Episode 203: OBBBA and You, Part 3: Building, Passing and Protecting Wealth Under OBBBA

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SUMMARY KEYWORDS

Retirement income, estate taxes, alternative minimum tax, Trump accounts, Roth conversions, 529 plans, educational expenses, bonus depreciation, research and development, qualified opportunity zones, clean energy credits, small business stock, tax planning, financial personality, retirement income personality.

SPEAKERS

Brett Layton, Briana Corbin, Alex Murguia, Wade Pfau, Speaker 1

Briana Corbin 00:00

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Briana Corbin 00:38

Part three of our deep dive into the one big, beautiful bill, Act takes us through estate taxes, alternative minimum tax, and the strange new world of Trump accounts. Brett Layton joins Wade and Alex one last time to sort through what it all means and why none of this is simple.

Wade Pfau 00:55

Okay, well, the next one on the list, and this is going to make Alex's ears perk up. Yes, the estate tax limits are going to increase further next year, starting next year. Well, I mean even further increase over inflation from this year, maybe not that much bigger, but estate tax limits, which were scheduled to revert to much lower numbers in 2026 what's happening instead?

Brett Layton 01:19

Yeah, so this has been a big push by the estate planning community and a big worry for the last year and a half or so, because in this year was going to be the last year of the higher exemption, and let's just Call it $14 million this year to round it, it was going to go back to an inflation adjusted 5 million, and we'll just call that 7 million. So at in 2025, if you were married filing joint you didn't have to worry about federal estate taxes until your net worth exceeded $28 million but had this bill not happened, that 28 million would have become 14 million, right? Basically half, and that would have brought a lot more people into the estate planning arena, and then, as you get along in retirement to the back half of retirement now, you're in a situation where, you know, I actually may want to pay income taxes, because the income taxes I Pay is going to reduce my taxable estate. And, you know, with the 10 year rule on inherited IRAs with no step up in basis, I'm giving my kids a tax bomb right at the point where their lifetime income, you know, let's say they're 45 to 55 hopefully we all live that long. They're at their maximum earning potential for their entire lives, and then they get saddled with a 10 year bomb on, you know, a couple million dollars in a rollover. Ira, I mean, that, that that's, that's, you know, tax death, right? That's no advantage to your kids. That's a liability that you've just flogged on.

Alex Murguia 03:32
Funny, I would just say, Thank you, pop.

Wade Pfau 03:36
Dare you give me this embedded income? Wow,

Alex Murguia 03:43
we've got a lot to unpack here. I just couldn't help. I just couldn't help, but

Wade Pfau 03:51
it's the Roth conversion discussion as a retiree pay at a lower rate than your potentially your higher earning children. How

Alex Murguia 03:57
about just be thankful

04:01
in your taxes,

Wade Pfau 04:04
but yeah, 15 million for singles, 30 million for couples, and

Brett Layton 04:09
then the state tax advantage. Now we have 15 million. We have portability, still in estate taxes, so to the extent that you take advantage of the marital deduction to to on the first spouse to die, then you can make a desu election on that first spouse to dies, estate tax return, and you can port over that unused exemption of 15 million to your surviving spouse and now she doesn't have to worry about estate taxes till she hits 30 million. The only thing she can't do is she she can't remarry, because if you remarry, then that it's not like you can collect, you know, multiple exemptions. From multiple husbands, right? And and we all know we're the first to go, so that would be an interesting wrinkle. You could have widows out of there exemptions I gotta pick carefully. Want somebody who's not going to live very long.

Wade Pfau 05:22
I maybe happening.

Brett Layton 05:30
What did we out on on the estate taxes exemption?

Alex Murguia 05:36

Well, I just an aside. This is more side note, because you said the estate planning community was pushing for it, I would think this, estate planners would want it to be at a lower threshold, so there's more work. Yeah, okay, we're pushing,

Brett Layton 05:51
yeah, yeah. It's like, okay, now you've really gotta, you know, let's, let's, you gotta redo your will, and we've got a plan for a lower, high

Speaker 1 06:01
man. Okay? Yeah, yeah.

