



Proposed Estate Tax Changes

On March 25, 2021, Senators Sanders and Whitehouse proposed a bill in the Senate which would make dramatic changes to the current estate and gift tax system. It is anticipated that a companion bill will be introduced in the House of Representatives.

Additionally, on March 29, 2021, Senators Booker, Van Hollen, Sanders, Whitehouse and Warren introduced a discussion draft of a bill (the "STEP" Act) to alter (and for many to essentially eliminate) the "step up in basis" at death – technically, the capital gains basis adjustment at death – which was part of President Biden's campaign platform.

We cannot predict what will or won't occur, or the timing of any revisions to the tax law, but unlike in prior years when there have been similar proposals, the White House has signaled that there needs to be significant changes to the tax laws to help pay for some of the spending initiatives favored by President Biden. For this reason, we will continue to follow the various proposals.

While both of these proposed tax law changes are far from complete and may be altered or "watered down" significantly before passage, clients should be already considering the planning implications. For anyone that has been considering gifting assets to or in trust for their loved ones, now may be the perfect time to act.

Sen. Sanders - "For the 99.5% Act"

The good news in Senator Sanders' proposed For the 99.5% Act is that the reduction of the gift and estate tax exemptions and the increase in the tax rates would not be retroactive. Instead, the lowering of the exemptions and the increasing rates would take effect as of January 1, 2022.

The bad news, however, is other than a lack of retroactivity, the bill is astonishing in its reach and impact on estate planning. Here are some of the key changes proposed:

1. Decreasing Gift and Estate Tax Exemptions:

The proposed Act would decrease the gift and estate tax exemptions from \$11,700,000 to \$3,500,000, effective as of January 1, 2022 – a 70% decrease! Even more significantly in terms of planning opportunities, the gift tax exemption would be reduced from \$11,700,000 to \$1,000,000, also effective as of January 1, 2022.

2. Increasing Gift and Estate Tax Rates:

Sen. Sanders proposal would increase in the estate tax rates as follows:

- 45% for estates from \$3,500,000 to \$10,000,000;
- 50% for estates from \$10,000,000 to \$50,000,000;
- 55% for estates from \$50,000,000 to \$1,000,000,000; and
- 65% for estates over \$1,000,000,000.

3. Reduction in Tax-Free Annual Gifting:

In addition to the above exemption and tax rate changes, there would also be major changes in the annual exclusion from the gift tax. The Bill proposes limiting annual gifting of up to \$15,000 per year per person to \$30,000 total per donor per year for gifts to irrevocable trusts or for gifts of interests in certain family entities beginning in 2022.

4. Virtual Elimination of Grantor Trust planning

The Act proposes a new Section to the Internal Revenue Code, mandating that any trust which is created, funded or transacted with after the enactment of the Act and which is a "grantor trust" for income tax purposes (sometimes referred to as an "intentionally

defective grantor trust”) must be included in the federal estate of the grantor on death, as if the assets in the trust are owned by the grantor directly.

If this change happens, clients will not be able to fund or have assets sold to “grantor trusts” which are disregarded for income tax purposes, without inclusion in the clients’ estates. Although existing and funded “grantor trusts” (put into place before the new law is passed) will be grandfathered as long as they are not added to or altered after the law is passed, at least as the law is presently written.

Grantor trusts have become one of the single most important and effective tools in the arsenal of estate planners, and this would be a major blow to planning for high net worth families. As with gifting, now may be the time to implement such planning.

5. Major Changes to GRAT Planning

In addition, the Act proposes to significantly curtail the ability to use GRATs (“Grantor Retained Annuity Trusts”) as wealth transfer tools. The Act would require GRATs to have a minimum term of 10 years and a minimum gift value on funding of at least \$500,000 or 25% of the fair market value of the assets transferred to the GRAT on funding.

6. Disappearing Valuation Discounts for Non-Business Entities and Assets

The Act would require families transferring or selling interest in family-owned entities to value the interests being transferred without valuation discounts at all; instead, valuing the interests based on a pro-rata percentage of the ownership in the entity multiplied by the value of the assets in the entity. The bill even includes look-through rules to make it harder to avoid their application.

7. Major Changes to GST Planning and Dynasty Trusts

Finally, the proposed new “For the 99.5%” Tax Act would cap the term a GST (“Generation-Skipping Transfer” Tax) exempt trust would remain tax-free. Existing Trusts will be deemed terminated 50 years after the passage of the Act and new trusts would be deemed terminated 50 years after formation.

Push to Eliminate Step-Up in Basis: With a \$1 million Exemption

During his 2020 campaign, President Biden proposed and urged an elimination of the tax-free step-up in basis at death presently afforded by the Tax Code. The basis adjustment at death has been part of the Code for decades, but has progressively been targeted as a means to raise revenue.

According to a summary published by Senator Van Hollen, the Joint Committee on Taxation estimates the tax-free step-up in basis costs the United States approximately \$41.9 billion in 2021 alone. Further, this summary asserts that 55% of the wealth in estates over \$100 million is untaxed capital appreciation, currently benefiting from a tax-free step-up in basis.

The STEP (“Sensible Taxation and Equity Promotion”) Act would tax unrealized capital gains on death, effective for deaths after January 1, 2020. However, the Act includes a few “softeners”: (i) a \$1 million exemption to “protect” smaller estates; (ii) up to 15 years to pay the tax for illiquid assets, like business entities and farms; and (iii) a deduction against the estate tax (for the gains taxes due) for larger estates.

Nevertheless, the taxation of previously untaxed gains would be a major change in federal tax policy with wide-ranging implications on estate planning. Especially for clients with depreciated real estate, the impact could be far-reaching. It would also greatly complicate the administration of estates, as there would now be a need for fiduciaries to figure out what the historical tax basis might be for assets.

Conclusion

Please feel free to reach out if you wish to discuss any of these proposals and how your planning might be affected by a change in the law. We look forward to speaking with you.

