

# TRIAGE TAX PLANNING IN THE US: ADAPTING TO AN UNCERTAIN TAX BILL



Chris Houston  
Managing Director of  
Tax Strategy  
Private Client Practice

The Build Back Better Act recently introduced in the US House of Representatives (the “House Bill”) includes many tax provisions that would significantly impact US taxpayers. However, any major bill’s road from introduction to enactment is typically long, winding, and unpredictable, so no one should be too certain about any specific outcomes from the House Bill at this stage. Instead, the focus should be on triaging for two types of potential action items: actions that should be taken—or accelerated—because they would still be reasonable or desirable even without any legislative changes, and actions that should be planned and teed up for execution on short notice if developments with the House Bill warrant. With that focus in mind, this note summarizes four tax planning–related questions we view as prime candidates for consideration by US families with substantial wealth.<sup>1</sup>

## SHOULD YOU PAY MORE TAX NOW?

The initial House Bill includes individual tax rate increases of 2.6% for most ordinary income and short-term capital gains, and 5% for long-term capital gains and qualified dividends, plus an additional 3% surtax on modified adjusted gross income above \$5 million. This is no surprise. Tax rates at the highest levels were expected to increase. Accordingly, where a US taxable investor owns assets with built-in gains but already anticipates (or could reasonably imagine) selling those assets in the next few years anyway, it could be advisable to sell as soon as possible this year.<sup>2</sup> Similarly, where a US taxpayer can accelerate into 2021 the realization of ordinary income that would otherwise occur in the next few years (e.g., from retirement plan distributions), that should be considered as well. Conversely, it may be advisable to defer the recognition of losses into future years, when the tax benefit of those losses may be greater.

- <sup>1</sup> While we highlight four prime candidates for consideration, the House Bill includes many other potential tax changes that could also be considered for action or preparation, depending on a taxpayer’s specific circumstances. Examples include an increase in the corporate income tax rate, expansion of the net investment income tax, new limitations on deductions related to business income and small business stock, and new restrictions on the use and investment of individual retirement accounts (IRAs).
- <sup>2</sup> To be sure, the House Bill would apply its higher capital gains rates beginning September 13, 2021, when the bill was introduced, which could make this approach less effective. However, history and practical considerations lead many observers to predict that any final capital gains tax increase would not be effective until January 1, 2022, or at earliest when the bill is enacted. Also, the 3% surtax and the higher ordinary income tax rate would not take effect until January 1, 2022. Based on these considerations, there may still be value in accelerating the recognition of gain notwithstanding the purported September 2021 effective date.

Published September 30, 2021

### **SHOULD YOU GIVE MORE AWAY NOW?**

The lifetime exemption amounts from federal gift, estate, and GST tax are currently just under \$12 million, but the initial House Bill would cut those amounts in half, effectively reversing the increases provided in the 2017 Tax Cuts and Jobs Act (TCJA). Transfer tax exemption that remains unused when the exemption amount is reduced is lost forever and effectively wasted. This should be presumed a matter of when, not if, since these transfer tax exemption amounts were already slated to be cut by half in 2026 under the TCJA's sunset provisions. US families with unused gift or GST tax exemption should thus work with their tax and legal advisors to use that remaining exemption, in ways that are effective and consistent with their overall gift and estate planning objectives, before it disappears.

### **SHOULD YOU TRUST GRANTOR TRUSTS?**

Provisions in the initial House Bill would affect so-called “grantor trusts” in various ways that would greatly reduce their utility and effectiveness for both income and transfer tax planning purposes. Aside from many “dynasty trusts” and other broadly defined grantor trusts, these new provisions might also extend to some specific “alphabet soup” grantor trusts, even where those specific trusts are authorized and dealt with by their own separate tax law provisions. One example could be grantor retained annuity trusts (GRATs), which offer compelling tax advantages.<sup>3</sup> Other specific trusts that could be affected include certain charitable lead annuity trusts (CLATs), spousal limited access trusts (SLATs), irrevocable life insurance trusts (ILITs), and qualified personal residence trusts (QPRTs). While fuller discussion of grantor trusts and the proposed tax changes applicable to them is beyond the scope of this note, US families are encouraged to consult with their tax and legal advisors about the potential establishment of such trusts. Potential transactions involving new or existing trusts (such as the tax-free substitution of assets) should also be considered, since they too would be affected by the proposed tax changes. Grantor trusts are a key example where anticipation, planning, and preparation are especially important to allow for execution on short notice depending on how the House Bill evolves. It may otherwise become very difficult to establish and fund these trusts or complete other transactions in time before a year-end or other effective date becomes apparent and arrives.

