

## Wills, Trusts & Estates Alert

This Alert is to advise you about recent proposals that, if enacted, are likely to have a significant impact on your estate plan.

### Current Law and Proposed Changes

Under current law, the Federal estate, gift and generation-skipping transfer (GST) tax exemptions in 2021 are \$11.7 million per individual. These exemptions, which are indexed annually for inflation, were doubled in 2018 under the Tax Cuts and Jobs Act from \$5 million per individual to \$10 million per individual, but are scheduled to revert back to \$5 million per individual (indexed for inflation) at the end of 2025, absent the adoption of new legislation. The tax rate for transfers in excess of the estate, gift and GST tax exemptions is 40%.

Two bills recently introduced in the Senate and currently under consideration are commonly referred to as the “For the 99.5% Act,” introduced on March 25, 2021 by Senator Bernie Sanders (VT), and the “Sensible Taxation and Equity Promotion Act of 2021,” or “STEP” Act, introduced on March 29, 2021 by Senator Chris Van Hollen (MD). A bill similar to the Van Hollen proposal was introduced in the House of Representatives on May 29, 2021 by Congressman Bill Pascrell (NJ). In addition, on May 28, 2021, the Biden Administration released its fiscal year 2022 budget proposal, which includes elements similar to the Senate and House legislative proposals.

If enacted, the changes to the federal tax law would have a disruptive impact on existing plans and future estate planning. These changes would affect not only the estate tax rate and the amount that an individual is able to pass free of estate tax at death, but would also curtail and restrict the effectiveness of many commonly used estate planning techniques.

### Proposed Changes under the Sanders and Van Hollen Bills

#### **• Sanders Bill - Estate and Gift Tax Exemptions and Tax Rates**

The Sanders bill would significantly reduce current estate and gift tax exemption amounts and increase tax rates. The bill would reduce the estate tax exemption from \$11.7 million to \$3.5 million (not indexed for inflation), reduce the gift tax exemption from \$11.7 million to \$1 million and would increase the estate and gift tax rate from the current 40% to a new progressive tax rate structure ranging from 45% (for values over \$3.5 million) up to 65% (for values over \$1 billion).

The following table<sup>1</sup> demonstrates the impact the Sanders bill would have on estate taxes:

Estimated Taxable Estate	2021 Estate Tax	Estate Tax under For the 99.5% Act	Proposed Tax Increase
\$5 million	\$0	\$675,000	\$675,000
\$7.5 million	\$0	\$1,800,000	\$1,800,000
\$25 million	\$5,320,000	\$11,745,800	\$6,425,800
\$60 million	\$19,320,000	\$29,745,800	\$10,425,800
\$100 million	\$35,320,000	\$51,745,800	\$16,425,800
\$2 billion	\$795,320,000	\$1,196,745,800	\$401,425,800

<sup>1</sup> Robert Keebler, Joy Matak, Jonathan Blattmachr and Martin Shenkman, *Sanders Tax Proposal: Analysis and Suggestions for Immediate Action* (4/5/2021).

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### · *Sanders Bill - Lifetime Gifts and Grantor Trusts*

Under the Sanders bill, the exemption for lifetime gifts would be reduced to \$1 million (not indexed for inflation), a massive decrease from the current exemption amount. The decreased gift tax exemption would limit the effectiveness of lifetime gifting strategies, which have long been an efficient way to use the exemption. The reduction in the lifetime gift exemption would be effective for gifts made after December 31, 2021, providing a short window of opportunity for planning before the reduction would come into effect.

Beyond the decreased exemptions, the Sanders bill includes other significant changes that would disrupt foundational estate planning methods, including plans involving annual gifting to trusts such as irrevocable life insurance trusts.

- The current annual \$15,000 per donee gift tax exclusion would be limited to \$30,000 per donor with respect to certain gifts in trust.
- Grantor trusts (which include irrevocable life insurance trusts) are targeted. Grantor trusts are treated as owned by the grantor for income tax purposes but if properly structured, are excluded from the grantor's taxable estate at death. Under the Sanders bill, grantor trusts that are created or to which contributions are made after the date of enactment would be included as part of the grantor's taxable estate at death, and/or subject the grantor to gift tax if distributions are made during the grantor's lifetime or if grantor trust status is toggled off. As a result of these potential changes, it may be prudent to fund existing life insurance trusts with cash or high basis income producing assets using the grantor's gift tax exemption so that the life insurance trust will have funds with which to pay premiums for several years.

