TAX INCREASE CONSIDERATIONS THAT ARE CURRENTLY ON THE TABLE

As legislation to increase taxes loom, life insurance becomes an important vehicle for preserving generational wealth.

Tax proposals offered by candidate Biden during his campaign, the current Biden Administration, and various members of the Congress are coming together for consideration. Increased taxation certainly ranks high in the President's plans of urgent items to address. American Presidents and Congress always think in terms of election cycles first and foremost. With the executive and legislative branches in Democratic control, all parties are aware that congressional elections in 2022 could flip either legislative chamber to Republican control, thereby complicating Mr. Biden's agenda. There is much pressure to tick the priority items off as DONE well before the next election cycle and preferably as soon as possible.

Control is a tenuous thing. After accomplishing the COVID funding objective (with zero Republican support,) the Administration most likely now looks to infrastructure. (Although high emotions over recent mass shootings might encourage a gun control measure to get in the way.) Like the COVID legislation, infrastructure includes much that doesn't directly relate to roads or bridges specifically and may be split into a couple of pieces—one or both of which can contain tax legislation. Absent bipartisan support, some part of the infrastructure proposals could be passed using budget reconciliation, which is how the COVID measure was passed. If Mr. Biden's first two major pieces of legislation are COVID and infrastructure the price tag could total about $5 trillion. Someone has to pay for that and a look in the mirror or across your desk may start to reveal who that someone is.

The Biden Administration will very likely look to increase tax revenue for two reasons: one, the U.S. budget deficit will demand it; and two, it likes the idea.

As mentioned, there is always the possibility of conflicting legislation emerging, the filibuster and Senator McConnell's "nuclear winter" remain highly emotional topics, and how far can Senator Manchin sway in the wind? --all things contribute to uncertainty. A sweeping tax proposal may require the budget reconciliation process to get below the 60-vote senate requirement. Budgets, though, are only set once per fiscal year. Legislation jammed through using budget reconciliation for the next fiscal year probably wouldn't see light of day before October 2021 which begs the question what the effective date of any new tax legislation would be.

So, if compromise can somehow be achieved in Washington, a bipartisan infrastructure bill with some tax increases (probably corporate) may happen sooner; absent compromise a broader tax bill might be dropped into the next budget reconciliation—all assuming the filibuster stays put. Regarding the must-do argument for tax increases to address the deficit, the federal budget deficit was 98% of GDP in the 2020 fiscal year and will exceed full GDP this year, according to the CBO. (From politico.com) GDP is Gross Domestic Product—the value of all goods and services of the country.

In short, GDP is the economy, and Washington spending exceeds our full economy this year for the first time since 1946 after four years of world war. Dire is too modest a word to describe this indebted condition. How would it feel to have your credit card debt exceed your household income? Such an imbalance would strongly suggest either a reduction in spending, (unlikely in today's Washington,) or an increase in revenue (taxes,) which Mr. Biden proposed long before he became president.

Lots of people on both sides of the aisle thought the Tax Cuts and Jobs Act (TCJA,) the so-called Trump tax cuts of 2017, went too far in lowering a broad array of taxes. It was bound to and did become a significant election year topic in both the 2018 and 2020 elections—both of which favored Democrats and their messaging. Increased rates for high income earners, some sort of wealth tax, significant increases in capital gains and dividend taxes, increased corporate income taxes—all were campaign topics. So was the estate tax, which we'll focus on in a minute. The bottom line for broad tax legislation is this: the Biden Administration would like to see it happen, and in the likely event of no Republican support, doing it through budget reconciliation is the likely route with timing in the fall.

Of course, nuking the filibuster would probably accelerate the Administration's agenda with tax increases front and center. With the filibuster gone, a simple Democratic majority in both chambers would send tax legislation to the President for signature. The Tax Proposals Democratic members of both the House and the Senate have voiced general suggestions of increasing corporate tax rates from 21% to 28% and the White House has mentioned taxing corporate foreign earnings. (Wall Street Journal 3/25/2021.) On the personal tax side, the White House has suggested increasing individual income tax rates from 37% to 39.6% on high income taxpayers, and significantly elevating capital gains rates on these same taxpayers.

The Biden election campaign offered a number of specific tax changes which, presumably, are all still on the table after the Democratic sweep in November. Those proposals include the individual tax rate increase mentioned above for earned income above $400,000, capital gains and dividend taxes at the ordinary rates (39.6%) for income above $1 million. The social security payroll tax, which caps at $137,700, would be reinstated at income of $400,000 and up. That 12.4% tax is evenly split between employees and employers. (The Tax Foundation October 2020.) Candidate Biden also proposed restoring the estate exemption and estate tax rate to 2009 levels. The 2009 exemption was $3.5 million per person and the tax rate above that was 45%. Those levels today, as you know, are $11.7 million per person and 40% respectively.

Senator Bernie Sanders introduced a bill on March 25 (euphemistically titled "For the 99.5% Act" which ups the Biden campaign one better: Estate exemption of $3.5 million per person, tax rate increase to 45%, and increasing from there to 50% at $10 million and up to 65% for the mega-wealthy. So, here's where we are: the Biden Administration wants to "go big" with its legislative agenda, the White House has both the House and the Senate on its side, and there is sentiment among Democrats that tax increases are necessary from a fiscal perspective, and equitable from a societal perspective.

Gallagher

Insurance | Risk Management | Consulting

Some questions persist about bipartisanship and the role of the filibuster in the Senate, but any betting on the status quo should probably be made with very long odds.

A Role for Life Insurance

Enter the role of life insurance and the benefits of tax free proceeds at death. Life insurance professionals grew up with this *Life Insurance 101* training: life insurance can provide a tax free legacy; for those who already have a substantial estate for legacy purposes, life insurance can replenish the estate tax erosion on that legacy. Financial advisors and wealth management professionals view life insurance primarily as protection against an early death in wealth building. – an important role, but one significantly complemented by life insurance's replenishment role in a high tax environment. If inherited assets are exposed to significant taxation, life insurance offers a brilliant tax free mitigation.

Almost nowhere is this mitigation better illustrated than in Federal estate taxation. (We'll save State estate and inheritance taxation for another day.) Losing 45% of an estate above $3.5 million, or $7 million on married couples, is a painful loss. Imagine a non-liquid asset valued as the bulk of a gross estate valuation, a family farm or successful business, for example. Some or part of the asset might need to be liquidated, mortgaged or otherwise leveraged to pay the tax liability. Those are challenges no heir wants to face on assets lovingly built by parents. With 2021 exemption levels at $11.7 million ($23.4 million for married couples) the estate planning market and clear need for life insurance to mitigate estate taxation was pretty much rarified air. Not so at these proposed lower levels. It's easy to imagine successful business owners, land and property investors, professionals in law or medicine or corporate executives with stock options, deferred compensation and qualified retirement plans in or growing into estate taxable positions. Think about the client with a substantial IRA rollover growing with today's wild market gains. As you think about these people, calculate their current positions at a modest growth rate, and compound it over decades to life expectancy. The numbers can become dramatic and the tax impact equally so.

We will continue to address this topic as it unfolds in coming months. And, as mentioned, if the filibuster goes down the likelihood of major tax increases occurring sooner, rather than later, is magnified. Preplanning for possible or likely estate taxes takes time. Transferring assets, gifting, drafting trusts and considering irrevocable designs and SLAT provisions might take months. Clearly the time to begin the conversation with clients is now. Even a quick, back-of-the-envelope calculation of today's gross estate, increased by some rate of growth over some assumed duration, and applied against proposed exclusions and tax levels, can be a sobering exercise.