Ep83: Biden's New Tax Proposal

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PATTI BRENNAN: Hi, everybody, welcome to "The Patti Brennan Show." This show is for those of you who want to protect, grow, and use your assets to live your very best lives.

Today, we are taking on a wonderful subject. It is the subject of the proposed tax legislation, and joining me today is none other than Eric Fuhrman. Eric, welcome to the show.

ERIC FUHRMAN: Thank you so much, Patti. Indeed, tax legislation, I mean I think this is a topic mundane for most people, but our job today is to breathe excitement, electricity and life to help people really understand how it can make a difference in their life.

PATTI: This is really interesting stuff. Just stay tuned, because we have a rich history of how this whole thing called income taxes really came about and why.

Actually, when you dig into it, it gives at least for me, a better perspective of what they're trying to do in Washington, and why, and how it really kind of gels out in the end.

ERIC: Absolutely, so I mean there's so much to cover. I just hope we can condense it all.

PATTI: We will.

ERIC: If you're driving, you might want to pull off into a parking lot somewhere because this is going to be good.

PATTI: And by the way, as always, all of this information will be on our website, keyfinancialinc.com. We've got a great white paper already done. It's got all this stuff that we're going to be talking about in today's show.

So, Eric, let's start out with the history. I did a little bit of digging in preparation. I wanted to kind of look back at the history and the intent of tax law right, and when it first started.

ERIC: Taxes have been around and been part of any great country and so forth. What defines our times though is that so many people think in the moment, since the 2020 election, there's been this steady drumbeat of major overhauls and tax law changes coming. I just feel like so many issues that define the present. This is a very contentious topic.

Really, you have people split on both sides that they believe taxation is a necessary tool to balance out income equality to make needed investments.

Others view it as an overreach and expropriation of treasure from people that work hard, and it just tears at that capitalistic identity that goes back to the founding of our country.

I don't know that we're going to solve one side or the other. As you point out, the history is so interesting. That tells this story of how it evolved, how we got here, and it is able to allow you to understand the policy choices and why they're being made with a much more informed or enlightened perspective.

PATTI: Absolutely.

ERIC: That's when we roll back.

PATTI: We are here to enlighten and ask...

ERIC: Enlightenment, right?

PATTI: You got it and have fun in the process. So, when you look back, when did all this stuff start? You know what, it started with the Stamp Act. It was when we were colonies and Britain came out and imposed this Stamp Act. The colonists were not happy about it. They got mad. Guess what it led to?

ERIC: Revolution? I don't know.

PATTI: You got it, the revolution.

ERIC: That's the outcome.

PATTI: Taxation without representation is tyranny, and that's really interesting in terms of framing even today's conversation. The Stamp Act was in 1765 led to the revolution.

And then we won that war and then lo and behold, guess what came back? Here we go. In 1797, there was a new tax that was imposed.

Basically, that was the beginning of what is now known as estate taxes. If someone passed away, you had to present the will with a particular stamp on it, and you had to pay for that stamp.

That new law was formed because we were bracing for a potential war with France.

Literally, that allowed us to build the navy. That was the beginning of the United States Navy. We didn't end up going to war with France, but we had a navy.

Most of the time when you look back at history, these taxes came in and went, and it was typically to finance wars.

ERIC: What's interesting is when you think about a fledgling Republic, like the United States was way back when, governments are scrambling to raise revenue. In modern society, we take for granted that a government can borrow, because we have a well-established bond market and a system to be able to raise funds from the public.

Back then, your only way to pay bills was to tax or print. Obviously, printing leads to very bad things inflation and so forth. This whole tax system that we see the day has been evolving for hundreds of years.

It was Abraham Lincoln, back in...It was the Revenue Act of 19 1861, where he enacted the first national income tax. Back then, it was three percent on individuals earning above $800 which is about 18,000 adjusted for inflation.

That was the genesis of this modern-day federal income tax. Now, the problem with a tax, or authorizing one, is you have to be able to collect it.

PATTI: I was just going to say, how in the world did they ever collect? There were no computers. How did they collect the money?

ERIC: That's a great question. Probably a subject for another podcast of collection methods. The Revenue Act of 1862, passed a year later by Abraham Lincoln, was meant to address that issue. That provided the foundation for what we now know as the Internal Revenue Service.

PATTI: Ah, so it was good old Abe.

ERIC: Yup. Throughout history, as you point out, there have been so many iterations of these different tax schemes, and bills to try and raise revenue. This argument has gone back and forth over the centuries, so this is nothing new today.

It wasn't until the 16th Amendment was ratified in 1913, which vested the power with the government to tax any source of income and led to the modern-day taxation system that we now see.