The Sanders bill includes a number of other changes that would reduce the effectiveness of several long-established planning techniques. Some of these changes include:

- Eliminating valuation discounts for "nonbusiness assets" (assets which are not used in the active conduct of a business) held by an entity.
- Eliminating minority/lack of control discounts where a family controls a business or owns the majority of the ownership interests (by value).
- Limiting the effectiveness of Grantor Retained Annuity Trusts (GRATs) by requiring a minimum term of 10 years and prohibiting the use of zeroed-out GRATs by requiring a remainder interest valued at the greater of 25% of the amount contributed to the GRAT or \$500,000.
- Limiting the utilization of dynasty trusts and strengthening the GST tax by permitting allocation of GST exemption to trusts created after date of enactment only if the trust terminates within 50 years. For existing trusts to which GST exemption was allocated before enactment, such exemption would terminate after 50 years from date of enactment.

### · *Van Hollen Bill - Recognition of Gain on Death and Gift*

Under current law, property that is included in an individual's estate for federal estate tax purposes receives a "step-up" in basis at death for income tax purposes. Consequently, the beneficiaries inheriting the property are not required to pay income tax on any capital gain on the inherited property, and a beneficiary's basis in such property, for income tax purposes, is adjusted to the fair market value at the time of death (other than retirement plans). This essentially eliminates capital gain at the time of death, so that the beneficiary must pay tax only on gains accruing after the date of death.

The Van Hollen bill would eliminate the step-up in basis at death and would instead cause the estate to recognize the gain on property passing at death, as if the property had been sold, causing the gains to be subject to income tax at that time, subject to a \$1 million exclusion. The bill would also cause gain recognition on property transferred by lifetime gift, subject to a \$100,000 lifetime exclusion, and would also require certain trusts to pay capital gains tax on trust property every 21 years. The effective date of the Van Hollen bill would be retroactive to January 1, 2021.

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### Biden Administration Budget Proposals

On May 28, 2021, the Biden Administration released its fiscal year 2022 budget proposal that includes elements similar to those outlined in the bills described above.

- The proposal calls for taxation of gains on appreciated assets by gift or at death, subject to a \$1 million exclusion per individual (\$2 million for married couples), indexed for inflation.
  - Assets transferred to a U.S. citizen spouse would retain a carryover basis, and capital gain would not be recognized until the disposition of the asset by the surviving spouse or his or her death.
  - Payment of tax on the appreciation of certain family-owned businesses would not be due until the interest in the business is sold or the business ceases to be family owned.
- The proposal sets forth other transfer events that would trigger a capital gains tax.
  - These events include transfers of appreciated assets to or from a trust, partnership or other non-corporate entity (other than a grantor trust that is deemed to be wholly-owned and revocable by the donor).
  - Gains on unrealized appreciation would be recognized by a trust, partnership or other non-corporate entity if that property has not been the subject of a recognition event within the prior 90 years, with the first possible recognition event to take place on December 31, 2030.
- The proposal does not address whether the Biden Administration will seek to lower the Federal estate, gift and GST tax exemptions as candidate Biden stated during the Presidential campaign.
- The proposals would be effective for gains on property transferred by gift, and on property owned by decedents dying, after December 31, 2021.

### Planning Considerations

It is not known at this time if, when and how many of these proposals may be enacted. Although certain changes would apply immediately upon enactment or retroactively to January 1, 2021, the proposed reduction in the gift and estate tax exemptions in the Sanders bill would not take effect until January 1, 2022. Accordingly, this could provide an opportunity for individuals, before the end of this year, to take advantage of available gifting strategies, including the use of Dynasty Trusts, Spousal Lifetime Access Trusts (SLATs), GRATs, and Intentionally Defective Grantor Trusts (IDGTs). However, it is crucial that the grantor be mindful of making gifts using property with significant built-in gain due to the possibility of recognition of capital gain on transferred property.

Please contact one of our attorneys to discuss your planning options before your window of opportunity closes.

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