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# **Estate and Gift Tax Planning in the Year of An Election**

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- National elections, especially Presidential ones, often bring changes to existing tax laws.
- Certainly, the last Presidential election portended huge tax law changes – none more significant than those to the transfer tax regime (estate/gift taxes).
- The changes brought about by the Tax Cuts and Jobs Act (TCJA), passed in December 2017 were huge, with nearly 90 percent of taxable estates being eliminated from taxation.

# Definitions

- Estate tax – is a tax levied on assets of a decedent over a specific amount (exemption) at the time of their passing.
- Gift tax – is a tax levied on gifts (taxable), given in a year which is over the annual exclusion and cumulatively are over the exemption amount.
- Exemption Amount – set by statute and increases every year by inflation. Currently as of 2020 is \$11,580,000 per person (expires in 2026 and goes down to \$6,500,000).
- Portability – the ability of a spouse to inherit the unused portion of a deceased spouse's exemption amount. Married couples therefore have a total of \$23,160,000 exemption.

## Definitions, continued

- Annual gift exclusion – a de minimis amount (\$15,000) which can be given every year to any individual (non-spouse) without using any exemption amounts.
- Estate tax rates – rates start at 18 percent, but quickly hit the top rate of 40 percent at \$1,000,000 above the exemption amount.
- Step-up basis – an asset passed on to a beneficiary has its income tax basis increased to the fair value at the time of death. This allows the estate or the beneficiary to sell the asset without an income tax being imposed, thereby avoiding the double tax of estate and income tax.

# Polling Question 1

- Do you currently have an estate plan?
  1. No, I have never done estate planning.
  2. Yes, I did one more than 7 years ago and never updated it.
  3. Yes, I have a current plan that I am content with.
  4. Yes, but with all the changes I should review the plan soon.



## History – Estate Tax Exemption

Year	Exemption	Top Tax Rate
1997	\$600,000	55%
2002	\$1,000,000	50%
2004	\$1,500,000	48%
2006	\$2,000,000	46%
2009	\$3,500,000	45%
2010	\$5,000,000	35%
2017	\$5,490,000	40%
2020	\$11,580,000	40%

## ••• Estate Numbers for 2019

- Currently, the percentage of deceased individuals who had an estate return filed on their behalf is less than .2 percent.
- For 2019, there was nearly \$20 billion tax dollars generated by estate taxes, and approximately 44 percent of the returns were audited for correctness.
- The current state of estate taxation for 2020, is, as follows:

Exemption Amount	\$11,580,000
Portability	Yes
Tax Rate	40 Percent
Step-up Basis	Yes

## Plans for Post-Election

- President Trump re-elected. Plans to keep the status quo and have the exemption amount extended to 2030.
- Vice-President Biden elected. Several different proposals disclosed on party platform, position papers and speeches. These include the following:
  1. Keep existing law in place until it expires in 2026, or terminate it early, 2024.
  2. In 2021, enact legislation/executive order terminating existing laws and revert back to 2017 amounts:

Exemption	\$6,000,000
Portability	No
Tax Rate	40 Percent
Effective	January 1, 2021

This will increase number of filers by 900 percent.

## Plans for Post-Election, continued

3. In 2021, enact legislation/executive order terminating existing laws and revert back to 2009 rules:

Exemption	\$3,500,000
Portability	No
Tax Rate	45 Percent
Effective	January 1, 2021

This will increase filings by 2,500 percent.

## Plans for Post-Election, continued

4. In 2021, enact legislation/executive order terminating existing laws and revert back to 2000 rates:

Exemption	\$675,000
Portability	No
Tax Rate	55 Percent
Effective	January 1, 2021

This will increase filings by 100-fold.



## Plans for Post-Election, continued

5. Using either options 2, 3, or 4 above, except effective date would be January 1, 2020.
- Please note that option 1 is the party platform but options 2 and 3 were most often mentioned in recent weeks and are both considered the more likely candidate for what is intended.
  - Option 4 was stated in answers to questions but may have been a slip of the tongue. Option 5 would be difficult to support, as retroactive tax increases have serious legal hurdles.

## Plans for Post-Election, continued

\* \* \*

Please note that in almost all cases, the position of the Democratic platform is to abolish the step-up/down in income tax basis for assets passing through an estate/inherited (Internal Revenue Code Section 1014).

\* \* \*

## Current Rules

### New York

Exemption Amount	\$5,850,000
New York Cliff Amount	\$292,500
Portability	No
Top Tax Rate	16 Percent
No Gift Tax Returns (3 Year Clawback)	-
Step-up Basis	Follows the Federal
Inheritance Tax	None

## ... Polling Question 2

- Do you think you will be subject to estate/gift taxes upon your passing, including money which may be left to you by a spouse?
  1. No, I/we have nowhere near the money to qualify for the tax (less than \$3,500,000).
  2. I am not sure – I have never added it up before.
  3. I didn't under the current rules, but probably should look again.
  4. Yes, I know my value and will most certainly be subject to the coming transfer taxes.

## Example

- Taxpayer has \$10,000,000 in assets. The majority of it in stocks worth \$8,000,000 and with a tax basis of \$2,000,000. The rest is real estate and cash with no appreciation.
- If she was to die today, the \$10,000,000 would be less than the Federal exclusion (\$11,580,000) and the stock would get stepped-up to \$8,000,000 (estate value) and be sold at no taxable gain. Therefore, there would be neither Federal estate nor income tax (New York estate tax would be \$1,000,000).
- Assuming option 3 above and, the taxpayer dies in 2021. The Federal taxable income will be \$6,000,000 (\$8-\$2) times Federal rate (including phase-out and no capital gain rate) 43 percent for a Federal tax of \$2,600,000. Add this to the Federal estate tax \$2,300,000 for a total Federal tax of \$4,900,000 plus state taxes (New York would be another \$1,000,000 for estate tax and \$500,000 gain on sale).



