2021 Estate Planning Update and Possible Changes Under the Biden Administration

While 2020 was challenging, both from a personal and economic perspective, Congress has begun to take steps to raise revenue in order to pay for the various stimulus packages it funded in 2020 and proposes for 2022. Senators Sanders and Whitehouse have proposed legislation which will increase both federal estate and income taxes. Some highlights are as follows:

- Lower the estate and generation-skipping tax exemption to $3,500,000 per individual ($7,000,000 for a married couple) and the gift tax exemption to $1,000,000 per person ($2,000,000 for a married couple). The current law has an exemption of $11,700,000 per individual.
- Increase the estate and gift tax rates from 40% to 45% for transfers over $3,500,000, 50% for transfers over $10,000,000, 55% for transfers over $50,000,000 and 65% for transfers over $1,000,000,000.
- Eliminate discounts for transfers of interests in family-controlled entities.

While these proposals are quite alarming, this is not new ground. Parts of this bill have been introduced and rejected during the Obama administration. Also, with regards to timing, while no one can read tea leaves as to what will pass and when, it appears that legislation (if passed) would be effective either after the date of enactment or later, such as January 1, 2022.

What does this mean for you? The main estate planning theme if the federal estate and gift exemptions decrease is to make gifts now so that they are "grandfathered" when and if the law changes. In other words, if you make a gift of $5,000,000 now and the estate tax exemption is reduced to $3,500,000, the excess $1,500,000 will not be added back to the estate after death. Plus, all of the appreciation on the $5,000,000 gift will avoid estate tax as well.

Keep in mind one quirk of the federal estate tax law. All gifts over the annual exclusion amount ($15,000 for a single person and $30,000 for a married couple) are added back to your estate at your death. In other words, if you have an estate of $10,000,000 and you gift $5,000,000, the IRS will add back the $5,000,000 gift at death and estate tax you on $10,000,000 (less the current exemption). So why gift? Because you are removing all of the growth on the $5,000,000 from your estate. If you didn't make the gift, you would be estate taxed on all of the appreciation as well.

From a New York perspective, only gifts made within 3 years of death are brought back into the estate for calculating estate tax. Connecticut is the only state in the country with a gift tax and the exemption in 2021 is $7,100,000.

What are some of the techniques our clients are implementing before legislative changes are enacted?

- Annual exclusion gifts of $15,000 to any individual (or $30,000 for a married couple). Many clients make these gifts in the form of cash to family members.

- Gifts to Spousal Limited Access Trusts (or SLATs). We discussed this in our Spring, 2019 newsletter and can be found here at https://danzigermarkhoff.com/newsletters/2019/NewsletterSpring2019-ChrisMiehl-SpousalLimitedAccessTrusts%E2%80%93HavingYourCakeAndEatingItToo.pdf This has been the most attractive technique due to its flexibility. It removes future appreciation from the estate while still giving the spouse access to money. In basic terms, Spouse 1 makes a gift to a trust in which Spouse 2 is the trust beneficiary. Spouse 2 has the right to receive the trust's income (being dividends, interest, rent or K-1 profits from a business) and can have certain rights to principal. Spouse 2 will then create a reciprocal trust benefitting Spouse 1. This way, in essence, both spouses are still benefitting from the trust monies while both are alive. One problem is that these two trusts cannot be implemented at the same time due to a principle called the "reciprocal trust rule", which would cause the IRS to disregard the gifts. However, if the trusts are drafted so that they are sufficiently different and are separated significantly in time, we can avoid this rule.

- Grantor Retained Annuity Trusts (also called GRATs). These trusts are used in order to remove future appreciation in a short period of time, such as 2-3 years. The concept with a GRAT is to transfer assets to a trust which pays you an annuity equal to what you put into the trust plus a government interest rate (which now is approximately 1%). For example, if you put $1,000,000 in a 2 year GRAT, it will pay you $509,000 after year 1 and $509,000 after year 2. Then, you ask, why do this if the GRAT repays what you put in with some interest? The benefit is that any appreciation during the 2 year term will be distributed to your heirs without having used any of your lifetime $11,700,000 estate and gift tax exemption. GRATs were targeted by the Sanders/Whitehouse bill to have a minimum length of 10 years and to be a significant gift, thus defeating the purpose of the GRAT.

- Sale to Intentionally Defective Grantor Trusts (or IDGTs). This transaction involves selling assets to a trust for the benefit of your heirs while taking back a promissory note. Since this is a sale, no estate and gift exemption is used. The benefit is that you, as the seller, have "frozen" the size of your estate by selling soon-to-be appreciating assets to a trust for the benefit of your heirs while your estate only has a promissory note which is fixed in value.

Please feel free to reach out to the estate planning partners at Danziger & Markhoff LLP, Michael Markhoff, Harris Markhoff or Christopher Miehl, with any of your questions. You can reach us at mmarkhoff@dmlawyers.com, hmarkhoff@dmlawyers.com and cmiehl@dmlawyers.com