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certainly possible. The last time a significant tax increase was enacted retroactively was in August 1993, when the Omnibus Budget Reconciliation Act included an ...

Jan. 27, 2021



The year 2020 was one like no other, and thus far into 2021, the 2020 mantra “expect the unexpected” has continued. The election cycle of 2020 finally ended on January 5, 2021 with the Georgia runoff elections with Democrats winning both Senate seats. As a result, President Biden will have slight Democratic majorities in both the House

and the Senate (with the Vice President's tie breaking vote). It was not the tsunami

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Americans, raises the federal minimum wage to \$15 per hour, and includes \$350 billion in emergency funding for state and local governments. Biden said the proposal is the first step in a two-part plan that is needed immediately and will be followed by an economic recovery plan — the Build Back Better Recovery Plan — that he will outline in February. The American Rescue Plan will bring the total amount of Covid-19 relief to exceed \$5 trillion.

From a tax policy perspective, 2021 could be a year of significant legislative tax change as well. Under the Biden plan, the top income tax rate on taxpayers with income greater than \$400,000 will most likely revert back to 39.6 percent, the top rate prior to the Tax Cuts and Jobs Act (TCJA) passed in 2017. Many of the other TCJA tax cuts could be rolled back as well, including the 21 percent corporate tax rate. A new corporate alternative minimum tax could also be introduced. Other tax increases are expected as well, including increased social security taxes and capital gains rates on income above \$400,000 and \$1 million, respectively.

The most significant proposed tax policy changes, could be in the area of estate and gift, where Biden's proposals have included eliminating the step-up in basis at death for inherited assets, and reducing the estate tax exemption from the current \$11.7 million amount to pre-TCJA levels of \$5 million (indexed for inflation), or possibly even lower, to \$3.5 million.

Some fear that these tax increases will be retroactive to January 1, 2021, which is certainly possible. The last time a significant tax increase was enacted retroactively was in August 1993, when the Omnibus Budget Reconciliation Act included an increase in the top estate tax rate from 50 percent to 55 percent, retroactive to January 1, 1993.

Many feel, however, that retroactive tax increases are unlikely in 2021, because unemployment is still high, and given the slow economic recovery from COVID-19,

it's not an ideal time for significant tax increases. It seems more likely that the

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2020 Coronavirus Aid, Relief, and Economic Security (CARES) Act. The 5,593 page CAA also adds numerous new tax, payroll and retirement provisions.

Recovery Rebates and Unemployment Benefits

The CAA provides a refundable tax credit in the amount of \$600 per taxpayer (\$1,200 for married taxpayers filing jointly), in addition to \$600 per qualifying child. The credit phases out starting at \$75,000 of modified adjusted gross income (\$112,500 for heads of household and \$150,000 for married taxpayers filing jointly). The rebates are based on 2019 tax returns, and therefore a taxpayer could receive a payment that is less than they are entitled to. These taxpayers would be able to claim an additional credit for the shortfall on their 2020 tax return. Conversely, if a taxpayer receives too high a payment, they won't have to repay the difference.

For the 14 million Americans collecting unemployment, the Act provides an additional \$300 per week from December 26, 2020 through March 14, 2021. The law also provides an extra benefit of \$100 per week for certain workers who have both wage and self-employment income but whose base unemployment benefit calculation doesn't take their self-employment into account.

Deductibility of PPP-Funded Expenses

The CAA relief package provides \$284 billion to reinstate the CARES Act PPP loan program through March 31, 2021; \$15 billion for live venues, independent movie theaters, and cultural institutions; and \$20 billion for EIDL grants to businesses in low-income communities. The Act makes numerous modifications to the CARES Act PPP and EIDL programs, generally making them simpler and more favorable for borrowers.

In a welcome provision, the Act clarifies that gross income does not include any amount that would otherwise arise from the forgiveness of a PPP loan. This

addresses a controversial issue where the IRS had taken the position that no

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CAA CARES Act Pandemic Provisions

Employee retention tax credit: The Act extends the CARES Act Employee Retention Tax Credit (ERTC) through June 30, 2021, expanding the ERTC and making necessary technical corrections. The expansions of the credit include:

- An increase in the credit rate from 50 percent to 70 percent of qualified wages;
- An increase in the limit on per employee creditable wages from \$10,000 for the year to \$10,000 each quarter;
- A reduction in the required year-over-year gross receipts decline from 50 percent to 20 percent;
- A safe harbor allowing employers to use prior-quarter gross receipts to determine eligibility;
- A provision to allow certain governmental employers to claim the credit;
- An increase from 100 to 500 in the number of employees counted when determining the relevant qualified wage base; and
- Rules allowing new employers who were not in existence for all or part of 2019 to be able to claim the credit.

