corporate and individual income tax rates, international taxation, and retirement planning. Some of the more relevant changes include:

- Top ordinary income tax rate of 39.6% (up from 37%)
- Top long-term capital gains income tax rate of 25% (up from 20%)
  Unlike other proposed changes that begin on January 1, 2022, changes to long-term capital gains rates are effective as of September 13, 2021. A transition rule allows the existing 20% rate to apply to gains that arise from transactions entered into before September 13, 2021, pursuant to a written contract.
- A new 3% surtax on adjusted gross income over $5 million

Proposed Top Ordinary Rate		Proposed Top LTCG Rate	
Federal Income Tax	39.60%	Federal Income Tax	25.00%
Net Investment Income Tax	3.80%	Net Investment Income Tax	3.80%
Wealth Surtax	3.00%	Wealth Surtax	3.00%
Max Ordinary Rate	**46.40%**	**Max Long-Term Capital Gains Rate**	**31.80%**
Current Top Ordinary Rate	**40.80%**	**Current Top LTCG Rate**	**23.80%**

- Expansion of the 3.8% net investment income tax to include the net investment income derived in the ordinary course of a trade or business (excludes wages)
- Top corporate tax rate of 26.5% (up from 21%)
  A graduated structure has been proposed based on income. The structure is phased out if income exceeds $10 million.
- Qualified Business Income (QBI) deduction limitations dependent on income
- Limit the Qualified Small Business Stock (QSBS) exclusion to 50% dependent on income. Effective on all sales occurring on or after September 13, 2021
- Permanently disallow deductions for business losses (those that exceed business income) in excess of $500,000
- Subjecting digital assets to wash sale rules. The wash sale rule states that if a security is sold at a loss and repurchased within 31 days, the prior loss will be disallowed.
- Changes to carried interest holding period requirements for preferential tax treatment to five years (up from three years)
- Corporate foreign earnings tax rate of 16.6% (up from 10.5%)

Retirement Planning

Proposed changes that can affect retirement planning include:

IRA contributions prohibited if combined retirement balance exceeds $10 million

- Mandatory 50% minimum distribution on retirement balance exceeding $10 million
- Mandatory 100% minimum distribution on retirement balance exceeding $20 million
- Removal of “back-door” Roth IRA conversions dependent on income

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The proposed legislation did not mention changes to the “step-up” in basis at death, increases to the federal gift and estate tax rate of 40%, and the expansion of the $10,000 SALT deduction cap. These items may be included at later dates.

While the suggested legislation will no doubt be subject to further revisions, we recommend a discussion of your financial plan with the possible impact of these proposals in mind. We welcome the opportunity to consult with you in this regard, in full partnership with your estate counsel and tax professional.

Find out which tax-planning strategies may be valuable to you prior to year-end.

Disclaimer: The information presented here is not specific to any individual’s personal circumstances. Each taxpayer should seek independent advice from a tax professional based on his or her individual circumstances. This information may change at any time without notice.

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