2020 Tax Update

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Presenter – Kevin Sell, CPA

Kevin worked at several other big accounting firms in Spokane before joining HMA in 2009. He is president of the firm, a former board member of the Washington Society of CPAs, and formerly on several AICPA Tax Committees. A Past President of the Spokane Estate Planning Council, he has been an adjunct instructor at Gonzaga University's Masters of Taxation program for the past 10 years. He specializes in helping closely held business owners and high net worth individuals with tax and estate planning. For fun, Kevin likes to run, mountain bike, golf, spend time with his family and quote old movies.

Agenda

- Current State of Estate Tax Planning
- Recent developments
- Secure Act
- Cares Act
- New Stimulus Bill – CAA, 2021
- Biden's Proposed Tax Plans
- Top Ten Planning Ideas
- Questions and Answers

Current State of Estate Tax Planning

- The best of times, and the worst of times:
  - Federal Exemption rate - $11,700,000 / $23,400,000 (2021), but sunsets after 2025
  - Federal Estate Tax rate – 40%
  - Annual gift exclusion remains at $15,000/recipient for 2021
  - Portability allows for surviving spouse to claim unused spousal exemption
- Maybe not so much for estate planners to do…
  - Washington State estate tax exemption amount is quite low ($2,193,000) and is now not indexed, and highest state rate in the country (max 20%)
  - Basis step up planning is critical
  - Consistent basis rules for taxable estates reported on Form 8971

Recent Developments

- Defined Value Gifts – (*Nelson,* T.C. Memo 2020-81) Careful wording is required for gift instruments – be sure to use "Wandry" type language
- Valuation of closely held business – (*Estate of Jones*, T.C. Memo 2019-101) Allows for tax-affecting of pass-thru entities in determining value for estate and gift tax purposes
- Near death estate planning disregarded – (*Estate of Moore*, T.C. Memo 2020-40) – Family limited partnership and gifts given near death were includible in estate deemed for tax avoidance and continued enjoyment until death
- GRAT term must be fully completed to avoid estate inclusion – (*Badgley*, No 18-16053 9th Cir) Grantor died shortly before 15 year annuity period expired, but still must be included in full at death
- Proposed Regulations under 1.67 and 1.652 on deductibility of various trust expenses as well as year of termination excess expenses and losses

Secure Act

- Setting Every Community Up for Retirement Enhancement Act
- Enactment December 20, 2019
- Changed Age for required minimum distributions (RMDs) from 70 ½ to 72. (Plus, New Life Expectancy Tables for 2022)
- No age limit on IRA contributions as long as you have earned income
- The End of the Stretch - 10-Year Distribution rule unless beneficiary is;
  - surviving spouse,
  - minor child,
  - disabled individual, or
  - individual who is not more than 10 years younger than deceased participant

Cares Act

Coronavirus Aid, Relief, and Economic Security Act

- $2.2 Trillion stimulus bill, Passed March 27, 2020
- Waiver of required minimum distribution rules for 2020 only
- $300 of cash contributions deductible even if don't itemize
- Individual cash contribution limitation modified from 60% of AGI to 100% of AGI
  - Stacking Allowed – qualified cash contributions taken last
  - Can elect which qualified cash contributions to treat as eligible for 100% limit

Cares Act (Continued)

Charitable Contribution Stacking Example

- Taxpayer has 2020 AGI of $150,000, with a carryover of $75,000 of 50% limitation charitable contributions from 2017, deductible state taxes of $10,000 and mortgage interest of $30,000.
- Limit for carryover contributions $150,000*50%= $75,000
- 2020 Cash contributions of $35,000 will zero out taxable income
- $150,000-75,000-10,000-30,000 -35,000 = $0
- If more cash contributions than needed, can elect not to treat as qualified for the 100% limit and carryover to future year.

