WealthPoint Advisors

October 2021

Dear Clients and Friends,

THE STOCK MARKET TAKES A BREATHER

Stocks had a slightly negative return in the third quarter, which after 5 straight positive quarters is not surprising. Actually, the majority of market increases happen in short bursts, so this is quite common. Lately there has been a bit more "nervousness" in the market over things like the debt ceiling, unemployment numbers, and supply chain disruptions. In the long run that can be a healthy thing to keep the market from overheating. The bottom line is that with interest rates near zero, an influx of government spending, and high consumer demand the environment is still a good one for public companies to prosper. The reason there is an expected return premium for stocks over time is because of the unknown short-term returns.

TAX LAW CHANGES ARE LIKELY COMING

Last month the House Ways & Means Committee approved draft legislation on significant tax proposals that, if passed, will dramatically change the tax and estate planning landscape for high income and high net worth individuals and families. While it is likely some of the provisions may change, the core of the plan seems to have enough Democrat support to become law. Below are points that will impact many of you reading this newsletter.

1. Increase in the top tax rate to 39.6%. Not only does the top tax bracket go from 37% back up to 39.6%, but the amount of income necessary to hit that rate goes down to $400,000 for individuals and $450,000 for married joint filers. Because of this, some income that was taxed at 35% goes to the top bracket too. For income below these amounts there is no proposed change to the tax rates.
2. Reduction in the estate tax exclusion amount. The bill would reduce the basic exclusion for gifts and estates from $11.7 million per person to approximately $6 million, which is the amount someone can give away either during their lifetime or death free of estate tax. Any estates above that number are taxed at 40%. The higher amount was scheduled to go down to $6 million in 2026 and the law would accelerate the change. This is a substantial change that could mean millions of dollars of additional tax for families over these limits.
3. Increase top capital gains rate to 25%. Current capital gains rates are 0%, 15%, and 20% based on a taxpayer's income. The zero and 15% rates would not change but the top rate increases, and the income needed to get to the top rate is lowered by approximately $45,000.
4. No more Backdoor Roth IRA contributions. A popular strategy for high income clients to make annual after-tax IRA contributions and then convert those dollars to a Roth IRA (commonly known as backdoor Roth contributions) could be eliminated. The proposed law unfortunately prohibits converting after tax dollars in retirement accounts.
5. Elimination of Grantor Trust benefits. The proposed law makes many popular estate planning trusts much less appealing and virtually ineffective. Some common grantor trusts are Grantor Retained Annuity Trusts (GRATs), Spousal Lifetime Access Trusts (SLATs), and Intentionally Defective Grantor Trusts (IDGTs). For a nice summary of these trusts please read Alex Perkin's blog post about them on our website. https://wealthpointadv.com/estate-planning-alphabet-soup-for-high-net-worth-families-2/

6. **Family Limited Partnership and LLC Discounts reduced.** Discounts for "nonbusiness" assets will not be allowed. Think investment assets and real estate.
7. **Net Investment Income Tax (NIIT) applied S Corporation Income for high income owners.** Current law does not subject S Corporation income to the 3.8% NIIT. This law would change that for those with income over $400,000 (single filers) or $500,000 (joint filers). Together with the change to the top ordinary income tax bracket, this change increases the top tax rate for high-income S corporation owners from 37% to 39.6% +3.8%=43.4%. Never underestimate Congress and their sneaky way of escalating taxes!
8. **Child tax credit extended.** Finally, one that can be beneficial instead of costly. The expanded child tax credit 2020 changes would be extended to 2025.

A few things that President Biden proposed are noticeably absent from the bill, notably any changes to step up basis rules upon death. For now, tax basis will continue to be stepped up to current market value.

When would these changes take effect? The changes to the top capital gain rate would be retroactive to the bill's release date of 9/13/21. Don't run out and sell appreciated holdings thinking you will get in under the wire. Grantor trust rule changes will likely take effect when the legislation becomes law, which could be within a few weeks or a few months. Having said that, grantor trusts created before the effective date will likely be "grandfathered" and the new rules only applicable to future trusts. For the rest of the changes the proposed effective date is January 1, 2022.

TAX ACTIONS TO TAKE BEFORE YEAR END

What should you do based on these potential changes? The tricky part is we do not know the final form of any changes yet. But there are a few things you should do right now. First, if you make Backdoor Roth IRA contributions each year, check and see if you have made a 2021 contribution. Here at WealthPoint we have made a list of "usual suspects" who make those, and we intend to get those done before year end, not in the spring before a tax return is filed which may be too late. Second, understand your taxable income. If you are below the $400,000/$450,000 in taxable income, there does not appear to be any meaningful change to your tax rates, and you can proceed without changes. If you are over those limits, the usual approach of deferring income and accelerating deductions may not be the right way to go. Deductions in 2022 and beyond will save more than deductions in 2021. Third, if you have delayed estate planning that requires grantor trusts, well, you better get on the phone with your estate attorney ASAP. The window of opportunity on those may be closing quick. If you have Family LLCs or partnerships in place and you want to make gifts using discounts, those should be done now too.

Fall is upon us and what a great time of year to get outdoors, particularly here in Indiana. And with all the negative Facebook news and the evils of social media there is even more of a reason to get outdoors. If we can be of any assistance with the items above, please let us know, and if you have friends or family that need help thinking through their plan, we would be happy to help in any way we can.

Sincerely,

Brent M. Walker, CFP®