MANTELL, PRINCE & REYNOLDS, P.C.

# Estate Tax Update

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## Introduction

As we begin making plans for the 2021 holiday season, President Biden's Build Better Back Act (the "Act") is making its way through the legislative process, having already been approved by the House Ways and Means Committee. The final provisions of the new law remain uncertain, but because of the Act's estate planning and tax implications, we want to provide you with an overview of the Act's key provisions, and affirmative steps you may want to consider taking in the current, more favorable climate, before the Act is signed into law.

## Potential Decrease to the Gift and Estate Tax Exemption

The current exemption for federal estate, gift, and generation-skipping transfer tax is $11,700,000. Under the Tax Cut and Jobs Act signed into law on December 22, 2017, the exemption is scheduled to increase annually for inflation until 2026, at which time it is scheduled to sunset, returning to $5,000,000, as adjusted for inflation from 2010. Under President Biden's Act, the basic exclusion amount could revert to $5,000,000 per person (as adjusted for inflation, $6,020,000), effective January 1, 2022. Although this significant change may have implications for your current estate plan, the Internal Revenue Service has confirmed that there will be no "clawback" for persons who use the exemption during life but die after the exemption is reduced.

*The Act accelerates the sunset of the Basic Exclusion Amount to pre-2017 levels.*

## Using the Basic Exclusion Amount in 2021

As the reduced exemption amount is not expected to apply to gifts made in 2021, there is a window for possible estate tax planning through the end of this year. For example, if an individual during 2021 gifts $11,700,000 to an estate tax exempt trust for the benefit of the individual's spouse and children, and the individual dies when the basic exclusion amount is $5,000,000 as indexed for inflation, the applicable credit amount against the estate tax will be based on the basic exclusion amount of $11,700,000, rather than the lower exclusion amount at the time of death. The assets of the trust, and any earnings and appreciation, would be removed from the individual's (and their spouse's) estate. In contrast, if no gift is made and the exclusion should drop to $6,020,000 in 2022, the opportunity to shield over $5,000,000, and its growth, will be lost. Accordingly, for those with the means to do so, making use of the higher exemption before the Act is passed will result in significant tax savings.

## Change in Treatment of Grantor Trusts

Irrevocable trusts of which the grantor is treated as the owner of the trust for income tax purposes, also known as "grantor trusts," are a valuable estate planning strategy because the grantor remains responsible for the income tax liability of the trust assets, thereby enabling them to grow tax free without the assets being included in the grantor's estate. A grantor can make sales to the trust without creating an income tax event and can remove assets from the trust and replace them with other assets of equivalent value for purposes of avoiding or reducing gain.

The Act may potentially change grantor trusts in the following ways, reducing or eliminating the benefits they provide:

- Sales between the grantor and an irrevocable trust will be treated as sales between the grantor and a third party, thereby triggering gain on the sale of appreciated property;
- The exchange of property between the grantor and the trust will trigger gain on any appreciated property;
- Distributions from a grantor trust to anyone other than the grantor or the grantor's spouse will be treated as taxable gifts;
- The change from a grantor to a non-grantor trust (the "toggling" off of the grantor trust status) during the grantor's lifetime will be treated as a gift by the grantor of all trust assets; and
- At the grantor's death, the trust will be includible in the grantor's estate.

The changes to the grantor trust rules will impact many popular estate planning vehicles, including Grantor Retained Annuity Trusts (GRAT's), Qualified Personal Residence Trusts (QPRT's), and Spousal Lifetime Access Trusts (SLAT's), that are executed on or after the date of enactment of the bill, or funded after the enactment of the bill. Grantor trusts executed prior to the enactment of the bill, as well as any contribution to such existing trusts, will be grandfathered under the current rules. Therefore, to take advantage of the existing grantor trust rules and the higher exclusion amount, it is necessary to both execute and fund any new or existing grantor trust prior to the date of enactment. Similarly, you may want to consider whether the grantor trust status of any existing irrevocable grantor trusts should be toggled off by releasing the powers that created grantor trust status (i.e., by releasing the power to substitute assests, or by repaying any loan to the trust that does not have both adequate interest and adequate security). Finally, individuals with new or existing life insurance trusts should contact our offices to review the terms of the trust to safeguard against the possibility of future premium payments from the trust causing inclusion of the insurance proceeds in the grantor's estate.

## Disappearing Discounts

Under current law, gifts of entities or of interests in entities such as limited liability companies and limited partnerships holding "nonbusiness" or passive assets are eligible for valuation discounts, such as lack of control or lack of marketability. The Act proposes disallowing valuation discounts attributable to the non-business assets held by an entity. This will have a profound impact on the transfer of interests in family partnerships and LLC's.

## Disappearing Discounts (cont.)

Since the elimination of valuation discounts on transfers of entities, or interests in entities, holding nonbusiness assets is proposed to be effective for transfers made on or after the date of enactment of the bill, it is important to consider making discounted gifts of entities or interests in entities holding passive assets as soon as possible.

## Conclusion

Although there is uncertainty surrounding the final provisions of the Act, now may be the optimum time to have your estate plan reviewed to determine whether modifications need to be made. For the past few years, we have enjoyed historically high gift, estate, and generation-skipping tax exclusions, believing they would not sunset until 2026. With the sudden decrease in the exemption scheduled for the end of this year, you might consider accelerating your plans for gifting assets to avoid creating a gift tax liability. We can review your current assets and discuss strategies to best utilize the exemption while there is still the opportunity to do so. We can also advise you as to the potential advantages of toggling off the grantor trust status of existing irrevocable trusts, or prepaying insurance premiums, prior to the bill passing. Because the Act may also impact income tax, we recommend discussing the proposed bill with your financial advisor or accountant.

If you would like to discuss any of these potential changes to the federal or state estate, gift and generation-skipping tax laws or their impact on your particular estate plan, do not hesitate to contact us.

In light of the possibility of the federal exemption amount decreasing effective January 1, 2022, now may be an optimum time to have your estate plan reviewed.

## About the Firm

Mantell, Prince & Reynolds, P.C. specializes in matters relating to tax and business planning for entrepreneurs, professionals and closely held businesses, business and corporate law including mergers and acquisitions, estate, trust and wealth preservation planning, administration of estates and trusts, trust and estate litigation, family office services and providing expert advice and expert witness support in tax, business, probate, and trust-related litigation.

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