PALLAS
CAPITAL ADVISORS

Turning the Page

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A TIME FOR CHANGE

When NFL quarterback Tom Brady left the New England Patriots in early 2020, you could say it marked a turning point in his long and incredibly successful Hall of Fame career. Many people doubted his ability to survive in a different "system" than the one he had enjoyed for so long in New England. Change is hard, and most people naturally try to resist it.

As I write this, Mr. Brady is not just surviving, he's thriving, and his new team, the Tampa Bay Buccaneers, are poised to start their playoff run to the Super Bowl. His former teammates in Patriot land? – well they are enjoying the start of the offseason.

Change happens – a lot, actually, and the onset of President-elect Biden's administration will undoubtedly bring with it many changes that will impact individuals from a financial planning standpoint. We have written before that those who keep their ear to the ground, plan ahead, and proactively take advantage of tax policy changes stand the best chance of meeting their long-term financial objectives.

In this month's newsletter, we will examine some of the "changes" that were brought about by the recent stimulus package that was signed into law. We will also revisit some of the planning ideas that are worth the reader's consideration as we anticipate changes to tax policy under the new Administration.

INTRODUCTION

Most of the people I have talked with recently were ready to say goodbye to 2020 and are looking forward to what changes the new year brings. Of course, one of the changes we have written about (and discussed in The Pallas Perspective podcast) is the changing of the guard so to speak – not only with the U.S. Presidency but now with the January 5 special elections in Georgia completed, changes also in power within the U.S. Senate.

In one of his last official acts that impact the economy, just before the New Year, President Donald Trump signed on December 27 a $900 billion pandemic relief bill into law. The measure is the second-largest federal stimulus package after the $2 trillion CARES Act that Congress approved in March.

THE PACKAGE

The Tax Relief Act of 2020 and the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (all part of the Consolidated Appropriations Act of 2021, "the Act") contain $900 billion in spending along with several tax-related items. There are several items in the bill that individuals need to be familiar with.

- **Stimulus checks**

  The package sends direct stimulus payments of $600 to individuals, half the amount provided in the first round of checks, which went out in the spring.

  Eligible families (eligibility is phased out as income exceeds certain thresholds) will receive an additional $600 per child - which is $100 more than Congress gave families in the first round of relief last spring.

The amounts will be based on 2019 incomes. Those who filed their 2019 tax returns will receive their money automatically, as well as Social Security recipients and those who uploaded their bank account information using the IRS's online portal to receive their first payments.

The payments start phasing out when individual adjusted gross income exceeds $75,000 when head-of-household income exceeds $112,500, and when income for married couples filing jointly exceeds $150,000. For individuals without children, the payments go to zero when income reaches $87,000; that is $174,000 for married couples.

The Treasury Department said on January 7 that it had paid $130 billion of the estimated $164 billion total.

- **Unemployment benefits**

The jobless will receive a $300 weekly federal enhancement in benefits through March 14. The amount is half of the earlier federal extension, which ran out at the end of July.

Also, the package extends by 11 weeks two other pandemic unemployment programs that were created in the CARES Act in March and were set to expire at year's end.

The Pandemic Unemployment Assistance program initially expanded jobless benefits to gig workers, freelancers, independent contractors, the self-employed, and certain people affected by the coronavirus for up to 39 weeks. The Pandemic Emergency Unemployment Compensation program provided an additional 13 weeks of payments to those who exhausted their regular state benefits.

Both programs will now close to new applicants on March 14, but continue through April 5 for existing claimants who have not yet reached the maximum number of weeks.

Also, the measure provides a federally funded $100 per week additional benefit to those who have at least $5,000 in annual self-employment income but are disqualified from receiving Pandemic Unemployment Assistance because they are eligible for regular state unemployment benefits.

WILL LAWMAKERS INCREASE THE PAYMENTS TO $2,000?

That is likely, now that Democrats have won both Senate seats in Georgia, giving them control of the chamber. Sen. Chuck Schumer (D., N.Y.), the expected majority leader, said that raising the payments to $2,000 would be one of the new majority's first moves.

- **Charitable contribution deductions extended**

The above-the-line deduction for cash contributions has been extended through 2021 for those who do not itemize. In addition, in contrast to the CARES Act, there is no more marriage penalty and now a married couple filing jointly can deduct $600 (instead of the previous $300). This extension is for 2021 only.

Also extended through 2021 is the ability to deduct up to 100% of an individual's adjusted gross income when making a cash contribution to a qualifying charity (not including donor-advised funds).

- **Medical expenses are deductible in excess of 7.5% of AGI**

The TCJA reduced the threshold for deducting unreimbursed medical expenses from 10% to 7.5% of AGI for 2017 and 2018. The 2019 SECURE Act saw this extended through 2020. Now this change is supposedly permanent, and supports the argument in favor of bunching, as it will be easier to exceed the standard deduction when all the other deductions are counted together.

- **Business meals at restaurants are now 100% tax deductible**

This extension is in effect through the end of 2022. Clearly, Congress wants small business owners to use funds to grow their networks, and turn prospective relationships into business opportunities.

- **Tax-free employer payments of student loans**

  The Act extends until 2025 the ability of an employer to pay up to $5,250 annually towards an employee's student loan principal or interest. The payments can be made to the employee or directly to the institution.