Consolidated Appropriations Act, 2021

- 100% Deductibility of certain business meal expenses through 2022
- $300 cash charitable contribution for nonitemizers extended to 2022, but up to $600 MFJ
- Modification of limitations on charitable contributions extended through 2021
- Reduction of Section 7702 interest rate on permanent life insurance policies from 4% to 2% for 2021 and floating thereafter
- Allows distributions from 401k plans for employees who are still working, if over 59 and ½
- Individuals allowed to deduct medical expenses that exceed 7.5% of AGI permanently, and roll over unused FSA amounts into 2021 and 2022

CAA, 2021- continued

- Clarifies deductibility of PPP funded expenses
- Second draw for PPP loan for qualifying businesses

- Employee retention tax credit extended through June 30, 2021
- Refundable payroll tax credits for paid sick and family leave extended through March 31, 2021
- Five-year extension of Sec. 51 work opportunity credits
- Two-year extension of Sec. 25D residential energy-efficient property credit
- One-year extension of Sec. 163(h) treatment of qualified mortgage insurance premiums as qualified mortgage interest

Biden’s Proposed Tax Plan

- Corporate income tax rate increase from 21% to 28%
- Top individual rate increase from 37% to 39.6%
- Capital gains taxed as ordinary income for taxpayers with over $1 million in income (and potentially no basis step up)
- Repeal of section 199A QBI deduction for those making more than $400,000
- Additional social security taxes on wages or SE income if over $400,000 (creating a “donut hole”)
- Make 1031 exchanges ineligible for taxpayers with income over $400,000
- Reduce benefit of itemized deductions to no more than 28%, and returning to phase out above $400k

Other Democrat Proposals

- 15% Minimum Corporate Tax on Book earnings
- 4% (or higher) Individual Wealth Tax – based on net worth
- Capital Gains tax on unrecognized gains
- No FMV basis step up at death
- Limiting GRAT terms to at least 10 years
- Lowering estate exemption amount to 2009 - $3,500,000 and gift limits to $1,000,000
  - What about prior gifting in excess of lower threshold?
  - IRS adopted final Regulations indicating no “clawback”

Top 10 Planning Ideas

- Gifts – Consider any assets with a depressed current value (hotel, airline stock) with expected higher value in the future. Keep all future appreciation out of your estate.
- Gift to an Intentionally Defective Grantor Trust (IDGT) – Along with removing appreciation from your estate, payment of the IDGT's income taxes by the grantor is not a taxable gift and can help reduce your estate.
- Loan to an IDGT – The IDGT's investment return above the interest rate (AFR Jan 2021 on long-term loan is 1.35%) on the note is excluded from estate.
- Renegotiate Intra-Family Loans – AFR may now be significantly lower. Consider renegotiating the terms to reduce the interest rate to incur less interest income adding to estate.

Top 10 Planning Ideas - continued

- Lend Money to Irrevocable Life Insurance Trusts (ILITs) or renegotiate existing loans – Consider lending funds instead of making taxable gifts to an ILIT.
- Grantor Retained Annuity Trust (GRAT) – If GRAT succeeds, any appreciation above the returned annuity passes to the remainderman gift and estate tax free. If you do not survive the term, the assets in GRAT are included in your estate.
- Sale to an IDGT – Sell an asset to an IDGT for an installment note bearing interest at AFR. Freezes value in your estate by converting an appreciating asset to a fixed income instrument. Only the unpaid balance of the note is included in your estate.

Top 10 Planning Ideas - continued

- Exercise “Swap” Powers in an IDGT – Assets previously sold to the IDGT was highly appreciated at that time with a low basis, but now may have lost value. Use swap power to pull out and replace with an asset with a more promising future.
- Charitable Lead Annuity Trust “CLAT” – Works well when interest rates are low. Income stream paid to charity for a specified number of years or your lifetime, or both. Assets in the CLAT pass to children or trust for their benefit at the end of the trust term.
- Roth IRA Conversion – Convert and pay tax with funds outside the ROTH if you are able to let it incubate five years and you are 59 ½ or older. No RMD and tax free forever.

Questions?

THANK YOU!

Please reach out if any questions.

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