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Estate Planning and the 2020 Election

by

Darren T. Case

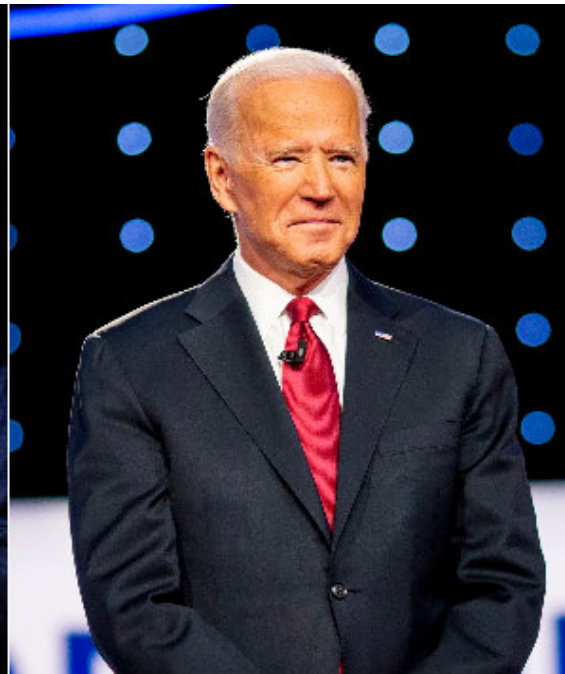
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Disclaimers / Trigger Warnings

- This CLE involves political discussions. Fortunately, we live in the United States of America, where political discussions are *always* civil and well-mannered.





Disclaimers / Trigger Warnings

- During this presentation, mainly when discussing Biden's Tax Plan proposal, my non-verbal communication may seem like I am favoring one candidate over the other. I promise this has nothing to do with the candidates.... *it has everything to do with my end of year workload.*
- Finally, I will not make any predictions on the election...

McCAIN ★ **PALIN**

**Here comes the Maverick Tax Plan:
I can see the elimination of the
Estate Tax from my House.**





Believe in GRATs and IDGTs: Romney Tax Plan to Preserve Advanced Planning Techniques.





I'm With Her (Tax Plan): The Return of ILITs and Lower Exemptions.





Overview of CLE

PART I

- **Briefly discuss Estate Planning in 2020**
 - *Macroeconomic Analysis of Estate Planning*
 - *Summary of certain Current Tax Laws in place that practitioners often analyze in the Estate Planning Process*
 - *Review of Basic and Advanced Estate Planning Transactions in 2020 (RLTs, ILITs, GRATs, IDGTs, & SLATs) and Capital Gains Analysis*

PART II

- **Analyze and Discuss Biden Tax Plan Proposals**
 - *Comparison of Current Tax Laws versus the Biden Tax Plan Proposals*
 - *Impact of Biden Tax Proposal on Basic and Advanced Estate Planning Transactions (RLTs, ILITs, GRATs, IDGTs, & SLATs) and Capital Gains Analysis*



PART I

Macroeconomic Analysis of Estate Planning

Estate Planning in 2020

“Greatest Wealth Transfer in Human History”

\$30+ trillion dollars in wealth will transfer over the next few decades... approximately 20% of that wealth is held by families with life expectancies of 7 years or less.



PART I

Macroeconomic Analysis of Estate Planning

Estate Planning in 2020

Of the \$30+ trillion dollars transferring...

- 17% of this wealth will be transferred prior to death, with the remaining 83% to be transferred through estates and trusts.
- 47-60% will pass to heirs,
- Charitable bequests will vary from 8-17%
- IRS will collect approximately 7-24% for estate taxes
- 1.5-2.0% will be spent on estate closing costs



PART I

Macroeconomic Analysis of Estate Planning

Estate Planning in 2020

“About a third of Americans will receive an inheritance in their lifetime... The research shows the average person will lose half of it, almost immediately, through thoughtless spending or bad investments.”

Judy Martel, *Planning For Inheritance: 4 Ways To Handle A Windfall*, Forbes.com (Nov. 6, 2015, 10:16 AM), citing study by Jay L. Zagorsky, *Do People Save or Spend Their Inheritances? Understanding What Happens to Inherited Wealth*, JOURNAL OF FAMILY AND ECONOMIC ISSUES 34:64-76, 68 (2013)



ROOT PROBLEMS

Families have **less than a 1 in 3 chance of maintaining wealth** through multiple generations.



What are the core issues behind this phenomenon?



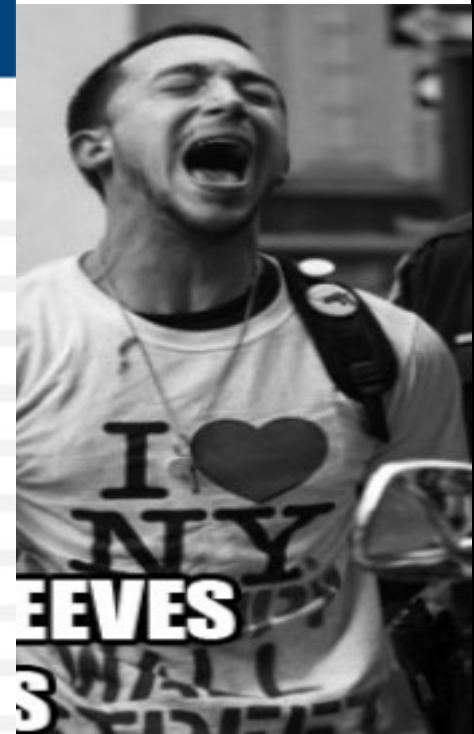
breakdowns in family communications and trust



unpreparedness of heirs



financial planning and tax errors





PART I

Macroeconomic Analysis of Estate Planning

Estate Financial Planning in 2020

“A mere 2% of children keep the money they've inherited with their parents' financial advisor... only 45% of wives keep their assets with the same financial advisor after the husband dies.”

Michael Sisk, *How to Keep the Kids*, Barrons.com (Jun. 4, 2011), citing survey conducted by PriceWaterhouseCoopers Global Private Banking/Wealth





PART I

*Summary of Current Tax Laws practitioners often
analyze in the Estate Planning Process*

Estate Planning in 2020

Current Tax Laws—

- Estate, Gift, GST Tax Exemptions and Tax Rate: \$11.58M / 40%
- Top Income Tax Bracket: 37%
- Capital Gains: In general, the long-term capital gains tax rate is 0%, 15% or 20% depending on your taxable income and filing status (additional 3.8% net investment income tax (NIIT)).
- Corporate Tax Rate: 21%
- IRC § 1014: In general, appreciated assets receive a step-up in basis upon death.