PATTI: In preparation for this, I think it's so cool that conversation that you and I were having with the book that you're reading. Why don't you tell our listeners and people who are watching about the book and the war of 1812?

ERIC: The book is called “Hamilton’s Blessing.” It’s an interesting book because it focuses on Alexander Hamilton and his contributions to forming the national debt and many different systems that we see today.

It provides a rich history of how things changed, how it affected the national debt, how did the government raise revenue. It’s fascinating for me, being a resident here outside Philadelphia, is that so much of that historical…

PATTI: Precedent.

ERIC: Those things took place right here in our backyard. Major figures, when you drive down Philadelphia, you see streets like Girard Avenue and so forth.

These are named after influential figures in the day that were financiers and were part of this amazing story of taxes and debt that take us to this point. I’m not through it yet, but it’s a page-turner.

PATTI: It’s so interesting because back then, right before that war, the government was broke. It did not have the money to finance this war that we were about to go into. As I understand it, they went to this guy named…I don’t know what his first name is, Mr. Girard.

ERIC: Stephen Girard.

PATTI: Stephen Girard and said, “Hey, we need some money,” and Stephen Girard said, “OK, I got some money.” That’s where he bought 95 percent of all of the government bonds. He owned the bonds, the government had the cash, we went to war, and we won.

ERIC: He was the richest man in America. He was a merchant out of Philadelphia. Yeah, the treasury needed money to continue the war of 1812, and they came to the one individual who bought 95 percent of the bond issue, which gave them money to continue to do that.

PATTI: I wonder what interest rate the government paid on those bonds back then.

ERIC: I think there is a mention of interest rates in the book. It escapes me now, but to be honest, I would enjoy a date night where you could sit down and someone would give you a two-hour lecture on the history of taxation. I’d have to convince my wife, so hopefully, there would be wine service or something.

PATTI: Totally.

ERIC: Otherwise, I’d be going solo.

PATTI: All right. Let’s bring it to today. Here we have this proposal. Now, let’s go through a little bit of the mechanics of how do we get to where we are today? Who came up with these ideas? Who is responsible for putting together this change in legislation, and what is that process all about?

ERIC: I think what's important here, just to close out the historical story, is since the 16th Amendment of 1913 was ratified, we have this marginal tax system. So much about what the current laws about related to the individuals is that top marginal tax bracket. You can see that throughout history. The lowest rate has been very, very consistent.

The top tax rate, though, has gone anywhere from 7 percent to 92 percent, which that was right after World War II. There's been tremendous volatility in that top tax rate, and it's a very political issue, because wealthy households, high-income earners are the people that are subject to that.

PATTI: It is an inflammatory issue, because those same people say, "We worked hard to get to this point, and you're killing us here. You're taking this money that we've earned and that's taken us a long time to get to the point where we can generate this cash flow."

Talk about Hauser's law. This is fascinating and important for everybody listening to understand.

ERIC: It was an interesting observation by an economist many years ago. There's been criticisms to it, just like anything else. Everyone's going to criticisms, but...

PATTI: The important thing is this is based on empirical data. It's not a theory. We talk about Laffer's Curve and the idea of if you tax something less, you're going to get more of that thing. This is not a theory. This is based on data.

ERIC: Right. It's not a theoretical argument that people can debate.

What you see when you lay it out is that despite the top marginal rate being anywhere from 7 to 92 percent, despite the highs and the lows of that tax rate, the federal receipts, the money the government collects as a percentage of output – output being GDP – has stayed very, very consistent.

Hauser's law observed about 19.5 percent. It's oscillated above and below that number, but about 19.5 percent. The inference is that regardless of how you manipulate the top tax rate, it has not had any effect on increasing the government's share of output.

The lesson is if you want more tax revenue, figure out policies that increase output, because changing the tax rates doesn't have any material effect.

PATTI: It is important and it is interesting, in terms of how they tinker with the rules, what you can and cannot do. Ultimately, the goal is to create revenue for the government to provide the services that so many people in America need.

That tight range of 15 to 19.5 percent is really important. Let's face it, our economy has grown tremendously. We are a $22 trillion economy right now, so something's working, right?

ERIC: Not to get economical or technical here, but the key is whatever these policies are, you want to make sure that it doesn't discourage employment, that it doesn't discourage productivity of those that are employed.

The underlying thing that guides and drives standards of living are output, how productive we are. Can we be more productive with the hours that we're working?

You want to make sure whatever the policies are, they're encouraging those types of things because more output leads to better standards of living for everybody. The pie gets bigger, everybody benefits.

PATTI: In our conversation, we were talking about taxation, tax policy being initially to provide economic value. It has now become a little bit more social value. What is the intent that we're trying to achieve here?

