

Adler & Adler, PLLC
Robert J. Adler
O: 212-843-4059 M: 646-946-8327
1180 Avenue of the Americas, 8th Floor
New York, NY 10036
robertadler@adlerandadler.com

MEMORANDUM

Date: May 2, 2021
To: Our Friends, Colleagues, and Allied Professionals
From: Robert J. Adler
Subject: **For the 99.5% Act and the Sensible Taxation and Equity Promotion Act of 2021**

Dear Friends, Colleagues, and Allied Professionals,

You may have read or heard news about two bills recently introduced in the Senate that, if enacted, could have a significant impact on many estate plans. I am writing to you, as a valued allied professional, to provide you with some additional information on these proposals, and the effect they may have on estate planning.

The Proposals

The two bills currently under consideration are commonly referred to as "For the 99.5% Act," which was introduced by Senators Sanders and Whitehouse, and the "Sensible Taxation and Equity Promotion Act of 2021," or "STEP" Act, introduced by Senator Van Hollen and others. Each bill proposes several technical changes to the Internal Revenue Code. The details of these proposals are too extensive to cover in this memo, but I offer a summary of what I think are some of the more important changes below. Please note that these proposals are separate from and in addition to the "Made in America Tax Plan" recently outlined by the Biden Administration. That plan primarily deals with corporate income tax, and is not discussed in this memo.

Proposed Changes Affecting Estate Plans

Both the Sanders and Van Hollen bills propose changes to the federal tax law that, for many, will have a significant impact on future estate planning, and may also disrupt existing estate plans. These changes would affect not only the amount that each U.S. citizen is able to pass free of estate tax at death (commonly referred to as the "estate tax exemption") and the estate tax rates, but would also alter the effectiveness of many common estate planning techniques.

Estate Tax Exemption and Rates

The Sanders bill proposes to decrease the estate tax exemption to \$3.5 million. That would reduce the exemption amount by more than \$8 million (the current exemption is close to \$12 million). In addition, the Sanders bill would increase the estate tax rates, creating a graduated series of rates with a top rate of 65%. The following example illustrates the impact of these changes:

The estate of a person who dies today leaving assets valued at \$11 million would not pay any federal estate tax under the current law (assuming the person had made no prior taxable gifts). Under the changes proposed by the Sanders bill, that person's estate would pay approximately \$4.7 million in federal estate tax, unless the person had "inherited" exemption from a previously deceased spouse, or the estate passed in a way that qualifies for an estate tax deduction (e.g., to a surviving spouse or charity).

If these changes are enacted, many more families will need to consider the effects of the federal estate tax when making decisions regarding their estate plans.

Lifetime Gifts

In addition to changing the estate tax exemption, the Sanders bill also proposes to reduce the exemption for lifetime gifts to \$1 million. Currently, the gift tax exemption is the same as the estate tax exemption amount, essentially allowing an individual to use all or a portion of the \$11.7 million exemption on gifts made during life rather than waiting to use it at death. Lifetime gifting strategies can be an effective and efficient way to use the exemption amount, if properly implemented with the right assets. The reduction in the gift tax exemption would limit the effectiveness of lifetime gifting strategies.

The Sanders bill would also place limitations on gifts that qualify for the gift tax annual exclusion (currently \$15,000 per beneficiary), limiting each person to a cumulative amount equal to twice the annual exclusion for certain types of gifts, including gifts in trust.

Gain Recognition on Death/for Certain Trusts

Under the existing tax laws, property that is included in an individual's estate for federal estate tax purposes receives what is known as a "step up" in basis for income tax purposes. This means that the beneficiaries inheriting the property are not required to pay income tax on any capital gain built into the property, and a beneficiary's basis in the inherited property, for income tax purposes, is adjusted to the fair market value at the time of death (with an important exception for interests in retirement plans, such as IRAs). This essentially eliminates any such capital gain at the time of death, so that the beneficiary only has to pay tax on gains accruing after the date of death.

The Van Hollen bill would eliminate the basis "step up" and would instead cause the estate to recognize the gain on property passing at death, as if the property had been sold, causing the gains to be subject to income tax at that time. The bill would also cause gain recognition on property transferred by lifetime gift, and would require certain trusts to pay capital gains tax on trust property on a periodic basis.

Other Changes: Grantor Trusts, GRATs, Valuation Rules, Generation Skipping Transfers

The bills include a number of other changes relating to particular estate planning techniques, including grantor retained annuity trusts (GRATs), trusts often referred to as "grantor trusts," and the rules relating to the valuation of family-owned corporations, LLCs, and partnerships for gift and estate tax purposes. The Sanders bill also proposes changes to the application of the Generation Skipping Transfer (GST) tax

exemption. It is not possible to cover the details of these proposals here, but I wanted you to be aware of them.

When Will These Changes Occur?

At this time, it is not possible to know, with any degree of certainty, if and when these changes may occur. Neither of these bills has passed the Senate. It is possible that they may never pass, or that they will be amended before passing and moving to the House for consideration. It is important to note that certain changes are drafted to apply retroactively, to January 1, 2021. However, the proposed reduction in the gift and estate tax exemptions, as currently drafted in the Sanders bill, would not apply until January 1, 2022. If that bill is ultimately enacted into law bearing that effective date with respect to those exemptions, this could provide an opportunity for individuals who can afford to and wish to take advantage of the current exemption amount to do so by making gifts before the end of this year (although, on account of the Van Hollen bill, it may be best to carefully consider the assets used in making gifts, so as not to transfer property with significant built-in gain).

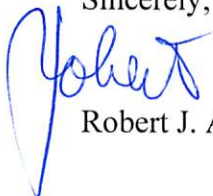
In addition, other proposals relating to grantor trusts, GRATs, and valuation rules are currently drafted to be effective immediately after the date of enactment and (in the case of certain proposals relating to grantor trusts) may provide "grandfathering" for trusts created prior to the date of enactment. Accordingly, in some cases, individuals who could benefit from these estate planning arrangements may wish to consider implementing them before any new legislation is enacted.

What to Do

Given the number of proposed changes in the Sanders and Van Hollen bills, and the uncertainty as to whether they will pass, with or without amendment, it is not possible to make a general statement as to how individuals should react to these proposals. Estate planning always requires analysis of each client's situation and goals, but that is especially true with respect to this proposed legislation. It stands to have a disparate impact on any particular individual or family, depending on their level of wealth, the assets involved, and the extent to which a prior estate plan has been put in place.

Finally, please know that although I have done my best to summarize some of the key points of the current proposals in this memo, I have omitted many details in the interest of brevity.

Sincerely,



Robert J. Adler

The contents of this memo are for informational purposes only and is not legal advice to you or any person. For information and advice particular to your situation, please contact our office. Every situation is different and must be evaluated on its own merits.