

Things to Know About Proposed Estate Tax Law Changes

By David Ruben & Dave Woodburn

While there has been a lot of confusion about various estate tax law changes that are currently being proposed in Washington, below is a helpful summary of the tax proposals currently being considered and the implications it could have on you.

Senator Bernie Sanders' Proposed Estate Tax Legislation (the "99.5 Percent Act")

In March, Senator Bernie Sanders released his proposed estate tax reform legislation. The 99.5 Percent Act would make significant and direct changes to the estate, gift and generation skipping transfer (GST) tax rules. Some of the more important proposals include:

- Reducing the federal estate and GST tax exemption to \$3.5 million per person from the current \$11.7 million per person;
- Reducing the federal gift tax exemption to just \$1 million per person from the current \$11.7 million per person;
- Increasing the top transfer tax rates to 65% from the current 40%;
- Providing that dynasty trusts could only remain exempt from GST tax for just 50 years; currently, dynasty trusts can remain exempt from GST tax for as long as state law permits the trust to remain in existence;
- Limiting or eliminating the use of valuation discounts on LLCs, partnership and other entities for transfer tax purposes;
- For Grantor Retained Annuity Trusts (GRATs) created after the effective date, requiring: (i) a minimum 10-year term and (ii) a minimum gift amount;
- Providing that irrevocable grantor trusts created after the enactment will be fully includable in the Settlor's estate; and
- Limiting annual exclusion gifts made to trusts to twice the annual gift tax exclusion, or \$30,000 per donor.

The reduction of the federal estate, gift and GST tax exemption would be effective as of Jan. 1, 2022. While not the first time such significant reductions in transfer tax exemptions have been proposed, the implication of anything close to the proposed language becoming law can be concerning. Married couples, who under current law can leave \$23.4 million at the second death to children free of estate tax, would be able to leave \$16.4 million less at death to children free of estate tax.

Biden Administration Revenue Proposals (the "Biden Proposals")

In late May, the Biden Administration released its revenue proposals for fiscal year 2022. While the Biden Proposals focus on income tax, many will have important estate planning implications. Following is a summary of some of the more significant proposals:

- Increasing the top marginal income tax rate from the current 37% to 39.6% (and decreasing the threshold at which the top marginal rate will apply);
- Taxing long-term capital gains and qualified dividends at ordinary income rates (potentially 39.6%) for taxpayers with income over \$1,000,000. Currently, long-term capital gains and qualified dividends are taxed at a top rate of 20%;
- Treating transfers (whether during life or at death) of appreciated property as income tax realization events (subject to exclusions). Currently, such transfers are not income tax realization events; and
- Subjecting the unrealized appreciation of assets of a trust, partnership or other non-corporate entities to a gain recognition event every 90 years if there has not been a realization event in the prior 90 years.

Most of these proposed changes would be effective as of January 1, 2022, however, the administration has stated that the increases in the long-term capital gain/qualified dividend tax rate would be retroactive to April 28, 2021. Conspicuously absent from the Biden Proposals is any mention of reducing the estate, gift and GST tax exemption amounts.

Sensible Taxation and Equity Promotion Act (“STEP Act”)

In March, a group of senators including Chris Van Hollen, Bernie Sanders, Sheldon Whitehouse and Elizabeth Warren released proposed tax reform legislation. Similar to the Biden Administration’s proposals, the STEP Act focuses on income tax. Following is a summary of some of the more significant proposals:

- Elimination of the step-up in basis at death;
 - Subjecting lifetime gifts and transfers at death to capital gain recognition (subject to exemptions);
 - Subjecting non-grantor trusts to a gain recognition event (i.e., a capital gain) every 21 years; and
 - Subjecting transfers into grantor trusts to capital gains if the assets are not included in the settlor’s taxable estate at death.
- This proposal would be retroactive to January 1, 2021.

2026

It is important to remember that the current estate, gift and GST tax exemption amounts of \$11.7 million per person will “sunset” in 2026. In other words, unless Congress passes legislation providing otherwise, the current \$11.7 million exemption will be reduced to approximately \$6.5 million per person starting January 1, 2026.

What Should You Do?

We do not know whether any one or more (or none) of the above proposals will become law. However, given the balance of power in Washington and the backstop of changes already scheduled to occur in 2026, there is a real potential that federal estate taxes will increase in the future.

It is often best to plan for the worst and hope for the best – the time to act is now. The historically-high transfer tax exemptions in 2021 provide an exceptional window for planning and many of the primary estate planning tools strategies we have used in the past (e.g., valuation discounts, Grantor Retained Annuity Trusts) will likely not be available under the above proposals.

Given the uncertainty regarding potential changes to the current tax laws, we suggest that individuals having assets that are expected to exceed \$3.5 million dollars review their present planning situation to determine whether they should take immediate steps to avoid death related taxes.

If you would like more information or would like to discuss planning options and develop a strategy, please contact any of the Roetzel attorneys listed below.

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