ERIC: Is there some kind of economic engineering that's behind the changes? Is it social engineering that they're trying to reinvent?

PATTI: I like that better, the engineering because that's what's going on.

ERIC: Is the tax system used to raise revenue to pay for important things, or is it used to create certain outcomes, socially and so forth?

PATTI: Close the gap between the rich and the right…exactly.

ERIC: Which, again, this is not a new argument. This has been going on forever.

PATTI: Absolutely, and we're not going to solve it today, but it does make me think a lot, in terms of what they're trying to do down in Washington.

ERIC: Exactly right. Onto the new tax law. We digress.

PATTI: Right. As always, we're going to get into actionable items throughout this podcast and at the end of the show, key considerations.

ERIC: I was going to put a plugin there. You beat me to it. I was going to say, "What do you call that? Key considerations? What?"

PATTI: There you go. I think we call it key considerations.

ERIC: Good. Mental footnote.

PATTI: Again, none of this is advice. We just want you to consider, go to your advisors, understand that these opportunities are here now and they may not go away as of January 1st. That's the most important thing.

ERIC: Some of these things could be ephemeral.

PATTI: Good deal.

ERIC: Good to join income taxes?

PATTI: Yeah.

ERIC: Exactly.

PATTI: You know what? Let's get one thing out of the way. How about we get the international tax law out of the way? Lots of changes in this proposal as it relates to the international tax system.

ERIC: You must be...

PATTI: A lot more...

ERIC: I was going to say you must be referring to the globally intangible low tax income or maybe the more obscure foreign-derived intangible tax.

PATTI: Talk about a snooze fest. Oh, man.

ERIC: That is a snooze fest for us for sure.

PATTI: We're not going to talk about all that. That is part of this legislation. It is something that they want to target.

ERIC: The thrust is targeting multinational corporations that have great ability and resources to defer, hide income, and so forth.

PATTI: You got it. Good. Let's focus on the income tax changes as well as the estate tax changes because they're big. I'm going to say especially the estates' tax stuff. Let's focus on the income tax. What's the proposal say? Who's it going to hit, and what should people do today?

ERIC: You always have to think about in these first couple situations is the rate upon what level of income does that rate then apply? The first is this proposal. Keeping in message with the whole election cycle that we're not going to raise taxes on anybody below $400,000 of income.

The next proposal says, "Let's take that top tax rate of 37 percent, go back to the 2017 level of 39.6, but rather than have that 39.6 kick in at $628,000, we want it kicking in at $450,000 if you're married, $400,000 if you're single."

Statistically, if you're making 450 a year as a household, you're in the 98th percentile. The proposal wouldn't apply to a lot of people, but that's one of the first changes that is being considered.

PATTI: More of that income is taxed at that higher rate. We're talking about almost $180,000 taxed at that top tier, so it is not inconsequential. It's a broader tax. More people are going to be caught in that highest tax bracket.

ERIC: There's this other interesting one that would be brand new, which is the surtax. If you were in an extraordinary high-income year where if you're married, your adjusted gross income is over 5 million, 2.5 million if you're single. This is something that would be brand new.

Again, it would not ensnare most individuals, but it would certainly affect people that have a large transaction that occurs in a single year, like, let's say, a sale of a business or some kind of divestiture of a major asset.

PATTI: Real estate, something of that nature. It's setting a precedent also that's saying, "OK, if you're at a particular tier, we're going to hit you with a surtax." Again, we don't know what we don't know, but I wouldn't be surprised if this gets passed this way, the level upon which that surtaxes hits could affect more people going forward.

I think the key thing that you said there, the key again, Eric, is adjusted gross income because that is different. Really important, everybody, listen up on that one.

ERIC: Right so, all these tax laws that are proposed are based on adjusted gross income. A lot of people think, "How can I evade this? Maybe by making a charitable contribution or having...

PATTI: Mortgage interest...

ERIC: …additional deductions?" All these things are being applied on adjusted gross income, or at least the surtax, in that case, would be applied there. It's a key consideration.

PATTI: Be careful. Be careful. Don't get caught in that. Basically, what we're talking about is instead of 37 percent, the exposure is 42.6 all in.

ERIC: Right. When you add everything in with the surtax and so forth. This brings into play if you're not maxing out employer-sponsored retirement plans if you're a higher-level employee that has access to a deferred compensation plan. These are vehicles where you can get that AGI number down below the limit.

PATTI: It is really important. That is very, very key because there's a domino effect with all of this. Not only are the ordinary tax rates affected, but so are capital gains, right?

ERIC: Exactly right. This requires advanced planning and modeling because things like a deferred comp plan has to be made in advance. You can't change it. You got to make it the year before. You have to really look at the bracket and look at all your options.

