

Tax, Benefits, and Private Client



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Estate Planning Provisions of the New Tax Plan

On Monday, September 13, 2021, the House Ways & Means Committee released a draft tax plan which provides the clearest direction to date on how Democrats intend to use the estate and gift tax regimes to pay for part of the President's agenda. It is important to note that these are only proposals and Congress is in the early stages of the legislative process. New details may emerge, and changes may be made over the coming weeks and months. We offer this summary merely to provide a window into the possible tax changes impacting estate planning.

EFFECTIVE DATES

There are three dates to keep in mind: (i) changes effective as of September 13, 2021, (ii) changes effective as of the date of the enactment of the act, which could be within a few weeks, and (iii) changes effective as of January 1, 2022.

EXEMPTION AMOUNT

As of January 1, 2022, the federal estate and gift tax exemption amount, currently \$11,700,000, is reduced to approximately \$6,020,000.

This provides a limited window for individuals to make full use of their \$11,700,000 exemption.

GRANTOR TRUSTS

The foregoing does not mean that individuals have until December 31, 2021, to take full advantage of all of the planning opportunities that exist today.

For decades, planners have used so-called "grantor trusts," which were structured so that the grantor remained individually liable

for income taxes on income earned by the grantor trust, but the grantor trust was still excluded from the grantor's taxable estate.

The draft act provides that grantor trusts created on or after the date of the enactment of the act will be included in the grantor's taxable estate. As a practical matter, if enacted, this would eliminate the use of grantor trusts in gift planning. It is often impractical to establish a trust that is not a grantor trust. For example, a trust that can distribute income to the grantor's spouse is a grantor trust.

Fortunately, existing grantor trusts are grandfathered into the current rules. *However, there is an important limitation to this.* If a gift is made to a pre-existing grantor trust after the enactment of the act, the portion attributable to the post-act contribution would be under the new rules and therefore such portion would be includible in the grantor's taxable estate.

In order to take advantage of the current law, a grantor trust needs to be executed and funded before the enactment of the proposed act.

This change, if enacted, would adversely impact the manner in which life insurance trusts (which are grantor trusts) are funded. Typically, gifts are made to a life insurance trust each year that are then used to pay insurance premiums. *In light of the proposed changes, consideration should be given to pre-funding life insurance trusts with enough cash to pay premiums for several years even if this means using a portion of a person's exemption amount.*

Finally, the proposal would upend the rules regarding the sale of an appreciated asset by a grantor to his/her grantor trust. Currently, this is not an income tax recognition event. However, the proposed act would deem such a sale as being between unrelated parties, meaning that a sale to a grantor trust would be an income tax recognition event for the grantor. Assets sold to grantor trusts usually have substantial built-in gains and, therefore, the strategy of a sale to a grantor trust would largely disappear if the proposal is enacted (losses could not be recognized upon such a sale).

If a sale to a grantor trust is being contemplated, it is critically important to execute the sale documents before the enactment of the draft act so that the transaction can be grandfathered into the current non-recognition rules.

VALUATION DISCOUNTS

The valuation rules are also in flux. The proposal would eliminate valuation discounts on ownership interests in entities that own “passive assets.” This would eliminate valuation discounts on both aggressive structures, such as an LLC that only owns marketable securities, and for those that have a very substantive business purpose, such as real estate holding companies. An individual who wishes to claim a valuation discount on a gift of an interest in an entity holding so-called “passive assets” must complete the gift before the enactment of the draft legislation.

This means that the window of opportunity for claiming such valuation discounts may close long before December 31, 2021.

FIDUCIARY INCOME TAX RULES

The new top marginal income tax rate of 39.6 percent will apply to income earned by an estate or trust that is in excess of \$12,500, effective January 1, 2022.

There is a new surcharge of three percent of the modified adjusted gross income of an estate or trust in excess of \$100,000.

While beyond the scope of this alert, consideration should be given to realizing income and gains in 2021 rather than in 2022.

WHAT IS NOT IN THE DRAFT ACT—FOR NOW AT LEAST

The draft legislation does not: (i) eliminate the step-up in basis at death, (ii) implement a carry-over basis regime at death, (iii) make transfers by lifetime gift (other than a sale to a grantor trust as noted above) or upon death an income tax realization event, (iv) set a minimum term for grantor retained annuity trusts or eliminate zeroed out grantor retained annuity trusts, (v) increase the estate tax rate from 40 percent or implement a progressive estate tax rate structure, (vi) limit annual exclusion gifts to trusts, or (vii) create new limitations on the use of dynasty trusts.

Blank Rome’s [Private Client](#) team is uniquely situated to navigate the many effective planning options available under current law, which can change at a moment’s notice. Everyone has their own unique situation. We urge you to reach out to us to discuss what works best for you and to be in a position to implement your decisions before the door closes on existing estate planning strategies.

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