Wade Pfau 06:06
Oh, so that the lobbyists for accountants would like lower estate tax, unless they're very wealthy themselves, personally, they generally want lower, more work for them, right? Yeah, yeah, irrevocable trusts, it's like when

Alex Murguia 06:20
they talk about someone finding the tax code. Brett says, No,

Brett Layton 06:26
yeah, and this is where CPAs and final financial planners are really in a tough spot, because neither of us can practice law. And you know for CPAs, the tax, the income tax area, sales tax, payroll tax, it's pretty well carved out. We pretty much can do quite a few things, but when you get into the estate tax area, you know, we can't draft trusts. We can't do wills. We should be very, very careful not to practice law and to save our license and to save our save us from litigation and and to keep our Eno insurance carrier happy. And you know, even a guy like me who just, I don't sign a thing, I don't sign a tax opinion letter, I'll happily draft you one. I drafted one old month or so ago, and but I'm not signing it. Yeah, I but even I take, you know, spend money on Eno insurance, just because it's prudent and and you know, you have to have a big homeowners policy and a big umbrella policy. It's, it's dangerous out there when you're a part time consultant.

Alex Murguia 07:52
No, I hear you. And so Wade, so we got the estate anything other than the estate tax that you want to discuss?

Wade Pfau 08:03
Yeah, there's a few more things, I guess we're done with the estate taxes, other than just kind of reminding people that it could change.

Brett Layton 08:11
And you've got a, you've got a, you know, California doesn't have an estate or inheritance tax, but there's a handful of states that do have them, and they have them at a relatively low limit. They're generally not hugely confiscatory. But if you're in a state that has an inheritance or an estate tax on death, then you just have to be aware of it and be prepared to pay that money to send whatever's left to the next either your charitable beneficiaries or your lineal descendants, or whoever you want to send the money to.

Wade Pfau 08:53
Got you Yeah, because with the estate tax, once you get to a million dollars over the exemption limits we discussed, you're already at a 40% estate tax rate at the federal level. Yep. All right, the next one probably applies to even fewer listeners than the estate tax limits, although with the estate tax, who knows how many?

09:19
But please, keep on listening.

Wade Pfau 09:23
Yes, oh yes, yes, but the alternative minimum tax, we can probably keep that one shorter. But there's some changes with the alternative minimum tax, though, really, since the tax cuts and Jobs Act, probably few people get impacted by

Brett Layton 09:36
it. Yeah, this is very, very, very few. I mean, you you really need to have a AMT preference or an AMT adjustment to drive yourself into it. The big one, the big one was the salt deduction, right? And and even moving the the limit from 10,000 to 40,000 isn't going to. Significantly throw people into AMT based on the current exclusions amounts, which basically have stayed the same, but the phase outs of those exclusion amounts are now a little broader. You really have to you really have to be deep into equity compensation or deep into oil and gas and have a lot of intangible drilling costs, expenses. That's a deduction on the in full against your ordinary taxes, but gets throttled back significantly for AMT, and so it's a very niche area. 20 years ago, well more than that, 30 years ago in Silicon Valley, it was, you know, driving a lot of planning because you always wanted to get to the AMT regular tax break even point because you didn't want to necessarily pay alternative minimum tax, and then an even smaller subset of Your preference items or deductions are available for the minimum tax credit, and that has to be driven off of a timing, a timing difference. So ISOs, your exemption on ISOs would be a timing difference. It eventually catches up. And so now you've got back, you get back into nerd land in a big way, and you're almost, you know, doing a deferred tax analysis on an individual return and trying to determine How much of that AMT payment will be. Eventually. Qualify for a minimum tax credit deduction. And it's, it's, it's a real narrow niche. I don't run into it at all here in Orange County.

Wade Pfau 12:20
Okay, well, the next one, we can leave nerd land temporarily. It's more straightforward. But can you talk? And this may impact more people, the expanded eligibility on the five to nine educational qualified educational expenses. Yeah. What's new there?

Brett Layton 12:36
529 plans are really becoming not just a college savings plan, but a real education, lifetime Education Savings Plan. And so couple things have happened. I believe it was the tax cuts and Jobs Act allowed tuition at private K through 12 schools, up to $10,000 that has now been doubled, and a whole bunch of other stuff is going to qualify. So not only would tuition qualify, but supplies, potentially, computers, tutoring costs qualify. Dual enrollment will now be, you know, deductible. So for example, since you have a kid that's bright kid who's gone to a public school and he's knocked through all the AP stuff that's offered advanced placement classes in his high school. What a lot of those kids do is they just register at junior college and they start