PATTI: Which is why we're talking about this now. Always remember, by the way, those of you who are listening today and watching this video, this is based on what we know today. They're still making the sausage. These rules can change between now and if this thing eventually gets passed, so stay tuned.

We'll be doing probably another podcast, but in the meantime, look at the worst-case scenario and understand that now is the time that most employers are requiring you to make an election on your deferred comp plan. You may or may not have been involved in it. This is the time to look at it really closely.

Worst comes to worst, you're reducing your taxable income even if the tax rates stay exactly the same. You're just taking additional money and putting it away for later on. It's a forced saving, depending on your employer and you have to understand the rules of your plan and understand the potential risk.

Boy, it's good sound planning, anyway. Right?

ERIC: Right.

PATTI: Talk about capital gains.

ERIC: Let's think of this in the old-fashioned term. We're talking about a tax on labor. What about a tax on capital?

PATTI: Right.

ERIC: Now, that's a separate tax regime, separate tax system, and the rules are changing there as well.

PATTI: Here's the thing that made me mad. I don't know about you, Eric and those of you who are watching, they kind of slid something in at the last minute and here's what it is, this 25 percent rate on capital gains at certain levels, that is retroactive to September 13th of this calendar year. If you sell anything after September 13th and you're ensnared in this...

By the way, the new rates don't become effective until January 1st of next year. We're talking about those people for joint filers who may have income over $501,000 plus or minus. If you're in that bracket and you sold something after September 13th, you're paying the higher tax.

ERIC: Yep, exactly. Right. It is sneaky just because the idea is they don't want people rushing for the exit before year-end to take and manage...

PATTI: Which is exactly what we would be doing, right?

ERIC: Yeah.

PATTI: I don't know about you, but we'd be making some phone calls and doing the analysis. Eric, we already bought a software program to do the analysis to say, does it make sense to sell for capital gains at the current rate or wait, and at what point what's the crossover period? That's off the table. So much for that software.

ERIC: It's the way software goes, right?

PATTI: Yep, you got it.

ERIC: Again, it's that the same old story here. It's the rate and what income does that new rate applies. I think the vast majority of people, the same rates of 0 or 15 percent will apply. It's only again the high-income earners, so they're increasing the rate and lowering the threshold when that rate kicks in.

The good part about capital gains is that you do have a measure of control over when things are realized. Ideally, that might mean holding on to an investment, and maybe selling it over time rather than it all at once, let's say when you retire, but it's challenging because there's always risk to holding an investment.

You always say all the time, I'm going to steal a saying from you, don't let the tax tail wag the dog.

PATTI: Fundamentals are important because, yes, there might be a tax, but don't you want to keep the money? You're still going to keep 85 percent of whatever it is.

If you're holding onto an asset, whether it be a stock, or a mutual fund, or a piece of real estate, especially right now, you might have to pay a higher tax, but you're still going to end up with more money.

ERIC: It's an important distinction here to remember too. What's the goal of investing? The goal is for appreciation, to make a profit. Wherever we can be strategic and help smooth that out or lower it, absolutely you want to do that, but I would much rather pay a capital gains tax than have a carry forward loss.

PATTI: You betcha. Absolutely. For those people who are listening, there are certain asset classes where you can do it over time. That's called an installment sale. That's probably going to become very popular for those of you who own businesses, rather than get a lump sum, have an installment sale so that you're not paying taxes all at once. That's still available. There are definitely still some planning opportunities for people who own businesses, both from an income tax and an estate tax perspective.

ERIC: Then there is this other sneaky one that hides in the tax code. Which is this net investment income tax.

PATTI: Yeah, ugly.

ERIC: In the current law, it says 3.8 percent tax that gets applied above certain income levels but it's being applied to passive incomes, so things like interest income, dividends, capital gains. Well, they're expanding the definition, so now it's not just passive income, it's income earned in any kind of trade or business.

They're going to raise the income thresholds before this kicks in, but again, they're expanding the definition. Again, really targeting high-income earners, which tend to be business owners and things like that.

PATTI: Yup, realtors, everybody. You know you got another 3.8 stacked on top of everything else.

ERIC: You're absolutely right, then we're going to have that.

PATTI: OK, so let's talk about the estate tax changes and the gift tax changes because that's big.

ERIC: I feel like for you this is the icing on the cake. This is your forte.

PATTI: I don't know, maybe it's philosophical, but people work all of their lives to save, accrue, pay the taxes. Done, you set it aside, and then somebody passes away and you're getting taxed all over again. Under the current law, you can leave $11.7 million per individual to your heirs. It could be your children, it could be other people, etc.