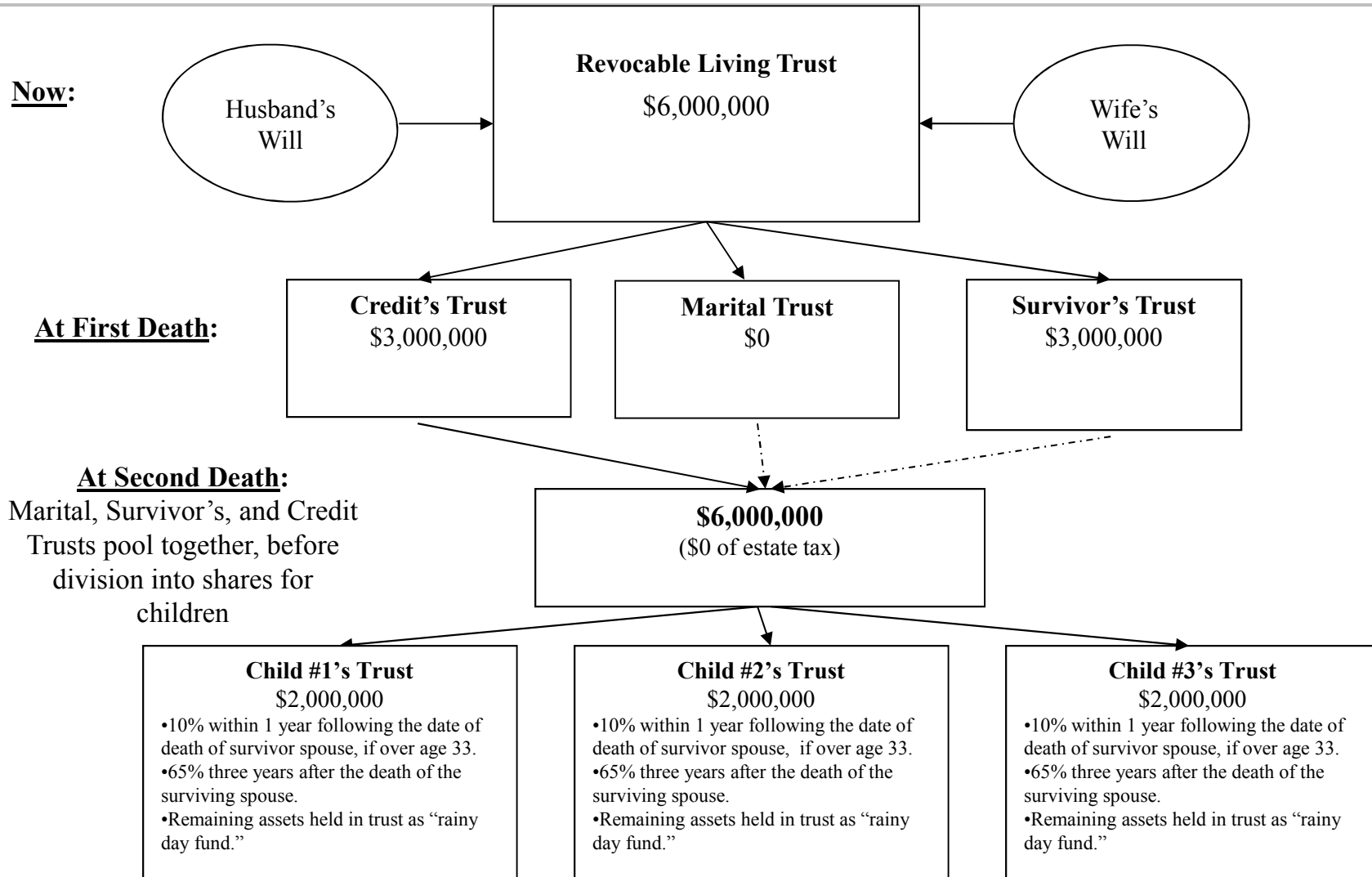


TAX CUTS & JOBS ACT



PART I

Review of Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

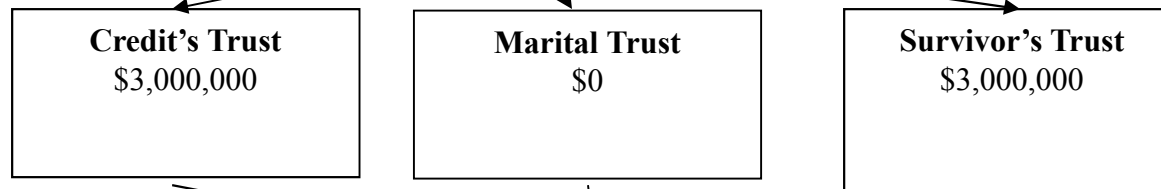




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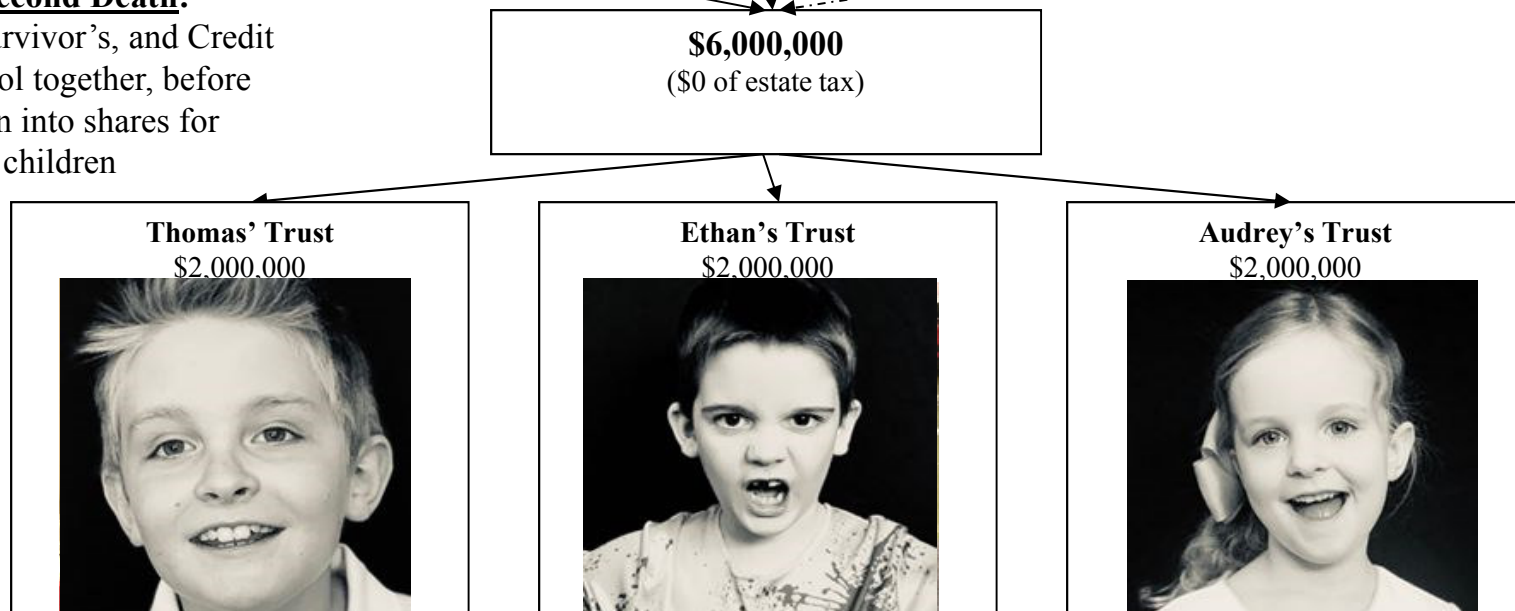


At First Death:



At Second Death:

Marital, Survivor's, and Credit
Trusts pool together, before
division into shares for
children



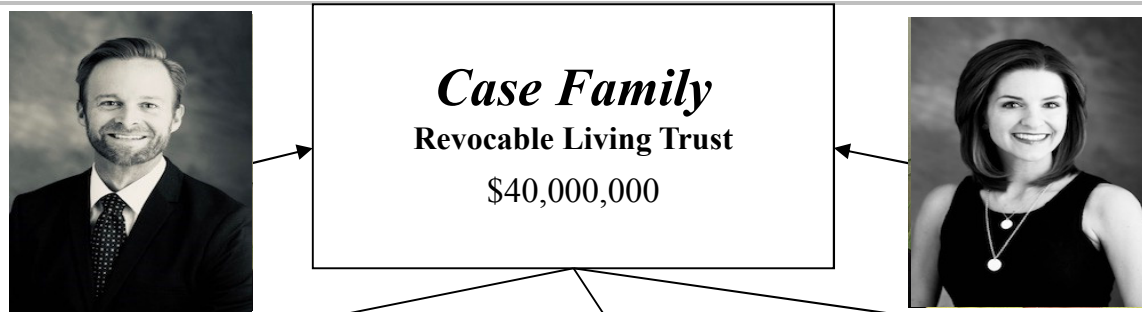


2020

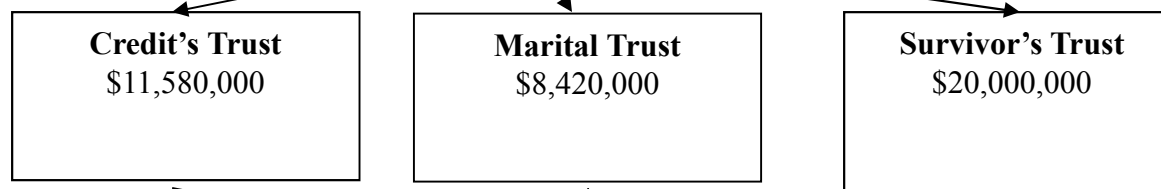
Example: ESTIMATED CALCULATIONS

Married Couple with more than the Estate Tax Exemption
(\$11.58M exemption (\$23.16M married))

Now:

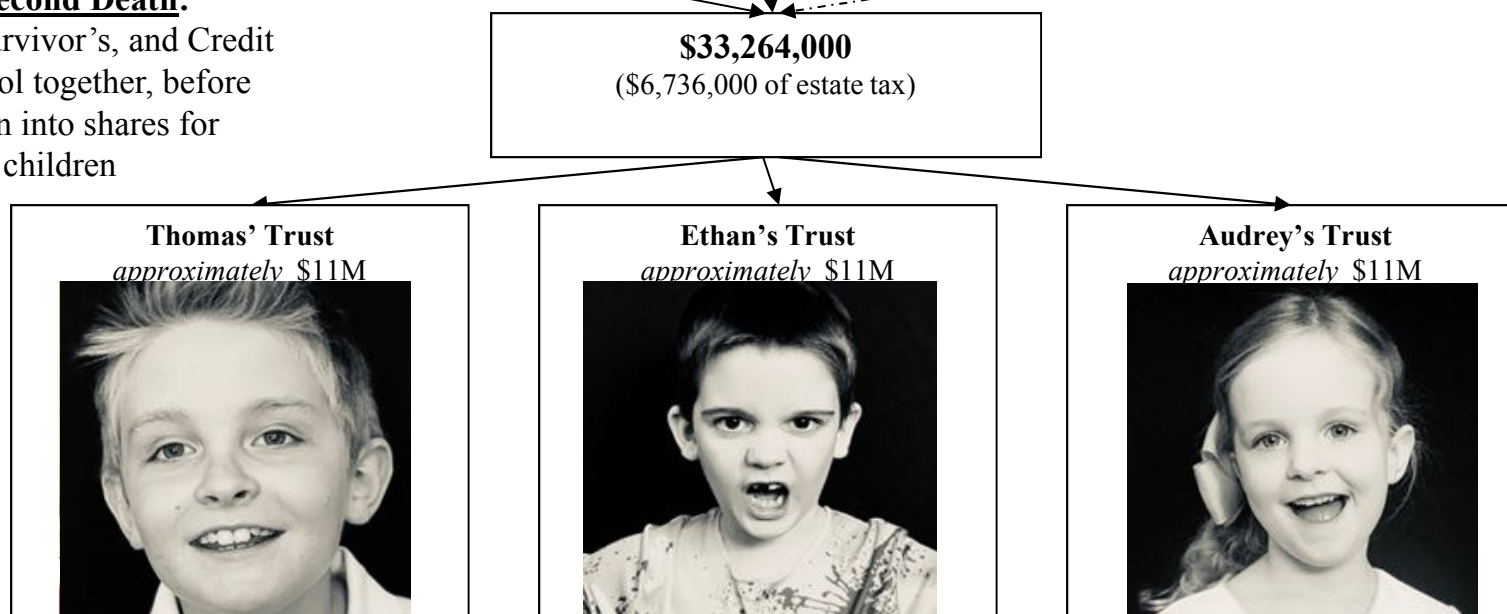


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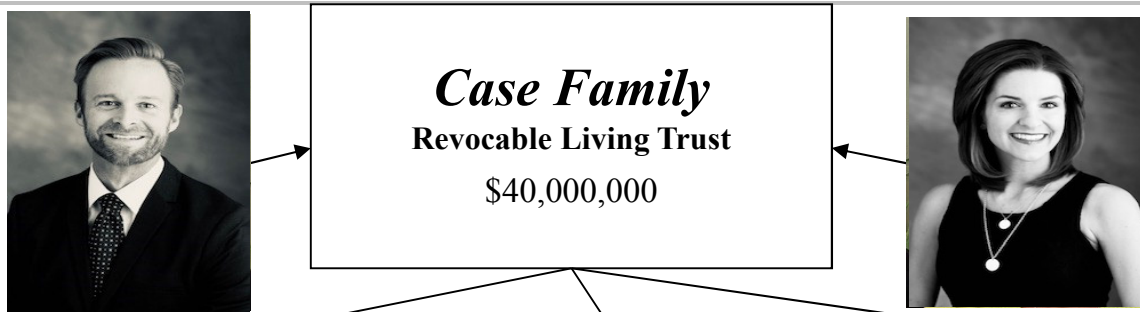




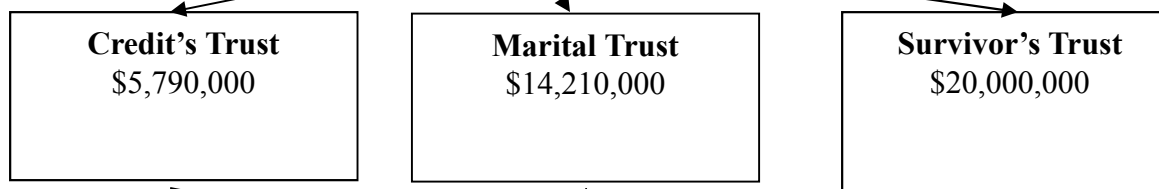
Sunset of the Tax Cuts & Jobs Act... 2026

Example: Married Couple with more than the Estate Tax Exemption
(approximate assumption of a **\$5.79M** exemption (**\$11.58M** married))

Now:

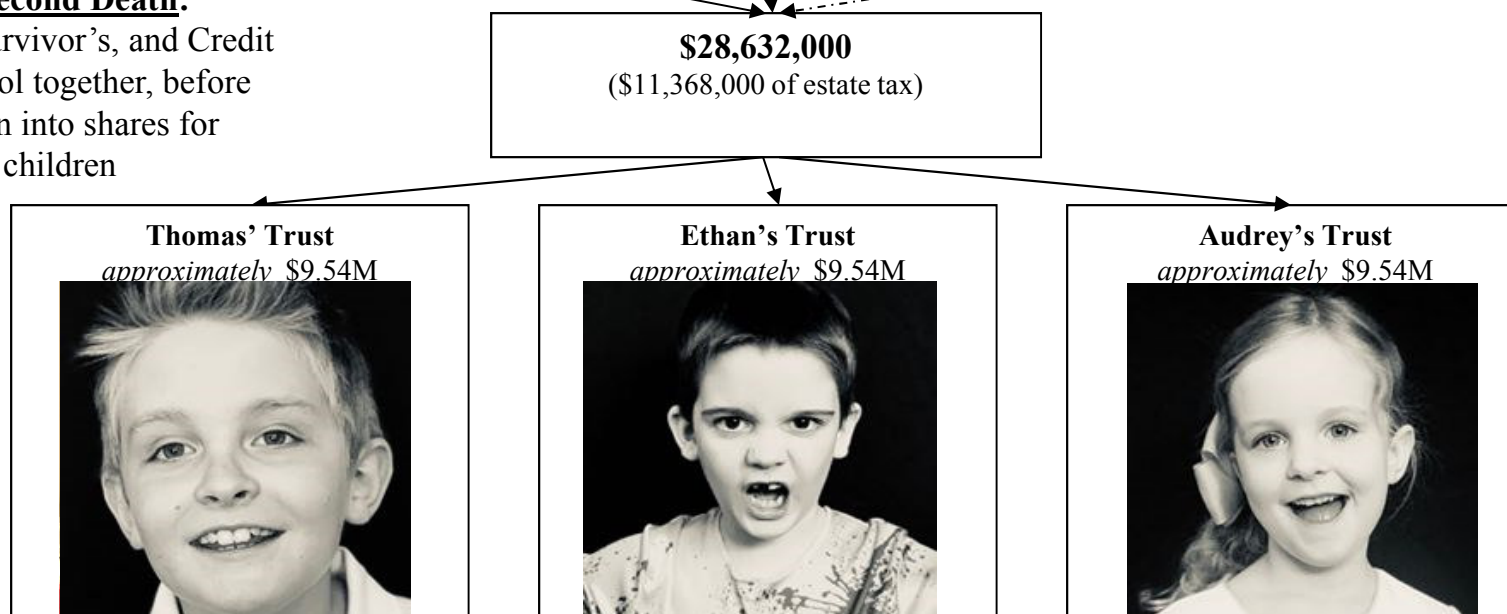


At First Death:



At Second Death:

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2020

Example: Married Couple with a lot less than the Estate Tax Exemption
(\$11.58M exemption (\$23.16M married))

Now:



Case Family
Revocable Living Trust
\$1,000,000



At First Death:

**NOTHING
HAPPENS**

At Second Death:

Assets divide into equal shares
for children

\$1,000,000
(\$0 of estate tax)

