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What November's Election Results Could Mean for Your Estate Planning

Family Wealth Planning Group

November's election may usher in taxpayer-adverse changes to the current taxpayer favorable gift and estate tax laws. Clients should consider implementing plans responsive to this potential wave of changes in the tax laws.

The following is written with U.S. taxpayers in mind, rather than foreign taxpayers, although some of these changes may still concern the latter.

The Favorable Tax Laws That Currently Exist, and How They May Change After November

While the precise federal tax law changes that might be enacted following the election remain obscure, commentators have focused on two potential changes that might follow a change in administration and control of the Senate:

Topic	Current law	Potential changes following November 2020
Gift, Estate, and Generation Skipping Transfer (GST) tax exemption (for U.S. taxpayers)	$11.58 M exemption per person, reduced by prior transfers and indexed to inflation. Scheduled to be halved beginning Jan. 1, 2026.	Reduction to the exemption effective as soon as next year
Treatment of basis of assets held at death and gifted during lifetime	Assets held by an individual at death generally receive an income tax-free step-up (or -down) in their basis to fair market value. Assets gifted during lifetime generally carry their basis over from donor to donee.	Either assets held at death may receive a basis adjustment but income tax will apply to gains or losses, *or* the assets may retain the donor's pre-death basis. Gifts could also potentially face changed consequences (e.g., triggering of gains on gifts and receiving basis step-up).

The foregoing should not be taken as a comprehensive statement of laws that are favorable and may be changed, but only those most relevant to estate planning which have been announced as, or are widely assumed to be, part of a Democratic tax platform. Many other longstanding legislative proposals to limit or eliminate other favorable estate planning techniques could also come to fruition, including the following:

Topic	Current law	Potential changes following November 2020
Estate and gift tax rate	Flat 40% rate.	Progressive rate; prior proposals have included a maximum 77% tax rate for estates and cumulative gifts in excess of $1 billion.
Zeroed-out grantor retained annuity trusts (GRATs)	GRATs may be designed so as to create a $0 gift, while still shifting the future appreciation of assets used to fund the GRATs to a donee. The GRATs may also have a very short term. Together, this allows simple tax-free gifts of much of the value of assets with appreciation potential.	GRATs may require a minimum gift amount (perhaps 10% of funding assets, judging from earlier legislative proposals). GRATs may require a minimum term (perhaps 10 years).
Grantor trusts	Trusts may be designed to, for income tax purposes, be treated as identical with their creator (to be "grantor trusts"), even though the assets in such trusts will be considered to have been transferred by the creator (and for such assets to thus not be in the creator's gross estate) for estate tax purposes.	Grantor trust rules may become tied to concepts of gift and estate tax, preventing the ability to have a complete transfer for gift and estate tax purposes but not for income tax purposes. The grantor trust rules could also be repealed or significantly altered in other ways.
GST exemption	Trusts which have GST exemption assigned to them equal to the value of the assets transferred to them are GST-exempt as long as they exist.	GST exemption assignment may only have a limited term (e.g., 50 years).

Congress has a surprising ability to pass retroactive tax legislation, with most commentators agreeing that any bill passed in 2021 on the foregoing topics could *at least* be retroactive to the start of 2021. That said, in the interests of fairness, Congress has rarely used the full extent of this power. Thus, although Congress may not ultimately use its retroactivity powers, implementing estate planning structures prior to the end of 2020 may prove prudent.

A significant set of changes may occur for income taxes, with proposals including the elimination of the capital gain preference. These should also be considered carefully in planning.

Further, clients should keep an eye on changes in state law. In California, for example, certain key aspects of real property taxation may soon change. In particular, clients may consider whether they should take advantage of the parent-child exclusion from reassessment for certain

transfers of real property, as Proposition 19 aims to cut back this widely-used planning technique. At the same time, Proposition 19 will help senior citizens transfer their existing base-year values between counties (with certain limitations attached). Separately, Proposition 15 may largely end California's property tax reassessment limitations for commercial real property.

One element comprising the current favorable estate planning climate, likely not changing anytime soon, is the low interest rate environment. Many estate planning techniques (including GRATs and sales to trusts for promissory notes) work better in such environments.

Considerations in Planning for Potential Changes in the Tax Laws

In response to the potential changes in the tax laws, clients and commentators have focused on the following considerations:

- Maximize Use of Gift Exemption. A key way to respond to a potential reduction in the gift, estate, and GST tax exemptions is to use such exemptions before they are reduced, most likely through a gift in trust (to preserve some control and flexibility). Under the anti-clawback regulations, the IRS has confirmed that such exemptions, once used, cannot be recovered by the government indirectly.

  Clients desiring to lock in the historically high exemptions will need to make large gifts because the gift exemption is used from the "bottom up," rather than "top down." For example, if person A makes a $5M gift and person B makes a $10M gift in 2020, and the tax exemption is reduced to $5M per person in 2021, neither A nor B will have any remaining exemption in 2021. For the same reason, in the case of a married couple, it may make sense not to split gifts and instead have one spouse use up his or her exemption. For example, assume that in 2020 married persons A and B each make a $5M gift, while for persons C and D, also married, C makes a $10M gift and D makes no gift (in 2020 or any prior year). If the tax exemption is reduced to $5M per person in 2021, A, B, and C will have no remaining exemption, while D will have $5M of exemption.

- Do Not Excessively Fund Gift. Although it may be painful to watch current estate planning benefits expire unused, clients may best be served by not transferring more of their assets than they can realistically afford. That said, some devices for preserving flexibility and access to gifts may be implemented for certain clients.

For More Information

Ultimately, a great estate plan is one tailored to the client's needs and desires, which takes the above considerations—provided only in summary form—into account as just some of its many facets. For information on how to best create an estate plan that works for you, taking into account the foregoing planning ideas and concerns, please contact any member of the Shartsis Friese Family Wealth Planning group.

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