



Estate & Succession Planning for the Family Farm

July 22, 2021

**Preview of Coming Estate Tax Law Changes –
How Might Changes Impact your Farm Family?**

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Four Major Pending Changes

- Increase in Income Tax Rate
- Increase in Capital Gains Tax Rate
- Capital Gain Taxation upon Gifts and at Death
- Reduction in the Estate Tax Exemption

THE AMERICAN FAMILIES PLAN

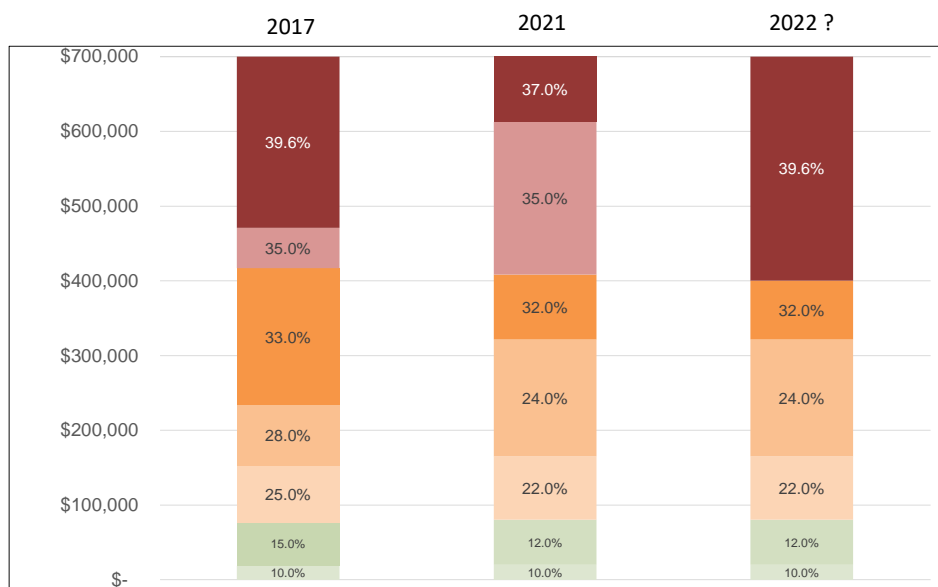
- **Proposal to Restore the 39.6% marginal rate**
 - Would apply to income over \$400,000
 - The threshold by filing status is unclear

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Married Filing Jointly



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Planning for a 39.6% Rate



- Roth conversions
- Gain Harvesting
- Defer loss harvesting
- Defer business expenses

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Capital Gains

- 39.6% rate applied to capital gains over \$1,000,000
- Eliminate the basis “step-up” at death in favor of recognizing gain at death

Objective will be to
“smooth out” income



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Capital Gains

- Proposal to eliminate the preferential rate for long-term capital gains and qualified dividends on income over \$1,000,000**
 - Most significant proposal & a fundamental shift
 - Basically an increase from 20% to 39.6%

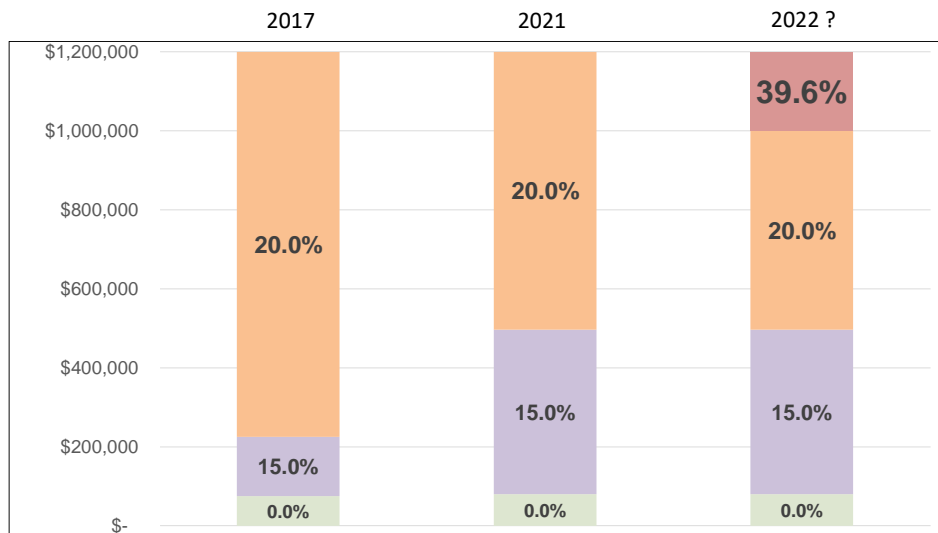
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Capital Gains

