LEBLANC & YOUNG

WWW.LEBLANCYOUNG.COM

TAX ALERT

October 2021

On September 13, the House Ways and Means Committee made public its proposed tax plan, the revenue from which would fund President Biden's "Build Back Better" spending package. This proposed legislation would impact (among other things) estate, gift, and generation-skipping transfer tax exemptions, valuation discounts, and grantor trust rules.

The proposals under consideration, if enacted, would most impact a client who wishes to make gifts in excess of $6,000,000 to utilize as much of his or her presently available $11,700,000 exemption as possible before the new law takes effect, and/or who has an existing grantor trust, such as an ILIT, GRAT, SLAT, or QPRT. Clients with estate plans involving only revocable trusts and/or who do not wish to make significantly large gifts do not need to make changes to their plans at this time.

As presented, the legislation makes the following changes to the estate tax laws:

1) Reducing the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts from $11,700,000 per person in 2021 to about $6,020,000 per person as of January 1, 2022 (remaining indexed for inflation).

2) Changing the rules applicable to grantor trusts, which are trusts that the grantor is considered the owner of for income tax purposes causing the grantor to be responsible for paying the trust's income taxes. The rules would result in the following consequences for grantor trusts established or funded after the legislation's enactment date:

    a. Any grantor trust created or funded after the date of enactment will be includible in the grantor's estate at death.

    b. A distribution from a grantor trust to anyone other than the grantor or the grantor's spouse will be treated as a taxable gift from the grantor as of the date of distribution.

    c. Terminating grantor trust status during the grantor's lifetime will be treated as a taxable gift of the trust assets on the date grantor trust status is terminated.

    d. Sales or exchanges between a grantor trust and the grantor will no longer be disregarded for income tax purposes and will result in the recognition of capital gain or loss.

   Grantor trusts in existence at the time of the legislation's enactment are grandfathered and thus protected from these rules with two caveats: first, if a "contribution" is made to such a grandfathered grantor trust after the enactment date, the portion of the grantor trust attributable to such post-enactment date contribution will be subject to the aforementioned rules; and second, sales or exchanges between a grandfathered grantor trust and the grantor after the enactment date would be a capital gain recognition event.

Practitioners are concerned that there is no direction as to what constitutes a "contribution" to a grandfathered trust that would result in the new laws applying to a grandfathered trust. Does a swap of the assets of a grantor trust between the trust and the grantor constitute a contribution?

3) Eliminating valuation discounts for lack of control and lack of marketability for minority interests of closely-held entities holding passive assets held for the production of income and not used in an active trade or business (i.e., nonbusiness assets).

4) Trusts and estates would be subject to a 3% surcharge on taxable income in excess of $100,000. The top capital gains rate applicable to individuals and trusts alike increases to 25% (current rate is 20%) (*effective as of date of introduction*).

These new rules would significantly impair the future use of common estate planning techniques, such as Irrevocable Life Insurance Trusts (ILITs), Grantor Retained Annuity Trusts (GRATs), Spousal Lifetime Access Trusts (SLATs) and Qualified Personal Residence Trusts (QPRTs). They would also pose some risk for estate plans already in place that use these techniques. For example:

a. ILITs (which are generally always grantor trusts) usually receive annual contributions from the grantor to provide liquidity for the ILIT that may be used to pay the premiums for the life insurance policy. Would such contributions expose the proceeds of the ILIT attributable to such post-enactment date contributions to estate tax at the grantor's death?

b. GRATs often satisfy their annuity distributions to the grantor with in-kind distributions - such in-kind distributions could be capital gain events. Also, often the appreciation within a GRAT is locked in by the grantor swapping the GRAT's investment assets for cash. Such post-enactment date swaps could be an exchange or even a contribution causing the ultimate distribution of the GRAT remainder to be a taxable gift.

c. Likely no additional gifts should be made to grandfathered grantor trusts after the date of enactment because such contributions would cause part of the trust to be subject to these new rules.

It is very probable that this legislation will change before being enacted. It must be approved by the House of Representatives, then the Senate and then signed into law by the President. Also, the latest news indicates that the expected cost of the Build Back Better package may be less than the initial $3.5 trillion price tag. If that is the case, less revenue will be needed to cover the cost and thus fewer tax changes may be enacted.

Nonetheless, it is prudent to consider how the proposed rules could impact one's estate plan. And if the impact could be great, it may be very worthwhile to plan for them now while there is still the opportunity to do so. Please contact us if you have questions regarding how these proposed rules could impact you. If you are comfortable that the proposed legislation does not impact you but you are interested in revising your plan, please understand that we may not be able to assist with such revisions until later this year and perhaps into the new year, as our schedules are all very busy.

LeBlanc & Young
Four Canal Plaza
Post Office Box 7950
Portland, Maine 04112-7950
(207) 772-2800

Attorneys

Elizabeth T. High, Esq.	ehigh@leblancyoung.com
Abigail King Diggins, Esq.	adiggins@leblancyoung.com
Justin D. LeBlanc, Esq.	jleblanc@leblancyoung.com
Matie B. Little, Esq.	mlittle@leblancyoung.com
Eliza M. Nichols, Esq.	enichols@leblancyoung.com
Kristin P. Barry, Esq.	kbarry@leblancyoung.com

Fiduciary Services Administrator

Karen M. Hart, CPA, MST	khart@leblancyoung.com