RE: 2021 TAX PROPOSALS and ESTATE PLANNING

Senate Democrats have proposed 2 bills, each of which, if enacted, would have an extremely significant impact on estate planning.

SANDERS 99.5% ACT

On March 25, Senators Sanders (I-VT) and Whitehouse (D-R.I.) formally proposed a bill which would make changes to the current estate and gift tax system. It is our understanding the bill has some support among Democratic Senators and Congressmen and contains many provisions that President Biden advocated during the campaign. While it is our hope that this proposed law will not be enacted, it seems best to "plan for the worst and hope for the best," given the unpredictable political climate, and the possible changes that may be made if a watered-down version of this potent proposed law passes. Fortunately, under this proposal, the reduction of the estate tax exemption amount from $11,700,000 to $3,500,000 would not occur until January 1, 2022. The same timing applies for the proposed reduction of the gift tax allowance to only $1,000,000, which means that people will not be able to gift more than $1,000,000 after 2021 without paying gift tax. Also, the proposed increase in the estate tax rate to 45% once a deceased person's taxable estate exceeds $3,500,000, and 50% and higher when the amount subject to tax exceeds $10,000,000 will not apply until 2022. Similarly, the restrictions on the amount of the annual exclusion contained in the bill (limited to $30,000 per donor per year for gifts to irrevocable trusts or interests in certain "flow through" family entities) will also not begin until 2022; other annual exclusion gifts of up to $15,000 per year per person will continue as under current law.

Under the bill, if enacted, some of the primary tools and strategies that we have used in the past will not be available, beginning upon the date that President Biden signs the bill into law. Thus, Grantor Retained Annuity Trusts (GRAT's) will be required to have a minimum term of at least 10 years and gifts made on the funding of the GRAT would have to be at least equal to either:

- 25% of the fair market value of the property placed in the GRAT; or
- $500,000, depending upon the circumstances.

Further, we will not be able to fund or sell assets to Irrevocable Trusts that can be disregarded for income tax purposes (grantor trusts) or use valuation discounts in valuing assets not used in the conduct of a trade or business.

In addition, any irrevocable grantor trust created after enactment will be included in the grantor's estate and distributions from the trust during the grantor's life will be considered gifts by the grantor. Moreover, transfers after enactment of the bill to pre-enactment grantor trusts would result in inclusion of a portion of the trust assets in the grantor's estate. In each of these cases, there is a partial exception to grantor trust estate inclusion to the extent the assets were subject to gift tax (or used exclusion). The new rules, if enacted, will adversely affect the future funding of life insurance trusts since a life insurance trust typically involves funding on an annual basis. To avoid or minimize the negative tax consequences of post enactment funding of a grantor trust, a large infusion of income producing assets should be transferred to the Trust to pay future premiums prior to enactment of the bill, rust. Alternatively or in addition, you may wish to consider a loan or split dollar regime to fund the premiums.

Significantly, under the proposed bill, arrangements put into place before the new law is passed will be grandfathered as long as they are not added to or altered after the law is passed. Thus, if you expect

your assets to exceed $3,500,000 per person, we strongly urge you to review your present planning situation to determine whether to take immediate steps to avoid death taxes

Sensible Taxation and Equity Promotion (STEP) Act

On March 29, Senators Chris Van Hollen (D-Md.), Warren (D-MA), Booker (D-N.J.), Whitehouse (D-R.I.) and Sanders (I-VT), proposed the Sensible Taxation and Equity Promotion (STEP) Act, which is intended to eliminate stepped-up basis at death. Under the current proposed version, the changes are scheduled to be effective retroactive to January 1, 2021.

Currently, under the Internal Revenue Code, inherited assets have their basis reset to the fair market value at the date of death. This means heirs don't pay income tax on unrealized capital gains from an inheritance except to the extent the sales price of the asset exceeds the date of death value.

The Proposal contains several exclusions to the imposition of the capital gains tax. The bill would allow individuals to exclude up to $1 million in unrealized capital gain. Thus, if an inherited asset has a FMV of $4 million and a basis of $2 million, the tax will only apply to $1 million of the $2 million gain due to the exclusion. In addition, the exclusion of gains of up to $250,000 per deceased individual or $500,000 per deceased married couple from the sale of a principal residence, as allowed by current law, would continue to be exempt, as would tax on capital gains on assets held in retirement accounts and bequests to charity. Finally, the proposed legislation would allow taxpayers to pay the tax in installments over a 15-year period for capital gains that apply to any illiquid asset like a farm or business.

We have been very busy with estate tax planning since the middle of last year. If you wish to develop an estate tax plan, or complete an estate tax plan that you have already started, or act upon an estate tax planning structure you already have in place, please let us know immediately (rona@lex-life.com) so that we can avoid any delays in putting whatever you would like to do into action before a new law may be enacted.

Regards,

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