Weill Cornell Medicine

Creative Strategies for Passing Your Wealth to Your Heirs

What you need to know about new tax proposals in DC

Martin M. Shenkman, Esq.

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Introduction

- The most comprehensive and far-reaching changes to income and estate tax laws have been proposed. These, if enacted, would dramatically change tax planning, and in particular, the ability to shift wealth to future generations.
- Several proposals have been made that would adversely affect estate planning, in fact transform it.
- Several proposals, including events on which gain on appreciated assets would be recognized, have been put forth.
- Elimination of the income tax free “step up” in basis on death is still under discussion although not included in the House proposal.
- Estate and wealth transfer planning may be transformed.
- If you have not completed all potentially beneficial planning you should do so on an urgent basis.

IRS Funding

- The legislation would appropriate nearly $80 billion to the IRS to improve compliance.
- This would double staffing.
- Increase revenue by $200B over 10-years.
- Expect more audits.
- If you have done aggressive planning hoping to play the “audit lottery” determine if anything should be done.

New Credit for Caregiver Expenses

- This is part of the social safety net the Democrats are endeavoring to build.
- Credit is up to $4,000 and is based on 50% of qualified expenses incurred caring for relatives living at home unable to perform the activities of daily living.
- The right to claim the credit is phased in as income exceeds $75,000

Higher Income Tax Rates

- The 39.6% maximum income tax rate is restored.
- The 20% capital gains rate increases to 25%
- Do you have income you can accelerate now at a lower tax rate?

3.8% Net Investment Income Tax (NIIT) Is Expanded

- Expand the NIIT to cover income derived in the ordinary course of a trade or business for high income taxpayers. The expanded NIIT tax will not apply to income on which FICA (Social Security tax) has already been imposed.

- This change is indicated to apply after 12/31/21.

- Review with your CPA how much income you can still take now as an S corporation distribution.

- Will buy sell agreements with fellow shareholders be affected? These may have been based on a formula and changing distributions and compensation may impact that formula.

Qualified Business Income (Section 199A) Deduction is Reduced

- This special rule enacted in 2017 permitted many businesses (but excluding certain professions such as lawyers, doctors, etc. from benefiting) to deduct 20% of qualifying business income (QBI).
- The proposed law imposes a maximum allowable deduction, a cap, on the amount that may be claimed as a deduction. These reductions apply after 12/31/21. For married taxpayers filing joint returns the cap is $500,000.
- However, for trusts, the cap is a mere $10,000.
- This $10,000 on trusts might dissuade many taxpayers from transferring business interests to trusts even if it is the preferred approach for asset protection planning and estate planning.

Reduction of Gift, Estate and GST Exemption

- Under current law you can gift or own on death $11.7 million of assets without incurring a transfer tax.
- The proposal terminates the temporary increase in the exemption and resets it back to $5 million inflation adjusted in 2022 instead of 2026. Thus, in 2022, the exemption will decrease by $6 million and change.
- The change is effective after 12/31/21.
- Be very careful, many of the harshest estate tax proposals take effect on the date the law is enacted so waiting to use your exemption to the end of the year could be a big mistake.
- If you have sufficient wealth, you should review the pros and cons of making transfers to trusts for heirs (and even you and a spouse) to lock in and use as much of the exemption as you can.

Reduction of Gift, Estate and GST Exemption (2)

- For many taxpayers it may be advantageous for one spouse alone to make a gift using all their exemption, while the other spouse makes no gifts and preserves the approximately $6 million of exemption under the proposed law.
- Create a trust you can access after the gift is made.
- Married couples can use a Spousal Lifetime Access Trust (SLAT). The benefit is that if your spouse is a beneficiary, your spouse can benefit, and hence you might indirectly benefit.

Reduction of Gift, Estate and GST Exemption (3)

- Consider a self-settled Domestic Asset Protection Trust (DAPT) which is a trust of which you are a beneficiary. That may permit you to benefit from trust assets but still have the trust property excluded from your estate.
- Consider a so-called hybrid DAPT. This is a trust in which someone, acting in a non-fiduciary capacity, is given the power to add you back as a beneficiary of the trust.
- Another trust is a Special Power of Appointment Trust (SPAT). That is a trust in which someone, acting in a non-fiduciary capacity, is given the power to appoint trust income or principal to you.