A couple can leave $23 million without a federal estate tax. The excess over that is taxed at 40 percent. Keep in mind, everything you have is included in that number. It is the value of your home, your retirement plans, your life insurance, everything is included no matter where it's located, so it can add up pretty quickly.

Now, the new proposal is basically accelerating the time when the Sunset Provision was to kick in. The Sunset Provision, we kind of knew that they were probably going to take that 11.7 back down to five and a half. What they threw in here...Again, this was a surprise.

I don't think anybody was expecting it because, as they were doing this, we had lots of people in Washington who were giving us updates in terms of what was and was not included, and estate, reducing the amount that you can leave to others was not part of this initially and then at the last minute, it was included.

Basically, under the proposal, effective January 1st of next year, the proposal is six million per person. Still a lot of money, so let's understand that most people are still not going to be affected by estate taxes.

But for those of you who are listening where when you add it all up, it is currently close to that point. Because, chances are, you're not going to die tomorrow. The estate taxes are due at the second death. Hopefully, you're going to live for another 10 20 years.

The question is, what happens in 10 years? What is your estate going to be in 10 years or in 20 years? To understand the scope of the issue and say, well, is there anything that I want to do now to capture what we have until December 31st.

Then going forward, what do we do from there? How do we do that? What do you do? What are the options? By the way, the rate is going to increase from 40 percent to 45 percent, so again, higher rate on the excess over that amount.

ERIC: I was going to say it sounds like we're moving over to a key consideration, right?

PATTI: Yes, very key.

ERIC: Is this where you're going to take a sunset and make it a sunrise?

PATTI: Well we are going to do a sunrise, absolutely.

ERIC: Because we're all about the sunrise.

PATTI: You got it. Also, there is a great opportunity through the end of this year to do something and to capture something that we will probably never see again in our lifetimes. That's pretty much everybody's assessment.

ERIC: The idea is to try and use it before you lose it, right?

PATTI: Exactly.

ERIC: Then what are the strategies you could do that?

PATTI: Here is the deal. Let's pretend Ed and I have a taxable estate. Basically, you can do something called a spousal lifetime access trust. I'm making him do it.

I'm making him do it.

ERIC: He's giving you the gift?

PATTI: Oh, yeah, you better believe that. He's going to put in 11.7 into this thing called a SLAT, or a spousal lifetime access trust. Now, keep in mind, he's still alive and I'm alive. I have lifetime access. I can get all of the income.

I can get whatever I might need for my health, education, maintenance, and support. Those are called the ascertainable standards. It has been tried, tested, you're good. He puts it there, we have access to it if we need it when we need it.

To the extent that we don't, here is where the real benefit comes. First of all, OK, we are getting another $5.7 million that out of the taxable estate never was taxed. That's just the beginning though, Eric, because in addition to that, to the extent that we don't use it, use the Rule of 72, 7 percent rate of return.

Every 10 years, that capital will double. Round it up. $12 million becomes $24 million, becomes $48 million in just 20 years, by doing this thing called a SLAT, we've avoided the tax on almost $50 million. At 45 percent, that's a lot of money.

ERIC: Probably more, we all know Ed's going to live to 120, right?

PATTI: Absolutely, yeah.

ERIC: For sure.

PATTI: It will be Ed, I'm sure. A spousal lifetime access trust may be something to consider. What else is available there? Well, there is something called a qualified personal resident's trust, where you can take either a home or a vacation home.

Neither one has ever been rented. It has to be a legit residence. You can put it into a trust. Here is the deal. It's not a gift today because any time you put money into a trust, it's a form of a gift. Let's say that you have a property, let's say it's worth a million dollars. We ran these numbers on a 60-year-old and we did a 20-year trust. I'm just going to round off numbers. Because it's not a gift today, it's a gift 20 years from today, there is a certain discounting that is allowed. Instead of using up a million dollars of that wonderful 11.7, we're only using 500,000.

The asset is in this trust. It's called a grantor trust. If this is your situation, you continue to pay the real estate taxes and the utilities just like you owned it before. What happens at the end of the 20 years? Well, this is where you got to really understand how it works because at the end of the term, everything is done and the kids own the house.

If it's a house that you're living in, just understand that you better be nice to those kids because they're going to own your house.

ERIC: Interesting concept then. Does that mean they have to come in and clean it then?

PATTI: Oh, yes.

ERIC: That you can live there but they clean it.

PATTI: Totally. It's payback time.

ERIC: They've got to put food in the cupboards. It's just a natural assumption.

PATTI: You got it. Exactly. By the way, they've got to provide the home healthcare, they got to do all that stuff.

ERIC: Cut the grass. Fill up dad's lemonade when it gets low.

