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Administration Change

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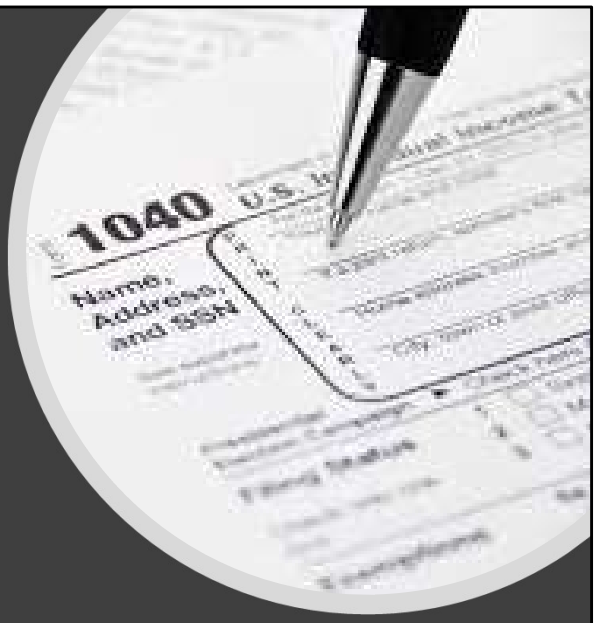
Elections have consequences – especially when they result in the Presidency, the House and the Senate all being controlled by the same party.

One of those consequences of political change is a change in personnel.
In the case of the Biden Administration, Janet Yellen, a for Fed Chairman, will now head up Treasury.
Her position will include being responsible for the direction of the Internal Revenue Service and its administration of the Tax Code.
Secretary Yellen's former role at the Fed is currently being filled by Jerome Powell. To date, he has continued the Fed's role in keeping interest rates low in an effort to curtail inflation.
Gary Gensler and Marty Walsh have been nominated to direct the SEC and the Department of Labor. Recently, both of these organizations have issued directives effecting how financial advisors will interact with their clients.
Lastly, Senator Manchin (D) will be an important vote when it comes to representing the residents of the State of West Virginia.
The perception is that his approach will be more conservative and moderate than other Democratic Senators.
In a 50/50 Senate, his vote may prove to be a swing vote on much of the proposed legislation supported by the White House.
Importantly, this includes any attempt to reform the Tax Code by Congressional action.

Current Tax Structure

- Tennessee Hall Tax – Gone
- Tennessee Estate Tax – Gone
- Tennessee Trust Law!
- Tennessee Asset Protection Laws
- Tennessee Power of Attorney Updates

- Tax Cuts & Jobs Act
  (2017 : effective 2018 -2025)
- SECURE Act – 2019
- CARES Act – 2020
- CRRSA Act – 2020
  (CARES 2.0)



Let's review at some of the recent Tax Law changes that have been passed at the Federal level of recent.
But first, it is important to note that the State of Tennessee has had some significant activity as well.
The tax on investment income, known as the Hall Tax has been phased out altogether.
Our Estate & Inheritance laws was eliminated within the last 10 years.
During that same period TN has been active in enhancing to opportunities to use Trusts in a variety of creative ways.
For instance, the Community Property Trust allows residents to declare that assets in such a trust will be treated as though TN was a community property states, such as California , Wisconsin, Louisiana and a handful of other states. This can be a valuable tool when planning to maximize cost basis adjustment at the death of a spouse.
Other trust such Domestic Asset Protection Trusts and Tenants by the Entireties Trust.
Both allow TN residents the opportunity to provide Asset Protection from creditors.

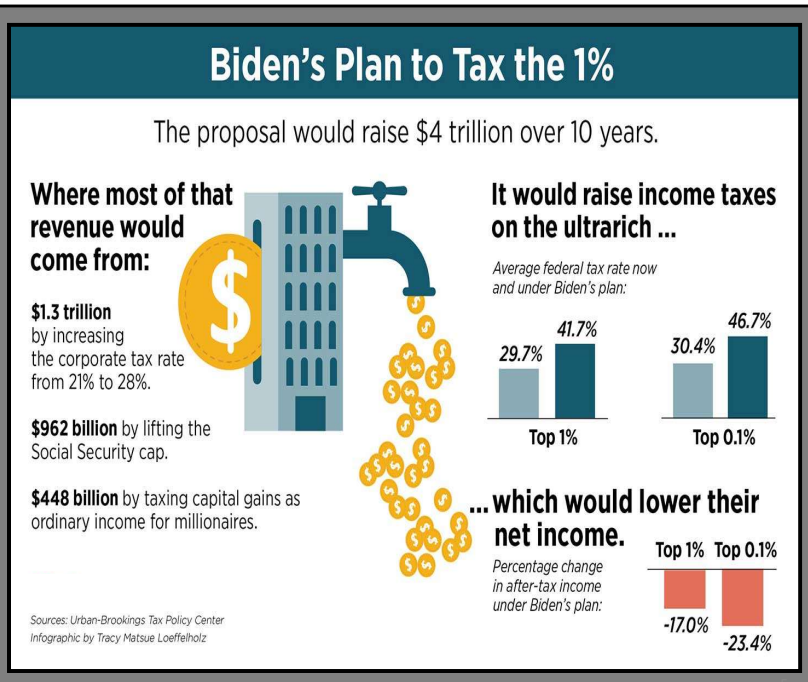
Planning in Transition

- No timetable for proposed legislation
- Blue Wave: 50/50 Senate with House
  - 60 Votes to end debate
  - Filibuster
- Budget Reconciliation Bill
  - No Way to Filibuster
    - 2001 Tax Bill and VP Chaney
    - Janet Yellen – Recovery – then tax reform

