Trump's Big Bill

Quick-Take: Pundits now claim that the federal income tax is the *new* estate tax to be avoided.

Background: The Big, Beautiful (beauty, as always, being in the 'eye of the beholder') Bill is now the law. What does it mean for estate planning going forward? Consider the following-

Transfer Tax Exemptions: The estate, gift, and generation skipping transfer tax exemptions are permanently set at $15.0 million per person, subject to annual inflation adjustments. This means with tariffs probably triggering above average inflation in the coming years, these applicable exemptions will probably grow close to $20 million per person over the next decade. With modestly wealthy individuals, who probably are never going to have to worry about federal estate taxes, they will continue to be good candidates to use Spousal Lifetime Access Trusts (SLATs) and long-term dynasty-type trusts.

Roth Conversions: Personal federal income tax rates and brackets remain the same. Accordingly, Roth conversions would seem to make a lot of sense, paying income taxes now at lower income tax rates, compared to higher income tax rates in the future when distributions must be taken.

Qualified Small Business Stock: The provisions of IRC 1202 were liberalized making a QSBS election for C corporate stock to be much more attractive. The holding period to qualify for this exclusion from gain recognition was reduced from 5 years to 3 years, the amount of the exclusion from gain recognition was increased from $10 million to $15.0 million, and the corporate asset limit was increased from $50 million to $75.0 million. Nothing was done by Congress to the planning strategy (loophole?) of stacking QSBS stock using multiple trusts, where each trust can qualify for its own, separate, $15 million exclusion from capital gain recognition. The upshot to this liberalization under IRC 1202 is that any discussion with an individual who is about to form a new business, e.g., S-corporation, LLC, or C-corporation?, will now have to include a discussion about improved eligibility and benefits to be derived from C-stock which qualifies as small business stock.

Opportunity Zone Investments: Starting in 2027 Opportunity Zone investments will become an even better investment vehicle, with greater deferral and eventually potential tax-free capital gains. In 2026 an Opportunity Zone investment will be of only marginal utility because the current deferral of gain recognition from such investments will end on December 31, 2026, which may mean the use of more hedging options like installment sales or the use of a charitable remainder trust (CRT) to bridge gains from 2026 to 2027.

Qualified Small Business Deduction: This federal income tax deduction under IRC 199A was supposed to increase from 20% to 23%, but that did not happen in the final bill. The deduction remains at 20%. The deduction phase-out increases slightly starting in 2026, increasing from $50,000 to $75,000. Starting in 2026, this income tax deduction still falls short for those small business taxpayers whose incomes only reach to the top of the phaseout.

SALT Deduction: The state and local tax deduction is now set at $40,000 with a phaseout when income exceeds $500,000 up to $600,000 (the phaseout range.) The SALT deduction will be available to non-grantor trusts, which means that non-grantor trusts might become more popular to expand the availability for the $40,000 SALT deduction to each trust.

SALT Deduction Phaseout: However, the SALT deduction falls from $40,000 back to $10,000 with the phaseout. This means that those individuals with adjusted gross income (AGI) over $500,000 could be subject to the phaseout that will increase their effective tax rate by 30%. A couple of examples demonstrate this situation.

Example 1: Fred and Wilma have taxable income of $500,000 and they have itemized deductions of $75,000, including the SALT deduction of $40,000. Their taxable income will be $425,000 under the new law ($500,000 income - $75,000 deductions = $425,000 taxable income.) Fred and Wilma's marginal federal income tax rate with taxable income of $425,000 is 32%.

Example 2: Fred and Wilma have taxable income of $600,000, and itemized deductions of $75,000, including a tentative SALT deduction of $40,000. However, the phase-in now applies to Fred and Wilma, and their SALT deduction will be reduced by $30,000 down to

$10,000. The phaseout mandates a reduction of the SALT deduction by 30% of income greater than $500,000 ($600,000 income - $500,000 income = $100,000 above $500,000; $100,000 X 30% reduction in SALT deduction = $30,000.) Fred and Wilma's taxable income will be $555,000 ($600,000 income - $45,000 = $555,000.) The marginal income tax rate on taxable income of $555,000 is 35%. In simple terms, Fred and Wilma's gross income increased by $100,000 but their taxable income increased by $130,000 [$100,000 more income + $30,000 in lost SALT deduction.] If Fred and Wilma's marginal tax rate was 35%, their effective tax rate on the increase in income from $500,000 to $600,000 of income is 45.5% (35% X 130%.)

Observation: If Fred and Wilma decide to reduce their hours of employment and they only earn $500,000 in the year, they give up gross income of $100,000, but the after-tax amount lost is *only* 54.5%, or $54,500. If you add state income taxes and/or payroll taxes to Fred and Wilma's situation, it is easy to see Fred and Wilma's marginal aggregate income tax rate increasing to over 55%. From a strictly financial savings perspective with the additional costs of working more, e.g., transportation, meals, wardrobe, daycare, it might make sense for Fred and Wilma to not work as hard due to the SALT deduction phaseout *penalty*.

Planning: Going forward with an applicable exemption amount of $15.0 million per person, there will be a renewed focus on income tax planning over the next decade. That planning will probably lead to the use of more non-grantor trusts as part of an estate plan. These trusts can be used to (i) shift income; (ii) 'stack' the QSBS to make the $15 million capital gain exclusion available to each non-grantor trust; (iii) allow for multiple IRC 199A income tax deductions using several non-grantor trusts; (iv) save state income taxes if non-grantor trusts are located in states without state income taxes, and (v) expand the SALT deduction since that $40,000 income tax deduction will be available to each non-grantor trust.

Example: Rather than create one non-grantor trust for the benefit of four grandchildren, the settlor might create four separate non-grantor trusts, one for each grandchild, so that each trust can claim the benefit of the $40,000 SALT deduction, or $160,000 in deduction total over each of the four grandchildren's trusts, and each trust could also qualify for the QSBS gain exclusion of $15 million.

Conclusion: Also, a sub-theme to the Big Beautiful bill is to shift more financial support from the federal government to the state governments. Consequently, while income taxes at the federal level might be less onerous over the next decade, the states will have to step forward and fill the 'revenue void' with increased state income rates to address the larger revenue burdens they will face going forward as the federal government steps back. It will be interesting to see just how long the handful of states [looking at you Florida and Texas] can go without increasing their own taxes to fill the federal shortfall.

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