

LEGAL UPDATES

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\$2.1 Trillion Reasons Why You Should Consider Estate Planning NOW

Key points

On Wednesday, September 15, The House Ways and Means Committee advanced a proposal for a \$2.1 trillion tax increase.

The proposal could drastically change the gift and estate tax treatment of new irrevocable trusts and transactions with certain existing trusts.

The proposal would also reduce the current gift and estate tax exemption of \$11.7 million to \$5 million (adjusted for inflation) as of January 1, 2022. This also reduces the current generation-skipping transfer tax exemption to the same level.

Other income tax measures are also included in the proposal.

Recommendation: Act now to implement or update your estate plan.

Background

The proposal would make major changes to some of the most popular estate-planning techniques.

A majority of the proposed changes would be effective as of the date the proposal is enacted.

Many of the proposed changes target trusts known as Intentionally Defective Irrevocable Trusts (IDITs) and other types of “grantor trusts.”

Under current law:

Assets in grantor trusts are not included in the grantor's estate for estate tax purposes and the grantor personally pays all income tax on the trust's assets, allowing the assets to appreciate without being depleted by taxes.

Sales of assets between a grantor trust and its grantor are disregarded for income tax purposes, which allows sales to occur without triggering capital gains taxes.

Distributions can be made from grantor trusts to beneficiaries of the trust without any gift tax consequence.

Grantor trusts come in many forms, including: Spousal Lifetime Access Trusts (SLATs), Irrevocable Life Insurance Trust (ILITs) and Beneficiary IDITS (BIDITs) to name a few. The proposal applies to any irrevocable trust where an individual, rather than the trust itself, is responsible for the payment of income taxes.

Summary of key proposal terms

Reduction in lifetime estate and gift tax exclusion amount

Under current law, the estate and gift tax exemption amount is \$11.7 million per person. This amount will be reduced on January 1, 2026, unless Congress acts to maintain the higher amount before that date.

The proposal would accelerate this reduction, so that the exemption amount would be reduced to \$5 million per person (adjusted for inflation since 2011) as of **January 1, 2022**.

Inclusion of assets owned by Intentionally Defective Grantor Trusts in grantor's estate

If enacted, grantor trust assets will no longer be shielded from estate taxes.

All assets owned by grantor trusts created on or after the date of enactment will be included in the estate of the grantor.

Assets gifted to a grantor trust after the date of enactment, regardless of when the trust was created, will be included in the estate of the grantor.

Distributions from grantor trusts created after date of enactment to anyone other than the grantor or the grantor's spouse will be treated as a gift to the beneficiary from the grantor.

Termination of grantor trust status, for a trust created after date of enactment, which would cause the trust to be responsible for its own income taxes, will be treated as a taxable gift from the grantor.

Income tax imposed on sales to grantor trusts

The proposal would treat sales of assets between the grantor and a grantor trust created after date of enactment as a sale to a third party for income tax purposes.

This change would force the recognition of gain on any asset sold to such a grantor trust after the date of enactment.

Elimination of certain valuation discounts

Under current law, taxpayers who purchase an interest in any entity, regardless of the entity's assets, may apply a valuation discount that recognizes certain features—such as minority ownership, lack of voting control or lack of marketability—that reduce the value of the interest on the open market.

The proposal would eliminate the availability of valuation discounts for any portion of an entity that is composed of passive assets such as marketable securities.

Passive assets would be treated as if they were transferred outside of the entity, without applying any valuation discount that may otherwise apply to the entity.

What this means to you

In light of the proposal, the following action items should be considered:

1. Forming and making gifts to grantor trusts before enactment, to take advantage of the current estate, gift and GST exemption levels.
2. Review existing grantor trusts to evaluate the impact of the proposal. In some cases, additional steps may be needed prior to enactment to minimize the negative effect of the proposal on existing trusts. For example:

Gifts (including indirect gifts) to a pre-existing ILIT made to fund life insurance premium payments may cause a pro rata portion of the death benefit to be included in the insured-grantor's estate at death. Gifting cash or income-producing assets to such trusts before enactment may be an effective way to ensure the trust continues to serve its purpose without incurring additional tax liability.

Many clients make annual exclusion gifts to grantor trusts (e.g., IDITs or ILITs); these gifts may cause a portion of the assets to be included in the grantor's estate at death. Converting such trusts to non-grantor trusts would facilitate continued gifting, without the imposition of additional tax liability.

Complete any contemplated transfers, whether by sale or gift, of interests in entities that include non-business assets if a valuation discount will be sought.

Contact us

If you have been considering whether to take the next step in your estate planning, now is the time to act. While the proposal is still being debated, and is therefore subject to change, of this much we can be certain: change is coming, and some, or all, of the planning opportunities described above will soon be lost forever. If you have any questions, or would like to take action on any of these items please contact Jacque Albus, Patrick Conner, Jill Palmquist, Jessica Quintero or a member of the Private Wealth team at Husch Blackwell.

Samuel M. DiPietro, law clerk, was a contributor of this content.