knocking down their, you know, lower division requirements for their bachelor's degree. Excuse me, so all those expenses are now are now payable out of the 529 plan, tax free. And then on the other end, you know your CPA review course for your CPA or your welding school, if you decide to bail out of academics at the undergrad level and go become a welder or machinist, all that expenses now can be taken out of the 529 plan. And you know, continuing professional education for CFPs or CPAs or attorneys. You know you that that 529 plan can provide cash flow for those type of expenditures, basically your entire life and what and, and, and the 529 plans themselves are getting a lot more of. Competitive. The maximum value is, in some states, is approaching 600,000 and it's it's so much different than when my kids were young, 529, plans. The investment options were very restrictive, the fees were high. I have, you know, basically 40 year olds as children, so I elected not to do it when they were in elementary school, just because I can, I can do better in a taxable brokerage account, and I don't have all these strings attached, and I'm not subjecting myself to such high fees, but today's a different story. Wouldn't, wouldn't you agree?

Wade Pfau 15:46
Wade, yeah, yeah, I did see value in setting those up, thinking it. You never know how many, how much you're going to have in terms of qualified educational expenses. So you don't want to necessarily overdo it. Does this start, and actually, I'm not sure the answers 2025 or 2026 with all these new things added to the list, I think that you mentioned the 10 to $20,000

Brett Layton 16:09
right? That's 2026

Wade Pfau 16:12
What about like I was just thinking, I've got a high school senior and popped out $500 for AP exams, the s, a T exams, AC, T exams, I know that's all going to be eligible now, but is that this year or next year? Do you know

Briana Corbin 16:27
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Brett Layton 16:53
I don't want to make a mistake, so I would have

Wade Pfau 16:57
to not sure when that starts,

Brett Layton 16:59
but I think, I think it may be, I think it may be now, as long as it's post July 4, 2025 I think the expanded definition started at the date of passage,

17:15
okay, and then

Wade Pfau 17:16
you do have to, if you're if it is, double check if it's eligible. But if it is, you do have to take the distribution from the five to nine plan before the end of the calendar year, or you you lose the opportunity, right?

Brett Layton 17:28
So the real problem with California residents is California's never conformed to the first expansion of 529 plans. So yeah, for federal purposes, I can take money out and pay for my kids private high school, but that's a disqualifying disposition, basically, for California, 925, 29 plans, and you're going to be playing penalties and full income tax on what, on a federal level, is a qualified distribution, and that's just a shame. But California is a strange state, and they value their public school system, and they're not terribly excited about making it easier for folks to get their kids into a private school, especially at the high school level. So you have to watch for that, because it's, it can be a bad surprise,

Wade Pfau 18:39
yeah, but yeah, that's it's gonna be interesting. Just a lot of additional eligible expenses. Yeah, we've got two more items. The next one also has gotten some media attention, although maybe not as much as you might think it's. There are now we have Roth accounts. Now we have Trump accounts. Yeah, what are Trump accounts? I

Alex Murguia 19:02
am surprised it hasn't been more like blustering about this.

Brett Layton 19:07
I actually really like Trump accounts. I think, I think for way, way too long, you've had a true inequality in the tax system. And what I mean by that is those folks that run their own small business are reasonably bright people. They're going to hire their kids in the business, and you know, they're going to pay, it's going to be real work, right? But you know, they'll, they'll empty trash cans or do janitorial, or they'll go out in the backyard and they'll weed, or they'll, you know, vouch payables, or they'll move boxes around, or whatever that they're capable of doing. And they're going to get, you know, there's $7,000 a year of. Of salary, and they can either pay into Social Security or not, because they're directly related to the business owner, and they're less than 21 years old, it's going to be fully deductible for the business. And now they have earned income, and they're going to do a Roth, right? I mean, it's just just easy, easy, easy way for kids to get started right away and get their future savings in order and but if I'm, if I if both of my parents are w2 people, they can't do that because I can't generate any, you know, any real earned income for the kids. Now, you don't have to have any earned income. You can do a Trump account, not quite as good as a Roth, I know, but, but at least it's a way to get the kids saving in their name. And you know, who knows if social security is going to survive 40 or 50 years from now, or what it's going to look like? So basically, what happens is a $5,000 cap per child, anybody can contribute, grandparents, parents, aunts and uncles, right? You just can't go generally, over 5000