PATTI: Yes. All right, so here is the real perk in the right situation though. Do you know how you can leave $15,000 per person per year? That's the gift tax exclusion. Again, understand how gifts work. You can gift $15,000 to all of your children, their spouses, your grandchildren. There are no forms that have to be filed there is no 709 gift tax return. You're good.

What if you want to help one of the kids out with a home, and you want to give them $150,000 for the down payment? Well, that's a different ball game. That's a gift over the exclusion, so you have to file the 709. Here is the thing. You can use that 11.7 while you're living or when you die. It can be used either time.

This is where we're taking advantage while we're living before it gets taken away. It's a neat way of taking advantage of the rules as they are. A lot of people ask me, "Well, Patti, how about if I don't want to do $11 million? We don't have that much. Why don't we just do three?"

Here is the deal, you're not really accomplishing anything. Because we know you're going to have six available under this proposal, so you're not accomplishing anything.

To really get some leverage out of it, you want to gift in one form or another, spousal lifetime access trust, qualified personal residence trust, or some of the other tools that we still have available through the end of December. It is a form of a gift, and you're using up that $11 million.

ERIC: I want to clarify that point because, originally, when I was looking at it, there was a little bit of a point of confusion for me, which is, if you don't maximize what's given to you, what's going to happen is it will go to six and then they will back out any prior gifts. It's not like you can use a little bit above and you'll still have six.

It goes to six and then they back up the prior gifts. To your point, if you don't utilize it, it's going to be a debit against that six million.

PATTI: Exactly, Right, because when you file that 709, they're keeping track. They're keeping track of what your prior gifts are and when someone passes away, that final tax return it's adding all those prior gifts to figure out, do you have anything left? What is the excess and what's the tax?

ERIC: Another interesting point that was left out which was a big topic...

PATTI: Yes, big.

ERIC: Step up in basis, that's not there. There is still going to be, as it is now, step up in basis.

PATTI: Basically, and that's important, Eric. Really important for everybody listening to know because that was contentious and that was something that we were honestly worried about. Here is the way this works.

Let's say that you paid $20,000 for an investment, and the value of that grows to $100,000 as of the date of death. You've held on to it. You didn't need the money, and now it's worth $100,000.

Well, under current law and even under this proposal, the cost basis of what you paid for it, it's an accounting thing, it just steps up to the fair market value as of the date of your death.

I will tell you in my own family situation. My parents had a place in the Poconos, they paid $50,000 for it. When dad got sick, we changed the deed and moved it out of joint names, and we moved it into dad's name. We pretty much had talked about it because dad loved it, but mom wasn't loving it.

What happened was, when dad passed away that $50,000 cost stepped up to the value as of the date of death. That was $250,000. My mother sold the property, she paid no income tax on all of that gain.

Step up in cost basis is important for your planning, it's important for your portfolio management, and it has been retained. Very important. The reason I'm making a big deal about this is that this would have been a very broad tax. Here the administration is coming out and saying, "We're only taxing the rich."

"Only those people making over $450,000 or $400,000, and only people who have more than $12 million in assets. We're not going to hurt or we're not going to tax people, Middle America." Guess what, that would have crushed Middle America because it's a broader tax.

I don't know about you, but there are a lot of people out there who have investments and real estate. Think about your home. You've probably got a gain on a primary residence or a vacation home. Under current law, it steps up in cost basis. If they had said no more step up anymore…and it was worse.

You ready for this one? They proposed that there would be a valuation upon death. Whether you sold it or not, you got to pay the taxes then. It was quite draconian.

ERIC: You mean you have a tax bill without a cash flow to pay the bill because you haven't sold the asset.

PATTI: Exactly, which is really important. You've brought up an important point with all of this when we think about America, we think about, what is America made up of? It is made up of small businesses and farmers. The estate taxes really hurt small businesses and here's why.

Let's say that you have a business and it is…I'm just going to use a value of five million dollars. Now, here's the deal. You might think it's worth two, but the IRS is going to think it's worth five because they want their money.

You've got this business and somebody passes away, the IRS says, "OK. Fork it over. You got to give us 45 percent of that business plus estate, so half the value of that business. $2.5 million has to be paid in the form of a tax." Family looks around and says, "We don't have that kind of money. Where are we going to get that kind of money?"

Guess what, they got to sell the business. This is exactly where the term fire sale came about. Everybody knew, "Hey, this family farm has to be sold to pay the tax. We're going to give them 40 cents on the dollar, 50 cents on the dollar."

The family didn't have any choice because the tax bill was due in nine months. They had to sell the farm or the business to pay the estate tax.

