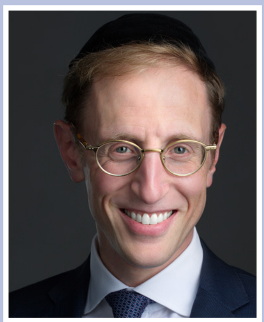
by RABBI BINYOMIN ZEV KARMAN

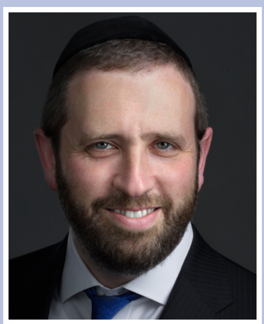
WATCHING YOUR BACK

HOW 'BUILD BACK BETTER' WILL AFFECT YOU

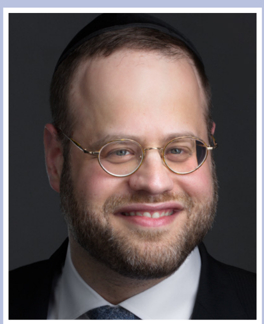
"The cost of this bill is zero!" So goes the refrain of the backers of President Biden's $3.5 trillion proposal to restructure the budget of the United States. If you believe their rhetoric, no one earning under $400,000 a year, or $450,000 for a couple, would be affected by the massive overhaul of the way Congress spends the country's money. The downplaying of the cost is coupled with much hyperbole about all the free benefits that the working people will get by taking it from the millionaires and billionaires.



Mr. Baruch (Brian) Greenwald



Mr. Hillel Weiss



Mr. Shimi (Sheldon) Mayer

ESTATE PLANNING

Mr. Baruch (Brian) Greenwald, Mr. Hillel Weiss and Mr. Shimi (Sheldon) Mayer of Greenwald Weiss Attorneys at Law shared with *Hamodia* what they have learned by studying what is presently included in the funding part of the proposal as it stands today before Congress.

"While a good deal of the changes are targeted towards corporations, there are several crucial rule changes which will affect traditional estate tax planning," the partners said. "These changes can affect those who have worked hard their entire lives and have historically used trusts to reduce the tax burden on their estate."

CUTTING THE EXEMPTION IN HALF

"While the progressives assert that the funding for the Build Back Better is coming from raising taxes on the super-rich, the truth is this will affect many people that are not in that class as well," Mr. Greenwald said. "A hard-working family who struggled to build a mid-sized business may see themselves closed out of some traditional techniques which allowed them to transfer their assets from parent to child with reduced tax liabilities."

One of the most crucial proposed changes involves the lifetime exemption from estate and gift tax, which currently is inflation-adjusted $10 million ($11.7 million in 2021). The proposed bill would cut the exemption in half for gifts given or estates of people dying after December 31, 2021.

GRANTOR TRUSTS

Another proposed change involves the treatment of grantor trusts, which is used as a means of transferring assets in a manner which helps reduce the tax burden on the grantor (the one who is giving the assets to the trust) and the beneficiaries (those who receive the benefits of the trust). Under the current law, a person may set up a grantor trust in which the assets of the trust are considered as belonging to the beneficiaries for estate tax purposes, but for income tax purposes are considered to remain by the individual who placed those assets in the trust — legally referred to as the "grantor." Trusts often pay higher tax rates than individuals (due to highly compressed brackets), and having the income taxed to the grantor can often result in lower income taxes.

"In a practical sense, let us say the grantor places a million dollars in a trust. For income tax purposes, that money is considered to belong to the grantor, or the person who placed it in the trust, and he is the one who must pay the income taxes on it," Mr. Mayer explained. "However, for estate tax and other purposes, it is considered as if it is no longer his.

"There is another advantage to this type of trust as well. If the assets would be considered the possession of the beneficiaries, then they would have to pay the income tax. If they do not have the funds, and the grantor gifts them money to pay the taxes, it would have to be counted as a gift, which would reduce the amount of funds that would be available for future gifts. Since the tax burden is the responsibility of the grantor, and he is liable for the taxes, the funds he uses to pay the taxes will not reduce his gift and estate tax exemption. If the value of the assets in the trust appreciates, those assets are able to grow tax-free for the beneficiaries."