The Act also makes the following changes retroactive to the effective date of the CARES Act:

- Provides that employers who receive PPP loans may still qualify for the ERTC with respect to wages that are not paid with forgiven PPP proceeds;
- Clarifies the determination of gross receipts for certain tax-exempt organizations; and
- Clarifies that group health plan expenses can be considered qualified wages even when no other wages are paid to the employee, consistent with IRS guidance.

Payroll tax credits: The CAA extends the refundable payroll tax credits for paid sick

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tax for any employee whose pretax wages or compensation during any biweekly pay period generally is less than \$4,000.

Trump's deferral applies to payroll taxes on wages paid from Sept. 1 through Dec. 31, 2020. Under the memorandum, employers are required to increase withholding and pay the deferred amounts ratably from wages and compensation paid between Jan. 1, 2021, and April 30, 2021. The CAA extends the repayment period through Dec. 31, 2021.

Educator expenses for protective equipment: The CAA requires Treasury to issue regulations or other guidance providing that the cost of personal protective equipment and other supplies used for the prevention of the spread of COVID-19 is treated as an eligible expense for the educator expense deduction. The regulations or guidance will apply retroactively to March 12, 2020.

Retirement Plan Relief: The CARES Act temporarily allows individuals to make penalty-free withdrawals from certain retirement plans for coronavirus-related expenses, permits taxpayers to pay the associated tax over three years, allows taxpayers to recontribute withdrawn funds, and increases the allowed limits on retirement plan loans. The CAA adds money purchase pension plans to the retirement plans qualifying for these temporary rules. The provision applies retroactively to the effective date of the CARES Act.

Be aware that the CAA doesn't extend the CARES Act's temporary waiver of required minimum distributions. Affected taxpayers should plan on resuming those distributions for 2021.

CAA Tax Provisions

Temporary allowance of full deduction for business meals: The Act temporarily allows a 100 percent business expense deduction for meals (rather than the current

50 percent) as long as the expense is for food or beverages provided by a restaurant.

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penalty is increased from 20 percent to 50 percent of the underpayment for taxpayers who overstate this deduction.

Modification of limitations on charitable contribution: The CARES Act increased the limitations on charitable deductions for cash contributions made in 2020, boosting it from 50 percent to 100 percent of Adjusted Gross Income (AGI). The CAA carries that over for 2021 more tax planning flexibility. Any excess cash contributions are carried forward to later years.

Education expenses: The Act repeals the deduction for qualified tuition and related expenses and in its place increases the phase out limits on the lifetime learning credit (so they match the phase-out limits for the American opportunity credit), effective for tax years beginning after Dec. 31, 2020.

Earned Income Tax Credits: The CAA includes a temporary change that could result in larger Earned Income Tax Credits (EITCs) and Child Tax Credits (CTCs). It allows lower-income individuals to use their earned income from the 2019 tax year to determine their EITC and the refundable portion of their CTC for the 2020 tax year. This could produce larger credits for eligible taxpayers who earned lower wages in 2020 due to the pandemic.

Temporary special rules for health and dependent care flexible spending arrangements: The CAA allows taxpayers to roll over unused amounts in their health and dependent care flexible spending arrangements from 2020 to 2021 and from 2021 to 2022. This provision also permits employers to allow employees to make a 2021 midyear prospective change in contribution amounts.

Depreciation of certain residential rental property over 30-year period: The CAA provides that the recovery period for residential rental property placed in service

before January 1, 2018, and held by an electing real property trade or business, is 30

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and who are still working. For certain construction and building trades workers, the age is lowered to 55.

Temporary rule preventing partial plan termination: The CAA provides that qualified plans will not be treated as having a partial termination during any plan year that includes the period March 13, 2020, through March 31, 2021, as long as the number of active participants covered by the plan on March 31, 2021, is at least 80 percent of the number covered on March 13, 2020.

CAA Disaster Tax Relief

The CAA provides disaster tax relief for individuals and businesses in presidentially declared disaster areas for major disasters (other than COVID-19) declared after Dec. 31, 2019, through 60 days after the date of enactment.

