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Memorandum

on

Pending Tax Legislation

To: **Clients, Friends, and Colleagues**

From: **Rader & Coleman, PL**

Date: **October 5, 2021**

The House Ways and Means Committee recently released a proposal for new tax legislation. The proposal alters income, estate and gift taxation. Some of these changes, if enacted into law, would dramatically impact the taxation of high net-worth individuals and families. The proposal is extensive and this memorandum is intended to summarize certain portions that are most relevant for estate planning.

We do not know if this legislation will be enacted or when and in what variation it may be passed. We do know that the proposed legislation has an effective date of January 1, 2021, except: the grantor trust provisions, which are effective when the legislation becomes law; and the capital rate increase is effective for transfers after September 13, 2021. Any transfers prior to the effective dates will be *grandfathered* under the current law. If the proposed law is passed as it is currently drafted, this *grandfathering* provides high net-worth individuals an opportunity for tax planning prior to the effective date(s).

Income Tax

The proposal provides the following income tax features.

- Increases the top marginal income tax rate to 39.6% from 37%. This rate would apply to: (1) individuals with income over $400,000; (2) married couples who filed jointly and have a combined income over $450,000; (3) heads of household with income over $425,000; (4) married individuals filling separate with income over $250,000; and (5) a trust or estate with income over $12,500.
- Increases the top capital gains rate from 20% to 25%, effective for transfers after September 13, 2021.

- The Net Investment Income Tax of 3.8% on investments is expanded to apply to trade or business income for individual taxpayers with income over $400,0000 and married couples with income over $500,000.
- Imposes an additional 3% income tax, for individuals who earn over $5,000,000 of *modified adjusted gross income*.

Estate and Gift Tax

The proposed legislation contains some significant changes from the current estate and gift tax law.

- **Decrease in Lifetime Exemption**. Currently, every person (pursuant to the 2017 Tax Cuts and Jobs Act ("TCJA")), has a base exemption from estate and gift taxes of $10 million, adjusted for inflation. In 2021, the estate and gift tax exemption (adjusted for inflation) is $11.7 million per person, regardless of marital status. Married couples have a combined exemption of $23.4 million. Once a person has used their entire exemption, either during life or at death, he, she, or the person's estate is subject to a 40% tax on any transfers over $11.7 million. The proposed legislation would revert the exemption to the pre-TCJA level of $5 million, indexed for inflation (This amount is estimated to be $6 million).

- **Irrevocable Grantor Trusts No Longer Outside Taxable Estate**. Grantor trusts are trusts that the grantor[1] is deemed the owner for income tax purposes, whether the trust is revocable or irrevocable. Gifts to irrevocable grantor trusts have been a popular planning technique to shift assets out of the grantor's estate while allowing the assets to benefit other family members. Grantor trusts allow the transfer of assets to be complete for gift tax purposes while the grantor remains responsible for the payment of the trust's income taxes. Accordingly, the trust property grows on a tax-free basis for the trust beneficiaries during the grantor's life. The grantor's payment of the trust's taxes is essentially a non-taxable gift to the trust beneficiaries. Under the proposed legislation, a grantor trust created after the effective date of the law will be part of the grantor's estate at his or her death and subject to estate tax. As well, any contributions to the trust after the effective date will be subject to estate tax at the grantor's death.

Planning Opportunities.

As previously stated, this is proposed legislation and we do not know if it will be passed into law in its current form or in a modified version. Still, there are planning opportunities to take advantage of before the new law may be enacted.

- **Make Taxable Gifts Before Year End**.
    - If one has not used his or her full $11.7 million exemption, this year is a good year to make significant gifts prior to December 31, 2021. These gifts for the benefit of a spouse and/or family members can be made outright, to a grantor trust, or to a non-grantor trust, If gifts to a grantor trust are contemplated, then that planning should take

[1] A grantor is the person or persons who create a trust.

place as soon as possible because the inclusion of grantor trusts into a person's estate is effective upon passage of the legislation (if it passes in its current version).

    - If one does not have $11.7 million available to gift, but has more than $6 million (the anticipated new exemption amount under the proposal), then gifting amounts in excess of $6 million will provide tax benefits that may not be available in the future if the proposed legislation passes.

- **Withdraw More than Required Minimum Distributions (RMD) from IRAs**. Since the proposal provides for higher income tax rates, a distribution greater that the RMD from an IRA taken prior to January 1, 2022, will likely be taxed at a lower rate than after the proposed legislation is passed.

Conclusion. The proposed tax legislation provides for dramatic changes. Most notable are the decrease in the lifetime gift and estate tax exemption and the inclusion of grantor trusts into a person's taxable estate. It is unknown: whether the proposed legislation will be passed; and whether the effective dates of the provisions in the final legislation will differ from the proposed legislation. The Firm will continue to monitor the proposed legislation. There is a *window of opportunity* to make gifts *grandfathered* under the current law and time is of the essence to seek competent tax and legal advice to implement a gifting plan intended to be completed before the *window* closes.

This writing is intended as general information and does not constitute legal advice.