If the proposed rule changes go into effect, all assets transferred to the grantor trust once the rules take effect will be considered as part of the estate of the grantor, and all the assets of the trust will be taxed, thereby eliminating any estate tax advantage that these trusts have traditionally provided.

SALES TO A TRUST

Another change in the law concerns the ability of the grantor to "sell" assets to the trust in a manner which allows it to "freeze" its value for the purpose of income taxes. This particular method of sale usually involves the grantor "selling" an asset, like an investment property, to the trust in exchange for a promissory note. While the value of the asset increases within the trust, thus escaping estate tax, the value of the promissory note remains static and does

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not increase the estate tax burden on the grantor.

As an example, if a building was bought for $5 million and increased in value to $10 million, the grantor can now "sell" it to the trust for a promissory note of $10 million without facing any tax liability on the $5 million paper profit. The profit, and any future increase in value, will remain as part of the trust, thereby shielding it from estate tax liability.

If the proposed rules go into effect, the "selling" of the asset to the trust will be regarded as a regular sale and would immediately trigger income taxes on the profit from the sale. This will not only affect new trusts that will be set up after the bill becomes law, but even existing trusts will be affected. This means that if a grantor wishes to sell assets to an existing trust after the law goes into effect, it will not be grandfathered in by the old rules but would be subject to the new rules and taxed accordingly.

There are some additional changes in the tax code, e.g. the disallowance of claiming certain value discounts where the grantor gives a minority interest in an entity to a trust, which will also adversely affect estate tax planning. In addition, the rules involving Charitable Lead Annuity Trusts will face changes, but those are beyond the scope of this article.

THE GOOD NEWS

"The good news is that several of the ideas that President Biden's team originally floated did not make it into the current bill," said Mr. Weiss. One key idea which was in an earlier iteration and was not included in the bill was the proposed elimination of the "step-up in basis." To understand this rule, consider the following:

If an asset was purchased for $1 million (the taxpayer's "basis" in the property) and appreciated in value to $10 million, the asset has a built-in as-yet-unrealized capital gain of $9 million, which will be taxed at the time of sale. Under the current law, if this asset is included in a decedent's estate for estate tax purposes, then the basis would be increased or "stepped up" to its fair market value at the time of death ($10 million), thus wiping out the capital gain. The earlier proposal of this rule change would have effectively done away with this benefit, by considering assets passing to heirs as being sold at the time of death, which would subject them immediately to income tax on the $9 million of capital gain (this is the current law in Canada). This proposal was not included in the current version of the bill.

In addition, there are, thankfully, no adjustments to 1031 exchange rules, allowing capital gains to continue to be deferred through the 1031 exchange strategy.

INCOME TAX CHANGES

"While a good part of the funding side of the Build Back Better proposals are aimed at high-income people, there are portions of the bill which will affect people in all brackets," Yosef Willig, CPA CFP®, a tax partner at Neuhaus CPA's & Advisors, told *Hamodia*. "Some of the proposed tax changes are considered positive to certain taxpayers while others are negative, so it really is a mixed bag. There are also some new rules for new products that have not been included in previous legislation."

EXPANDED CHILD TAX CREDIT

The proposal to extend the expanded Child Tax Credit, which was enacted in 2021, until 2025 is something which many have become familiar with over the past few months. The American Rescue Plan, signed into law on March 11, 2021, raised the expanded Child Tax Credit from $2,000 per child in 2020 to $3,600 for each child under age 6, and increased it from $2,000 to $3,000 for each child ages 6 to 16. Married couples filing jointly earning below $150,000, those who file as heads of household earning below $112,500 and those earning below $75,000 for single filers are eligible for the expanded Child Tax Credit. Checks have flowed into the personal accounts of the parents for the past few months, and will continue in that manner until at least 2025.