Use of retirement funds for disaster mitigation: The CAA allows residents of qualified disaster areas (as defined in the Act) to take a qualified distribution of up to \$100,000 from a retirement plan or individual retirement account (IRA) without penalty. Amounts withdrawn are included in income over three years or may be recontributed to the plan.

Employee retention credit for disaster zones: The CAA allows a tax credit of 40 percent of wages (up to \$6,000 per employee) to employers who conducted an active trade or business in a qualified disaster zone (as defined in the Act). The credit applies to wages paid without regard to whether the employee performed any services associated with those wages.

Qualified disaster relief contributions: The CAA modifies the CARES Act's modification of the charitable contribution limits for 2020 to allow corporations to make qualified disaster relief contributions of up to 100 percent of their taxable income.

Qualified disaster-related personal casualty losses: The CAA permits individuals

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for tax years beginning after December 31, 2020.

Five-Year Tax Extenders: The CAA includes five-year extensions to the following provisions:

- New markets tax credit.
- Employer credit for paid family and medical leave, which is in addition to the payroll tax credits for paid sick and family leave.
- Work opportunity credit.
- Gross income exclusion for discharge of indebtedness on a principal residence, although the amount of exclusion is lowered to \$750,000 from \$2 million.
- Tax-free exclusion for certain \$5,250 employer payments of student loans through 2025. The payment can be made to the employee or the lender.
- Empowerment zone designation.

Two-Year Tax Extenders: The Act provides two-year extensions to the following provisions:

- Residential energy-efficient property credit. The bill also makes qualified biomass fuel property expenditures eligible for the credit.
- Carbon oxide sequestration credit (through 2025).
- Energy investment tax credit for solar and residential energy-efficient property.

One-Year Tax Extenders: The Act provides one-year extensions to the following provisions:

- 10 percent credit for qualified non-business energy property.
- Credit for qualified fuel cell motor vehicles.
- 30 percent credit for the cost of alternative fuel vehicle refueling property.
- 10 percent credit for plug-in electric motorcycles and two-wheeled vehicles.
- Health coverage tax credit.

- Credit for electricity produced from certain renewable resources.

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AGENDA

Biden's American Rescue Plan

President Biden's American Rescue Plan builds on previous relief to individuals, households and small businesses. It would include funding for vaccine distribution and aid to state and local governments.

Stimulus Checks: The Biden plan would boost direct payments to individuals to \$2,000 for most Americans, on top of the \$600 that the CAA provided in December. The plan would also allow residents who are married to undocumented residents, who were barred in prior rounds, to receive stimulus payments.

Tax credits, childcare: Biden would expand tax credits for low- and middle- income families and make them refundable for 2021. He is proposing to expand the child tax credit to \$3,000 from \$2,000 for each child 17 and younger. Children under age six would be eligible for \$3,600. Biden is also requesting \$25 billion for a stabilization fund to help open child-care centers and \$15 billion in grants to support essential workers in meeting childcare costs.

Paid leave: The Biden plan would create a requirement for employers, regardless of size, to offer paid sick leave during the pandemic to workers, extending the benefit to a projected 106 million workers. Parents and family members caring for sick relatives or out-of-school children could receive more than 14 weeks of paid sick and family leave. The plan would provide benefits of up to \$1,400 per week and tax credits for employers with fewer than 500 employees to reimburse them for the cost of the leave.

Vaccinations, testing: Biden's plan includes \$20 billion to create a national vaccine distribution program that would offer free shots to all U.S. residents regardless of immigration status. The plan calls for creating community vaccination centers and

deploying mobile units in hard-to-reach areas. Biden is also calling for \$50 billion to

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Minimum wage: Biden would increase the federal minimum wage to \$15 an hour from \$7.25, and would end the tipped minimum wage used widely by restaurants and the hospitality industry.

Schools: The plan is also calling for \$170 billion to help schools to open. About \$130 billion would go to K-12 schools to help them hire additional staff to reduce class size, modify spaces and purchase resources to help meet students' academic and mental health needs. The plan would also direct \$35 billion to colleges and universities and create a \$5 billion fund for governors to direct help to schools most hard-hit by the virus.

