PLANNING IN AN ERA OF TRANSFER TAX UNCERTAINTY

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1. Introduction

For years, high net worth individuals have pursued many estate planning techniques to reduce the value of their taxable estates in order to minimize estate taxes at death. Discounted transfers (sales to "defective trusts", GRATs, QPRTs), annual exclusion gifting, purchase of life insurance in life insurance trusts, and many other options were undertaken with this goal in mind.

Donald Trump promised to eliminate the estate tax during his campaign. He proposed to eliminate the basis step-up at death and to replace the estate tax with a Canada-like "deemed sale" at death. He suggested that there would be no deemed sale until the second spouse of a married couple died, and he also suggested that $5 million of property would be exempt from the deemed sale rules.

Donald Trump continues to insist that he will accomplish the repeal of the estate tax. Bills have been introduced to accomplish that end. If there is no estate tax, high net worth individuals now wonder whether estate planning is worth pursuing at all.

Action on taxes isn't expected to occur until August (or later). Until then, the estate tax remains in effect. Importantly, no one knows when they will die; no one knows if there will be a change to the estate tax rules; and no one knows if there is change what that change will be. So, the question is: what estate planning should be done at the present (uncertain) time?

2. What Bills are Presently Being Considered by Congress?

Attached is a "Summary of 2017 Estate Tax Repeal Legislation to Date" document which summarizes with specificity the bills that are currently before Congress. There are three different options now being considered:

The January 3 Acts repeal the estate, gift and generation-skipping tax. The law would be effective on the date of enactment and apply to transfers that occur after that date.

The January 11 Act repeals the estate tax to deaths occurring after 2017. The gift and generation-skipping tax remain applicable.

The January 24 Acts repeal the estate and generation-skipping tax applicable to transfers occurring after the date of enactment. The gift tax remains intact at a (reduced) 35% rate. Further, distributions from pre-existing qualified domestic

trusts remain taxable for 10 years after the effective date.
There has been no bill introduced to eliminate the "basis step-up" at death, though if the estate tax is repealed, this law will probably be part of the income tax changes (not yet in bill form in Congress).

Bottom line: there are three very different options being considered by Congress now.

3. What Will Happen?

NO ONE KNOWS.

Since the Republicans control the Presidency, the House and the Senate, at first glance it looks likely that some sort of repeal will occur. However, the Senate does not have 60 Republican votes meaning that the Senate is not filibuster proof. As a result, any new tax law would have to be passed as part of a Reconciliation Bill, requiring only 51 votes. Importantly, a Reconciliation Bill change can only (effectively) be in place for up to 10 years.

Current scuttlebutt is that there will *not* be estate tax repeal. The word filtering out is "there isn't enough tax at risk to make the estate tax an issue, when the focus is on reducing corporate and personal income tax rates" and "it isn't worth getting into a fight over the estate tax and we'll trade that for the income tax changes we want". **This is only rumor. No one knows what will happen.**

4. What Planning Should Not be Done Until there is More Clarity?

Under current law, gift tax is about one-quarter cheaper than estate tax (there is no transfer tax on the money used to pay gift tax). Therefore, sophisticated clients make gifts and pay gift tax during life in order to reduce the overall cost of transfer taxes in moving money to children. (Note: there is no "time value" calculation here, as if one assumes assets appreciate in value, deferring the tax will simply cause the tax to be imposed later on a higher value.)

If the estate tax is going to be repealed, assets can transfer at death without the imposition of transfer taxes. If that were to occur, forcing the imposition of a gift tax makes no sense. And later, if there is no repeal, bigger gifts can be made in the future to make up for the ones that were postponed can be made at that time.

Similarly, transfers that would be subject to the generation-skipping tax should be avoided as well.

Another technique clients consider is buying back low basis assets from grantor trusts before they die so that they can accomplish a basis step-up at death, still saving estate tax because "high basis" cash is transferred out of their estates. If the law is changed so that there is no estate tax but, instead, a deemed sale at

death, the buyback should not be pursued. Instead, the low basis assets should be left outside the taxable estate so that there is no deemed sale when the grantor dies.

5. What Planning Can Still be Done?

Most estate planning can still be done, even though times are uncertain.

Creating revocable trusts to avoid probate makes sense no matter what the tax law is. Also, leaving assets in trust at death to put in place someone to manage those assets for minor or unsophisticated beneficiaries is always helpful. Assets in trust are also protected from creditors and divorce in most cases after someone dies.

Health care powers, durable powers of attorney for health care, and wills (to name guardians for minor children) also make sense no matter what the tax law is.

Current estate plans – that provide for a "bypass trust" and a "marital trust" would still be proper even if the tax law is repealed. Everything would simply end up in the bypass trust, with (for example) income and principal distributable to a surviving spouse, and upon her death, continuing on for children. (Note: if the bypass trust is solely for the children, however, a "cap" should be put on what funds the bypass trust so that the survivor is not left with nothing.)

If irrevocable transfers are made, there should be a "back door" to modify the irrevocable trust in case that would make sense if the tax law changes. Decanting language can be included in the trust, or the ability to appoint a "trust protector" to make changes should be part of the trust's language.

Life insurance may still be an appropriate tool to provide liquidity for a surviving spouse or a business. However, the more permanent (and expensive) life insurance typically purchased for estate tax purposes may not be needed. Consider purchasing "convertible term" insurance for the moment, and converting to the permanent product if repeal is not forthcoming.

6. How Will Planning Differ if the Estate Tax is Repealed?

Under current law, estate plans are prepared as "A/B/C" estate plans – primarily to take advantage of the unified credit and marital deduction when a first spouse dies. Oftentimes, a client will say "I want the marital trust for my spouse, but if he/she remarries, I want the trust assets to be for my children." Under the current environment, estate planners have to say "we can't do that or you'll lose the benefit of the marital deduction."

But, if you don't need the marital deduction, then anything can be done. If a spouse remarries (or cohabitates), assets can pass immediately to children. Estate plans won't write themselves – almost each plan will be individually crafted, once

the shackles of the tax law are removed.

7. <u>What Will Happen if the Democrats Take Control of the Government in 2021</u>?

   NO ONE KNOWS. But it is likely that the "99%-ers" will reenact the estate tax if it has been repealed.