The American Rescue Plan changed the eligibility requirements in favor of the recipients. Before the law was enacted, only those who earned a minimum were eligible for the credit, but the revised law made the credit fully refundable, meaning that even those not earning the minimum were eligible for the credit. (There is still a cutoff point for the maximum earnings.) The proposal would leave this expanded credit intact, which would benefit the parents of young children who are low earners.

SALT DEDUCTION LIMITATIONS

Until the passage of the Tax Cuts and Jobs Act (TCJA) in 2017, the State and Local Tax (SALT) deduction allowed filers to deduct on their federal returns the entire amount they paid in state and local income taxes. The TCJA capped the deduction of SALT at $10,000, which mainly affected high-tax states. Although there has been much talk about eliminating the SALT cap, with politicians of high-tax states advocating for its elimination, the proposals does not include a lifting of that cap at this time.

MEDICARE

Seniors who are on Medicare will receive dental, hearing and vision coverage under the new proposals.

MODIFICATION OF TAX BRACKETS

The top tax bracket for federal taxes was reduced under TCJA in 2018 from 39.6% to 37%. The new proposals will make two major

Mr. Yosef Willig

"Although President Biden has repeatedly asserted that no one earning under $400,000 will have his taxes raised, the way I see it, there is a good chance this is not correct," said Mr. Willig.

"As of today, the 35% bracket begins for married filing jointly earning $414,701 and singles earning $207,351. The 32% bracket begins at $326,600 and $163,300 respectively. Although the new provisions have not been decided yet, logic tells us that if the 39.6% bracket is lowered to $450,000 and $400,000, then the 35% bracket will certainly be lowered below the current $414,701. The domino effect will then probably force the current 32% bracket to be lowered from the $326,600 as well. These changes will raise the amount of income subject to the higher rate, and will end up costing more in taxes even for those earning less than $400,000."

changes to this top bracket, both of which will raise the taxes on high earners.

The first change proposed is to restore the 39.6% rate for the highest bracket, which will mean an immediate increase of 2.6% of the taxable income for those in the highest bracket. However, there is another component which has not received as much publicity and is overlooked by many. Currently, the highest bracket only kicks in for earnings above $622,051 for joint filers and $518,401 for those filing as single or head of household. The new proposal would lower the bracket to include those earning $450,000 if filing jointly, or $400,000 if filing as a single. Thus, this change would subject well over $100,000 of additional income to the higher bracket (39.6%) as well.

IRA CONTRIBUTIONS

One of the biggest changes to affect those of moderate-income earners concerns what is commonly known as a "backdoor Roth IRA contribution."

A Roth IRA is a retirement account where post-tax dollars are contributed and are allowed to grow and later be withdrawn tax-free. High-income earners are ineligible to contribute to Roth IRAs but can contribute to non-deductible traditional IRAs and later convert these to Roth IRAs.

The new proposal would not allow anyone to convert a non-deductible traditional IRA into a Roth IRA, thus eliminating this tax benefit for these people. In addition, it would eliminate converting a 401k to a Roth IRA, but that would depend on the plan owner's income.

Another proposed change is to place a ban on contributions to an IRA once it has accumulated $10 million dollars in assets.

S CORPORATIONS AND QBI DEDUCTION

There are several changes to S corporations and the QBI deduction, and filers using this business model must consult with their tax advisers.

WASH SALES ON CRYPTOCURRENCIES

A "wash sale" is selling a stock at a loss in order to record the loss on your tax return, and then repurchasing it immediately. Concerning stocks, the rule is that you may not record the loss if you repurchased it within 30 days.

When the current law was written, cryptocurrency was not yet in use, so there is no rule governing a "wash sale." The proposed bill would include cryptocurrency in "wash sale" rules and bar it from being listed as a loss if it was repurchased within 30 days.

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"The proposed legislation is still being written, and the changes that we discussed are of course subject to be modified," said Mr. Willig. "I suggest that when the bill is finally signed into law, every filer and business owner consult with their tax adviser to see how it will affect their personal tax status." ■