Rental assistance: The proposal would extend the eviction and foreclosure moratorium through September. It would also provide \$30 billion to help low-income households who have lost jobs to pay rent and utility bills. The plan would also provide \$5 billion to states and localities to offer emergency housing for families facing homelessness.

Small businesses: Biden is proposing to leverage \$35 billion in government funds into \$175 billion in low-interest loans to finance small businesses. He is also calling for \$15 billion in grants for such employers.

PRESIDENT BIDEN'S RESCUE PLAN PART II: THE BUILD BACK BETTER RECOVERY PLAN

President Biden has said his American Rescue Plan will be followed by a second economic recovery plan, the Build Back Better Recovery Plan, targeted toward recovery, infrastructure, green energy, health care, and education initiatives. It will focus on the longer-term recovery and will be outlined in more detail in February.

BIDEN CAMPAIGN TAX PLATFORM

Biden's American Rescue Plan did not include any tax increases, and with stimulus

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retroactivity is possible, the later in the year that the legislation enacted the more likely that most provisions will be prospectively effective on January 1, 2022. Some provisions, however, could become law on an earlier date, such as the date the legislation is introduced or the date it is signed into law.

Higher Income Tax Rates

During the election campaign, Democrats proposed to raise taxes on earners with more than \$400,000 of annual income, cut them for others, and raise benefits for the lowest earners. Assuming these income tax hikes will be effective in 2022, those affected would want to deploy basic tax bracket management strategies for times of rising tax rates, such as accelerating income into 2021, making Roth IRA conversions, exercising stock options and taking bonuses in 2021, if possible.

From a corporate rate perspective, Biden's proposal is to increase the corporate tax rate, bumping it from 21 percent to 28 percent. Since the campaign, some speculate that the rate will only increase to 24 or 25 percent given the fragile economy and the narrow Democratic majority. The Biden plan would also create a new alternative minimum tax of 15 percent on corporations with over \$100 million in book net income, a plan which may get some bipartisan support among Republicans in an effort to reduce the deficit.

Limits on Itemized Deductions

A Biden administration would limit the value of itemized deductions by limiting a taxpayer with more than \$400,000 of income to a 28 percent tax bracket benefit. Itemized deductions would be further limited at that income level by restoring the pre-2018 Pease Limitation, which would reduce itemized deductions by 3 percent of AGI up to 80 percent of itemized deductions. Also proposed is the elimination of the

TCJA \$10,000 state and local tax (SALT) deduction cap. Itemizers should plan to

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Increased Payroll Taxes

The Biden payroll tax proposal would subject wage and self-employment income in excess of \$400,000 to the Social Security payroll tax. Currently, the 6.2 percent tax is on the first \$142,800 of wage income, so wages and earnings between \$137,700 and \$400,000 would not be taxed, creating a donut-hole structure. For those self-employed individuals who pay both the employee and the employer halves, the tax is 12.4 percent. Someone who is self-employed making \$1 million a year would see their self-employment (SE) tax increase by \$74,400, mitigated slightly by the fact that the 50 percent employer-equivalent portion would be deductible in calculating AGI.

Should this tax be expanded, business owners might consider converting to an S corporation structure, as S corporation dividends are not subject to employment taxes, assuming reasonable compensation rules are met. As for executive compensation, incentive stock options would likely become more popular because there is no Social Security tax on the option spread.

Higher Capital Gains and Investment Income Taxes

Under the Biden plan, individuals earning over \$1 million would be subject to ordinary income tax rates on their long-term capital gains and qualified dividends. Investors with incomes over \$1 million should consider selling appreciated assets in 2021, prior to elimination of the 20 percent preferential rate for long-term capital gains and qualified dividends in 2022.

Other options to consider include investment in opportunity zone funds, gifting of appreciated assets (also to utilize the current estate and gift tax exemption), and charitable contributions of appreciated assets to qualified charities, including donor-advised funds and private foundations.

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Estate and Gift Tax Changes

The 2021 estate tax exemption threshold is \$11.7 million per individual (indexed for inflation) with a top tax rate of 40 percent. After 2025, this amount is scheduled to revert to the pre-TCJA exemption, which is an indexed amount that would equate to approximately \$5.8 million. The Biden plan would accelerate the reduction of the exemption now, either to the pre-TCJA level of \$5 million (indexed for inflation), or as low as \$3.5 million as proposed by the Obama administration. The top tax rate would increase to 45 percent or possibly higher.