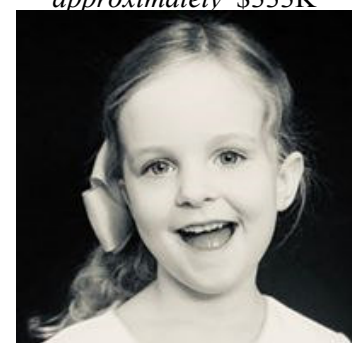
Thomas' Trust
approximately \$333K



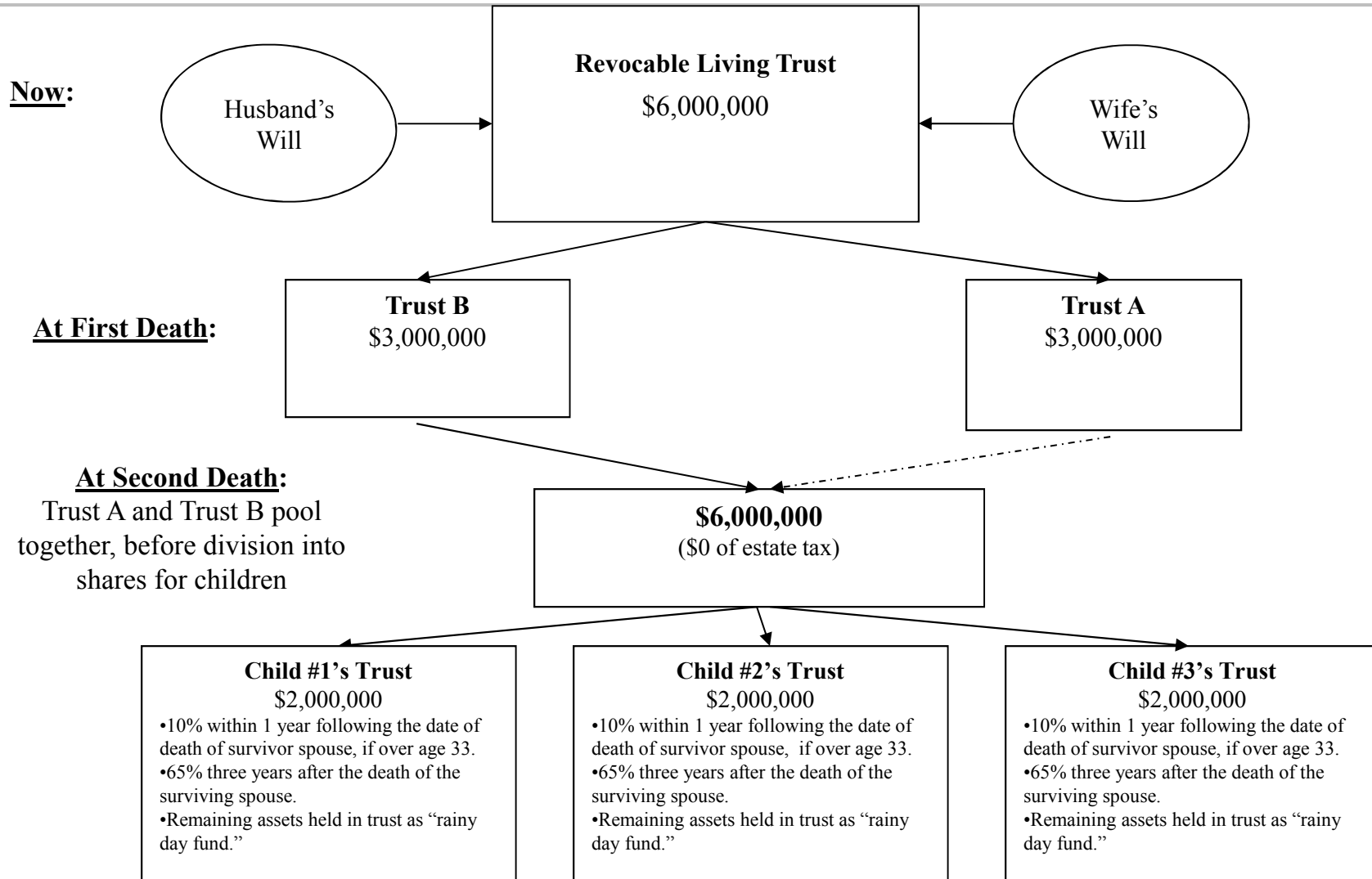
Ethan's Trust
approximately \$333K



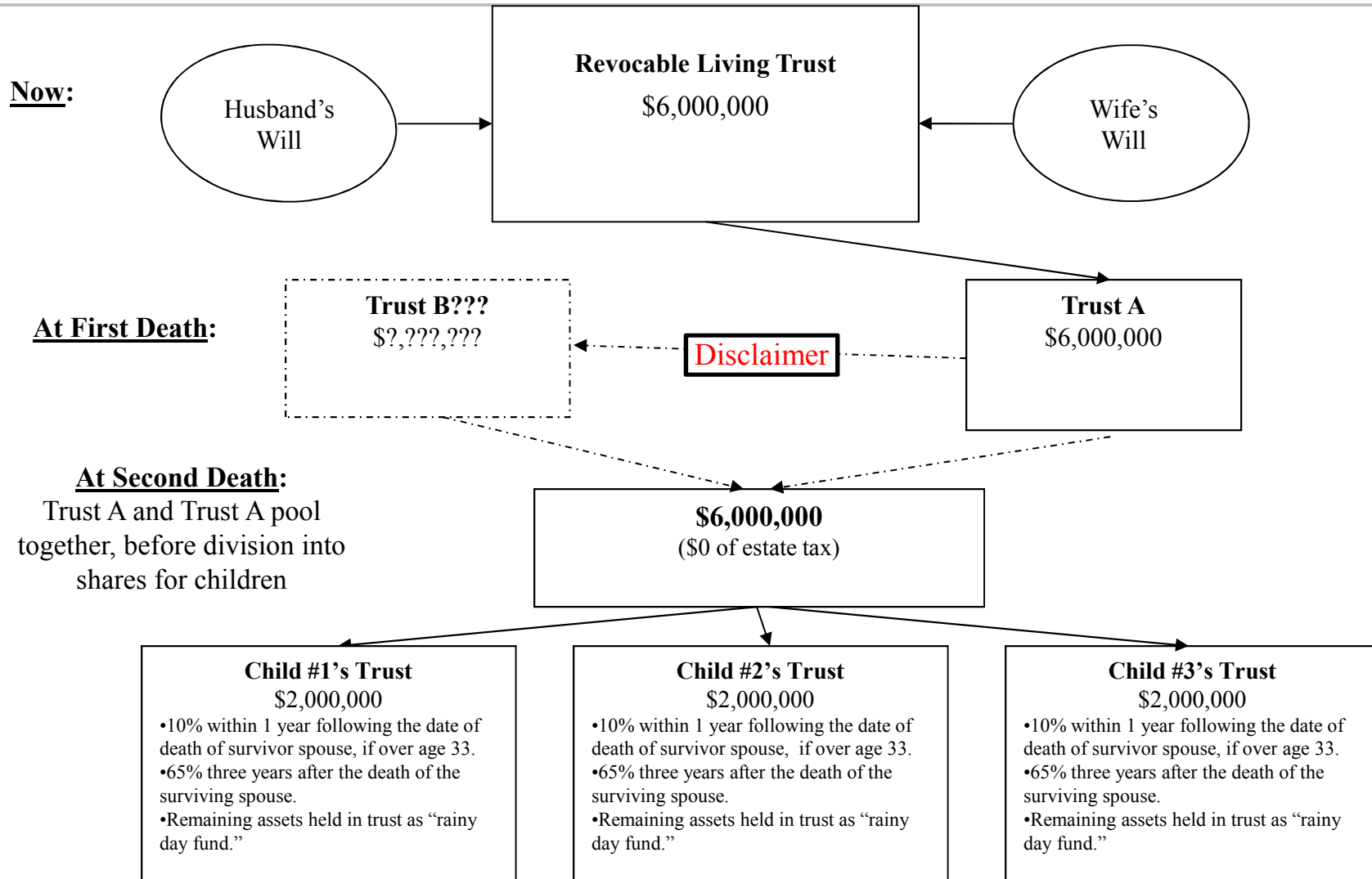
Audrey's Trust
approximately \$333K



Traditional “A-B Split” Trust Agreement
TRUST A (i.e., Marital Trust) & TRUST B (i.e., Credit Trust)



Disclaimer Trust Agreement
TRUST A and, if Disclaimed, TRUST B

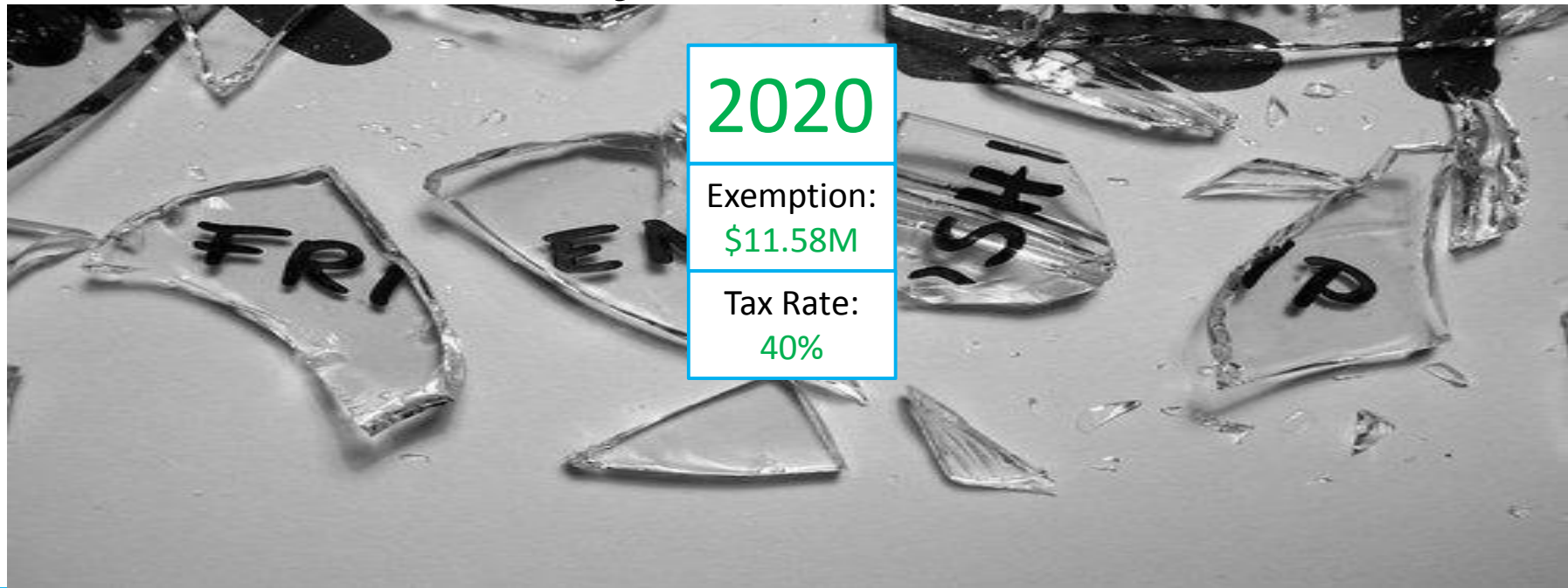




PART I

Review of Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Irrevocable Life Insurance Trusts (ILITs)