One of the central issues of debate around the Biden administration concerns when and if Tax Reform will be proposed and passed into law.
Given the slim majority in the Senate -50/50 + the VP vote – it is doubtful that tax reform will be offered up as a standalone bill.
Instead, as occurred in past administrations, the reform may be cloaked in a Budget Reconciliation act. These are not subject to the filibuster rules, which have been used by the opposing party to derailed proposed legislation in the past.
In the hearings on her nomination to the Cabinet, Janet Yellen responded to the question, *When might Tax Reform be proposed?, by stating* she was under the impression President Biden would want to steer the country toward recovery from the recession that has gripped the US since the appearance of the COVID virus.

Biden's Tax Plan

- Where will most of the tax money come from?



During the campaign and since, President Biden's supporters have consistently said that they would like to maintain most of the rules set out in the Tax Cuts and Jobs Act (2017). The primary change sought will be increasing the C corp tax rate from 21% to 28%. The chart from the Brookings think tank project the revenue expected from that change. The other elements of that chart reflects the other area of focus from the Biden Tax proposals. That is the increased taxation of the highest income earners. Let's look at some of those proposed changes, with an especial focus on those ***earning more than $400,000*** annually.

Biden Tax Proposals

Income & Estate Tax Proposals

HNW & High-Income Earners

- **Cap Gains Tax Rate** (20%)
- **Tax Capital Gains** at ordinary income rates *with income more than $1 million*
- **Eliminate Section 1031 *Exchanges*** for *real estate*
- **Incomes over $400,000** are taxed at top rate)
- **Limits on 401k Tax Benefits**
- **Gift/Estate tax proposals:**
  - *Eliminate the "step up" in basis* at death on capital assets.
  - *Lifetime Exemption returns to 2017* levels, as adjusted for inflation.
    - Roughly, in 2021, $5.7 million/person at 1% COLA.
    - May be lower - $3.5Million /person

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At the moment, short-term capital gains (assets held for 365 or fewer days) are taxed at the ordinary income tax rate, whereas long-term gains are taxed at 0%, 15%, or 20%, depending on a filer's income. The 20% rate is applicable to single and married couples filing jointly with earned income above $441,450 and $496,600, respectively, in the 2020 tax year.

Tax capital gains at ordinary income tax rates for individuals who earn more than $1 million annually.

For business owners generating over $1M in the sale of the business, expect to have earnings ("capital gains") taxed as ordinary income under the Biden plan. Today, capital gains are taxed as income. A capital gain is a profit from the sale of a capital asset, such as a stock or home, from the time that asset is acquired until the time it is sold. Taxpayers pay the difference on the purchase price of the asset ("basis") less the sales price.

Corporate income tax from a flat 21% to 28% and impose a 15% minimum tax on "book income" for entities with net income in excess of $100 million.

Support in general a "**financial transactions tax**" that would impose a tax on the value of security trades. (Specific proposals or rates have not yet been published.)

Social Security payroll tax of 12.4% on wages in excess of $400,000, split evenly between employers and employees. Currently, wages in excess of $137,700 are not subject to such a tax. Currently, wages in excess of $137,700 are not subject to such a Social Security tax.

Eliminate the "step up" in basis to date of death value at least for certain assets, mainly capital assets.

Earning More than $400,000

- Reversion to **Top Tax Rate of 39.6%**
- ***Section 199A*** Phase Out of 20% Deduction once income exceeds $400,000 for pass-thru companies (S corps, Sole Props, Partnerships, and LLCs)
- ***Doughnut Hole*** Implemented
  - *Now:* 12.4% Payroll Tax for Social Security FICA Stops at $137,700
  - *Biden:* No Tax Between $137,700 and $400,000.
  - *Biden Over $400,000* - 12.4% is Reinstated
    - (*Example:* A person earning $425,000 would pay $1,550 more annually, as would his employer.

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The Biden proposals to date have set out that those earning more $400,000 annually may be subject to a change in the tax rules.
Here are a few of those proposals.

Action Items

As with any Tax Planning, you will want to work with your CPA or other tax advisor familiar with your situation before making changes.

