# Potential Planning Impacts of Recent Tax Proposals

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# American Families Tax Plan Looks to Personal Taxes to Cover Costs

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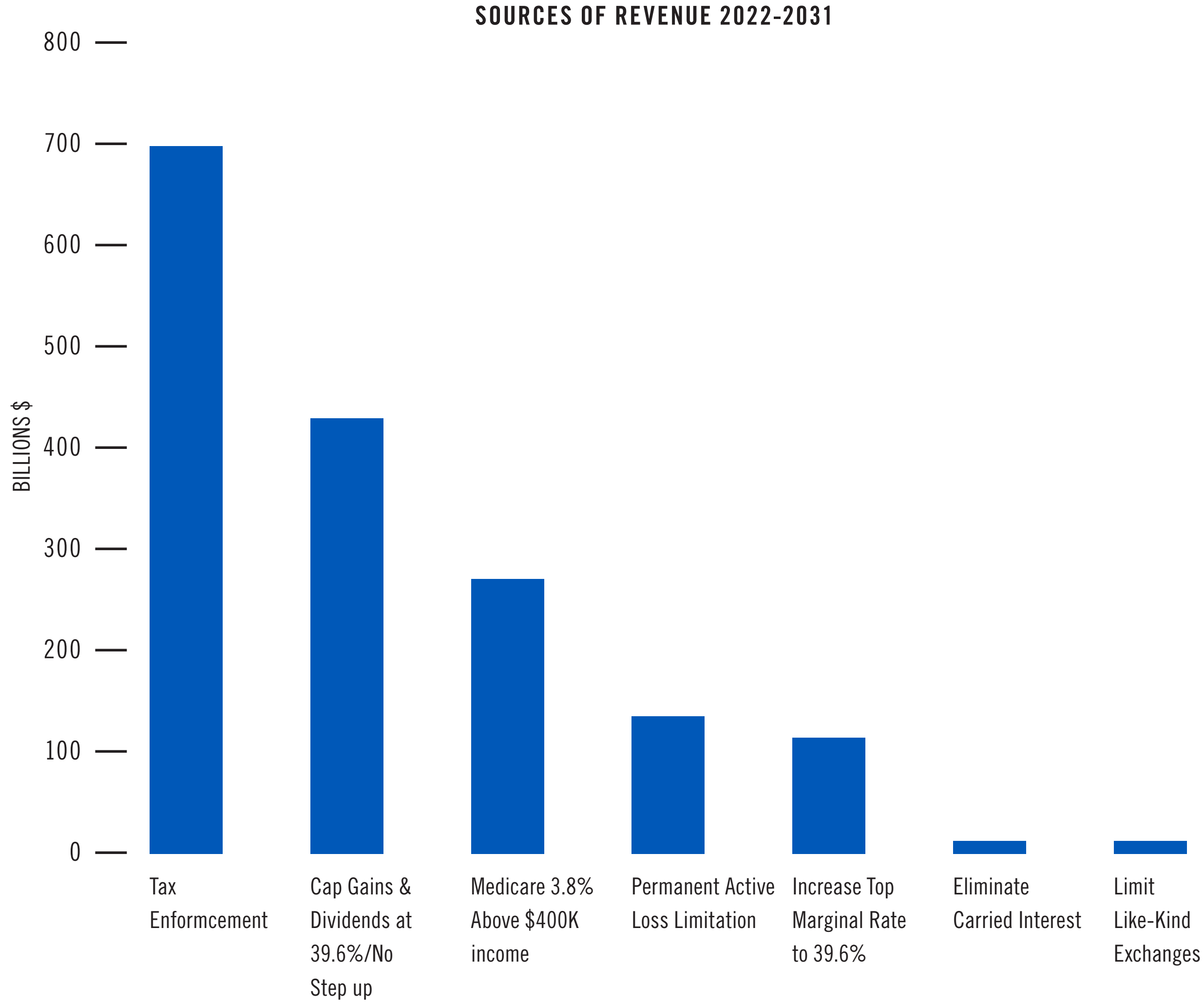
| **Increase Top Marginal Tax Rate** | • Increase top marginal rate from 37% to 39.6%<br>• Restores top rate to pre-2017 level |
| **Tax Capital Gains and Dividends at Top Rate** | • Applies to households with annual income over $1 million<br>• Nearly doubles rate on affected households |
| **Eliminate Cost Basis Step Up at Death** | • Likely triggers capital gains bill at death for gains in excess of $1 million<br>• Protections promised for family-owned farms and businesses, but both estate and capital gains taxes could be triggered |
| **Expand 3.8% Medicare Tax Application** | • Expands the existing 3.8% surtax on investment income to broader categories of income. Applies to higher income earners |
| **Permanent Active Loss Limitation** | • Limits the amount a noncorporate taxpayer can deduct in losses from pass-through entities. Was enacted in 2017 and set to expire 2025 |
| **Close Carried Interest** | • Applies to general partners of private equity and hedge funds<br>• Would change treatment from capital gains to ordinary income |
| **Restrict Like-Kind Exchanges** | • Would limit amount of deferral on 1031 real estate exchanges to $500,000 |
| **Enhanced Enforcement** | • Allocates $80 billion in extra funds to IRS to expand audits and enforcement on high income individuals as well as corporations |

Note: These are approximate cost estimates based on one interpretation of the proposal

# Expected Tax Enhancements May Be Different Than Headlines

- The increase in the top marginal tax rate has captured much attention, but is expected to have much smaller revenue impact than other items.
- The single largest increase in tax revenue is tied to enhanced tax enforcement. Generally these funds would not be deemed scoreable savings by the Congressional Joint Committee on Taxation. This potentially limits the legislative alternatives for the proposal.
- Changes in Estate and Gift Tax exemptions were not included in the proposal. It is possible that such items might be introduced at a later date, potentially as a substitute for one of the items enumerated.
- Absent other action, however, the current estate tax exemptions are set to sunset at December 31, 2025 and will return to Obama-era levels which are projected to be about $6 - $7 million in 2026. In addition, maximum estate and gift tax rate would increase from 40% to 45% at that time.




