When Congress Says, "Never Mind", Does It Mean It? The latest news regarding changes to the Gift and Estate Tax Laws.

Article
October 29, 2021

For nearly a year, various proposals and so-called "frameworks" have been debated in Congress regarding changes to the federal estate and gift tax laws. Nearly all would have (i) reduced the amount that individuals could gift during lifetime or bequeath at death before application of federal transfer taxes, (ii) eliminated the so-called "step up" in basis that occurs at death and enables those inheriting assets to avoid tax on the capital gains accruing during a decedent's lifetime, (iii) taxed capital gains at death or sooner without need for a sale of assets, or (iv) some combination of the above. High net worth individuals and their advisors have been scrambling to beat the anticipated effective date of these rules, with many fearing retroactive application to January 1, 2021, but more likely planning for a January 1, 2022, effective date. To the surprise of many, the language of the House of Representative's latest proposal, released on Thursday, October 28, 2021, contains none of the above provisions. The Build Back Better Act (H.R. 5376) contains no modifications to the estate and gift tax exclusion amount or the basis step up rules. While many may breathe a sigh of relief, two items are worth noting:

1. The current $11.7M (this amount is indexed for inflation) estate and gift tax exclusion was provided under a temporary law. Even without any act of Congress, the exclusion will be cut in half effective January 1, 2026. Amounts in excess of the exclusion are taxed at a federal rate of 40%. The 2026 cutback in the exclusion amount is a vestige of the Tax Cut and Jobs Act of 2017, which temporarily doubled the amount of the exemption through December 31, 2025. The sunset provisions of the 2017 Act remain in place. Previous Congressional proposals in 2021 merely served to accelerate the date on which roll back (or sunset) of the exclusion would occur. Thus, while the Build Back Better Act provides a temporary reprieve for those with assets in excess of the exclusion amount, it does nothing to make the larger exclusion permanent. Individuals would still be wise to consider the impact of the 2026 sunset in their ongoing estate planning.

PROFESSIONALS

Ann M. Rieger
Partner

RELATED SERVICES

Trusts, Estates & Succession Planning

2. It is not unheard of for Congress to reinsert previously drafted proposed legislation into bills in the waning hours before legislation is put to an actual vote. Many are familiar with changes made by the SECURE Act which eliminated the ability for most people inheriting individual retirement accounts (IRAs) from stretching withdrawals from such accounts over their own lifetimes and thereby deferring taxation. Special rules exist for spouses, minor children and disabled beneficiaries. The provisions of the SECURE Act appeared stalled in Congress for months before being tacked on to an unrelated spending bill late in December of 2019 and becoming law on December 20, 2019. While certainly speculative, the same could happen with modifications to the estate and gift tax exclusion amount or other provisions impacting estate planning.

Also absent from the Build Back Better Act are several byzantine provisions that applied to so-called "grantor trusts". The complexity of "grantor trusts" and the rules applicable to them are beyond the scope of this article.

While the Build Back Better Act provides relief from prior proposals which would increase the amounts subject to estate and gift tax, the Act does not present good news regarding the income tax rates applicable to estates and trusts. Included in the Act are provisions which would subject estates and irrevocable trusts to new income tax surcharges that are also proposed for individuals. In what has been called the " Millionaire Income Tax Surcharge", the Build Back Better Act applies a surtax of 5% on income in excess of $10M for individuals and an additional 3% surtax on income above $25M. The amounts listed are those which apply to single individuals, as well as persons who are married filing jointly. There is no separate threshold for married couples filing jointly. If a person is married but filing separately, each spouse will trigger application of the surtax when (s)he reaches modified adjusted gross income of $5M for the 5% surtax and $12.5M for the additional 3% surtax. However, surtaxes apply to estates and trusts at much lower levels. The thresholds applicable to estate and trust income are far below the million-dollar level, with the 5% surtax beginning to apply at the $200,000 income level and the additional 3% surtax at the $500,000 income level. In all cases, the income measurement for application of the surtax is "modified adjusted gross income".

Those with grantor trusts or estates in excess of the federal estate and gift tax exclusion, or who have previously funded irrevocable trusts to which the proposed surtaxes would apply, would be wise to stay in touch with their advisors on these topics. The legislative proposals in these areas remain very fluid.