Tax, Trusts, and Estates Alert: 2020 Year-End Tax Letter

10/27/2020

We are writing to you as we reach the end of this extraordinary and difficult year. Although the year is nearing an end, the events we have experienced undoubtedly will have an effect well into the future. Naturally, the most significant impact is the human toll of the pandemic, and the lingering effects of the economic downturn on our community, the nation, and the world. We know that you likely have many things on your mind other than your estate plan. However, this year also brings an election that could possibly lead to changes in the nation's tax laws. These changes, if they occur, may have a significant impact on your estate plans. As an advisor, we suggest you consider reviewing your current estate plan and consider any additional planning that may be beneficial to you and your family.

Potential Changes in the Tax Law

Although we anticipate that any significant changes in the tax law would be effective no earlier than the beginning of 2021, we think it may be appropriate for you to consider taking action before the end of this year to protect your family's wealth and preserve the integrity of your estate plan. At this time, it is not possible to know or even predict precisely what changes may occur. However, we believe the following are some of the changes that may be considered in the near future. Some of the changes could happen regardless of the outcome of the election.

1. The tax law, as it stands today, provides that the current estate and gift tax exemptions, which are now over $11.5 million, will be cut in half beginning in 2026. However, many have long speculated that changes in the political structure in Washington, DC may result in the reduction of the exemptions well before then. It seems this possibility is even more likely given the current need to generate revenue, and could occur possibly as early as the beginning of next year. This means that many more families may soon be subject to the federal estate tax. We have no way to be certain of this and at some point in the future, the opposite could be true, i.e., an elimination of the federal estate tax in its entirety.
2. For a number of years, the federal tax law has provided for a "step up" in the income tax basis of assets owned at death. This can be a valuable benefit to the families of those who die owning assets with very low basis, such as land that has undergone extensive development or stocks that have performed significantly well since the date of purchase, because it essentially eliminates the built-in gain at the time of death, allowing the family or other beneficiaries to later sell the asset without triggering a large amount of capital gains tax. There have been many proposals to eliminate this step-up in basis at death, instead requiring those inheriting the property to take the same basis as the deceased owner, or alternatively, to pay tax on the built-in gain at the time of the owner's death. This proposal was made by President Trump before the 2016 election (although it was tied to a suggested repeal of the estate tax) and by former Vice President Biden. We anticipate such a change may occur sometime after this year. Although it may not be possible to address this issue through planning, we wanted you to be aware of the possibility, and will be happy to discuss how it might affect your family and your estate plan.
3. In addition, many estate planning arrangements that have the potential to shift growth in your assets out of your taxable estate may be eliminated or made less effective in the relatively near future. Proposals and suggestions from past presidential administrations and Congressional terms could resurface, affecting estate planning techniques ranging from life insurance trusts to grantor retained annuity trusts (GRATs) and grantor trusts. In addition, prior administrations and proposed regulations looked to eliminate or significantly reduce the ability to take lack of marketability and lack of control discounts on transfers of certain types of assets.
4. At this time, there is no New Jersey estate tax, although an inheritance tax does continue to apply in New Jersey on transfers to individuals who are not Class A (spouses, parents, children, grandchildren, great-grandchildren, etc.) or

qualified charities (Class E). New Jersey has a three-year look back on gifts when someone passes away for inheritance tax purposes, so if there are beneficiaries other than Class A or Class E, a special review should be made regarding this issue, but otherwise, gifts in New Jersey are largely immune from transfer tax in New Jersey. New York, however, does impose an estate tax.

What This May Mean for You

Many of our clients will wish to act now, before the end of the year, to take advantage of the current federal gift tax exemption before a possible decrease. This can be done through lifetime gifting, and there are many flexible gifting options our office can discuss with you in more detail. Although we do not know what changes to the tax law may occur in the coming months, in recent years the Treasury has indicated that it will not try to recapture or "claw back" the exemption used through lifetime gifts if the exemption later decreases. That means those who make gifts in order to use the current high exemption amount may ultimately succeed in transferring more wealth to their beneficiaries than they would otherwise be able to transfer on death, if the exemption amount decreases next year. We believe that in order to take advantage of the higher exemptions, it is necessary to make a gift (including all prior gifts which you have made) of more than the decreased exemption. For example, if the exemption amount decreases to $6 million, it is our belief that only cumulative gifts of more than $6 million will prevent a clawback. For a full use of the exemption subject to possible elimination, it is necessary to use the full $11.58 million. It is worth noting that we encourage clients who could benefit from making a gift of the higher gift tax exemption to do so in any event before the higher exemption is scheduled to disappear in 2026.

In addition, clients who might benefit from an estate planning strategy such as a GRAT should consider acting to implement that strategy now, while the opportunity exists, in the event that those strategies or some of their benefits are later eliminated. Whether any such strategy is appropriate for you and your family depends on your assets and your estate planning goals.

What You May Wish To Do

Given the current climate of uncertainty and change, we suggest you consider being proactive in protecting your wealth from potential adverse tax law changes. Some items to consider:

1. Funding a limited liability company now with assets which you would consider gifting, so that you will be ready and prepared should you determine to make a gift before the end of the year.
2. Creating spousal access trusts, which are trusts for the benefit of your issue (children and grandchildren, etc.) and your spouse. That way, your spouse would still have access to funds should he or she need them and the trustee makes a distribution to him or her. Each spouse could set up one of these types of trust for the other spouse, although the SLAT trusts cannot be identical.
3. It is important to consider the income tax basis of the assets gifted to make sure that there is no income tax gain triggered on the transfer or at some time in the future.
4. Consider whether the gifting trust will be a grantor trust or a non-grantor trust for income tax purposes.
5. Consider whether the gifting trust will be a dynasty trust to extend for many generations.
6. It is also important to understand the loss of basis step-up at death of assets owned by the gifting trust, if basis step-up is in effect at the time that the grantor passes away.

The above is just a brief list of considerations with respect to gifting. We look forward to speaking with you about what steps you can take now, including ways in which property you transfer out of your taxable estate may continue to benefit members of your family.

Most of all, we send our best to you and your family, and we look forward to connecting with you when you are ready to work toward your estate planning goals, whether that time is now or in the future.

For information and advice particular to your situation, please contact your Brach Eichler Trusts and Estates attorney or one of the partners listed below:

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