Capital Gain & Qualified Dividend Rates



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Capital Gains

Capital Gain Harvesting

- Selling assets for tax reasons generally only shifts when tax is due, not how much is due
- Except if the rate is different year-to-year

Eliminate the “Step-up”

- **Forced recognition of unrealized gains (treated as sold) when assets are transferred at death**
 - \$1,000,000 exemption
 - \$2,500,000 exemption per couple (including principal residence)
 - “protections so that family-owned businesses and farms will not have to pay taxes when given to heirs who continue to run the business”
 - No forced recognition if the property is donated to charity

Legislation proposed in both Houses of Congress

Eliminate the “Step-up”

- **Example**

- Assume a 40% average income tax rate at death
- Assume a cost basis of zero
- Fair market value of \$3,000,000 at death
- About \$1,200,000 of tax due

- These numbers are for easy math, but consider a 60 acre Hamilton County farm located just north of Grand Park purchased in 1960 by Grandma for \$300/acre or total basis of \$12,000.00 – which is now worth \$50,000/acre as housing or \$3,000,000

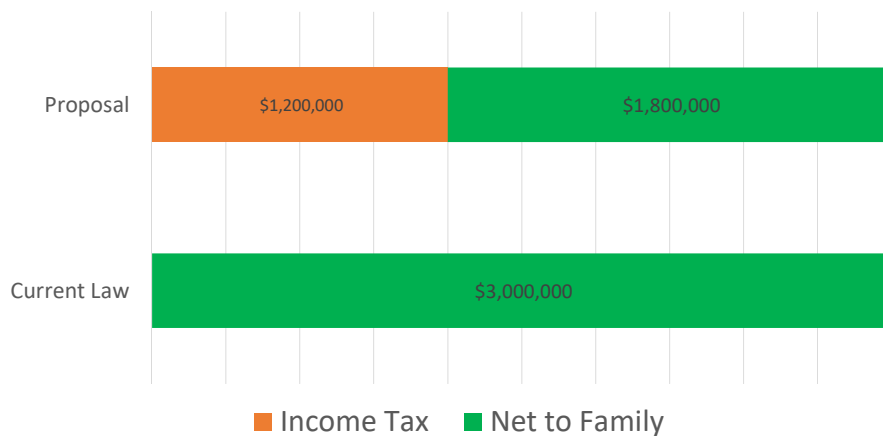
Legislation proposed in both Houses of Congress

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Consider a decedent with an asset valued at \$3,000,000 with a basis of \$0 with a 40% income rate (for easy math).



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Gain Realization at Gift & Death

Details in the Legislation

Basic Proposal to Eliminate the “Step-up”

The Heart of the Issue

- Repeal of carryover basis for gifts
- Repeal of the adjustment of basis to fair market value at death (the step-up)

- Realization of gains at gift
- Realization of gains at death

Introduced Legislation

- **House Bill**
 - Introduced by Mr. Bill Pascrell (D., Nj.)
 - 2022 effective date
- **Senate Bill**
 - Sensible Taxation and Equity Promotion (STEP) Act of 2021
 - Introduced by Mr. Chris Van Hollen (D., Md.)
 - *Retroactive* 2021 effective date
- **Very similar proposals**