Wade Pfau 21:30
and we should note, this is starting next year, not not in 2020,

Brett Layton 21:33

starting next year. And they're trying to, you know, it's going to take them a while to get the infrastructure around these accounts, but I think it'll come out just like, you know, Shyam will offer a Trump account, or, you know, whoever, right, yeah, and you can go and open one for the benefit of your kids. And they're the federal government is actually going to do a little program from is it 2024, to 2028 there's

Wade Pfau 22:05
some data, I think, for for US citizen children born between 2024 and 2028

Brett Layton 22:11
so US citizens born here between 2024 and 2028 they're going to throw in 1000 bucks To get it started. And again, these accounts really aren't going to materialize until after July of 2026, but once that infrastructure is in place, then that starts. There's also provisions for your employer to kick in, I believe, up to $2,500 I'm not sure on that limit, but that kick in from your employer doesn't count against the 5000 that you can fund from friends and relatives. And so there's lots of little ways to fund this account that the investment options are limited. It's, you know, simply S, P Index Fund, right? And they put a limitation on management fees, so that probably demotivates some brokerage houses from establishing one. But we'll, we'll see how it plays out. That there's no distributions out of that account, until the child becomes 18. And then there's some more complications here. But to simplify things, it basically converts into a IRA,

Wade Pfau 23:44
and then so you don't get the tax deduction. So it's like having non deductible contributions

Brett Layton 23:49
tax deduction. A lot of those contributions that come from friends and family will give you a tax basis, you know, and then you, you know, sort of do the annuity thing at the end. But I mean that that that's an insignificant amount of money, if, if this account grows from age 18 to age 60, right when they retire and and, you know, you can get charitable organizations can also kick into this account that doesn't necessarily inhibit or reduce that $5,000 limit. Now you have a IRA that will grow tax deferred until retirement, and then the normal we'll see how the normal IRA rules apply. But you know, there's some things like first time homeowners that will allow for at least penalty free withdrawals before retirement.

Wade Pfau 24:58
Yeah. Mm, hmm. And you know, then it's treated like the IRA and that that money comes out as ordinary income and is taxed, but

Brett Layton 25:07
you get the tax deferral, right? So you're giving up capital gains rates for ordinary income, but you're getting deferral, and

Wade Pfau 25:18
there's the 859, penalties. Yep.

Brett Layton 25:23
Age 59 and a half is just like a normal IRA is the 10% penalty threshold.

Wade Pfau 25:29
And then there's a lot of questions people might have about these that we don't really have the answers yet. Like a natural question might be, can I Roth convert these at age 18, so that it would be then growing as a Roth rather than an IRA. But I think we don't really have the answers for that. Well,

Brett Layton 25:50
I don't, we don't have the answer yet on that and that. You know, that would be a natural point to convert if you're, you know, out of college and haven't started your career job yet, and you're still, you know, working part time in a restaurant and making a tip deception, there

Wade Pfau 26:15
you go. There we go. Yeah, don't go over those phase out limits.

Brett Layton 26:21
Here, here. Right? So I think Russia the Roth accounts are or rather, I think Trump accounts really have an equity aspect to them. They're not as valuable as a Roth, but they allow a whole new class of people to, you know, start funding a pool of money for young children,

Wade Pfau 26:49
and that's because you don't need earned income for the contribution.

Alex Murguia 26:53
Yeah, and wait. I suspect even the government is going to kick in a little bit at the beginning. But I suspect here that in much the same way we were talking about, look how 529, plans have evolved since it started. I mean, it's much that it's amplified by a significant portion. You could see something like this, you know, open the door to contributing something for retirement before you're even having earned income right at the end of the day, that's the special sauce here. This can more than anything I would think.

Brett Layton 27:29
And if you do 5000 a year, you know, by the time the kids 18, they have, what, maybe 160,000 bucks in this account. And if they leave it alone, and it just compounds at 6% for 40 years. They they have, they have a million and a half bucks, or 1.7 million. Yeah, and that, that is going to go a long way to softening the blow for, you know, massive reductions to Social Security, which may be a future reality.

Alex Murguia 28:04
No, but you can maybe. I now we're just, this is just for kicks. If you have an existing 529 plan, merge it into that. I, what I'm thinking is, at a certain point they're gonna, they're gonna play around with this a lot. You're gonna see a lot of this, this specific thing more the same way that 529 has more, right?

Wade Pfau 28:24
And there's some discussion with Social Security. Your point like this, about 20 years ago, this was what I did my dissertation on the personal retirement accounts for Social Security. And it seems like these Trump accounts have borrowed a lot of their design and infrastructure from the proposed personal retirement accounts for Social Security?

