Welcome to Thursday Tax Topics!

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Today's Discussion

- Key Updates
- Review of the American Families Plan

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IRS Has Released More Detail on Advance CTC

- May 6: https://www.irs.gov/credits-deductions/advance-child-tax-credit-payments-in-2021
- Advance payments of the 2021 Child Tax Credit will be made **regularly** from July through December to eligible taxpayers who have a main home in the United States for more than half the year. The total of the advance payments will be up to 50 percent of the Child Tax Credit. Advance payments will be estimated from information included in eligible taxpayers' 2020 tax returns (or their 2019 returns if the 2020 returns are not filed and processed yet).
- The IRS urges people with children to file their 2020 tax returns as soon as possible to make sure they're eligible for the appropriate amount of the CTC as well as any other tax credits they're eligible for, including the Earned Income Tax Credit (EITC).
  - **No more information on opting out, but IRS says will be provided…**

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PPP Update

General Fund Exhausted May 4

- May be some funds remaining for "community financial institutions"
  - Community Development Financial Institutions
  - Minority Depository Institutions
  - Certified Development Corporations (CDCs)
  - Some microloan intermediaries

  - Applications that had not been approved are OUT.

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State Deadlines

- Iowa deadline is June 1. Deadline for first quarter estimates was extended as well.
- Wisconsin follows the federal rule: May 17, no extension for 1st quarter estimates.

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Other Relief Provisions

Restaurant Revitalization Fund

- **PORTAL FINALLY OPENED MAY 4. https://www.sba.gov/funding-programs/loans/covid-19-relief-options/restaurant-revitalization-fund**

- Created by the **American Rescue Plan Act ($28.6 billion)**.
  - Will provide restaurants, bars, food trucks, caterers, etc. with grants equal to their pandemic-related revenue loss (2019-2020 gross receipts), up to $10 million per entity, $5 million per physical location.
    - Provision for *new businesses in 2020*.
- Funds could be used to pay expenses: Payroll costs; Principal and interest payments on a mortgage; Rent; Utilities; Maintenance expenses; Supplies; Food and beverage expenses; Covered supplier costs; Operational expenses; Paid sick leave; and any other expenses the SBA determines to be essential.
- If restaurant closes, funds must be returned.

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Shuttered Venue Operators Grant

- Finally opened last week: https://www.sba.gov/funding-programs/loans/covid-19-relief-options/shuttered-venue-operators-grant
- Created by CAA and modified by ARPA.
- Eligible applicants may qualify for grants equal to 45 percent of 2019 gross earned revenue, with maximum single grant = $10 million.
  - Live venue operators, theatrical producers, performing arts organization operators, movie theaters, museums, zoos, talent representatives.
  - Must have been in operation as of February 29, 2020.
  - PPP loans after December 27, 2020, reduce SVOG.

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Iowa Update – May 4

- Governor Reynolds signed a proclamation on April 30, 2021, that provides an extension to owners of **First-Time Homebuyer Savings Accounts** to make required account and beneficiary designations.
- The proclamation also extends the time that owners of Iowa Educational Savings (529) Plans may make contributions to their accounts that may be considered made in tax year 2020.
  - The proclamation extends both deadlines to **May 30, 2021**. The due date for filing 2020 Iowa individual income tax returns remains June 1, 2021

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Iowa Update…More Updates Next Time

- Iowa has some tax legislation pending...still…
  - PPP Loans (SF364) — Allow 2019 entities to deduct expenses paid with PPP funds/exempt federal jobless benefits/exempt COVID grants from state taxation (Livestock Producers Grants, etc.)
  - Tax Bill (SF576) — Accelerates the income tax triggers and phases out inheritance tax.
  - Property Tax Reform (SF587) — Revamps mental health funding and cuts property taxes

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American Families Plan

"Build Back Better"

1. On March 11, 2021, President Biden signed the $1.9 trillion **American Rescue Plan** into law. Congress passed this legislative package, described as providing COVID-19 relief to businesses and families, through the budget reconciliation process with a vote of 50-49 in the Senate (one Senator did not vote) and 220–211 in the House.
2. On March 31, President Biden proposed the $2.4 trillion American Jobs Plan (infrastructure).
   - Made in America tax plan would pay for provisions with changes to corporate and international tax structure.

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"Build Back Better"

3. On April 28, President Biden unveiled the $1.8 trillion **American Families Plan**.
   - Although detail is restricted to a bulleted fact sheet, the Plan proposes to "grow the middle class, expand the benefits of economic growth to all Americans, and leave the United States more competitive."
   - The Plan calls for two years of free community college, free universal preschool, direct support for families with children, paid family and medical leave, and much more.
   - States that it will only increase tax on the "wealthiest" Americans.

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Why Talk about Proposals?

- The American Families Plan would completely overhaul current estate and business planning for agricultural producers and rural landowners.
- We cannot jump to conclusions or overreact, but we must keep up with what is on the table.
  - If history is our guide, law could pass within days or even hours of final legislative text being made public.