Note: These are approximate revenue estimates from sources proposed in the American Families Plan, based on White House data and third-party research.

# Strategies for Increased Income Tax Rates

If passed, the increase in the top marginal rate from 37% to 39.6% would impact individuals earning $452,700 and married couples earning more than $509,300. In addition, the expanded 3.8% Medicare tax on earnings could bring the top tax rate to 43.4%. Here are some strategies you may want to discuss with your CPA to help reduce this tax burden if you are impacted:

- Consider **accelerating income** in 2021 to avoid additional taxes when rates go up.
- Reduce taxable income by allocating a portion of investments to **municipal bonds**.
- **Establish pensions for business owners** to allow deferral of income into a qualified retirement plan.
- Consider a **Roth IRA Conversion**. Roth conversions accelerate the income tax of the IRA assets and allow them to grow tax-free.
- Consider **funding your charitable gifts** with your required minimum distribution directly from your Traditional IRA to reduce your taxable income.
- Married Couples with similar incomes should **review filing status** to determine if they are subject to the "marriage penalty" which occurs when couples pay more taxes together than individually.

# Strategies for Increased Capital Gain Rates

In addition, the proposal to treat capital gains as ordinary income for taxpayers with taxable income over $1 million would almost double their tax rate from 20% to 39.6%. Adding the 3.8% Medicare tax rate, the long-term capital gains rate could be 43.4%. While a small percentage of taxpayers earn over $1 million, there are a few strategies that top earners may want to discuss with their tax advisers to help limit this tax increase.

- Consider funding your **charitable and annual gifts** with assets that have unrealized capital gains instead of cash.
- **Asset Replacement Trust** strategies may also be beneficial. Consider gifting low basis assets to a charitable trust. The trust income then pays the premium on a permanent life policy which can provide income tax free death benefit to replace the assets going to Charity..
- Review income planning strategies with your CPA for possible ways to **reduce annual income below $1 million**.

## Strategies to Reduce Capital Gains at Death

The tax proposal also eliminates the long time tax benefit of a step up in basis for unrealized capital gains in excess of $1 Million. This may be the most impactful change and careful estate planning with your trusted advisor is crucial. Here are some strategies that may be beneficial.

- Creating an **Irrevocable Trust** that transfers property and can still provide an income stream.
- Creating a **Charitable Trust** that provides an income stream for yourself or loved ones while living and benefits a charity at a future date or death.
- Funding an **Irrevocable Life Insurance Trust (ILIT)** can provide death benefits that are income and estate tax fee. The benefits could be used to offset higher capital gains on illiquid assets and/or provide additional assets to heirs.
- **Life Insurance Retirement Planning (LIRP)** allows you to purchase cash value life insurance that can provide a tax-favored income stream during life and/or income tax-free death benefits to your heirs.
- Using a **Grantor Retained Annuity Trust (GRAT)** to move assets into a trust where the grantor receives an annuity stream. The asset then passes to the remainder beneficiary and out of the grantor's estate when the trust terminates.
- Using a sale to an **Intentionally Defective Grantor Trust (IDGT)** allows a transfer of assets to a trust and out of the grantor's estate. The grantor continues to pay income tax on any income generated by the asset within the trust.

## Commonly Used Estate Planning Strategies

While changes to the current Estate and Gift Tax Exemption level are not included in the current proposal, there continues to be discussions around a possibly reduction from $11.7 million to as low as $3.5 million per person. As it stands, the current exemption is set to sunset in 2025 and will return to Obama-era levels which are projected to be about $6 - $7 million in 2026. In addition, maximum estate and gift tax rate would increase from 40% to 45% at that time. If these changes or something similar become effective, many clients will need to re-address their current planning.

It's important to remember that Estate Planning is more than having a will. With uncertainty around tax law changes, there are many commonly used planning strategies that individuals with estates of all sizes should consider to reduce taxes:

- Lifetime gifting up to the annual exclusion amount ($15K for 2021) is one way to start passing along assets to your heirs.
- In addition, paying qualified education or medical expenses directly to the provider is also a way to help reduce your taxable estate.

Consider discussing with your legal and tax advisers if any of these strategies or options are right for you.

## Expenses that Reduce an Estate

**Medical** | **Qualified Education** | **Lifetime Gifting**

# How Hancock Whitney Can Help

It's important to start preparing now. Many of these strategies have to be in place well before you pass away and certainly before any new tax legislation is passed. It's important that you begin conversations now to determine the plan that is right for you. Hancock Whitney is here to help guide you through that process.

- Hancock Whitney has provided trust and fiduciary services since 1935 and will work closely with your attorney to ensure that any trust will meet your wishes. We also have retirement plan specialists that can assist with solutions that work best for you and your business.

- In addition, Hancock Whitney offers many asset management solutions such as Tax Loss Harvesting, a Tax Aware Investment Strategy as well as a Municipal Fixed Income Strategy that can assist in managing your tax situation.

- Most importantly, we provide financial and estate planning solutions that help clients identify and establish goals, assess where there are today, and plan for the future.

Our team is ready to help you achieve your financial goals.

Sources:

White House Fact Sheet, Associated Press, Cornerstone Macro, Strategas Research, Tax Foundation