Retro-Activity Risk

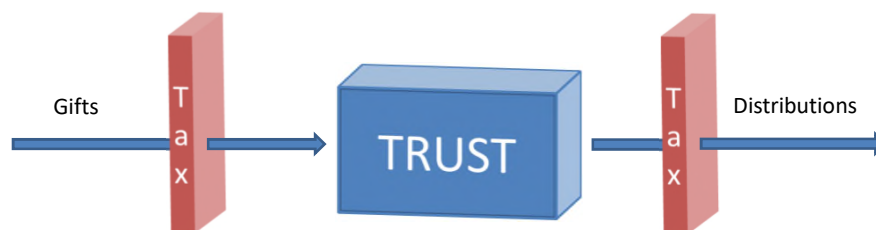
- Congress may have the ability to enact retro-active tax legislation thereby limiting the ability to front-run changes
- Retroactive taxation of transactions is possible if rationally related to a legitimate legislative purpose. *Pension Benefit Guaranty Corporation v. R. A. Gray & Co.*, 467 U. S. 717 (1984); *United States v. Carlton*, 512 U.S. 26 (1994).

Introduced Legislation

- **Exceptions – Common to Both Bills**
 - Certain tangible personal property (scope varies)
 - Transfers to spouses or surviving spouses
 - Gifts and bequests to charity
- **Special Rules for Grantor Trusts – Common to Both Bills**
 - No realization when assets are transferred to a grantor trust
 - However, a realization event occurs:
 - If the trust is included in the grantor’s estate
 - When distributions are made to beneficiaries
 - If grantor trust status is “turned off”

Introduced Legislation

- **Special Rules for Non-Grantor Trusts – Common to Both Bills**
 - Recognition event upon transfer to trust
 - Recognition event upon distribution from trust



Introduced Legislation

- **Special Rules for Non-Grantor Trusts – Common to Both Bills**
 - **Periodic deemed recognition event**
 - House Bill
 - Deemed recognition event for any property continuously held in trust after a period of 30 years
 - Any property continuously held in trust for more than 30 years on January 1, 2022 shall be treated as transferred
 - Senate Bill
 - Deemed recognition event for all property held in trust every 21 years
 - All property held in trust on since December 31, 2005 on December 31, 2026 (21 years)

Exceptions to Forced Recognition

Under Proposed New § 1261

- Spouses
- Certain grantor trusts (e.g. living trust)
- Gifts & bequests to charity
- Tangible personal property not used in a trade or business or for the production of income

Exceptions to Forced Recognition *Under New § 139I*

- \$100,000 gain exclusion for gifts during life

Mom gifts \$250,000 of stock to daughter with a basis of \$120,000. \$30,000 of taxable income is recognized
($\$250,000 - \$120,000 - \$100,000$)

- \$1,000,000 gain exclusion for gifts at death

Mom gifts \$2,500,000 of stock to daughter with a basis of \$1,200,000. \$300,000 of taxable income is recognized
($\$2,500,000 - \$1,200,000 - \$1,000,000$)

Income Tax Planning Ideas *To Manage Capital Gains*

- **Gain Harvesting to avoid a 39.6% tax rate**
- Advanced Security Strategies
- **Charitable Remainder Trusts**
- Charitable Lead Trusts
- Donating Capital Gain Property
- **Installment Sales**
- Opportunity Zones
- Section 1031 Exchanges

