

## TOP FOUR CONCERNS WE HEAR FROM OUR CLIENTS

We are hearing growing concern from our clients regarding proposed legislation that could have wide-ranging implications if passed. Below are these concerns and ways in which we are addressing them.

### **FEAR #1: INCOME TAXES WILL INCREASE.**

These fears likely came about after the Biden administration shared its American Families Plan, which increases the income tax rate for the top 1 percent of earners—from 37 percent to 39.6 percent—affecting taxpayers with incomes over \$400,000.

#### **Discuss with your financial advisor and CPA the following:**

- Educate yourself about the tax rates, what it means for you, and how to plan should you fall within the affected income tax bracket;
- Make sure you understand the income reduction benefits of contributing to an individual retirement account or 401(k), with which taxes are deferred until you withdraw funds during retirement. Considering the time value of money and the likelihood that you will be in a lower tax bracket in retirement, the income tax savings can be substantial. If you expects a higher tax rate during retirement, you should consider converting existing retirement accounts into Roth accounts;
- Consider gifting income-producing assets. By shifting income-producing assets to your heirs, you reduce not only your taxable income but also the size of your estate for estate tax purposes. In addition to an increase in ordinary income tax rates, there may also be an end to the preferential treatment of long-term capital gains. Business owners or others with appreciated assets may wish to recognize long-term gains now under the preferential rates. Finally, for the charitably inclined person, charitable giving can prove an effective means to reduce income taxes.

### **FEAR #2: THE ESTATE TAX EXEMPTION AMOUNT WILL DECREASE.**

Another common concern among clients is the potential decrease in the estate tax exemption amount. The current federal estate tax exemption amount is at a historical high, impacting less than 1 percent of the US population (\$13.61 million for individuals and \$27.22 million for couples). ***However, this amount is unlikely to last very long. Unless Congress acts, the exemption amount will sunset on January 1, 2026, and revert to \$5 million.*** We could see the amount decrease before that date, as the current administration has indicated that it would support a proposal to reduce the estate and gift tax exemption to \$3.5 million (or \$7 million per married couple).

With these two facts in mind, ***it is no longer if but when the exemption amount will decrease.*** When it does, the federal estate tax will affect a much larger portion of individuals—meaning you may want to rethink your current estate planning strategies.



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- The Tax Cuts and Jobs Act of 2017 doubled the estate and gift tax exclusion amounts for 2018 through 2025. Practitioners were concerned about clawback issues until the Treasury Department and the Internal Revenue Service released final regulations in Treasury Decision 9884 on November 26, 2019, which alleviated those concerns. *The current school of thought is that high net worth individuals should lock into the higher exclusion amounts by completing gifts before the exclusion amounts are reduced either in 2026 or by earlier action of Congress.*
- Consider taking full advantage of the annual gift tax exclusion (\$18,000 for 2024) but also complete gifts either outright to beneficiaries or to irrevocable trusts. By utilizing certain irrevocable trusts such as a spousal lifetime access trust, you potentially could continue to indirectly benefit from the trust if you need funds in the future.
- For clients who have a comfortable amount of assets and do not wish to increase the size of their taxable estate, they may want to consider a grantor retained annuity trust (GRAT), specifically a zeroed-out GRAT, which would allow you to transfer the appreciation on investments without having to use gift tax exemptions.

A NOTE OF CAUTION: As attorneys we cannot predict tax law changes. It is possible that Congress acts and there is no reduction in the estate and gift tax exclusion.

### **FEAR #3: STEPPED-UP BASIS AT DEATH WILL BE ELIMINATED.**

Another reported concern among clients is—no surprise—the elimination of stepped-up basis at death. An asset's value on the day the owner dies currently determines its basis, effectively eliminating income tax on any appreciation that occurred during the owner's lifetime and requiring the owner's beneficiaries to pay income tax on only the appreciation that occurs after the death.

The Biden administration enacted the American Families Plan and proposed therein initially to eliminate the step up in basis at death for gains of more than \$1 million on inherited assets (\$2 million if inheriting from a married couple). The administration refers to this as the “stepped-up basis” loophole and it is once again being looked at in the Biden's budget proposal. This could require beneficiaries to pay additional tax when they sell the inherited asset. Or, the gain could be realized when the asset is inherited, creating an immediate tax liability. With the Millennial and Gen X generations standing to inherit 30 trillion dollars in the coming decades, this change could have far-reaching implications.

- The elimination of stepped-up basis at death and the preferential treatment given to long-term capital gains would be a double whammy. Clients should review appreciated assets to determine whether it makes sense to recognize gains now or, upon their death, pass the gains to their beneficiaries who, in turn, will pay the taxes on the gains. Gifting assets before they appreciate can help alleviate the loss of the benefit of stepped-up basis at death.

It is unknown what Congress will eventually do. Before making any hasty moves, clients should review their entire estate plan and analyze how the elimination of the step up in basis may impact their assets. Please discuss this with your financial advisor and CPA.

#### **FEAR #4: ESTATE TAX RATES WILL INCREASE.**

The top tax rate remains at 37% in 2024. There were tax proposals in Congress that would drop the exemption down to \$3.5 million (transfer at death) and \$1 million (for lifetime gifts), the proposals would increase the tax rates for gifts, estates, and generation-skipping transfers from the current rate of 37 percent to as high as 65 percent. However, at the end of January 2024 a \$78-billion tax legislation package was agreed on and would expand a tax benefit that provides money to parents and restore three popular expired business tax breaks. Stay tuned to see what Congress does.

- Consider zeroed-out GRATs to freeze estate values. Also consider irrevocable grantor trusts. Not only does funding an irrevocable trust reduce the grantor's estate size, but so does paying income taxes. The best way to avoid increased estate tax rates is by reducing your taxable estate.
- Ultra-high net worth clients may wish to take advantage of discount gifting in conjunction with a family limited partnership or a sale to an intentionally defective grantor trust. Discount gifting is a powerful way to reduce the size of a taxable estate, as seen in *Nelson v. Commissioner*, T.C. Memo 2020-81, where the Tax Court permitted multiple layered discounts totaling approximately 60 percent!