ERIC: I guess the other thing that's a real challenge, assuming that...again, this is all proposal, these new grantor trust rules, planning would usually call for something called an irrevocable life insurance trust, to create a life insurance policy that's removed from the estate but it gives you that liquidity.

As you said, so much of America is made up of small businesses and farmers. It's a liquid asset. This was a technique to create the money to cover the tax, so you avoid that fire sale. Now they're changing the rules on that, on that insurance.

PATTI: It's brought back into the taxable estate.

ERIC: It can potentially be brought back into the state.

PATTI: Again, I'm so glad you brought it up, Eric because this is really important for everybody listening. If you have an insurance trust, an irrevocable insurance trust, which is exactly what Eric said, it was there, you pay a premium, you pay your $10,000 a year, or whatever it might be for your million dollar insurance policy.

Hope you live a long time, but if you don't, at least that money would come in triple tax-free because of life insurance, there's no income taxes due, there was no estate tax due, and there's no inheritance tax due, as long as it's owned by an insurance trust.

Now, where do you come up with the money to pay the premiums? Typically mom and or dad, or both, make a gift into the trust. It's held there for a period of 30 days.

After that period, it pays for the insurance. That is what is being threatened, because if after January 1st, if you do that there, the grantor rules are changing and that's going to cause inclusion.

Some of that million dollars that you thought was going to come in tax-free, guess what, is not going to be tax-free, anyway, or a portion of it. The takeaway from here, the key consideration is, if this is your situation and you have an insurance trust and you really want to have it to provide that liquidity to pay the tax and you can't say in the trust, please use this to pay the tax.

It's a complicated formula I'm not going to get into it, but the fact of the matter is, at least you have the money to pay the tax, so you don't have to have the fire sale. The takeaway from this, where the planning technique is to front-load your insurance trust between now and December 31st.

Throw in 10 years of premiums. Again, assuming that you even have it. These are big world problems, big problems but again if you don't know about it, you're not going to do it, and you wish that you had.

Throw in $100,000. By the way, it doesn't have to be cash you can transfer in existing investments, just do a journal from one account into the insurance trust account. It's there to pay the premiums for the next 10 years, so you're good.

Again, we want to be creative. We want to be proactive. We want to understand the implications and how each one of you who is listening, the things that might apply to your situation, throw out the rest.

For those people where this might apply, there are things that can be done, and honestly, should be done. The thing about some of this stuff also is that there's no real downside. You do a spousal lifetime access trust.

Ed set it up. Remember, he's setting it up for me. He sets it up. What if the law doesn't change? What have we given up? Really not much. What about the personal residence trust, what have we given up? Really not much, because again, it's a grantor trust.

ERIC: Proactive planning really pays dividends and so forth. What do you think?

PATTI: IRAs, retirement plans, funds scam. That's going to affect a lot more people. What's happening in the retirement area, I've talked long enough. Eric, you take it away here.

ERIC: Thanks. There are some rules that are not going to touch most Americans. There have been certain very crafty entrepreneurs that have used IRAs to accumulate massive, massive balances and IRAs without ever paying any kind of tax. These laws are targeted at these certain individuals, where an IRA balance might be above 10 or 20 million.

Now, for the average person putting in the maximum every year, it's nearly impossible to get there without just an absolutely fantastic compounded rate of return. These are situations that they're trying to head off.

If your IRAs are above 10 million or 20 million now, there are special required distribution rules, regardless of age where you have to distribute that money.

Again, most people aren't going to be faced with this. The one that is more germane to the average American techniques that most people can take advantage of either individually or through employer plans really deals with rollovers and conversions.

They're changing the rules there, where they want to eliminate the ability to move money from an IRA to a Roth if you're above certain income limits to eliminate the ability to convert after-tax money into a Roth. You might have heard of this strategy called the backdoor Roth.

PATTI: This is a big one. This is a big one personally because this is what we were having all of our clients do if they had it available through their employer and have the cash flow.

What that means is what you could do is make contributions up to the Internal Revenue Service max, $26,000, depending on your age, but you could still put in more into your 401(k). You just wouldn't get a tax deduction for it. That's called an after-tax contribution.

When a person retires under current law, you have a one-shot opportunity and it's a great opportunity. Take all that after-tax money that you were saving year after year after year and move that instead of rolling it over into a regular IRA, which you never want to do, FYI.

You roll it into a Roth IRA. Guess what? You don't owe any taxes because you already paid the taxes on it. It's a sweet deal. Most Americans are not going to be able to get that kind of money growing tax-free for the rest of their life when they don't even have to take the required minimum distributions.

ERIC: Yeah. I think they're just trying to short circuit these ways to get money into Roth IRA accounts. Because again, the growth will never, ever be taxed and they're just trying to figure out ways to curb those avenues to get it in there.

