

# Proposed Legislation Would End Popular Estate Planning Techniques and Reduce Exemptions, May Warrant Prompt Action for Some Clients

*October 1, 2021*

Proposed legislation that would have a significant impact on estate planning could be passed imminently. There is, however, considerable uncertainty as to the terms of the final legislation and when it will be enacted (if in fact it is enacted). In this rapidly changing environment, it can be particularly difficult to plan. However, because some of the proposed provisions would take effect on January 1, 2022, and others would take effect immediately upon enactment (which could be a few weeks away), clients may wish to consider acting promptly to lock in certain tax benefits.

There are two significant elements of the proposed legislation, described in more detail below, that may warrant prompt action. First, gifts to grantor trusts should be made as soon as possible because changes to the grantor trust rules would be effective on the date of enactment. In particular, clients may wish to pre-fund life insurance trusts with sufficient funds to cover future premiums. Second, clients who wish to use their remaining gift tax exemptions should do so prior to year end (or, if they wish to make the gift to a grantor trust, as soon as possible).



### **Changes to Grantor Trust Rules**

Substantial changes to the grantor trust rules would cause grantor trusts to be highly tax inefficient. The new rules would apply (i) to grantor trusts created on or after the date of enactment and (ii) to the portion of any grantor trust created prior to enactment that relates to contributions made to the trust on or after the date of enactment.

In particular, (i) distributions to trust beneficiaries (other than to the grantor or the grantor's spouse) would be treated as taxable gifts and (ii) the trust would be includable in the grantor's estate (in both instances, after taking into account prior taxable gifts to the trust in order to avoid a double tax). Further, a sale or exchange between a grantor trust and the grantor would be recognized for income tax purposes (unlike under current law), and this provision might apply to grantor trusts that would otherwise be grandfathered.

Because the changes to the grantor trust rules (with the possible exception of the rules for sales or exchanges) would not apply to trusts created and funded prior to the date of enactment, clients may wish to consider taking the following steps as soon as possible:

- Pre-fund a life insurance trust to provide the trust with sufficient funds to pay future premiums.
- Fund a grantor trust with any remaining gift tax exemption to lock in the benefits associated with grantor trusts, including the ability to pay trust income taxes and, depending on final legislation, to engage in sales and loans with the trust without adverse income tax consequences.
- Implement estate planning techniques that involve grantor trusts, including spousal lifetime access trusts ("SLATs"), grantor retained annuity trusts ("GRATs") and qualified personal residence trusts ("QPRTs").
- Make 2021 annual exclusion gifts (if not yet made) if the gifts are to be made to grantor trusts as to the donor.

### **Reduction in Federal Estate, Gift and GST Exemptions**

The federal estate, gift and generation-skipping transfer ("GST") tax exemptions are currently \$11.7 million. Under the proposed legislation, the exemptions would be reduced as of January 1, 2022 to \$5 million, adjusted for inflation from 2010 (estimated at \$6.02 million in 2022).

- Clients may wish to use their remaining federal gift and GST tax exemptions prior to year end.
- However, clients interested in taking advantage of the current grantor trust rules (discussed above) or valuation discounts (discussed below), should consider making gifts as soon as possible.

### **Elimination of Discounts for Nonbusiness Assets**

Valuation discounts would no longer be permitted for gift or estate tax purposes in valuing interests in entities owning nonbusiness assets. This provision would be effective for transfers made after the date of enactment.

### **Increase in Income Taxes**

The proposal would increase the top income tax rates for both individuals and trusts and estates. Because the lower brackets for trusts and estates are highly compressed, trusts and estates would reach the top bracket at significantly lower income thresholds.

- **Increase in top ordinary income tax rate:** A new top marginal income tax rate of 39.6% would apply to individuals with taxable income exceeding \$400,000 (or more, depending of their filing status) and to trusts and estates with taxable income exceeding \$12,500. The new rate would apply for tax years beginning after December 31, 2021.
- **Increase in top capital gains rate:** The 20% capital gains rate would be replaced with a 25% rate for both individuals and trusts and estates. The new rate would apply to any sale or exchange occurring on or after September 13, 2021.
- **3% surcharge tax:** A 3% surcharge would be imposed on modified adjusted gross income exceeding \$5 million for individuals and married joint filers and on modified adjusted gross income exceeding \$100,000 for trusts and estates. The surcharge would apply for tax years beginning after December 31, 2021.
- **Limitations on QSBS gain exclusion:** The 75% or 100% exclusion for capital gains from qualified small business stock (“QSBS” shares) would no longer be available to individuals with adjusted gross income of \$400,000 or more (including the gain on the sale of QSBS shares). Such individuals would instead be limited to a 50% exclusion. Trusts and estates holding QSBS shares would also be limited to a 50% capital gains exclusion, with no income threshold. This provision would apply to any sale or exchange of QSBS shares occurring on or after September 13, 2021.

### **Changes to IRA Provisions**

The proposal contains the following changes with respect to IRAs, 401Ks and deferred compensations plans, which, unless otherwise noted below, would take effect for tax years beginning after December 31, 2021:

- The proposal would limit contributions to, and increase the required minimum distributions from, retirement assets of high-income individuals if the aggregate value of an individual’s retirement assets exceeds \$10 million (adjusted for inflation beginning in 2023).
- ROTH conversions of traditional IRAs and 401Ks by high-income individuals would be prohibited, but this provision would not be effective with respect to IRAs funded with pre-tax contributions until January 1, 2032.
- IRAs would be restricted from holding any investment in an entity in which the taxpayer has a substantial interest or is an officer or director and any investment that is only available to certain qualifying investors (such as accredited investors). This provision would be effective January 1, 2022, provided that the effective date for investments held on the date of enactment would be January 1, 2024.

...

Please contact any of the below members of the [Private Clients Practice Group](#) if you wish to discuss the proposed legislation or implementing any planning techniques.

**Steven M. Loeb**

T: +1 212 225 2620

[sloeb@cgsh.com](mailto:sloeb@cgsh.com)

**Elana S. Bronson**

T: +1 212 225 2617

[ebronson@cgsh.com](mailto:ebronson@cgsh.com)

**Judith Kassel**

T: +1 212 225 2062

[jkassel@cgsh.com](mailto:jkassel@cgsh.com)

**Heide H. Ilgenfritz**

T: +1 212 225 2358

[hilgenfritz@cgsh.com](mailto:hilgenfritz@cgsh.com)

**Catherine A. Borneo**

T: +1 212 225 2292

[cborneo@cgsh.com](mailto:cborneo@cgsh.com)

**Michele Leibson**

T: +1 212 225 2166

[mleibson@cgsh.com](mailto:mleibson@cgsh.com)

**Nicholas K. Gumas**

T: +1 212 225 2295

[ngumas@cgsh.com](mailto:ngumas@cgsh.com)

**Madison Grant**

T: +1 212 225 2298

[magrant@cgsh.com](mailto:magrant@cgsh.com)