Brett Layton 28:43
Are you going to sue for a royalty payment? Wade, oh, no,

Wade Pfau 28:47
that that would be George W Bush. That would want those royalties, I think. But that would be interesting in terms of just having very limited investment options, so that people can't be making mistakes with their investing and so forth, and yeah, not carving out from payroll taxes to do it, but maybe laying that foundation to have this all encompassing retirement based account that, as Alex is saying, could be expanded in the coming years, and maybe at some point, does take some of the payroll taxes from Social Security.

Speaker 1 29:18
You think we're in Chile. Yeah, Social Security.

Brett Layton 29:27
I'm 68 so somebody from my vintage you know, when 529 plans first came along, and my kids were young, they were the fees were ridiculously high, from my perspective, so I didn't do it, and then Roth accounts came in. But, you know, I was a mid career in corporate America. I couldn't touch a Roth because I couldn't get my taxable income or my AGI under, under the limits, right? And I wasn't going to get a pay cut just so I could do. The Roth, but the

Alex Murguia 30:01
pain is real. Brett, the pain is real. Yeah,

Brett Layton 30:04
yeah, and, and, so, fortunately, fortunately, Stacy worked a little longer than I did, so she was able to do 401, K, Roth. So we were able to build a little bit of tax location diversification, and then I did a few little modest Roth conversions and and, you know, built up a little bit in Roth for myself.

Speaker 1 30:31
But, yeah, it's just, it's

Brett Layton 30:37
retirement savings is getting better and better as the years go by. I guess bottom line,

Alex Murguia 30:47
kudos to you. Seriously, good job, Brad.

Wade Pfau 30:50
All right. Well, the last one, last one.

Brett Layton 30:53
Thank you for backing me up with all your vast technical knowledge and start dates and stop dates. That's a little hard for me to think my feet. Yeah,

Wade Pfau 31:04

that's a hard part of it. Everything has different dates. I completely missed. I was thinking I could take advantage of those five to nine plan things for my son's high school expenses, but now I got to double check if it works for this year or not. But yeah, the last thing is, and this is maybe an easy one, the Clean Energy Credits,

Brett Layton 31:24
yeah, they're gone.

Brett Layton 31:31
And then, you know, qualified opportunity zones are going to have a new iteration. Those are going to be interesting. But again, we don't have a lot of guidance yet on what they'll be, other than the fact that there's going to be a nice deal for rural farming developments, is a 30% reduction of your capital gains, as opposed to 10. On the business side, the three big hits for from my perspective, is the return of 100% bonus depreciation, as opposed to 40% that's huge, the ability to fully deduct research and development costs, that's huge. And this is a sleeper, but when it works, it is a home run, which is qualified Small Business stock section 1202, of the Internal Revenue Code, you can basically make a lot of money in a startup, and your first $15 million of capital gains is tax free. The only, the only penalty you pay is once you go over that limit, they throw you in the 28% capital gains bracket. So if you make, you know, a billion dollars off your startup, then maybe the 1202 stock doesn't, doesn't help you that much. But if you've made a billion dollars off your startup, you don't need any help.

Wade Pfau 33:15
Alex has to think about that for the RESA, yes, okay, but yeah, I think that's we've thanks everyone for bearing with a three part overview of all the various aspects and provisions of the one big, beautiful Bill act. It was a lot to cover, but hopefully there's a lot of useful information. It really does impact tax maps and tax planning and Roth conversions and so much to be thinking about. It didn't get easier, it got harder. So thank you, Brett, for walking through all that with us and bringing that accountant CPA perspective to this. Thank

Brett Layton 33:51
you both for having me and I just I think you guys are wonderful. I really love your book. I really love the retirement researcher Academy. It's just a wonderful group. I My only regret is that I wish I had more time to spend in the academy, but until I slow down from a consulting standpoint, I have to budget my time.

Alex Murguia 34:22
Oh, that's great. Thank

Wade Pfau 34:25
you for the AI agent to post for you. You have that one life to give to the academy.

Alex Murguia 34:32
There you go. Wait, yes.

Speaker 1 34:35
Thank you. All right. Bye. Bye, thank you, thanks everyone, bye, bye, we'll

Alex Murguia 34:46
just, we'll just stop it. Okay. All right, thanks everyone. All right, yeah, thanks everyone.

Briana Corbin 34:53
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