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Client Alert: Are Changes Afoot for Estate and Gift Taxes?

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With the current administration and composition of Congress, the short answer is "yes." Senator Bernie Sanders introduced proposed tax reform legislation on March 25th, which would make major changes to the current estate and gift tax rules.

Major changes introduced are to reduce the estate tax lifetime exemption from the current $11.7 million per taxpayer to $3.5 million, which would ***not*** be adjusted for inflation. The gift tax lifetime exemption would be reduced to $1 million. While the $15,000 per person per donee annual exclusion will not be reduced in general, gifts to irrevocable trusts and certain family entities, and gifts of assets subject to prohibitions on sale and those that cannot immediately be liquidated will be subject to a limit of $30,000 ***per donor annually***. These changes would become effective on January 1, 2022.

The rate of the estate tax would also be increased from the current flat 40 percent to a ***progressive*** rate of 45 percent for taxable estates between $3.5 million and $10 million, 50 percent for estates between $10 million and $50 million, 55 percent for estates between $50 million and $1 billion, and 65 percent for estates over $1 billion. The rate changes also would become effective on January 1, 2022.

Other proposals would include the value of assets in intentionally defective grantor trusts (IDGTs) that are created, funded, or transacted with after the date of enactment in a grantor's gross estate for federal estate tax purposes. It also would eliminate discounts for assets held in family entities, such as limited liability companies (LLCs). Grantor retained interest trusts (GRATs) would have to be held for a minimum of 10 years and would be subject to a gift of the greater of 25 percent of the fair market of assets placed in the GRAT or $500,000. In addition, dynasty trusts would be subject to generation-skipping transfer (GST) tax after 50 years.

Besides the obvious fact that many more estates would be subject to estate and gift tax, several techniques currently in use would be greatly curtailed, including the use of grantor trusts, GRATs, and family entity discounts.

Trusts that are considered to be owned by a grantor for income tax purposes will now be subject to federal estate tax upon the death of the grantor. Also, distributions from grantor trusts will be considered as gifts from the grantor. This will essentially end planning for gifts and installment sales to IDGTs.

Currently, taxpayers can use minority interest discounts when transferring assets to family entities such as LLCs. These proposals would eliminate those discounts so that even a 10 percent ownership of a family entity would be valued at 10 percent of the underlying assets without a discount. This will greatly reduce the use of family pass-through entities for planning purposes.

Under current law, a taxpayer can establish a GRAT and have the growth in value of the assets placed in the GRAT, pass to family members without being considered a gift. This use of GRATs will not be as advantageous under these proposals as at least 25 percent of the value of assets would be subject to gift tax. In addition, due to the new 10-year minimum term, the short-term GRAT, or "Walton GRAT," would essentially be eliminated.

What should taxpayers be doing now? As long as these proposals, if enacted into law, are not retroactive, taxpayers should consider using their full lifetime exemptions from estate tax by making gifts or sales to IDGTs or other irrevocable trusts, make annual exclusion gifts this year to irrevocable trusts and family entities, and create GRATs where appropriate.

Other techniques that should be considered, and that will still be available if the proposal passes, are low-interest rate promissory note sales between family members, self?cancelling installment notes, and charitable lead annuity trusts (CLATs).

Now is not the time to delay! Remember, if you do not take advantage of the current laws, you can miss out on some very effective estate planning techniques and could also lose your current lifetime estate tax exclusion.

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