- **RMD's are back in 2021**

  RMDs are again required in 2021. Individuals should recognize that account balances could be much higher at the end of 2020 and therefore RMDs are likely to be much higher in 2021 for many retired taxpayers, particularly if they skipped their RMD in 2020.

- **For small business owners**

  The law provides that employers may permit paid leave and receive a tax credit for wages paid during the employee's leave through March 31, 2021. This tax credit has also been extended to self-employed taxpayers who can satisfy the existing criteria for leave.

  For those few employers who deferred paying payroll taxes in 2020, the Act extends the period for repaying those deferred employee payroll taxes from April 30, 2021, to December 31, 2021. The Act contains $284 billion in relief for a second round of Paycheck Protection Program (PPP) loan funding. In addition to first-time PPP loan applicants, businesses with 300 or fewer employees that have already spent an initial PPP loan are now eligible for a second loan for up to 2.5 times average monthly payroll costs.

  - These "second draw" loans are only available up to a maximum of $2 million

  - To qualify for a second draw loan, the business must demonstrate at least a 25% reduction in gross receipts of any quarter in 2020 as compared to the same quarter of 2019.

  - Borrowers are permitted to choose whether to use the eight-week or the 24-week covered period for spending down loan proceeds.

  - The forgiveness process for loans under $150,000 has become greatly simplified.

  - Congress has clarified that businesses are able to take the deduction for otherwise eligible business expenses even if those expenses are paid out of PPP loan proceeds that are forgiven. The law also reaffirms that those forgiven amounts will not be included in income.

- **Other areas**

  While, not covered in this newsletter, the Act addresses a number of other issues (funding for schools and childcare, rental assistance, increased funding for foodbanks, vaccine and hospital funding, FSAs, earned income credits, etc.).

PRESIDENT-ELECT JOE BIDEN'S TAX POLICY

Now, as we turn the page to a new chapter – the Joe Biden Administration – it would do well to briefly recap some of the tax policy proposals that Mr. Biden espoused during his successful run for office.

President-elect Biden has indicated he would increase income and payroll taxes for high-income individuals (earning over $400,000) and businesses that are structured as C Corporations; expand the child and dependent care tax credit, the earned income tax credit, and the premium tax credit; create a new renter's tax credit; and enhance incentives to save for retirement and purchase homes.

TIGHTENING THE FOCUS ON ESTATE PLANNING CHANGES

Under the current law, as of January 1, 2021, individuals can transfer at death assets valued up to $11.7 million to other U.S. citizens (and an unlimited amount to spouses) without incurring federal estate tax. Alternatively, individuals can gift up to this amount during lifetimes without paying any federal gift tax, and any remaining exclusion can be used to offset estate taxes at death. Many states have a separate state inheritance and/or estate tax.

- A key feature of the former Vice President Biden's proposed tax plan would be a 50% reduction of the Federal exclusion amount for estate and gift taxes, from $11.7 million to the pre-TCJA amount of $5.79 million.

- Notably, this lapse of the current estate tax exclusion amount back to its pre-TCJA limits ***is already scheduled to occur in 2026*** – *after the Tax Cuts and Jobs Act sunsets* – but the Biden tax plan would accelerate that reversion back to the old limits in 2021 instead.

The current law also states that heirs can receive appreciated assets with a step-up in tax basis to the asset's fair market value at the time of death. Therefore, appreciated assets can be transferred at death without a capital gains tax liability.

- Biden's tax plan also proposes to eliminate the step-up in basis rules which would impact both higher- and lower-earners potentially facing a significant and problematic tax bill on inherited assets.

SO NOW WHAT?

A structured sale or gifting strategy throughout a lifetime can be a good way to mitigate taxes for the beneficiary should Biden's plans be enacted into legislation.

Other strategies that can be considered to deal with a smaller exemption in the long-term can potentially include the use of Grantor Retained Annuity Trusts (GRATs), Charitable Lead Annuity Trusts (CLATs), and sales to Intentionally Defective Grantor Trusts (IDGTs).

Life insurance will likely see renewed potential as a tool to provide liquidity and/or mitigate the burden of a high estate or income tax liability.

High net worth individuals should consider using as much of their $11.7 million gift exemption in early 2021 as their circumstances allow. Notably, the IRS is already on record stating that it will not 'claw back' previous transfers (by gift or by bequest) of assets if the exemption amount goes back to its pre-TCJA levels.

CHANGE IS COMING - BUT HOW SOON?

It is difficult to say how soon President-elect's tax proposals become law. However, it is likely that since the Executive branch and the U.S. Senate majority are both from the same political party, changes to tax laws will become a reality in 2021.

SUMMARY

At Pallas, we believe the future is bright for those who plan ahead. We encourage each of you to reach out to us to discuss any changes that you should be considering as you turn the page on 2020 and begin the new year. Our best wishes for a bright one!

Sincerely,

James Landry, ChFC
Chief Operating Officer,
Director of Planning
Pallas Capital Advisors

Pallas Capital Advisors Founding Partner Richard Mullen's mother at the Nevada state line - *circa* 1950. Notice the proud pronouncement of the state being a haven from all kinds of taxation – just under the bullet holes.

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