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Estate & Gift Tax Update:
Build Back Better Act

MHH Trusts & Estates Practice Group

On September 13, the House Ways and Means Committee released a proposed plan to pay for the $3.5 trillion Build Back Better Act (the "Act"). The proposed legislation contains a variety of changes across the tax code, but the following summary focuses on the proposed provisions that most directly impact estate tax planning.

Reduction of the Estate Tax Basic Exclusion Amount

The current estate tax basic exclusion amount is $11,700,000 for 2021. The proposal would decrease the estate tax basic exclusion amount to $5,000,000, indexed for inflation (accelerating a reduction that is set to occur in 2026). Under this proposal, the basic exclusion amount in 2022 is anticipated to be $6,020,000.

- The proposal would apply to estates of decedents dying and gifts made after December 31, 2021.
- Planning opportunity: Consider making gifts before year-end up to the 2021 estate tax basic exclusion amount, $11,700,000 (less any taxable lifetime gifts you may have made to date).

Changes to the Treatment of Grantor Trusts

A "Grantor Trust" is a term used in the Internal Revenue Code to describe any trust over which the grantor retains certain powers. If a grantor retains certain powers, the income of the trust will be taxed to the grantor as if the Trust did not exist. As a result, the income and deductions associated with Grantor Trust assets are reported on the tax return of the grantor. For years estate planners have used various techniques to utilize the unique nature of a Grantor Trust and transfer wealth. When the grantor of a Grantor Trust dies, the assets of that Grantor Trust (other than a fully revocable trust) are generally not included in the deemed owner's estate.

- The proposal would require that assets in a Grantor Trust be included in the gross estate of the deceased deemed owner.

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- Additionally, the proposal would treat distributions from a Grantor Trust (other than to grantor) during the life of the grantor as a gift for gift tax purposes and if a trust ceases to be a Grantor Trust during the grantor's life, it will be treated as a gift by the grantor of all trust assets.
- The proposal would treat any sale of assets to a Grantor Trust as a sale to a third party, and thus subject to income tax on any gain.
- The proposal would apply to Grantor Trusts <u>created on or after the date of enactment (i.e., when the President signs the legislation)</u>.
- Existing Grantor Trusts would be grandfathered, but if a "contribution" is made to a grandfathered trust after date of enactment of any new legislating a portion of that trust would be subject to these new rules.
- <u>Planning opportunity</u>: Create Grantor Trusts and fund them with up to the 2021 estate tax basic exclusion amount, $11,700,000.

An Irrevocable Life Insurance Trust ("ILIT") generally includes language that causes the ILIT to be a grantor trust. The concern is that if contributions continue to be made to an existing ILIT after the provision's enactment date, *<u>the portion of the ILIT attributable to those contributions will be includible in the deceased owner's estate</u>*.

- <u>Planning Consideration</u>: Consider terminating grantor trust status and/or front-loading an ILIT now with funds to cover future policy premiums prior to enactment of any new legislation.

<u>Valuation Discounts</u>

Under current law, valuation discounts, such as marketability discounts and minority interest discounts, are allowed for transfers of nonbusiness assets for estate and gift tax purposes. The proposal would eliminate valuation discounts for certain transfers of "nonbusiness assets" for estate and gift tax purposes. "Nonbusiness assets" are defined as passive assets that are held for the production or collection of income and are not used in an active trade or business.

- Valuation discounts for nonbusiness assets would be disallowed for gift and estate tax purposes, effective for transfers on or after the date of enactment (i.e., when the President signs the legislation).
- <u>Planning Opportunity</u>: Complete any gifts of non-business assets as soon as possible.

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Keep in mind that this is only a proposal that may or may not be enacted into law. Our T&E department would be pleased to speak with you about how the new proposal may affect you.

If you have any questions regarding this alert or any other estate planning concerns, please do not hesitate to contact any of the attorneys in our trusts and estates department, as set forth below:

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