MILL CREEK
Our values appreciate yours

WEEKLY MARKET UPDATE
October 18, 2021

MARKET COMMENTARY

Last week, we were re-joined by Libby Cantrill, Head of Public Policy at PIMCO, Michael James, Principal of Personal Finance at PwC, and Tom Chapin, Chief Investment Officer for a tax and public policy panel moderated by Michael Crook, Deputy Chief Investment Officer. During the panel, we addressed the road ahead for the budget bill, the infrastructure bill, and the debt ceiling, and tactical approaches to plan for these potential legislature changes.

On the public policy front, the more things change, the more things stay the same – especially as it pertains to Washington. Inter-party fights have led to legislative delays for the Democrats, but tensions between parties have been relatively predictable. To recap a few of our panelists' views:

- **Debt ceiling**—the deadline was pushed to mid-December/early January and will be increased at that time.
- **Infrastructure bill**—the proposed legislation has been passed by the Senate and will be passed by the House by the end of the year or early next year.
- **Budget reconciliation**— the final bill will likely have a $2 trillion dollar price tag over 10 years with some tax increases, which means that the final bill will be significantly smaller than President Biden's initial proposal.
- **The effective date of these changes** will not be retroactive. Capital gains will be effectuated on the date of introduction of the legislation or upon signage.
- **The bottom line—** Libby believes, from a political standpoint, "failure isn't an option" for the Democrats, and the infrastructure bill, budget reconciliation, and a debt ceiling increase will be passed by year-end or shortly thereafter.

On the tax and estate planning side, we will likely see higher taxes across the board. The highest marginal rate is projected to increase by almost 3% while capital gains and qualified dividends could rise by 5%. There could also be a 3% surcharge for taxpayers with income over five million. The details remain in flux, but it is likely that the proposed tax changes could go into effect on January 1, 2022.

Some strategies to consider:

- **Accelerate income into 2021—**Some individuals and businesses have flexibility around pulling income into 2021. For example, there is an opportunity to accelerate bonuses into 2021 and skip them next year.
- **Defer deductions—**When tax rates increase, individuals want to defer deductions when the rate is higher. Income provisions like charitable contributions are not as challenged by time-sensitivity since contributions can be made until year-end.
- **Qualified opportunity zones** – Capital gains could be deferred through an investment in a qualified opportunity zone. Keep in mind, the gains will be recognized and taxed at the prevailing rate in 2026. Therefore, if tax rates go up and remain higher over this period, opportunity zones offer less potential upside all else equal.

For transfer tax exemptions and trust structures, the reduction of the gift tax, estate tax, and GST exemption is $11.7 million per person, which was scheduled to sunset in 2026 and go back to $5 million plus inflation. However, the proposed bill would accelerate the sunsetting process. This could mean the exemption amount may decrease to $6.2 million per person if the bill is enacted on January 1, 2022.

Considerations regarding grantor trusts and the new provisions:

- **Irrevocable grantor trusts**—there are risks that a portion of the trust could be included in the gross estate. If a distribution is made from a grantor trust other than to the deemed owner or the deemed owner's spouse, then it would be treated as a gift.
- **Transactions between a grantor and an irrevocable grantor trust** will be treated as a sale or exchange and there would be a capital gain recognition at that time.
- **Selling assets to a grantor trust**—if receiving an annuity (including interest payments, the balloon payment on a note, etc.) and it is satisfied with an in-kind payment of property, there is a risk that this could become an income tax recognition event.
- **Provision enactment**—As of now, new provisions would affect any trust created on or after the date of enactment. The changes could also impact any portion of a trust that was established pre-enactment where contributions were made after the enactment date.

If you'd like to watch the panel or revisit the content, you can access the replay here.

This week's contributor: Rachel Hassett