Grantor Trusts Severely Restricted

- Grantor Trusts are trusts for which the trust income is taxed to the person creating the trust, not to the trust. These types of trusts have been the foundation of much of estate planning for decades.

- The proposed legislation would cause assets in a grantor trust to be included in the gross estate of the grantor (the person creating the trust).

- Grantor trusts will trigger gift tax if your trust makes a gift of trust assets (to other than a charity or spouse).

Grantor Trusts Severely Restricted (2)

- You will not be able to create a new grantor trust after the law changes, nor will you be able to make gifts to an existing trust that remains respected.
- Transactions between a grantor trust and their grantors will be recognized for income tax purposes. This change would prevent selling assets to a grantor trust for an installment note or the use of Grantor Retained Annuity Trusts (GRATs) or Qualified Personal Residence Trusts (QPRTs).
- These changes will apply to trusts created on or after the date of enactment and transfers on or after the date of enactment to pre-existing trusts

High Income Taxpayer Surcharge

- An income tax surcharge of 3% will be assessed on modified adjusted gross income ("MAGI") over $5 million (half that if you are married filing separate returns).
- This limit of $5 million, consistent with several other provisions attacking trusts, is reduced to a mere $100,000 for trusts.
- This means that if a trust sells an asset or is the beneficiary of a retirement account (which after the Secure Act must receive a distribution of the IRA proceeds at the end of the 10^{th} year following death of the plan holder), it will face a higher tax.

Valuation Rules – Restrictions on Valuation Discounts

- Say you own 40% of an entity that is worth $10 million. Your 40% might be worth $4 million (40% x $10 million total value). But an unrelated buyer might only pay $2.6 million for your 40% interest to reflect the fact that as a mere 40% owner they will not be able to control when distributions are made, and other key decisions.
- The proposed tax legislation would eliminate valuation adjustments for non-business assets.
- If your planning might benefit from transferring assets that can be discounted under current law, consider whether you should do so as soon as possible before a change in the law.

Conclusions

- Consult with your tax advisers and entire advisory team.
- If you may benefit from any further planning you should pursue it on an urgent basis.
- Incorporate into any planning as much flexibility as you can give the uncertainty about what the law may be.
- Include ways to unwind the transactions you are pursuing if new information suggests that may be better.
- Expect higher taxes and plan accordingly.

Strategic Gift Planning

Examples of planned gifts received during lifetime

- Retirement asset distributions (IRA rollover, QCDs)
- Appreciated stock
- Donor advised funds
- Real estate, Retained Life Estate Gifts

- **Life income gifts, such as:**
  - Gift annuities
  - Charitable remainder trusts
  - Charitable lead trusts

Strategic Gift Planning

Examples of planned gift established during lifetime, but received by charity upon death

- Bequests
- Living trusts
- Beneficiary designations for:
  - Donor-advised funds
  - Life insurance
  - Retirement accounts
  - Financial accounts

Giving Opportunities

- Your gift can be expendable (for current use), a multi-year pledge, or you can create an endowed fund that provides an ongoing source of future support.

- Gifts can be directed to departments or research programs that have special meaning for you.

- Funds can be established in your family's name, the name of a loved one, or a trusted physician.

  - Named Positions/Funds
  - Dept. Chair/Div. Director
  - Full Professorship
  - Senior Scientist/Scholar
  - Clinical, Research or Education Scholar
  - Postdoctoral Fellowship
  - Predoctoral Fellowship
  - Medical Student Scholarship
  - Director/Dean's Discretionary Fund
  - Research Fund in your area of interest

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- Lisa Lager, Director of Planned Giving
- Vikki Jones, Planned Giving Officer

Phone: (646) 962-9567
Email: plannedgiving@med.cornell.edu
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