1999	2002	2005	2008	2011	2013	2016	2017
Exemption: \$650K	Exemption: \$1M	Exemption: \$1.5M	Exemption: \$2M	Exemption: \$5M	Exemption: \$5.25M	Exemption: \$5.45M	Exemption: \$5.49M
Tax Rate: 55%	Tax Rate: 50%	Tax Rate: 47%	Tax Rate: 45%	Tax Rate: 35%	Tax Rate: 40%	Tax Rate: 40%	Tax Rate: 40%



PART I

Review of Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Estate Freezing & Estate Squeezing

- *Grantor Retained Annuity Trusts*
 - *A GRAT is an arrangement where you may "give away" one or more of your assets, while retaining the right to receive a set percentage of the value of that asset for a period of time.*
 - *Often utilized to “freeze” the value of assets; especially popular due to interest rates being at historical lows.*
- *IDGTs and SLATs*
 - *An intentionally defective grantor trust (IDGT) is an estate planning tool used to freeze certain assets of an individual for estate tax purposes, but not for income-tax purposes; assets within IDGT often are for the benefit of children or descendants, and should not be included within decedent's estate if structured and maintained properly.*
 - *Spousal Lifetime Access Trusts (SLATs) are similarly structured irrevocable trusts, but for first for the benefit of a spouse.*



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Estate Freezing & Estate Squeezing

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PART I

Review of Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Estate Freezing & Estate Squeezing

- Grantor Retained Annuity Trusts*

Applicable Federal Rates (AFR) for September 2019

Applicable Federal Rates (AFR) for September 2020

	<u>Annual</u>	<u>Period for Compounding</u> <u>Semiannual</u>	<u>Quarterly</u>	<u>Monthly</u>
<u>Short-term</u>				
AFR	1.85%	1.84%	1.84%	1.83%
110% AFR	2.03%	2.02%	2.01%	2.01%
120% AFR	2.22%	2.21%	2.20%	2.20%
130% AFR	2.40%	2.39%	2.38%	2.38%

	<u>Annual</u>	<u>Period for Compounding</u> <u>Semiannual</u>	<u>Quarterly</u>	<u>Monthly</u>
<u>Short-term</u>				
AFR	0.14%	0.14%	0.14%	0.14%
110% AFR	0.15%	0.15%	0.15%	0.15%
120% AFR	0.17%	0.17%	0.17%	0.17%
130% AFR	0.18%	0.18%	0.18%	0.18%

<u>Mid-term</u>				
AFR	1.78%	1.77%	1.77%	1.76%
110% AFR	1.96%	1.95%	1.95%	1.94%
120% AFR	2.13%	2.12%	2.11%	2.11%
130% AFR	2.31%	2.30%	2.29%	2.29%
150% AFR	2.68%	2.66%	2.65%	2.65%
175% AFR	3.12%	3.10%	3.09%	3.08%

<u>Mid-term</u>				
AFR	0.35%	0.35%	0.35%	0.35%
110% AFR	0.39%	0.39%	0.39%	0.39%
120% AFR	0.42%	0.42%	0.42%	0.42%
130% AFR	0.46%	0.46%	0.46%	0.46%
150% AFR	0.53%	0.53%	0.53%	0.53%
175% AFR	0.61%	0.61%	0.61%	0.61%

<u>Long-term</u>				
AFR	2.21%	2.20%	2.19%	2.19%
110% AFR	2.43%	2.42%	2.41%	2.41%
120% AFR	2.66%	2.64%	2.63%	2.63%

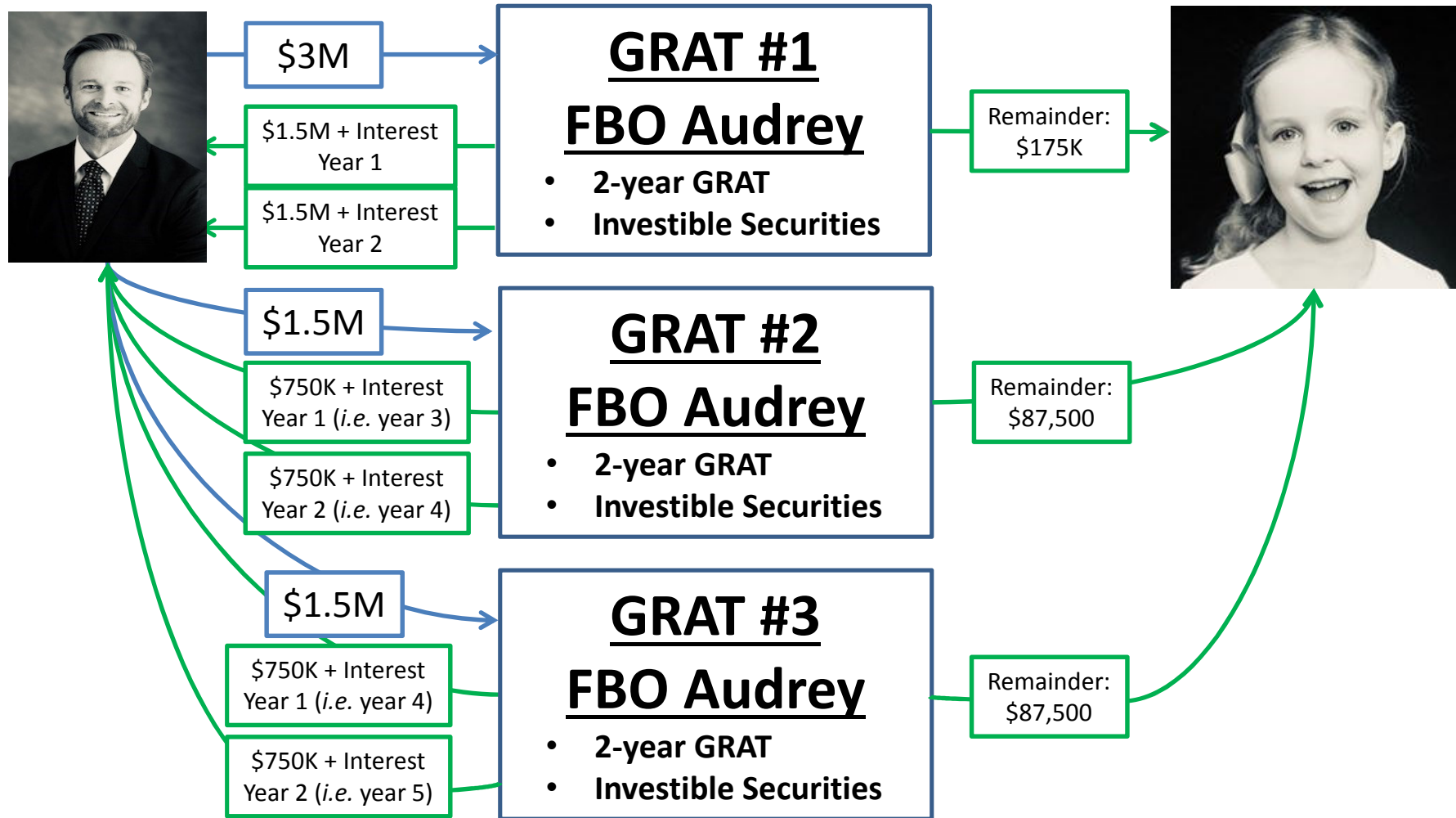
<u>Long-term</u>				
AFR	1.00%	1.00%	1.00%	1.00%
110% AFR	1.10%	1.10%	1.10%	1.10%
120% AFR	1.20%	1.20%	1.20%	1.20%



Current Tax Law Questions re GRATs

- *With interest rates essentially back to an “All-Time Low,” why not lock in a GRAT long-term? While GRATs can be structured in a variety of manners, “one of the advantages of a two-year GRAT is that if a GRAT has a year of poor investment returns, the net benefit will be greatly reduced, if not eliminated... One would prefer to get the assets back out of the GRAT so that they can be put into a new GRAT as soon as possible with a new baseline.”*

David A. Handler & David Herzig, Drafting Superior GRATs and Deciding If Certain Assets Classes Are Appropriate for a GRAT, Notre Dame Tax & Estate Planning Institute (Oct. 26, 2017)





PART I

Review of Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Estate Freezing & Estate Squeezing

IDGTs

- *An intentionally defective grantor trust (IDGT) is an estate planning tool used to freeze certain assets of an individual for estate tax purposes, but not for income-tax purposes; assets within IDGT often are for the benefit of children or descendants, and should not be included within decedent's estate if structured and maintained properly.*
- *The so-called “squeezing” of one's estate occurs when the value of property transferred to an IDGT is discounted for minority ownership interests and/or lack of control or marketability of said interest.*
- *In general, IDGT are used in one of two ways; gifting interest to the IDGT or a sale of assets to an IDGT.*

Recommended Reading: :¶30.10. Sale to Intentionally Defective Grantor Trust

Checkpoint Source: Henkel / Estate Planning and Wealth Preservation: Strategies and Solutions (WG&L)

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PART I

Review of Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Estate Freezing & Estate Squeezing

IDGTs

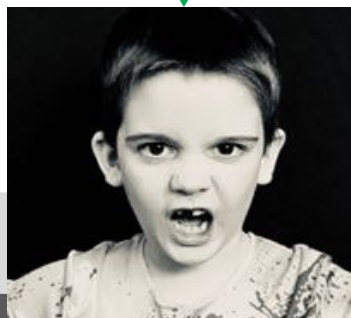


\$?M

IDGT

- Income Taxed to Trustor
- Assets and their appreciation are *not* included in Trustor's Estate.

