Four Planning Considerations Despite Legislative Limbo

December 2021

The Current State of Tax Negotiations

More than six months after President Biden outlined key tax policy proposals, taxpayers are still waiting for clarity on tax legislation. As of this writing, the administration's Build Back Better Act (BBBA) remains on hold, as disagreements between the Democratic Party's Centrists and Progressives stalled progress on both the tax legislation and the infrastructure bill (Infrastructure Investment and Jobs Act) which has already passed the Senate. With Democratic Senators Joe Machin and Kyrsten Sinema pushing back at the BBBA's estimated $3.5 trillion cost, Democratic leadership will need to scale back earlier proposals, with many tax experts believing the revised legislation might need to target a cost between $1.5 to $2.0 trillion.

Tax negotiations could take quite a few twists and turns over the coming weeks, although taxpayers can ponder several strategies despite current legislative uncertainty.

- ### Utilize the Lifetime Gift Tax Exemption

  The Tax Cuts and Jobs Act (TCJA) significantly increased estate/gifting exemptions, with the elevated amounts scheduled to remain in effect until January 1, 2026. For 2021, the federal estate and lifetime gift tax exemptions are $11.70 million per person. The House Ways and Means Committee's proposals would drastically alter current amounts, with the exemption reverting to a $5 million base (plus inflation adjustments), beginning as of January 1, 2022. It is unclear whether the House's proposed limits will make their way into a final bill, though this may represent a limited window for wealthy individuals to gift additional assets out of their taxable estate while exemption amounts are at such favorable levels.

- ### Accelerate Income

  It is generally accepted that future tax legislation will incorporate an increase for the top federal income tax bracket from 37 percent to 39.6 percent. With that in mind, high-income taxpayers who can control the timing of certain income items may wish to do so in 2021, prior to a potential increase beginning in 2022. It bears noting that accelerating capital gains would ***not*** be a consideration, as the House proposal (if adopted) would raise the federal long-term capital gains tax from 20 percent to 25 percent for transactions after September 13, 2021, unless the seller had already entered into a binding contract prior to that date.

- ### Defer Deductions

  On the campaign trail, President Biden proposed limiting the tax benefit of itemized deductions to 28 percent for high-income taxpayers, though the earlier proposal has not gained traction in legislative drafts. So long as a cap would not apply to itemized deductions, high-income taxpayers would receive a greater tax savings from itemized deductions in a higher tax rate environment. This consideration may vary depending on a taxpayer's year-over-year variability in taxable income.

- **Convert a Traditional IRA to a Roth IRA**

  Following the ProPublica leak that PayPal co-founder Peter Thiel has a $5 billion Roth IRA, large retirement accounts are now in Congress's crosshairs. In September, House Democrats proposed various changes to retirement accounts, which could include income limits ($400,000 for single taxpayers; $450,000 for married couples) for Roth conversions. Possibly lost among the recent headlines is the fact that proposed income-limit restrictions on Roth conversions would not go into effect until after December 31, 2031 – a full ten years from now.

Retirement expert Ed Slott opined, "Congress still wants that money from the higher earners. They're using it to fund this whole package and Congress loves Roth IRAs and Roth conversions. They only say they don't like them because it sounds good, but they love the income that comes from them. They're addicted to the Roth IRA and just can't quit them because the tax revenue is too good to be true." Individuals considering this strategy should compare their current tax bracket to expectations for their future tax bracket, while also acknowledging that equity markets remain near all-time highs.

Recognizing that current proposals could change markedly in the coming weeks, high-income taxpayers might consider the strategies outlined above, though further discussion with a trusted advisor (accountant, estate planning attorney, investment advisor, etc.) is highly recommended. Given current uncertainty, the best strategy may be to narrow down potential planning options for 2021, while we await further clarity.

For more information, please reach out to any of the professionals at Veracity Capital.

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