

Client Alert

Potential Changes In Federal Tax Law

April 7, 2021

Recent bills introduced in Congress would raise estate tax rates, reduce exemptions, deem gains to be realized on transfers by gift and at death, and curtail or effectively eliminate popular wealth transfer strategies. The For the 99.5% Act, introduced by Senator Sanders, would make the following changes, among others:

- Grantor trusts – *i.e.*, trusts that are treated as owned by the grantor for income tax purposes – created or added to on or after the date of enactment would be subject to estate tax at the grantor's death or to gift tax if distributions are made during lifetime or grantor trust status is turned off.
- A valid grantor retained annuity trust or "GRAT" created on or after the date of enactment would be required to have a minimum 10-year term (and a maximum term of no more than life expectancy plus 10 years) and a remainder at least equal to the greater of \$500,000 or 25% of the value of the GRAT property.
- Beginning on the date of enactment, valuation discounts for an entity's "nonbusiness assets" would be prohibited, regardless of family ownership or control, and discounts for lack of control and lack of marketability would be eliminated in the case of entities controlled by the transferor and family members or entities in which the transferor and family members own a majority of the ownership interests.
- Beginning in 2022, gift and estate tax rates would be increased to 45% for amounts between \$3.5 million and \$10 million, 50% for amounts between \$10 million and \$50 million, 55% for amounts between \$50 million and \$1 billion, and 65% for amounts above \$1 billion.
- Beginning in 2022, the lifetime gift tax exemption amount would be reduced to \$1 million and the estate and GST exemption amounts would be reduced to \$3.5 million, all without adjustments for inflation.
- An individual's generation-skipping transfer or "GST" exemption could only be allocated to a trust created after enactment if the trust terminates within 50 years
- GST exemption allocated to pre-enactment trusts (including trusts created or funded now) would effectively expire after 50 years.
- In the case of gifts to trusts, gifts of interests in passthrough entities, and certain other types of gifts, the gift tax annual exclusion amount, which is currently \$15,000 per donee, would be limited to an aggregate amount of \$30,000 per donor (adjusted annually for inflation).

The For the 99.5% Act is broadly consistent with the policies of the Biden administration. Given that changes to GRATs, grantor trusts, and valuation would be effective the date of enactment, clients should consider implementing these strategies as soon as possible.

In addition, bills introduced in the Senate and the House by Senator Van Hollen and Representative Pascrell, respectively, would deem gains to be realized on the occurrence of certain events such as at death, on gifts, and when grantor trust status terminates or assets are no longer included in the grantor's estate for estate tax purposes.

In light of these bills, it is more important than ever to fund irrevocable trusts with cash or high-basis assets. If enacted, these bills would also cause gain to be taxed upon termination of a GRAT or a qualified personal residence trust or "QPRT," even if the trust was created prior to enactment. It may be possible to defer tax on such gain. Although we continue to strongly recommend GRATs, especially given the potential changes

under the For the 99.5% Act, clients who create them should discuss with us plans for deferring gain recognition in case these bills are enacted.

Potential Changes In New York Wealth Transfer Taxes

Proposed bills in New York would, among other things, have increased the New York estate tax rates to a top rate of 20%. These proposals were removed or are not included in the 2021 budget bill as of the date of this alert.

Legislation has also been introduced to reinstate a New York gift tax and impose inheritance tax on recipients of gifts and bequests. We expect to address these impact of these changes in future client alerts if the bills progress in the New York legislature.

Importance of Funding Revocable Trusts

We have long recommended that clients fully fund their revocable trusts in order to avoid probate. (As a reminder, funding a revocable trust has no income or gift tax consequences.) The importance of doing this became even more evident during the COVID-19 epidemic, as courts were closed and probate was delayed by months. As a reminder, when an individual dies holding assets in his or her name, the assets are effectively frozen. No one may access them, sell them or otherwise dispose of them until the court admits the decedent's will to probate and appoints the executors. During that period, unnecessary market risk is taken and the decedent's assets cannot be used to pay expenses. Also, the probate process, including the decedent's will, balance sheet and names and addresses of beneficiaries, is public record. These consequences can be easily avoided if the assets are held in a revocable trust. In that case, when the grantor dies, named successor Trustees are automatically appointed without any court involvement, and they immediately have authority over the assets. If you would like assistance with funding your revocable trust, please let us know.

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Trusts & Estates Group

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