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HERE COME THE TAXES…MAYBE?

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With the recent passage of the American Rescue Plan, President Biden's $1.9 trillion stimulus package, it is natural to consider what kind of revenue generating legislation may be coming in the next months and years in order to pay for what has now been three separate rounds of stimulus bills to address the challenging economic conditions brought on by the Covid-19 pandemic.

The Biden administration also has designs on passing a substantial infrastructure bill that would likewise require raising significant additional funds.

At a local level, although State budgets will receive some relief from the American Rescue Plan, many States are also looking to new tax legislation to help balance budget deficits.

In short order we are likely to see Congress and State legislatures take up debate on significant tax legislation. The following is a select overview of possible and proposed tax legislation at the Federal and State level:

President Biden's Tax Proposals

Now that the American Rescue Plan has been signed into law, many news outlets are reporting that President Biden is turning his attention to various tax proposals first announced during his presidential campaign. With respect to transfer taxes (Estate, Gift and Generation-Skipping Transfer Tax) President Biden had proposed lowering the federal exemptions back to $5,000,000 as adjusted for inflation ($10,000,000 per couple), although the more widely reported figure now suggests a return to the law as it existed in 2009, an estate tax exemption amount of $3,500,000, with only $1,000,000 of this allowed during lifetime for gifting is the likely target. The proposed decrease in exemptions might also be coupled with a proposed increase in the estate and gift tax rates from 40% to 45%.

President Biden also has proposed repealing the "stepped-up basis rule" upon death. Under current law when a person dies, appreciated assets that are included in their taxable estate and subject to estate tax receive a new cost basis for capital gain tax purposes equal to the date of death value so that if sold the day after death there will be no capital gains taxes due. For those under the current exemption, it means many families pay no capital gains tax or estate tax on inherited wealth. Eliminating this "stepped-up basis" rule would be a significant change to the transfer tax system. There is also a suggestion that a Biden tax proposal might include a provision such that all unrealized gains would be taxed at death as if the assets were sold, thus generating capital gains taxes at death in addition to potential estate taxes if the taxable estate exceeds the exemption amounts.

Possible tax law changes are not limited to estate and gift taxes; rather many proposals would target and unwind various tax cuts introduced by the Tax Cuts and Jobs Acts passed in 2017 by the Trump Administration (i.e. returning the top marginal rate for income taxes, earning in excess of $400,000 per year to 39.6% from 37%).

Last, but not least, is a proposal to tax long-term capital gains for those reporting annual income in excess of $1 million at the same rate as ordinary income (the aforementioned 39.6% rate). This is a significant departure from existing tax law as long-term capital gains have historically been taxed at rates between 15-20%.

It remains to be seen if any or all of these proposals, and others not discussed above, make it into proposed legislation before Congress. However, it is important for all taxpayers to consider what impact these changes would have on them and their families and should consider discussing such concerns with their estate planning attorney or other tax advisor.

Senator Warren's Wealth Tax - "The Ultra-Millionaire Tax Act"

U.S. Senator Elizabeth Warren (D-Mass.) recently introduced a bill entitled the "Ultra-Millionaire Tax Act" which aims to levy an annual tax on households and trusts with a net worth in excess of $50 million. The act is co-sponsored by several other Democratic members of the Senate, including Bernie Sanders (I-Vt.), and is described by its proponents as being a vital response to the growing wealth inequality across the U.S. The act proposes the following new tax structure:

1. A 2% annual tax on the net worth of households and trusts between $50 million and $1 billion; and
2. A 1% annual surtax (3% tax overall) on the net worth of households and trusts above $1 billion.

There also is a provision in the bill that doubles the total 3% tax, on households and trusts with a net worth in excess of $1 billion, to 6% in any year in which there is legislation in effect that establishes a public, universal health care system.

It is important to note that this new "wealth tax" would exist alongside the existing estate and gift tax infrastructure and, in the year of death, it is possible that both this wealth tax and an estate tax could be assessed against a decedent's estate if the estate was in excess of the relevant exemption amounts.

The bill seemingly anticipates that the imposition of such a wealth tax could lead individuals to consider relinquishing their U.S. citizenship to avoid the tax. Accordingly, the bill would impose a 40% exit tax on such renunciation of citizenship.

Finally, the bill mandates that at least 30% of taxpayers subject to the tax be audited each year and imposes significant penalties for underreporting wealth and taxes due.

Connecticut Estate Tax Exemption

As of January 1, 2021, the estate tax exemption for Connecticut residents dying during the 2021 calendar year is $7.1 million. The exemption is scheduled to rise again on January 1, 2022 to $9.1 million and ultimately equal the Federal exemption amount (currently $11.7 million, adjusted annually for inflation) on January 1, 2023.

However, recently introduced legislation could change this schedule and reverse course to an exemption more in line with the lower exemptions of past years. While there are several bills that have been introduced (all of which are still in committee), the common theme is a reduction of the estate tax exemption and eliminating the current cap of $15 million on the estate tax payable to the State of Connecticut from a decedent's estate.

Various reports suggest that there is a preference among the Democratic majority in the State legislature to return the estate tax exemption to $2 million, which is the level it was set to for the majority of the prior decade. There is at least one proposed bill that would maintain the current exemption amount; however, there seems to be consensus among the proposed bills regarding the elimination of the $15 million cap on estate tax payments.

Ultimately, it is worth noting that the Connecticut exemption for the 2023 tax year and later is currently set to match the Federal exemption each year. Accordingly, any changes that may be made at the Federal level could directly impact exemption amounts in Connecticut without further legislative action by the State. Absent any action either Federally or at the State level, the increased exemption put in place under the Tax Cuts and Jobs Act in 2017 is schedule to "sunset" on January 1, 2026 at which point a lower $5 million Federal exemption (adjusted for inflation) would return.

Governor Ned Lamont has recently stated that he does not support "broad-based" tax increases, but it is unclear if his opposition extends to the reduction of the estate tax exemption or if more narrowly tailored to the proposed statewide property tax and other taxes recently introduced in the current legislative session.

New York Estate Taxes

As of January 1, 2021, the estate tax exemption for New York residents dying during the 2021 calendar year is $5,930,000. However, this figure remains somewhat misleading in practice. New York's estate tax is colloquially referred to as a "cliff tax" in that if the gross taxable estate is more than 105% of the current exemption amount (or for 2021, $6,226,500 or greater) the exemption is not available and the entire estate is subject to estate taxation. Currently, the maximum estate tax rate, applicable to those estates in excess of $10,100,000, is 16%. Recent legislation was introduced that would change this top rate to 20%. This rate increase is part of a broader set of proposed new taxes and tax computation formulas which would be levied to implement the State budget for the upcoming fiscal year.

What To Do

While it is certainly difficult to plan in the face of the unknown, many high net worth individuals are taking advantage of the historically high exemptions while they still remain in place. This remains a good tactic, especially while these proposed changes are in their early stages of implementation. For those taxpayers who are considering various strategies to plan for the possibility of significant changes to Federal and State tax laws, now would be a good time to consult with a Cummings & Lockwood LLC estate planning attorney or another trusted advisor.