CORE
STRATEGIES

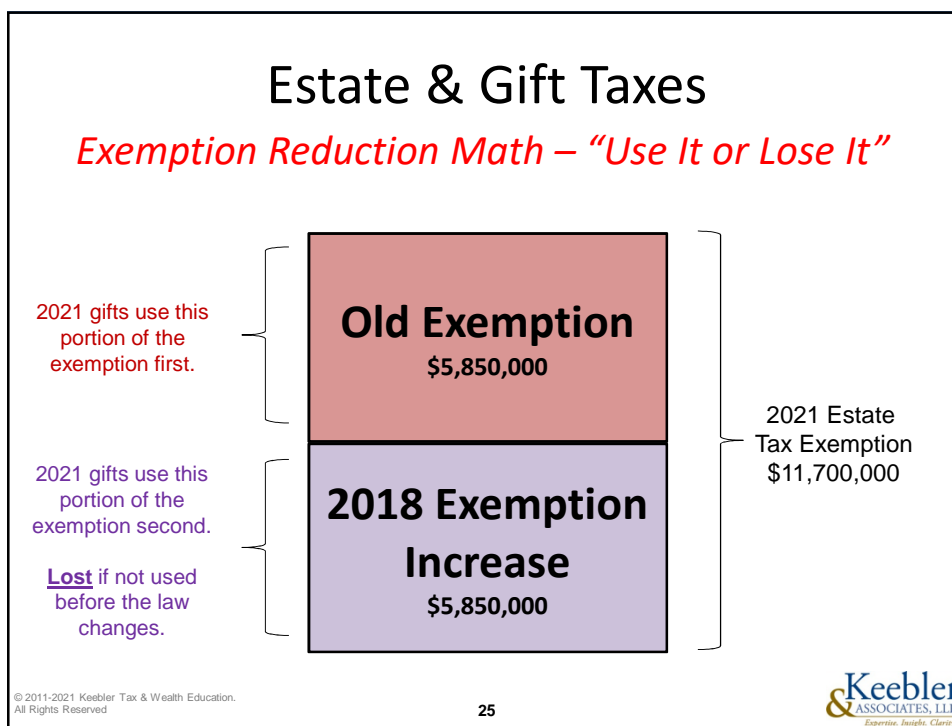
PROPOSED ESTATE TAX REFORMS

Estate & GST Taxes

Current Situation

- The TCJA doubled the Basic Exclusion Amount and GST exemption in 2018-2025 (\$10,000,000 in 2011 dollars)
- In 2026 the exemptions revert to pre-TCJA law (5,000,000 in 2011 dollars)
- Given the success of Democrats in the 2020 election, we expect the exemption to substantially decrease by 2022.

**POTENTIAL
“USE-IT-OR-LOSE-IT”
OPPORTUNITY**



Democratic Estate Tax Policy Proposals

- The Democrats have proposed specific estate tax changes that we must now consider
- Three such proposals are detailed in:
 - The “For the 99.5% Act” in 2021 *and* the “For the 99.8% Act” in 2019 – similar proposals
 - President Obama’s final proposed budget, published in 2016

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Exemption Levels

All Proposals are Similar

- Gift Tax Exemption:
 - \$1,000,000
 - Not indexed for inflation
- Estate & GST Tax Exemption:
 - \$3,500,000
 - Indexed for inflation
 - “Portability” retained

For the 99.5% Act, Section 2(b)

Rate Structure

Proposals

Over	But Not Over	99.8% Act	99.5% Act	President Obama's Final Budget
\$ 3,500,000	\$ 10,000,000	45%	45%	45%
\$ 10,000,000	\$ 50,000,000	50%	50%	45%
\$ 50,000,000	\$ 1,000,000,000	55%	55%	45%
\$ 1,000,000,000		77%	65%	45%

For the 99.5% Act, Section 2(a)

Effective Date

For the 99.5% Act

The exemption & rate structure is effective to deaths, GST transfers, and gifts made after December 31, 2021

For the 99.5% Act, Section 2(c)

Overview of Specific Changes

For the 99.5% Act

- Significant limits on valuation “discounts”
- Significant limits on Grantor Retained Annuity Trusts (GRATs)
- Eliminating sales to Grantor Trusts
- Eliminating use of Spousal Interest Trusts
- Limiting generation skipping transfer tax (GST) Exempt Trusts to 50 years

Action Items

Action Items

- Discuss impacts of possible legislation
 - Project income tax increase (including taxing capital gains at death)
 - Project estate tax increase
- Make lifetime exemption gifts before enactment
- Consider GST Trusts before enactment
- Fund Spousal Access Trusts before enactment
- Undertake IDGT sales before enactment
- Discuss strategies to smooth taxable income

Questions

Thank You