- The irrevocable trust is structured many times for the benefit of children and later generations.
- A "Power of Substitution" provision under IRC 675 (or similar non-estate inclusionary provision under the grantor trust rules) is inserted into trust agreement to make it defective for income tax purposes.
- Does the Trustor wish to preserve their exemption amounts? Or is it time to use the exemption before losing it? Sale vs. Gift.
- Allocate GST tax exemption? Dynasty Trust?
- Application of valuation discounts to assets?





PART I

Review of Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Estate Freezing & Estate Squeezing

SLATs

- *Spousal Lifetime Access Trusts (SLATs) are irrevocable trusts for the benefit of a spouse.*
- *“By including his or her spouse as a beneficiary, the grantor is able to take advantage of his or her increased lifetime gift tax exemption to (if all goes well) transfer the trust assets and all appreciation thereon out of his or her estate without fully relinquishing either the assets or the appreciation...”***
- *“The grantor’s spouse will often be entitled to receive distributions from the trust for his or her health, education and support, or for his or her best interests, and given that the wellbeing of both parties to a marriage is inherently intertwined, the grantor maintains a safety valve through which he or she may (indirectly, through his or her spouse) reacquire the trust assets if the need should arise...”***

***Domingo P. Such, III, Reciprocal Trusts: Language That Causes Problems And Reciprocal Consideration, Notre Dame Tax & Estate Planning Institute (Oct. 26, 2017)*

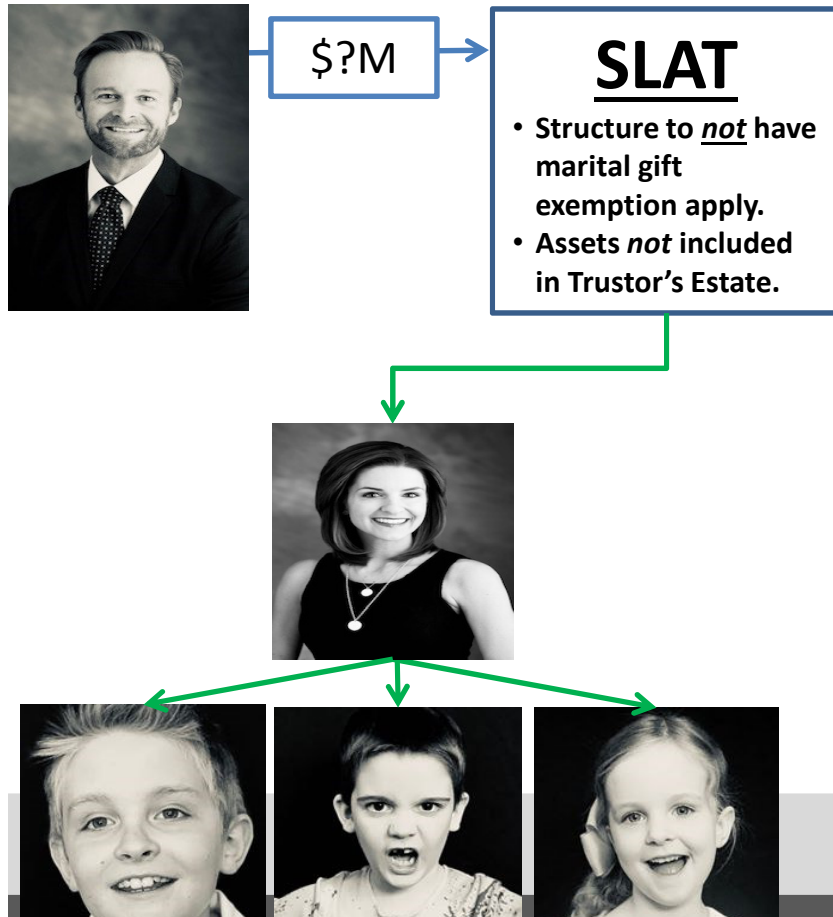


PART I

Review of Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Estate Freezing & Estate Squeezing

SLATs



- The irrevocable trust is for the benefit of the spouse providing only a “HEMS standard” that is carefully structured, where children and descendants are also beneficiaries at certain points of the trust’s life.
- Most commonly used for gifting of assets, rather than a sale.
- Must use separate property. Separate counsel needed?
- Which spouse will establish the SLAT first? What if there is a divorce?
- Careful consideration of trustee selection or use of independent trustee to navigate IRC 2036 concerns.

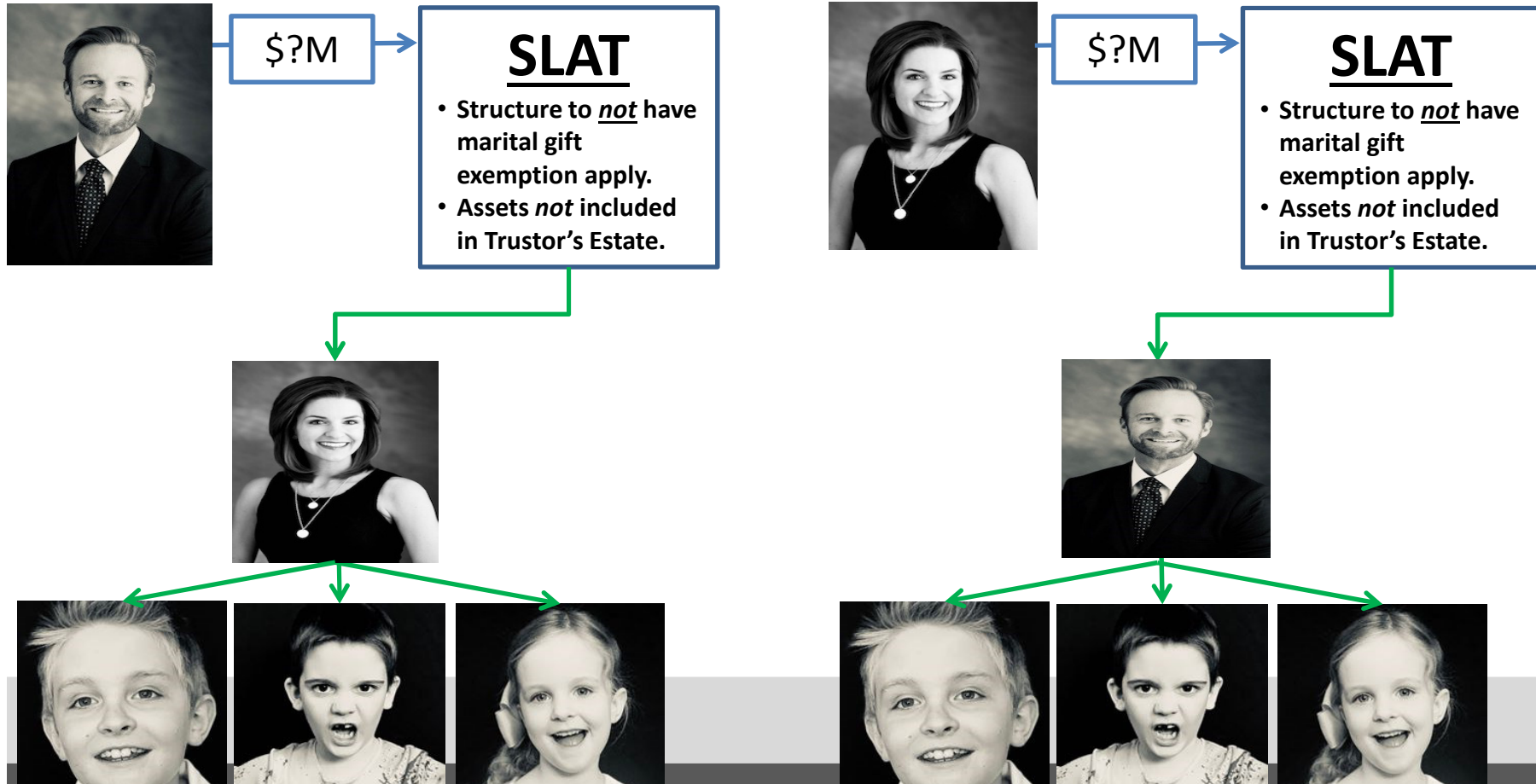


PART I

Review of Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

What about the reciprocal trust doctrine?!