### **SHOULD YOU DISCOUNT FAMILY LIMITED PARTNERSHIPS?**

Some tax and estate planning techniques, often involving the use of family limited partnerships (FLPs), are effective due to the availability of valuation discounts for transfer tax purposes. For example, the gift of a 10% interest in an FLP that owns \$10 million might be valued at less than the pro rata \$1 million for gift tax purposes because on its face it is a minority interest in a private entity and subject to transfer and other restrictions. The House Bill would substantially curb the use of valuation discounts, especially where the underlying assets are marketable securities and other non-business assets. This is another area where advance anticipation, planning, and

<sup>3</sup> For more information on this topic, please see Chris Houston, “GRAT Expectations: Extra Opportunity in the Current Environment,” Cambridge Associates LLC, June 2020.

preparation with advisors and other relevant parties is important, given the potential difficulty of establishing, funding, and transferring interests in an FLP quickly enough in a tight timeframe.

Over time, some of the House Bill provisions described above may be modified or omitted, new provisions may be added, the timeframe for consideration or enactment of the Bill may be extended, and eventually the Bill may be enacted in some form or abandoned altogether. While this note highlights some specific items for consideration, the House Bill also provides a broader and more enduring reminder that families of wealth should regularly monitor potential tax law changes and engage trusted tax, legal, and investment advisors to anticipate and adapt to such changes. ■

---

Copyright © 2021 by Cambridge Associates LLC. All rights reserved.

This report may not be displayed, reproduced, distributed, transmitted, or used to create derivative works in any form, in whole or in portion, by any means, without written permission from Cambridge Associates LLC ("CA"). Copying of this publication is a violation of US and global copyright laws (e.g., 17 U.S.C. 101 et seq.). Violators of this copyright may be subject to liability for substantial monetary damages.

This report is provided for informational purposes only. The information does not represent investment advice or recommendations, nor does it constitute an offer to sell or a solicitation of an offer to buy any securities. Any references to specific investments are for illustrative purposes only. The information herein does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Information in this report or on which the information is based may be based on publicly available data. CA considers such data reliable but does not represent it as accurate, complete, or independently verified, and it should not be relied on as such. Nothing contained in this report should be construed as the provision of tax, accounting, or legal advice. Past performance is not indicative of future performance. Broad-based securities indexes are unmanaged and are not subject to fees and expenses typically associated with managed accounts or investment funds. Investments cannot be made directly in an index. Any information or opinions provided in this report are as of the date of the report, and CA is under no obligation to update the information or communicate that any updates have been made. Information contained herein may have been provided by third parties, including investment firms providing information on returns and assets under management, and may not have been independently verified.

The terms "CA" or "Cambridge Associates" may refer to any one or more CA entity including: Cambridge Associates, LLC (a registered investment adviser with the US Securities and Exchange Commission, a Commodity Trading Adviser registered with the US Commodity Futures Trading Commission and National Futures Association, and a Massachusetts limited liability company with offices in Arlington, VA; Boston, MA; Dallas, TX; Menlo Park, CA, New York, NY; and San Francisco, CA), Cambridge Associates Limited (a registered limited company in England and Wales, No. 06135829, that is authorized and regulated by the UK Financial Conduct Authority in the conduct of Investment Business, reference number: 474331); Cambridge Associates GmbH (authorized and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht ("BaFin"), Identification Number: 155510), Cambridge Associates Limited, LLC (a registered investment adviser with the US Securities and Exchange Commission, an Exempt Market Dealer and Portfolio Manager in the Canadian provinces of Alberta, British Columbia, Manitoba, Newfoundland and Labrador, Nova Scotia, Ontario, Québec, and Saskatchewan, and a Massachusetts limited liability company with a branch office in Sydney, Australia, ARBN 109 366 654), Cambridge Associates Investment Consultancy (Beijing) Ltd (a wholly owned subsidiary of Cambridge Associates, LLC which is registered with the Beijing Administration for Industry and Commerce, registration No. 110000450174972), and Cambridge Associates Asia Pte Ltd (a Singapore corporation, registration No. 200101063G, which holds a Capital Market Services License to conduct Fund Management for Accredited and/or Institutional Investors only by the Monetary Authority of Singapore).