

Tax, Trusts and Estates Alert: Proposed Legislation May Alter Estate and Gift Tax Laws

10/14/2021

This is an alert as to changes that are taking place in Congress right now. Some of the proposed legislation, if passed, will eliminate certain estate planning opportunities immediately. Other estate planning opportunities will be eliminated at the end of 2021.¹

There are a series of legislative proposals that are focused on bringing about significant reform to federal estate and gift tax. The proposed legislation reduces the federal estate, generation-skipping transfer ("GST"), and gift tax exemptions, and eliminates certain estate planning techniques that have been commonly used.

One of the proposals would reduce the federal estate and gift tax exclusion² to its 2010 level of \$5 million per individual, indexed for inflation, effective for decedents dying, and gifts made after December 31, 2021. Another proposal would reduce the effectiveness of grantor trusts in optimizing federal estate, GST, and gift tax exemptions, which would be effective upon enactment of the statute.

The proposed legislation affecting grantor trusts would include in the donor's taxable estate: (1) assets in a grantor trust established post-enactment, and (2) post-enactment contributions to a grandfathered grantor trust. This means that any assets held by a grantor trust created post-enactment or any portion of assets held by a grantor trust (created before enactment) and attributable to contributions made post-enactment would be includable in the grantor's taxable estate. This is especially problematic for clients with existing Irrevocable Life Insurance Trusts ("ILITs") because, in the statute, as currently proposed, future annual contributions to the trust to pay insurance premiums will cause a portion of the ILIT's death benefit to be included in the grantor's taxable estate since additional contributions are made post-enactment. Minimizing gifts to ILITs post-enactment will reduce the risk of estate inclusion for a portion of the ILIT's death benefit, and, accordingly, donors may consider prefunding their ILITs currently with many years' worth of premium payments if they can do so.

In addition, the proposals would treat any distribution (other than to the grantor and the grantor's spouse) from grantor trusts created after the date of enactment or grandfathered grantor trusts with post-enactment gifting as gifts made by the grantor. Further, turning off grantor trust tax status of any grantor trust created after the date of enactment or any grandfathered grantor trusts with post-enactment gifting would be deemed a gift by the grantor subject to tax liability. Collectively, the proposals outlined above may eliminate the utility of grantor retained annuity trusts ("GRATs") and qualified personal residence trusts ("QPRTs"), which under the current tax regime, serve as valuable wealth transfer tools.

Although the specific provisions of the tax reform legislation are still under debate, high and moderate net worth individuals should consider implementing currently available gifting strategies. To find out more about how the information contained in this client alert may relate to your personal estate plan and to identify present opportunities for transferring wealth out of your taxable estate while the large federal exemption amounts are in still place, please contact us as soon as possible, as the new law may be enacted before the end of 2021.

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¹ Based on currently available information.

² The Tax Cuts and Jobs Act (“TCJA”), which became effective on January 1, 2018, set the federal estate, generation-skipping transfer (“GST”) and gift tax exemption amounts to a \$10M base, adjusted annually for inflation (\$11.7M for 2021) for each living individual and decedent. For a married couple, this amount increases to \$23.4M for 2021. Under current law, the TCJA is set to sunset (or revert to prior law) after December 31, 2025.