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Path Forward

- Congress is currently seeking to negotiate a deal on the American Jobs Plan (infrastructure).
- Speaker Pelosi has said she wants a vote by July 4.
- At that point, we may see more clearly how landscape is developing.
  - Parliamentarian has said budget reconciliation can be used several more times before 2022 election.

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Budget Reconciliation – What Does it Mean?

- The Congressional Budget Act allows *reconciliation* for legislation that changes spending, revenues, and the federal debt limit.
  - Allows Congress to enact legislation flowing from a budget resolution.
  - Resistant to filibuster (only 51 votes needed in the Senate)
  - Subject to the Byrd rule (provisions that do not change revenue or spending are extraneous)

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Other Proposals

- In late March, Senators Van Hollen, Booker, Sanders, Whitehouse, and Warren released the **"Step Act of 2021."**
  - Includes a discussion draft of sample legislative text. Many of the provisions in the American Families Plan appear modeled after language in the Step Act, although differences exist, even at a high level.
  - On March 25, 2021, Senator Bernie Sanders introduced the "**99.5 Percent Act**." This proposal would lower the basic exclusion to $3.5 million ($1 million for lifetime gifts) and increase the highest estate tax rate from 40 percent to 65 percent.

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American Families Plan

- Eliminate the Preferential Capital Gain Tax Rates for Taxpayers with > $1 million in Income
  - The Plan proposes to subject long-term capital gain to **ordinary income tax rates** where overall income (including gain) exceeds $1 million.

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American Families Plan

- Extend the Application of the **Net Investment Income Tax**
  - Proposes that all income over $400,000 (presumably not otherwise subject to FICA or self-employment tax) would be subject to the 3.8 percent net investment income tax (Medicare) tax.
    - In other words, the "net investment" income tax (NIIT) would apparently be extended to non-investment income above this threshold as well.
      - Now calling it the Medicare tax.

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American Families Plan

- **Increase the Top Individual Tax Rate**
  - Would restore the 39.6 % individual tax rate that was in effect before the TCJA.
  - For tax years beginning in 2018, the TCJA lowered the top tax rate from 39.6 percent to 37 percent. This would also mean that capital gain for those earning more than $1 million would be taxed at a top rate of 39.6 percent, plus the 3.8 percent Medicare tax, for a **top federal rate of 43.4 percent**.

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    - Reference to restoring "tax bracket" may also lower income thresholds subject to highest rate.

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American Families Plan

- **Treat Property Transfers at Death as a Sale**
  - The proposal would treat the **transfer of appreciated property at death as a sale**, meaning that unrealized capital gain in the hands of the decedent would be taxed at the time of death.
  - Passing appreciated property to a child through a will or trust at death would trigger a hefty tax bill, presumably on the final return of the decedent.
  - The bill might be especially high given the proposal's other provisions that would **increase the top tax rate**, subject gains to **ordinary income tax rates where income is more than $1 million**, and **apply the NIIT to the sale of business assets, like farmland**.

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American Families Plan

- Each deceased person would be allowed to exclude **up to $1 million in gain from taxation**.
- Married couple would each get their own exemption, which is presumably portable, meaning that a couple could exempt $2 million in gain from tax.
  - $250,000 in gain from taxation for the sale of a personal residence ($500,000 for married filing jointly)would also be excluded
    - A married couple could potentially exempt up to $2.5 million in gain from taxation at death.
- Basis would continue to step up ($1 million under exemption and rest as tax is paid.)

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Current Law Example

Harris and Harriet - 1,000 acres of farmland

- 500 acres in 1974 at a cost basis of $550/acre.
- 500 acres in 1987 for $800 an acre.
- If Harris and Harriet sell their farmland in 2021 for $7,200/acre, they will have taxable long-term gain of $6,525 per acre or $6,525,000.
- At current rates, assuming other income is offset by the standard deduction, this sale would result in tax of approximately **$1,267,800** (17.6 percent of the sales price)
  - Farmers – No NIIT and Iowa Capital Gain Deduction

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Current Law Example

- This result would change if Harris and Harriet had begun cash renting their land 10 years before retiring.
- In that case, the sale would also trigger the 3.8 percent NIIT and an Iowa tax on the capital gain.
- This would mean an additional $238,450 in NIIT and approximately $556,000 in Iowa tax, for a total tax bill of **$2,062,250 (28.6 percent of the sales price).**

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Current Law Example

- Assume for simplicity that Harriet and Harris die together in 2021, leaving their property to Jordan.
- When Jordan inherits the farmland, her basis is adjusted to be equal to the value of the assets on the date of death.
  - Land – 1,000 acres at $7,200 / acre basis
- No income tax is due and no estate tax is due because the estate is well below the current exemption amount.

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Current Law Example

- Assume that Harris and Harriet instead gift their property to Jordan during their lifetime.
- Here, Jordan's basis in the assets would be the same as that of her parents:
  - Land – 500 acres at $550/acre and 500 acres at $800/acre
  - Capital gain tax would only be due if Jordan decided to sell the land.
  - No gift tax would be triggered because gift amount is well below the current exemption.

