Unified Tax Credit:

Planning for the Sunset

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What is the Unified Tax Credit?

- In brief: a tax exemption that allows you to gift your hard-earned assets to beneficiaries, rather than to the government, during life or upon your death
  - …well, at least some of your assets.
  - In 2021, If you are worth over $11.7M individually or $23.4M jointly with your spouse, then the government will graciously accept your taxes.

- The size of your gifts and estate exceeding the above threshold while your living or dead, are subject to a 40% unified tax
- The credit is applied to gifts while you are alive and the value of your estate upon death: if gift $10M during life…any estate/gift value beyond $1.7M more is subject to the tax
- State estate taxes differ. 17 states have an estate tax (levied on the estate) or inheritance tax (levied on the beneficiary). State-level taxes apply in WA, OR, NE, MN, IA, IL, KY, PA, NY, VT, ME, MA, RI, CT, NJ, MD, DC, & HI

From the Beginning of Time …in 1997

- 1997 – Taxpayer Relief Act to increase from $600k to $1MM by 2006
- 2001 – Econ. Growth & Tax Relief Recon. Act – tax to grow through 2010
- 2010 – Tax Relief Unemp. Ins. Reauth, & Job Creation Act – set at $5MM for 2 years

Year	Amount	Year	Amount
2001	675,000	2011	5,000,000
2002	1,000,000	2012	5,120,000
2003	1,000,000	2013	5,250,000
2004	1,500,000	2014	5,340,000
2005	1,500,000	2015	5,430,000
2006	2,000,000	2016	5,450,000
2007	2,000,000	2017	5,490,000
2008	2,000,000	2018	11,180,000
2009	3,500,000	2019	11,400,000
2010	Repealed	2020	11,580,000

- 2012 – American Taxpayer Relief Act made $5MM permanent minimum
- 2017 – Tax Cuts and Jobs Act increased to $11.18MM w/sunset at 2025
- 2021 – gradually increased to $11.7MM now

What changes are being discussed that could affect my estate?

- Estate Taxation Changes
  - Discussions of halving Unified Credit (currently $11.7M)
  - 12/22/17 legislation from the Trump Administration sunsets on 12/31/25, causing reversion to prior Unified Credit scheme, halving the credit
  - Use it or lose it! In the event that an estate tax modification is made, high net worth individuals will need to consider gifting assets – perhaps in Charitable Remainder or similar irrevocable trust vehicles.
- Example: Assume President Biden signs a law into effect reducing the Unified Credit by 50%, from $11.7M to $5.85M effective 1/1/22
  - A single person with an estate worth $10.85M could gift $5.85M to a charitable remainder or other trust vehicle on 12/31/21, with no claw back if done before the law takes effect.
  - If that person died in 2022 with a $5.85M estate (assuming a new UC of $5.85M), no estate tax would be owed at the federal level
    - If the person did no gifting and died with $10.85M in 2022 under this hypothetical, $5M would be subject to a 40% tax ($1.25M)
- Capital Gains Changes (discussed after estates)
- Stepped-up Basis Changes (discussed after capital gains)

Could a Charitable Remainder Trust help? One option:

- Step One
  - Form a Charitable Remainder Trust (CRT - there are different types)
    - When you die, whatever remains in the trust goes to charity – AKA 501(c)(3)
    - Designate a lifetime beneficiary
- Step Two
  - Donate appreciated asset to CRT
    - That is tax deductible according to a time value equation (remember – the charity doesn't get anything until the FUTURE) – Deduction is roughly 30-35% of the amount donated, which must be used over five years
- Step Three
  - Sell the appreciated asset FROM the CRT. Don't sell THEN put the proceeds in the CRT. The sale is tax free – a charity has sold the asset. If basis is $100,000 and sale price is $1M – no capital gain payable

Could a Charitable Remainder Trust help?

- Step Four
  - Set Up an Annuity
    - Imagine 6, 7, or 8% lifetime annuity or other investment income
    - The annuity/investment income are taxable, but you have a significant tax deduction that can be used over the first five years. The first five years offset the annuity payments
    - Bonus: Money in CRT is asset protected
- Step Five – What about my heirs?
  - Set up an Irrevocable Life Insurance Trust (ILIT)
    - Take the payments from the annuity for the first five years and overfund or "front load" a life insurance policy. The cash value continues to pay the premium into the future.
      - First five years of annuity payments fund the policy, but not taxable due to deduction.
    - Life insurance trust buys a $1M policy on your life. That policy goes to your heirs, who will receive the insurance payout free of tax.
- Step Six
  - On death, heirs get the insurance proceeds. You get the lifetime annuity payments. Charity gets the remaining dollars in the CRT.

Discussions regarding capital gains…

- Initial Biden Proposal
  - Initial discussions were to make the top rate for long-term capital gains 39.6% (to match ordinary income levels)
- House Proposal (9/15/21)
  - LTCG rate proposed to top out at 25%, with increase in ordinary income tax rate to 42.6%

Discussions regarding stepped-up basis

- Stepped Up Basis Allows Appreciated Assets Bequeathed to Beneficiaries to be Sold Without Tax on the Gain from Date of Purchase to Date of Death
  - Mom bought home for $100,000 in 1972. When she died, it was worth $1M. The home was left to Son. Son sold the home for FMV shortly after Mom's death for $1M. There is no tax on the $900,000 gain. Why?
    - The basis in the asset "stepped-up" to current FMV when it was bequeathed to son
- Original Biden Proposal
  - Exempt the first $1M of "step-up" gains for a single person or $2.5M for a married couple. Gain beyond those figures would be taxable.
- Recent House Proposal entirely eliminated modification to the stepped-up basis rule

Planning for an uncertain future…

- With mid-term elections only thirteen months away, it is likely that Democrats will avoid large-scale changes to stepped-up basis, as it would be deeply unpopular to their base and a lightning rod for conservative campaigning
- Capital gains and estate taxation remain on the table, and are more likely to change
  - Estate planning can strategically reduce the effects of some of these changes
- Regardless of the vehicle you choose, the assets in the vehicle require financial oversight and guidance – Soltis can better assist as to asset management and strategies
  - Leave the drafting to the lawyers and the investment advice to the financial professionals!

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