SLATs





PART I

Review of Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

What about the reciprocal trust doctrine?!

- *In general, the reciprocal trust doctrine may be applied when two trustors (often related in some manner) create identical or nearly identical trusts at approximately the same time, and there is some crossing of beneficial interests or powers ultimately benefiting one another.*
- *If the doctrine is applied successfully by the IRS, each trustor will be required to include in his or her estate the property held in the trust he or she created (i.e., uncross the transfers).*
- *Methods to create NON-reciprocal trusts: (1) have different beneficiaries included; (2) include different provisions for the beneficiaries (distributions standards and withdrawal rights); (3) include different powers of appointment; (4) execute trusts at different times (preferably in different tax years); (5) utilize different trustees; and (6) gift different assets to each SLAT.*



PART I

Review of Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Capital Gains Analysis

- *Hypothetical: Business Owner in Top Tax Bracket Sells \$10M Business***

\$10M sale price - \$0 basis x 28.34% tax rate (23.8% CG & NIIT and 4.54% AZ) = \$2,834,000 Fed & State Taxes // \$7,166,000 Post-Tax

- *Hypothetical: Same Facts, except Business Owner Dies; Children Sell Business following Step-Up In Basis.***

\$10M sale price - \$10M basis x 28.34% tax rate (23.8% CG & NIIT and 4.54% AZ) = \$0.00 Fed & State Taxes // \$10,000,000 Post-Tax

***Calculations are simple estimates intended on showing general logistics of certain applicable tax code provisions and are not exact. This “fun” disclaimer is applicable to all slides.*



PART II

Comparison of Current Tax Laws versus the Biden Tax Plan Proposals

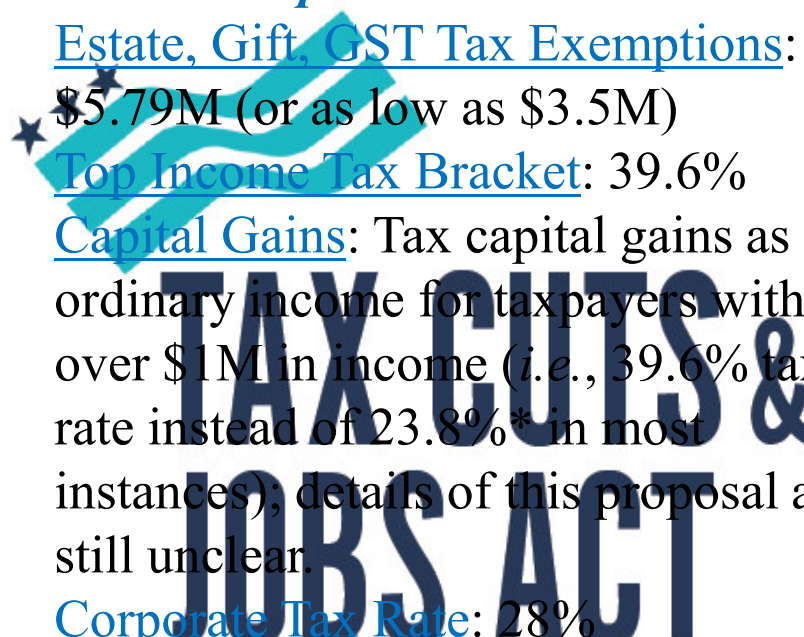
Estate Planning in 2020

Current Tax Laws—

- Estate, Gift, GST Tax Exemptions: \$11.58M
- Top Income Tax Bracket: 37%
- Capital Gains: In general, the long-term capital gains tax rate is 0%, 15% or 20% depending on your taxable income and filing status (additional 3.8% net investment income tax (NIIT)).
- Corporate Tax Rate: 21%
- IRC § 1014: In general, appreciated assets receive a step-up in basis upon death.

Biden Tax Proposal—

- Estate, Gift, GST Tax Exemptions: \$5.79M (or as low as \$3.5M)
- Top Income Tax Bracket: 39.6%
- Capital Gains: Tax capital gains as ordinary income for taxpayers with over \$1M in income (*i.e.*, 39.6% tax rate instead of 23.8%* in most instances); details of this proposal are still unclear.
- Corporate Tax Rate: 28%
- IRC § 1014: In general, appreciated assets will be taxed on unrealized gains at death for the “wealthy.”

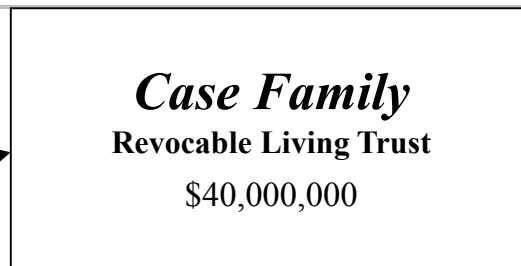




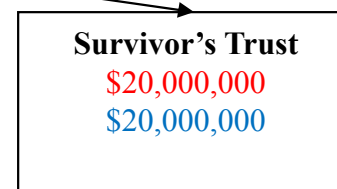
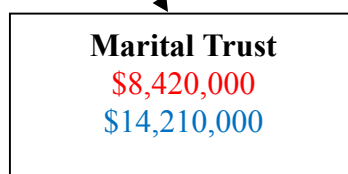
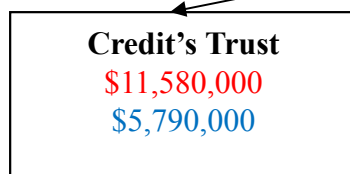
PART II

Impact of Biden Tax Proposal on Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

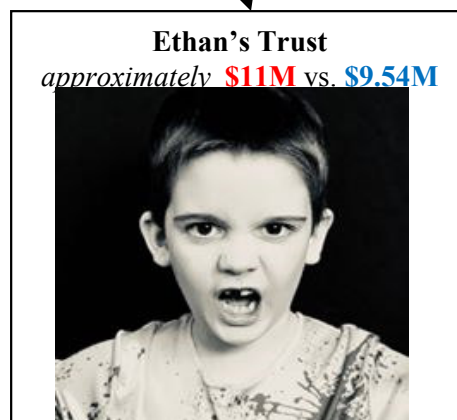
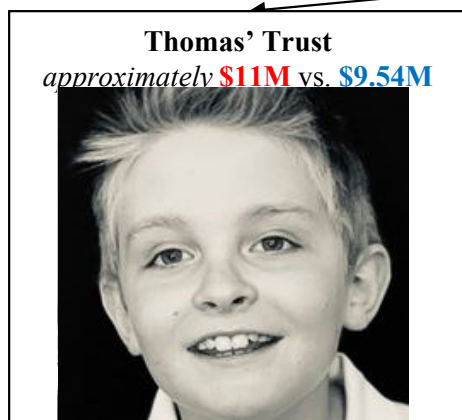
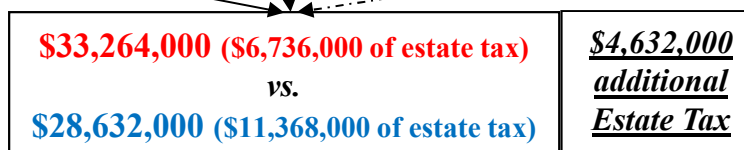
Now:
\$11.58M
EXEMPTION
Vs.
\$5.79M
EXEMPTION



At First Death:



At Second Death:
Marital, Survivor's, and Credit
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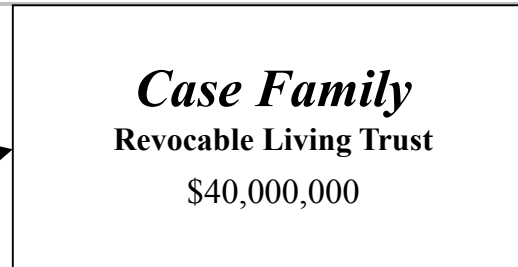