The other thing too is you have to distinguish some things like the backdoor Roth are these in-plan conversions of after-tax money, the Roth money. Those things are being excluded, but some of these other things, conversions, and rollovers, are dependent on income. It's not like some of it is going away.

If you're going to retire, you might just have to defer a tax year before you do it, so that way you're in a lower bracket and so forth.

PATTI: By the way, I'm glad you brought it up. This is not for everybody. There are situations where it does not make sense for someone to do a Roth conversion. It really doesn't. Again, run the numbers, understand the downside of doing it. Because if you do a Roth conversion, you've got to pay that tax right away.

ERIC: Yeah, that's an important point. It's not like the transaction is for free. You're just making an election, is it better to pay tax now or later? That's driven by tax rates and your assumptions.

PATTI: I hope it's OK, Eric. I just have to say this. Let's go back to the estate tax stuff for a second. Here we go. You think about people who have been saving, saving, saving. They have these wonderful balances in their IRAs, in their 401Ks.

Let's say that someone accrues $2 million. Not unusual between a husband and wife to see that kind of money in a retirement plan. Basically, pass away, etc. The problem is that that $2 million is included in their taxable estate.

You stack on top of everything. When you think about it, someone is paying a tax on a tax because the kids are going to have 10 years to pay the taxes on those, I say the kids, anybody, your heirs are going to have to pay the taxes on that $2 million.

Basically, $600,000, give or take, is really a tax that somebody is going to have to pay either right away or eventually. When we include that $2 million, it's not really $2 million because $600,000 is going to go in the form of income taxes. Now you're paying estate tax on an income tax. You're paying a tax on a tax. We don't want to do that.

For those people that may have an estate situation, this is the year. This may be the year to do a Roth conversion on those retirement plans. Pay the taxes while you're alive so that the kids aren't paying an estate tax on it when you pass. Does that make sense?

ERIC: Yeah. Gotcha.

PATTI: All right, good deal. Thank you for letting me digress.

ERIC: No problem. Any time you want to go back to estate taxes, just let me know. I'm in the passenger seat here. You're driving. Maybe I'll chime in and be a front seat driver.

PATTI: Good deal.

ERIC: Where's the car going next?

PATTI: Yeah. I say we pull this all together. Because I think we've talked a lot about history. We've talked about the history of taxes and what is being proposed and some of the key considerations. Really, to boil it down and really keep it as simple as possible, here's the deal.

If you have income of $400,000 to $450,000, above those amounts, those are the people who may be paying a higher ordinary income tax rate and higher capital gains. Just understand that going forward.

When it comes to estates, there's a lot of things that may change. This is the time to consult your adviser, your estate planning attorney to figure out is there anything that we should be thinking about or considering?

A lot of this other stuff, it's noise and it will continue to be noise until we know what the final proposal looks like. The things that were not included, important, step up in cost basis is still there.

The SALT limitation, we were hoping that they would remove that, state and local income taxes, that $10,000 on your itemized deductions. A lot of states are pushing to remove that. That is still there. That did not change.

Like kind property exchanges. For those of you who have rental properties, there is a nice little perk that you can sell one and buy another. As long as it's a similar type of property and you follow all the little nitty-gritty rules, no capital gain tax is due. That remained. That was also being threatened, but that did remain in this proposal.

For those people who have businesses, some of the discounting tools like family limited partnerships and things of that nature that were being discussed, etc. Those opportunities will also remain.

ERIC: The other thing to remember too is that these are all proposals. This is not the first one. Our branch of government, the legislative branch made up of the Senate and the House, Senate has what's called the Senate Finance Committee. They are responsible for overseeing taxation. They have a proposal.

The most recent one we're talking about today came from the House, the House Ways and Means Committee, which is the House version that oversees tax policy.

If they decide to come out with something new before the end of the year, it looks like we have a wonderful opportunity to do another podcast. Because this is not the first time we've had one of these and it continues to evolve with every iteration here.

PATTI: All of this stuff is very important. Again, keep in touch with your advisors. Those people have their finger on the pulse of what's going on in Washington and most importantly what you can be doing about it. Thank you, Eric. As always, this was fun.

I hope you enjoyed it as well. Lots of topics and lots of information, history, etc. Perspective, hopefully, and some action items as well. Things, key considerations that can make a big difference for you as well as your families. Thank you so much for joining us. Go to our website, keyfinancialinc.com.

We'll have all of this information on the website. In the meantime, I hope you have a wonderful fall. I hope you have a wonderful fall. Enjoy your family. Happy Thanksgiving. I'm hoping that this gets launched well before Thanksgiving. Thank you so much for tuning in. Take care.