



ALERTS

Unprecedented Changes Proposed To Gift And Estate Tax Laws

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Highlights

Current estate, gift and generation-skipping transfer tax exemptions and tax rates may be affected if new tax legislation passes

President Biden's American Families Plan would eliminate the step-up in basis upon death

The proposed For the 99.5% Act includes provisions that could significantly affect how wealth is transferred and restrict widely used estate planning techniques

Under a new administration, proposed tax legislation has been introduced that could significantly impact individual tax and estate tax planning. While it is not clear if, or when, any of these proposals will be enacted, it is vitally important to be prepared and plan ahead.

Proposed 2021 Legislation

While many of the provisions enacted under the 2017 Tax Cuts and Jobs Act are set to expire in the next few years, changes may occur earlier if

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any of the recently proposed legislation is enacted.

The [American Families Plan](#), announced by the Biden administration, aims to close tax loopholes that are seen as allowing wealthy individuals to avoid tax on inherited wealth. The [For the 99.5% Act](#), sponsored by Sen. Bernie Sanders and Rep. Sheldon Whitehouse, aims to curtail planning strategies used mainly by 0.5% of wealthy Americans to avoid tax.

Current Law in 2021

The current estate, gift and generation-skipping transfer (GST) tax exemption is \$11.7 million per person, with a top tax rate of 40%, which is set to “sunset” at the end of 2025 to pre-2018 levels to approximately \$6 million (\$5.6 million adjusted for inflation). An annual exclusion of \$15,000 per donee/per year is also available to individuals, without any limit on the number of donees. Upon death, certain assets receive a “step-up” in cost basis, meaning its basis becomes its value at death. This can result in the elimination of taxable gains on inherited assets. Capital gains and dividend tax rates are presently 23.8% (including the net investment income tax), and the top individual income tax rate is 37%.

Proposed Changes Under the American Families Plan

Through its American Families Plan (the Plan), the Biden administration has proposed an elimination of the step-up in basis. While it has not been specified how that will be implemented, it will most likely mean that upon one’s death, a capital gains tax would be imposed upon all unrealized gains that exceed \$1 million. Under current law, if a person buys a stock for \$10, never sells it, and the stock is worth \$100 when the person dies, the \$90 of gain is never taxed, and the basis of the stock in the hands of the heirs will be increased (or “stepped up”) to \$100.

Under the Plan, the \$90 of gain would be taxed, but only if and to the extent that the total gain in all unsold assets exceeds \$1,000,000. Accordingly, if a person buys a business for \$250,000 and it is worth \$2,000,000 when the person dies, the untaxed gain would be \$1,750,000, and \$750,000 of that would be subject to a capital gains tax. The \$1 million exemption is intended to exclude smaller estates, and would not apply to charitable gifts. The \$250,000 exemption for principal residence gains would remain in place, and be in addition to the \$1 million. Exceptions would apply for certain family-owned businesses and farms, with a 15-year payment plan allowed for illiquid assets. It is unclear if this would be in place of, or in addition to, the imposition of any estate tax on larger estates – potentially subjecting estates to historically high effective tax rates.

Additionally, capital gains and dividend tax rates could be as high as 43.4% (39.6% plus 3.8% net investment income tax) for those making greater than \$1 million gross income (although it has been suggested that this threshold could be as low as \$400,000). The top marginal rate for individuals earning more than \$400,000 would be similarly increased to 39.6%.

The estate tax exemption was not addressed under the Plan, although it has been suggested that Biden would propose a reduction to \$3.5 million.

The Plan has a proposed effective date of January 1, 2022.

Proposed Changes Under the For the 99.5% Act

In late March, the For the 99.5% Act (the Act) was introduced to Congress, and proposes several changes that could significantly affect how wealth is transferred, including:

- **Reductions to Exemptions and Increases to Tax Rates.** For gifts and estates occurring after Dec. 31, 2021, the Act would reduce the estate and gift tax exemptions from their present high level and increase the top tax rates as follows:
 - Gift Tax Exemption reduced to \$1 million
 - Estate and Generation-Skipping Transfer Tax Exemption reduced to \$3.5 million
 - Estate Tax Rates:
 - \$3.5 million-\$10 million: 45%
 - \$10 million-\$50 million: 50%
 - \$50 million-\$1 billion: 55%
 - \$1 billion and greater: 65%
- **Reductions to Annual Exclusion Gifts.** Starting in 2022, the act would reduce the annual exclusion to \$10,000 per year/per donee, and limit the donor to \$20,000 annual exclusion gifts in total. These limits will greatly restrict an individual's ability to make gifts without using their lifetime exemption.
- **Limits on Planning for the GST Tax.** The GST tax is assessed on transfers of wealth to generations two or more removed from the donor, in addition to gift or estate tax. However, like the gift and estate tax, an exemption is available. Trusts can be structured to maximize the use of this exemption to pass wealth to multiple generations without being subject to GST tax. The Act, however, is proposing to lower the GST exemption and cap the duration of trusts that are exempt from GST tax to 50 years – presumably assessing GST tax at the end of the period at the same rate as the estate tax. This change would be effective upon enactment.
- **Limits on Valuation Discounts.** Currently, closely held business interests can be discounted for lack of marketability and for minority interests – allowing a greater amount of assets to be transferred at a lower estate tax cost. The Act proposes to eliminate or reduce allowable discounts for businesses not actively engaged in a trade or business, thereby curtailing planning for family entities frequently used in estate planning to effect an efficient transfer of wealth. This change would be effective upon enactment.
- **Changes to Taxation of Irrevocable Grantor Trusts.** Irrevocable grantor trusts remove assets from an individual's taxable estate, but are structured so that the individual is deemed to own the trust

assets for income tax purposes. By having the grantor pay the income tax, it leaves the trust property intact, while further reducing the grantor's taxable estate. The Act would require that grantor trusts be included in the taxable estate of the grantor upon death, and any distributions to beneficiaries would be subject to gift tax. This proposal would also apply to insurance trusts, which would affect more than just the ultra-wealthy. This change would be effective upon enactment.

- **Changes to Grantor Retained Annuity Trusts (GRATs).** GRATs are a common planning technique to transfer appreciation on assets outside the taxable estate. A "zeroed out" GRAT allows for a transfer with little to no gift tax due. The GRAT pays the grantor an annuity for a certain term (usually two years), and the appreciation of the trust's assets that exceed the applicable rate are transferred out of the taxable estate to the beneficiaries. The shorter term allows for greater leverage to capture upswings in the market, without having to account for the inevitable downswing. The Act would require a minimum GRAT term of 10 years, and require a gift tax to be assessed on the greater of \$500,000 or 25% of the value of the property used to fund the trust. This would eliminate the most beneficial aspects of using this type of planning.

Considerations for the Year Ahead

If any of these tax proposals are enacted as currently suggested, common estate planning techniques used to effectively and efficiently transfer wealth to future generations will be greatly restricted or eliminated. We continue to monitor the progress of these proposals, but as any changes are not anticipated to be retroactive, now is the time to consider taking advantage of the existing tax provisions and rates.

To obtain more information, please contact the Barnes & Thornburg attorney with whom you work or Jennifer Mendel at 312-214-4813 or jmendel@btlaw.com.

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