## ... Example, continued

- Total tax would be \$3,300,000 for estate taxes on \$3,100,000 for income taxes, for total due to the government of \$6,400,000.

- Remember that all lifetime gifts, in excess of the annual exclusion, are added to assets held at death, to determine total estate assets. However, gifts in New York escape transfer taxation if the giver outlives the 3-year clawback period.
- Note that for Federal purposes, non-taxable gifts given before January 1, 2021 will continue to be non-taxable, even if the exemption amount is lower.

## So What Can We Do?

- First realize that you may be subject to estate/transfer tax.
  - You should inventory all your assets.
    - All assets!
    - Everywhere (worldwide).
  - You can project into foreseeable future.
    - Bequests.
    - Sales.
    - Valuation issues.

## So What Can We Do?, continued

- Second, know that all decisions are yours and should be made with all available information.
  - Provide for loved ones/charities.
  - Control may be an issue.
  - Many options are irreversible.
  - Document your wishes.
  - Taxes are not the only major consideration.

## So What Can We Do?, continued

- It is a process, with lots of options, that takes time.
  - As it is a long process, you need to start it as soon as possible.
  - Consider including some/all stakeholders.
- There are many different options to assist in reducing your taxable estate.
  - Gifting to family members, to maximize the annual exclusion.



## So What Can We Do?, continued

- Example: Married couple with 4 children and 11 grandchildren.

$$\begin{array}{r}
 4+4 \text{ (Spouses)} \\
 \hline
 8 \text{ Children} \\
 11 \text{ Grandchildren} \\
 \hline
 19 \\
 \times 15000 \\
 \hline
 285,000 \times 2 = 570,000
 \end{array}$$

A year in transfers/every year.

## ... Polling Question 3

- Has the Pandemic changed your approach to bequests/estate planning?
  1. Yes, I am going to travel/spend more while I can.
  2. Yes, I am taking, more seriously, the idea that I am mortal and addressing these issues now.
  3. No, I intend to let family/others deal with it when I am gone.
  4. No, this does not apply to me, I don't have the assets.

## ... So What Can We Do?, continued

- Gifts for tuition/medical above the annual exclusion.
- Gifts to charities – during life rather than at death (income tax deduction).
- Plus, if you donate appreciated stock, you avoid the capital gains tax (triple duty) and remove future appreciation as well.

## So What Can We Do?, continued

- Traditional planning techniques.
  - Balancing estates.
  - Use of credit shelter trusts.
  - Family limited partnerships.
  - Use of other trusts.
  - There are dozens of trusts.

## So What Can We Do?, continued

- Timing may be critical.
  - Gift limits for lifetime exemption:
    - 2020 – \$23,000,000.
    - 2021 – ??? (\$3,500,000/\$7,000,000)
  - Internal Revenue Service ruling IR.2019-189 allows NO clawback on gifts if exception amounts decrease.
  - Use it or lose it.



## ... Gifting/Transfers During Your Lifetime Becomes Important

- Use of family partnerships may allow for discounts due to:
  - Lack of marketability; and
  - Lack of control
- Valuation of business may be at a low point due to COVID.
  - Transfers to next generation at lower value.
- Use of trust allows for some degree of control/restrictions.

## Balancing of Estates Now Becomes Essential Due to Elimination of Portability

- If most assets are with spouse A, and they die, we can use a previously set-up trust to tax \$3,500,000 and pass the rest to spouse B, for them to use their exclusion upon passing.
- What happens if spouse B dies first?
- So we balance the estate and give each person  $\frac{1}{2}$  of the value.
  - Second marriages.
  - Step-children.
  - Closely held stock.

## Example 2

- Couple with estate of \$16,000,000, consisting of the following:

Cash/Personal Property	\$ 1,000,000
Real Estate	2,000,000
Stocks (Basis \$1m)	3,000,000
Family Camp (Basis 0)	10,000,000
	<u>\$ 16,000,000</u>

- Second marriage, spouse B to get \$3,000,000 upon death of spouse A. Children/trust of spouse A receives camp and \$3,000,000 (to continue to pay the upkeep on camp).
- Currently (2020) no estate tax, no income tax. Under new law, estate tax is \$4,100,000 on an estate of \$13,000,000 (\$3,000,000 went to spouse B) plus have to sell stocks \$3,000,000-\$1,000,000 = \$2,000,000 gain generates \$900,000 of tax, and as we have \$5,000,000 (\$4,100,000+\$900,000) in tax due and only \$3,000,000 is cash, we are forced to sell the family camp. This triggers a \$10,000,000 gain and more taxes (no step-up) for a total of nearly \$10,000,000 in taxes and spouse B getting the same after-tax money as spouse A.

## ... Polling Question 4

- Will upcoming changes to estate and gift tax laws change your approach and timing to managing those taxes?
  1. No, I am not affected by estate/gift taxes.
  2. Maybe, I will see what happens next year.
  3. Yes, but I will wait until 2021 to implement changes.
  4. Yes, I will be making decisions/transfers before the end of the year.





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# Questions