- Income Taxation
  - Use the lower tax rates now
  - Establish a Donor Advised Fund (DAF) for ease in "bunching"
- Increased Attention to Tax Diversification
  - Reconsider – *"Defer taxes now. I'll pay lower taxes in retirement"*
  - *Roth, Roth 401k, & Roth Conversion*
  - *HSA*
  - *Cash Value Life Contracts (IRC Section 7702 update)*

The current tax law containing the lowered rates introduced by the Tax Cuts and Jobs Act (TCJA) are still in affect as of March 2021.
There are no proposals in the Congress form the Biden administration currently.
One adage in tax planning is to "…*work with the law as it is… while being aware of might change*…"
As with any Tax Planning you will want to work with your CPA or other tax advisor familiar with your situation.
With that in mind, consider using the lower rates from the TCJA. Accelerate income, especially, if you can stay within the same marginal tax bracket.
If tax rates rise, one way to minimize your taxes is to drive or *"bunch"* your expected deductible items into one year.
As an example, charitable individuals may consider making three years of expected deductible contributions into one year, by contributing to their Donor Advised Fund (DAF). They can then distribute funds from their DAF to favored charities.
Another approach to tax planning, for those who believe that taxes will likely rise in the future, is Tax Diversification.
Here, we are trying to provide a mix of income , especially post-retirement , so that it does not all come form sources that will be taxed as ordinary income.
Ordinary income is taxed at higher rates than capital gains are today. Other accounts,

such as ROTH 401k/IRAs, Health Savings Accounts (HSA), can provide sources of tax free income if the rules surrounding them are met. The same is true when a policy holder accesses the cash value of a life insurance policy. ***Before doing so, make sure to meet with your CPA to understand how your policy works and the impact any loans or withdrawals might have.***

It should be noted that Tax Code Section 7702, which governs the taxation on the cash values in a life policy, has recently been changed. You'll want to assess these changes in respect to how they will affect existing policies and those purchased after its passage.

Action Items

- Estate Tax Planning
  - *Even if I don't have an estate tax problem , I still may be leaving my heirs an income tax problem*
  - No *"Stretch"* for most heirs – 10 years & out
  - Estate document review for Retirement Plan trust
- Gifts and Use of Exemption
  - Continue to Plan
  - Use of Lifetime Exemption
  - Alternative to Gifts – *Intrafamily loans, Split Dollar, Discounted Sales*

Whether ***the income tax law changes*** or not, you need to be aware of changes to Estate & Gift planning.

Already in the law are the changes surrounding inheriting qualified retirement accounts, such as 401k and IRAs.

The SECURE Act set out that the practice of Stretching or continuing the tax deferral on inherited accounts would no longer be available to many non-spouse beneficiaries. Under those rules heirs could opt to use IRS mortality tables to determine what required minimum distribution (RMD) had to be taken from the inherited IRA. They could always take more but had to take at least the RMD each year. The rest of the account continued to grow on a tax deferred basis.

Now those who inherited after the passage of the SECURE Act have only ten (10) years to empty the account. The result could find heirs being forced into higher income tax rates when receiving the distributions.

The Stretch approach was often incorporated into Testamentary Trust planning. Retirement Account holders will want to review, with their attorney, the impact of the SECURE Act has on any Testamentary Trust included in their estate documents. Otherwise, the SECURE Act changes may cause unexpected results within your estate plan.

Lastly, some commentators have suggested that an Estate and Gift Tax reform bill may emerge in 2021. They further warn that it could be made retroactive to as early as 01/01/2021. The fear is that gifts or transfers of assets to heirs, designed to "*use up*" all or a portion of the individual's lifetime gift and estate exemption, might run afoul of this retroactivity. It could result in a portion of the transfer being treated as a taxable gift.

While that view seems to be in the minority, for those who are continuing significant estate planning moves, it should be noted that not every transfer is treated as a gift. That includes intrafamily loans. A variation of a loan approach is known as Loan Regime Split Dollar. It allows the purchase of life insurance for planning purposes, using a loan of premium dollars instead of gifting that same amount. Other approaches include selling assets to family members, often applying appropriate valuation discounts to the item being sold.

2020 Medical Professionals: *Financial Planning Priorities*

- Retirement Planning – 67%
- Personal Risk Management - 63%
- Debt Reduction – 51%
  - $200,000 loan balance
- Tax Reduction – 40%
- Investments
  - Focused on Capital Growth vs Preservation
  - Funds/ETFs/Stocks/Real Estate/Cash

Source: *The 2020 Medical Professionals: Financial Planning Priorities Study*

While tax law changes and planning may be paramount for many, most clients are concerned about more mundane matters.
Regardless of where you might be employed, the discussion seems to focus on several items. Let's take the example of a physician.
When surveyed in 2020, medical professions cited the areas listed here as their principal financial planning focus.
Most listed, as a primary concern, making sure they could retire with sufficient funds.
Many cited debt reduction both personal and practice related.
Do these look like your areas of concern too?
The best way to get a sense of control over them is to have a written financial plan prepared accompanied by on-going financial advice.
That's why our SFP *Wealth Strategies* group is in place. The people there work with your advisor in developing such an approach.
For those of you who are members of the Tennessee Medical Association (TMA) , we are an approved provider of financial planning.


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