Also proposed is the elimination of the “basis step-up” at death. Currently, a future capital gains tax upon disposition of an inherited asset is based on its value at the time of death or six months later, referred to as the basis step-up. The Biden plan is unclear as to how this change would be implemented, but there are two options. The first is to tax unrealized gains of the decedent, whereby the decedent's estate would pay the tax at death based on its fair market value, and presumably the heirs would take the assets at a basis stepped-up to that value. Alternatively, the heirs would receive carryover basis at death, and would pay capital gains tax on the sale of the asset based on that basis. Either option would lead to a significant tax on appreciated assets.

It is also possible that certain estate planning trust structures such as Grantor Retained Annuity Trusts (GRATs), Spousal Lifetime Access Trusts (SLATs) or Dynasty trusts could be modified or eliminated. Anticipating that the estate tax exemption could be cut in half or more, taxpayers with estates as low as \$3.5 million should seriously consider a wealth-transfer plan in 2021.

SECURING A STRONG RETIREMENT ACT OF 2020

Proposed retirement legislation, Securing a Strong Retirement Act of 2020, was introduced in the House in October. If enacted, this would significantly impact

401(k)s, 403(b)s, and IRAs, helping employers improve the strength of their

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plans would be required to automatically enroll eligible participants unless employees opt out. The initial automatic enrollment deferral would be at a minimum of 3 percent but no more than 10 percent. Each year, the amount would increase by 1 percent until it reaches the maximum 10 percent.

Simplify and increase in Saver's Credit: The proposal would amend the Saver's Credit to create a single 50 percent rate, increase the maximum credit amount from \$1,000 to \$1,500 per person, and raise the maximum income eligibility amount. The legislation would index the credit to inflation.

Index the IRA catch-up limit: Under current law, the limit on IRA contributions is increased by \$1,000 (not indexed) for individuals who have attained age 50. The legislation would index IRA catch-up limit contributions beginning in 2022.

Allow higher catch-up contribution after age 60: Currently, employees who are 50 and older can make catch-up contributions to retirement plans that exceed overall applicable limits. For 2021, the catch-up contribution is \$6,500. The legislation would increase these limits to \$10,000 and \$5,000 (both indexed), respectively, for individuals 60 and older.

Allow small immediate financial incentives for contributing: To motivate participants to contribute to a 401(k) plan, the bill would allow small immediate incentives such as gift cards.

Reduce the excise tax on certain accumulations in qualified retirement plans: The Act would reduce the penalty for failure to take a RMD from 50 percent to 25 percent. If a failure to take a RMD is corrected in a timely manner (as defined under the bill), the excise tax on the failure is reduced from 25 percent to 10 percent.

Exempt individuals with low account balances from RMD rules: The proposed legislation would not require participants to take a RMD if the balance in their

retirement plans and IRAs (excluding defined benefit plans) is not more than

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in 2021.

SUMMARY

2021 is shaping up to be another year of significant new legislation after the Democrat's Blue Wave, leading to many tax and financial planning opportunities for investors to surf. With the potential of retroactive tax legislation unlikely, investors should be planning now for these upcoming law changes. Your Wintrust advisor is here to guide you on your financial planning, the PPP loan application process, or other investment or financial needs you may have.

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Daniel F. Rahill, LL.M, CPA, J.D., is a Managing Director at [Wintrust Wealth Management](#), where he works with clients to determine their financial objectives and develop strategies for their tax, estate, investment, philanthropic, and family capital needs. Dan works closely with shareholders and their privately-held businesses on mergers, acquisitions, divestitures, and succession planning. He also advises wealthy families on tax minimization, wealth preservation, and family office management.

Previously, Dan was with KPMG for 27 years, where he held numerous leadership roles over his 21 years as a tax partner, including tax managing partner of the Chicago Metro Business Unit and trustee of the KPMG Foundation. He served as the lead partner on many of KPMG's high-profile multinational accounts, privately-held companies, and family offices. Prior to KPMG, Dan practiced law in Chicago, specializing in tax and estate planning. He began his career in audit with Ernst & Young.

Dan frequently lectures to CPA societies, bar associations, family office organizations, trade and industry groups, and universities. He is often published and interviewed in the media, including Chicago Tribune, Crain's Chicago Business, ABC7, WBBM Radio, Yahoo Finance, and the Illinois CPA Society's Insight Magazine. Dan is currently President of the

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