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Current Law Example

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American Families Plan Example

Lifetime Sale

- In the first example, where Harris and Harriet continued to farm and then sell land, the American Families Plan would more than double their tax liability from **$1,267,800 to approximately $2,594,700 (36 percent of total sales price)**.
  - This increase would flow from the taxation of most of the gain at a new higher ordinary income tax rate and the imposition of the 3.8 percent Medicare tax on the gain above $400,000.
- If Harris and Harriet were not farming, they would also owe approximately $556,000 in Iowa tax, for a total tax bill of **$3,150,700 (43.8 percent of sales price) (as compared to $2,062,250 (28.6 percent of the sales price) under current law.**

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American Families Plan Example

Transfer at Death

- The American Families Plan would treat the transfer of Harris' farmland at death as a sale of the property.
- If Jordan is not actively farming, this would trigger the taxation of $5,525,000 gain ($6,525,000 total capital gain minus $1,000,000 exemption), resulting in **a tax bill of approximately $2.19 million (or 30 percent of the FMV).**
- The basis in the farmland would step up to $7,200,0000 (because of the $1 million exemption and the payment of the tax).
- Jordan may have to sell a portion of the land to pay the tax.

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American Families Plan Example

Transfer at Death

- If Jordan is actively farming, the family may receive an exemption to **defer the tax liability** on the previously unrealized gain.
  - The Plan would "*defer* **any tax liability on family farms as long as the farm remains family-owned and operated."**
- The tax would presumably become due at any point where the land was no longer actively farmed by a family member, perhaps with interest.
- If Jordan takes advantage of the active farming deferral, the basis in the farmland would step up by $1,000,000 (pursuant to the $1 million exemption), but no further basis adjustment would be made.

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American Families Plan – Farmer Deferral

- Would appear to provide no protection to ongoing rental or business relationships with non-family members, such as neighbors or beginning farmers.
- Not appear to recognize that for many multi-generational farmers, their family "retirement plan" is not a tax-advantaged 401K or IRA, but a section of farmland.
- Generational farms may have transitional periods where farmland is rented to others. The owners of many of these farms are not wealthy speculators or investors, but heirs to a family legacy.

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American Families Plan – Farmer Deferral

- Where the basis of a small to moderate-sized farm is very low because of a transfer through a life estate or a purchase or gift early in a farming career, steep transition taxes could exceed the reasonable ability of heirs to cash flow a loan to pay the tax.
- This would lessen the chances that any one of these heirs could hold onto the family property and hasten the transfer of these parcels to wealthy investors.

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What about gifts?

- The Plan does not specifically discuss lifetime gifts. Presumably, however, the same general rules would apply to lifetime gifts.
- Without a complementary rule, property could be serial gifted to younger family members in an attempt to avoid the recognition of gain at death.
  - Step Act would provide $100,000 exemption for gain transferred through gift.

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What about other gain, farm assets?

- How would the American Families Plan impact grain in the bin or depreciated machinery or other farm assets?
  - The Plan only references "capital gain."
  - The Step Act proposal has an exemption for tangible personal property used in a trade or business or Section 212 activity.
    - Legislative text will be important.
      - These assets may continue to step. Otherwise, ongoing farmers would incur depreciation reductions if they use the exemption.
      - Or, passing these assets could potentially be subject to transfer tax as well.

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What about the estate tax?

- The American Families Plan does not reference the estate or gift tax (or the GST).
  - 99.5 Percent Act would reduce exemption.
  - It would appear that taxes paid under AFP would be deductible from estate.
    - Again, little is known and the details of any final plan will matter.

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American Families Plan

- Limit Section 1031 Exchange Deferral to $500,000 in Gain
  - The proposal would end the application of IRC § 1031 like-kind exchange tax deferral rules for gains greater than $500,000.

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Current Law Example

- Martin, who farms in western Iowa wants to move to eastern Iowa to be closer to family. His 500-acre farm, a lifetime gift from his grandfather, has a basis of $600/acre. Martin has found a farm in eastern Iowa of equal value.
- Using a section 1031 exchange, current law allows Martin to sell his farm in western Iowa and reinvest the proceeds into the farm in eastern Iowa without incurring tax liability. Martin's basis in his new 500-acre farm (worth the same for simplicity), is $600/acre.

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American Families Plan Example

- The American Families Plan would significantly restrict Martin's options. The Plan would allow him to defer only $500,000 in gain under IRC § 1031.
- As such, he would be required to realize $2,950,000 in gain upon the exchange.
  - Furthermore, $1,950,000 of this gain would be subject to ordinary income tax rates ($772,200) and $2,550,000 would be subject to the Medicare tax ($96,900).
    - **In total, Martin would owe an estimated $1,065,100 in tax on the $3,750,000 "exchange" (or 28.4 percent of the sales price).**

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Watch For Your Postcards…

- We've mailing save the date cards for our fall tax schools.
- We will be offering in-person and online options this year. There should be a lot to talk about.
- We are also planning summer webinars. Let us know if you have a topic you'd like to see!

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QUESTIONS?