HECKSCHER TEILLON
TERRILL & SAGER, P.C.
PERSONAL, TRUST & ESTATE LAW

(610) 940-2600
1001 CONSHOHOCKEN STATE RD, STE 1-300
WEST CONSHOHOCKEN, PA 19428

On September 13, 2021, the Ways & Means Committee of the U.S. House of Representatives released a series of proposed legislative changes to the income and estate and gift tax laws (the "Proposed Tax Act" or the "Act"). The Proposed Tax Act is fairly preliminary at this stage, and it is entirely possible that changes to the tax laws, if any, will evolve to be something substantially different by the time of the enactment of any new laws. Nevertheless, the Proposed Tax Act represents the Ways & Means Committee's current view on tax law changes. Because the proposed changes could impact many individuals' personal estate planning matters, and because some changes would be effective on the date of enactment of the Act (and not necessarily January 1, 2022), it is important to consider whether any planning should be done in advance of the potential enactment of the Act.

This Client Alert summarizes the proposed changes that would most impact estate planning for individuals.

Federal Estate, Gift and Generation-Skipping Transfer (GST) Tax Exemption Amounts

The federal estate/gift exemption amount is $11,700,000 for 2021. The GST tax exemption amount is the same. However, the current amounts are slated to automatically "revert back" in 2026 to the lower, pre-2018 exemption amounts ($5,000,000 each, but indexed for inflation from 2011). *The Proposed Tax Act would accelerate the reduction in the exemption amounts to January 1, 2022.* Therefore, as of January 1, 2022, the estate, gift and GST tax exemption amounts would be reduced to approximately $6,030,000. It may be advantageous for some clients to make significant gifts before year end (or even sooner because of the effective date of potential changes to the grantor trust rules, described below) to take advantage of the higher exemption amounts and to "lock in" the benefit of the "bonus" exemption amounts. We addressed this type of gift planning in more detail in our Client Alert of July 30, 2020, which can be accessed here.

Changes to Grantor Trusts

The use of so-called "grantor trusts" – trusts that are outside of the grantor's taxable estate for gift and estate tax purposes, but which are treated as owned by the grantor for federal income tax purposes – has long been a useful estate planning technique for the tax efficient transfer of wealth. The Proposed Tax Act would eliminate the tax planning benefit of grantor trusts by treating grantor trusts as includible in the grantor's taxable estate for federal estate tax purposes, and by eliminating non-recognition treatment for transactions of appreciated assets between a grantor and his or her grantor trust.

The changes to the grantor trust rules in the Proposed Tax Act (presumably) only would apply to grantor trusts created after the date of enactment, or with respect to "contributions" after the date of enactment to grantor trusts that were in existence prior to the date of enactment. Therefore, in order to engage in grantor trust planning based on the current tax laws, a grantor trust must be created and funded before the date of enactment of the Proposed Tax Act (and no contributions should be made to the trust after the date of enactment).

Special attention and planning is warranted for clients with existing grantor trusts to which additional gifts are planned for future years. This is very common for clients with existing irrevocable life insurance trusts. One option that clients in this situation might consider is to make additional gifts now to a life insurance trust to "pre-fund" future insurance premium obligations before possible changes to the grantor trust laws.

Income Taxation for Individuals, Estates and Trusts

The Proposed Tax Act would increase the top individual income tax rate from 37% to 39.6%, which rate would apply to married individuals filing jointly with income over $450,000, married individuals filing separately with income over $225,000 and single individuals with income over $400,000, and estates and trusts with income over $12,500. The new rates would apply to taxable years beginning after December 31, 2021. The top capital gains rate would increase from 20% to 25% and would apply to taxable years ending after the date of the introduction of the Proposed Tax Act (September 13, 2021). The 20% rate will continue to apply to gains and losses for the portion of the taxable year prior to the date of introduction of the Act.

The Proposed Tax Act would also impose an additional 3% surtax for taxpayers for tax years beginning after December 31, 2021. The 3% surtax would apply to an unmarried taxpayer and married taxpayers who file joint returns with modified adjusted gross income greater than $5,000,000, to a married taxpayer who files a separate return with modified adjusted gross income greater than $2,500,000 and to trusts and estates with modified adjusted gross income greater than $100,000.

Changes to Roth and Traditional IRAs and 401(k)s

There are a number of technical changes in the Proposed Tax Act to rules relating to tax-deferred retirement accounts such as Roth IRAs, IRAs, 401(k)s and Roth 401(k)s, most of which we do not address in this Alert. The primary proposed change that would impact our clients is that the Act would impose certain mandatory distributions for individuals with tax-deferred retirement assets totaling in excess of $10,000,000. *If your combined Roth IRAs, IRAs, 401(k)s and Roth 401(k)s are in excess of $10,000,000, please contact your HTT&S attorney promptly to discuss potential planning options in light of these potential changes.*

Valuation Discounts

A common estate planning technique is using valuation discounts. The Proposed Tax Act would disallow a valuation discount for transfer tax purposes when a taxpayer transfers interests in an entity owning nonbusiness assets owned by an entity, with some exceptions. This change would apply to transfers after the date of the *enactment* of the Act.

****

If the Proposed Tax Act in its current form is passed, many of the changes are effective January 1, 2022, but many would be effective on the date of enactment, which presumably would be in the next several weeks. Therefore, if you are considering estate planning based on the current estate, gift and GST tax laws, or if you are interested in discussing how the Proposed Tax Act might impact your personal planning, we encourage you to reach out to your HTT&S attorney promptly.