

Client Alert

Potential Changes in Federal Tax Law: House Ways and Means Committee Legislation

September 17, 2021

On September 15, 2021, the House Ways and Means Committee advanced tax and other legislation to be incorporated into the broader \$3.5 trillion reconciliation bill and voted upon by the House of Representatives.

Of note, the legislation passed by the House Ways and Means Committee includes the following provisions which would impact estate planning:

- **Effective as of September 13, 2021:**

- Increase to Long-Term Capital Gains Tax Rate

- The top tax rate applicable to long-term capital gains and qualified dividends would be increased to 25% (or 28.8%, including the net investment income tax of 3.8%). Currently, the legislation does not change the long-term capital gains tax rate applicable to the sale of collectibles.
 - This new rate would not be applicable to qualified dividends, gains, and losses accruing on or before September 13, 2021 (including gains recognized pursuant to binding contracts entered into on or before September 13, 2021).

- **Effective as of the date of enactment of the proposed legislation (conceivably as early as October 1, 2021):**

- Amending Treatment of Grantor Trusts

A grantor trust is a trust which is treated as owned by the grantor for income tax (but not necessarily estate tax) purposes. Under present law, grantor trusts are powerful tools that facilitate various estate planning transactions.

The following changes to the rules governing grantor trusts (other than trusts already includible in the estate of the deemed owner of the grantor trust) would take effect upon enactment, starkly changing the current landscape. These changes would be applicable to (i) trusts created on or after date of enactment and (ii) any portion of a “pre-enactment” trust which is attributable to a contribution made on or after date of enactment.

- All trust assets would be included in the deemed owner’s gross estate.
 - Any distribution from a grantor trust (other than to the deemed owner or the deemed owner’s spouse) during the deemed owner’s life would be treated as gifts by the deemed owner.
 - If the deemed owner ceases to be treated as the deemed owner of the trust during the deemed owner’s lifetime, all assets of the trust would be treated as having been gifted by the deemed owner.
 - The bill provides that “proper adjustments shall be made with respect to amounts so included in the gross estate, or treated as transferred by gift” to account for amounts treated previously as taxable gifts by the deemed owner, although it is unclear what that would mean in practice.

- Any contributions post-enactment to a pre-enactment grantor trust may taint the pre-enactment grantor trust, including gifts that qualify for the annual exclusion from gift tax, as the proposed legislation is presently drafted.
- Sales or exchanges between a deemed owner and a grantor trust would no longer be disregarded for income tax purposes (i.e., the sale or exchange would be treated as if it occurred between the grantor and a third party) (unless the trust is fully revocable by the deemed owner). It is unclear whether sales and exchanges with grandfathered grantor trusts are excluded from the above changes.
- The related party rules of section 267 would apply to sales between grantor trusts and their deemed owners, meaning losses arising from sales between grantor trusts and their deemed owners will be disallowed and suspended.

Changes to Valuation of “Nonbusiness Assets”

- For estate and gift tax valuation purposes, the transfer of a non- “actively traded” interest in an entity containing “nonbusiness assets” would be treated as a direct transfer of those nonbusiness assets, with no valuation discounts permitted.
- The term “nonbusiness asset” would include any “passive asset” held for the production or collection of income and not used in the active conduct of a trade or business.
- Look-through rules would apply where the entity holds a 10% or greater interest in another entity.

• **Effective for taxable years beginning after December 31, 2021:**

Reduction of Exemption from Estate and Gift Tax

- The temporary increase to the unified credit against estate and gift tax created by the 2017 Tax Cuts and Jobs Act would be eliminated, effectively reducing the amount by half (\$5,000,000 per individual, indexed for inflation).

Other Income Tax Changes

- The top ordinary individual income tax rate would be increased to 39.6%. This rate would be applied beginning at \$450,000 of taxable income for married couples filing jointly and at \$400,000 of taxable income for single individuals.
- A surcharge tax of 3% would be imposed upon high income individuals, estates and trusts. This rate would begin at \$5,000,000 of modified adjusted gross income for married individuals filing jointly and single individuals, and would begin at \$100,000 of modified adjusted gross income for estates and trusts (other than fully charitable trusts).
- The cap on the special valuation reduction available for qualified real property used in a family farm or family business would be increased from \$750,000 to \$11,700,000.

Of note, the draft proposal does not repeal the step-up in basis at death provisions nor includes a provision treating death as a gain recognition event.

The provisions contained in the legislation may change, as the legislation is still subject to further consideration and review by the House and Senate. However, given the significant impact of the proposed tax law changes, we recommend that you contact us to discuss the potential effects of this proposed legislation upon your estate plan.

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