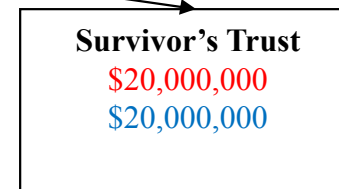
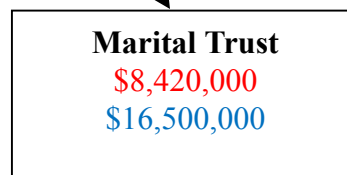
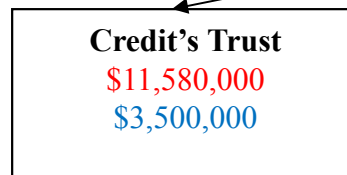
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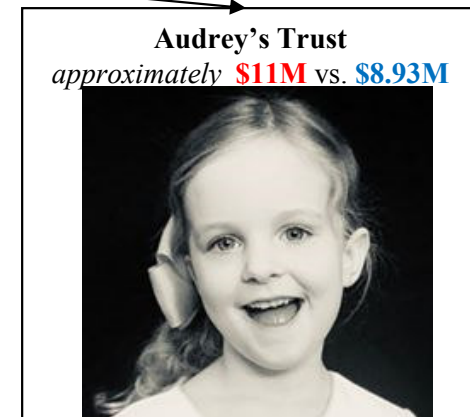
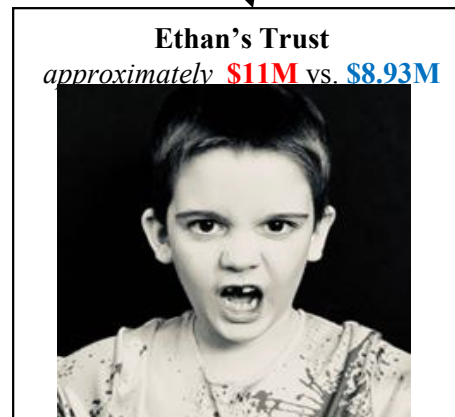
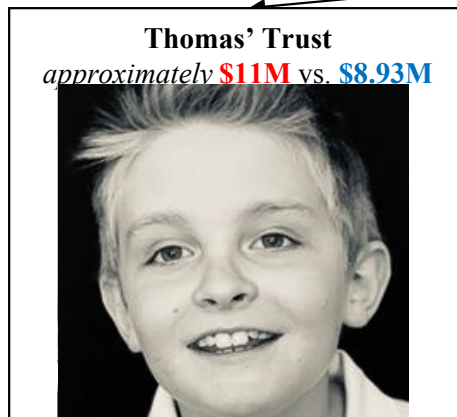
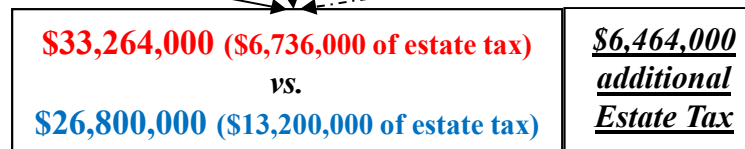
Now:
\$11.58M
EXEMPTION
Vs.
\$8.93M
EXEMPTION



At First Death:



At Second Death:
Marital, Survivor's, and Credit
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PART II

Impact of Biden Tax Proposal on Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Irrevocable Life Insurance Trusts (ILITs)



2021

1999	2002	2005	2011	2013	2016	2017
Exemption: \$650K	Exemption: \$1M	Exemption: \$1.5M	Exemption: \$2M	Exemption: \$5.25M	Exemption: \$5.45M	Exemption: \$5.49M
Tax Rate: 55%	Tax Rate: 50%	Tax Rate: 47%	Tax Rate: 45%	Tax Rate: 40%	Tax Rate: 40%	Tax Rate: 40%



PART II

Impact of Biden Tax Proposal on Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Estate Freezing & Estate Squeezing

- ***Grantor Retained Annuity Trusts***

- *Will minimum term on GRATs become 10 years?*
- *Should clients lock in a long-term GRAT based upon low interest rates and current laws?*

Recommended Reading: David A. Handler & David Herzig, Drafting Superior GRATs and Deciding If Certain Assets Classes Are Appropriate for a GRAT, Notre Dame Tax & Estate Planning Institute (Oct. 26, 2017)

- ***IDGTs and SLATs***

- *IDGTs:*
 - *Are clients finally ready to move forward with using up their exemption?*
 - *Have enough time/bandwidth to get to all HNW & UHNW clients?*
- *SLATs:*
 - *Running out of time?*
 - *Reciprocal Trust Doctrine?*

Recommended Reading: Domingo P. Such, III, Reciprocal Trusts: Language That Causes Problems And Reciprocal Consideration, Notre Dame Tax & Estate Planning Institute (Oct. 26, 2017)



PART II

Impact of Biden Tax Proposal on Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Estate Freezing & Estate Squeezing

- **Accounting of Exemption Reduction**

- Remember, a drop in estate tax exemption is presumed to be a “FIFO” accounting system... First In, First Out

~~\$11.58M~~

~~\$10.00M~~

~~\$9.00M~~

~~\$8.00M~~

~~\$7.00M~~

~~\$6.00M~~

~~\$5.00M~~

~~\$4.00M~~

~~\$3.00M~~

~~\$2.00M~~

~~\$1.00M~~

~~\$0M~~

- **Hypothetical:**

- Client Gifts \$7.00M in taxable gifts
- Estate Tax Exemption is reduced to \$3.5M
- Remaining Estate Tax Exemption is reduced to \$0M following change in tax laws.

- **Recommendation:**

- If exemption is believed to drop, but client is unable or unwilling to use all of his or her exemption, consider using up one spouse's exemption instead of using both.



PART II

Impact of Biden Tax Proposal on Current Tax Laws practitioners often analyze in the Estate Planning Process

Capital Gains Analysis

- ***Hypothetical: Business Owner in Top Tax Bracket Sells \$10M Business*****
\$10M sale price - \$0 basis x 28.34% tax rate (23.8% CG & NIIT and 4.54% AZ) = \$2,834,000 Fed/State Taxes // \$7,166,000 Post-Tax
- ***Hypothetical: Same Facts, except Business Owner Dies; Children Sell Business following Step-Up In Basis.*****
\$10M sale price - \$10M basis x 28.34% tax rate (23.8% CG & NIIT and 4.54% AZ) = \$0.00 Fed/State Taxes // \$10,000,000 Post-Tax
- ***Hypothetical: Business Owner in Top Tax Bracket Sells \$10M Business*****
\$10M sale price - \$0 basis x **44.14%** tax rate (**39.6% Ordinary Income Tax** and 4.54% AZ) = **\$4,414,000** Fed/State Taxes // **\$5,586,000** Post-Tax
- ***Hypothetical: Same Facts, except Business Owner Dies; Unrealized Gains are Taxed on Business Owner's Death.*****
\$10M sale price - **\$0M basis** x **44.14%** tax rate (**39.6% Ordinary Income Tax** and 4.54% AZ) = **\$4,414,000** Fed/State Taxes // **\$5,586,000** Post-Tax

***Calculations are simple estimates intended on showing general logistics of certain applicable tax code provisions and are not exact. This "fun" disclaimer is applicable to all slides.*



PART II

Impact of Biden Tax Proposal on Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Recommendations

- *Which clients will the tax bill impact immediately?*
 - HNW and UHNW worth clients need to use up their exemption, if they can; this really does appear to be a use it or lose it scenario.
 - Do not forget about the use of GST Exemption as well!
 - If married clients are unable or unwilling to use up all of *both* of their exemption amounts, explore the benefits of using up one spouse's exemption instead.
 - If uncomfortable with establishing non-reciprocal SLATs due to timing, marital dynamics, etc., consider having one spouse establish a SLAT and the other establishing an IDGT for the children.
 - Revisit the HNW and UHNW clients' "basic estate plans"; the funding formulas or the type of revocable living trust such client may have may no longer be ideal.
- *Still reach out to all of your clients... when you can.*
 - Even if clients are *not* HNW or UHNW, their basic estate plans may still need to be updated (*Ex.* Clients may have "I love you trust" but now need an A-B Trust or Disclaimer Trust).
 - Clients appreciate hearing from you. Even if they tax bill does not warrant a structural update to their estate plan, they may wish to disinherit a child for voting for Kanye West.



PART II

Impact of Biden Tax Proposal on Basic and Advanced Estate Planning Transactions and Capital Gains Analysis

Dear _____:

With the upcoming election only a few months away and the “Biden Tax Plan” generally having been proposed, I am sending this email to summarize the provisions within the bill that may impact your tax and estate planning matters. Such tax plan, if enacted, would have a broad impact on high net worth individuals and families, not only in the area of estate tax, gift tax, and generation skipping transfer tax, but also on capital gains taxes on high income earners. The following is a very brief and generalized summary:

Biden Tax Plan Proposals**

- *Income Tax*—
 - Tax capital gains as ordinary income for taxpayers with over \$1M in income and tax unrealized gains at death.
 - Restore the top individual income tax rate to 39.6%.
 - Cap itemized deductions (28% limit and Pease limitation).
- *Estate, Gift, & Generation Skipping Transfer Tax*—
 - Reduce the exemption amounts from \$11.58M per person to \$5.79M (or even as low as \$3.5M per person).
- *Business Tax Matters*—
 - Increase corporate tax rate to 28%.
 - Phase out small business income deductions above \$400,000.

**These are a few of the key provisions impacting high net worth individuals, but there certainly many other proposals under the Biden Tax Plan.

In reviewing your estate plan, I would highly recommend that we schedule a 15-20 minute phone call to discuss the election’s impact on your estate plan, along with potential strategies to explore to take advantage of the current tax laws of 2020. I have copied my assistant, Jordan, to this email to follow-up with some date and times to schedule a call. I look forward to speaking with you soon.

Thanks,



TIFFANY
& BOSCO
P.A.

Experienced Lawyers Committed to Results

Thank you

