THE IMPACT ON WEALTH TRANSFER PLANNING STRATEGIES & STRUCTURES

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Thursday, October 21, 2021

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BUILD BACK BETTER ACT (H.R.5376)

- Currently making its way through Congress via budget reconciliation
- House proposal (released on September 13, 2021) includes significant tax reform, which would impact high net worth individuals
- The relevant proposals would be effective as of (i) September 13, 2021, (ii) January 1, 2020, or (iii) the date of enactment
- It is too early to predict what aspects of the House proposal will be included in the final bill
- Congressional leaders have indicated that they wish to strike a deal on the contents of the Build Back Better plan by the end of October
- Senate Democrats (led by Senator Wyden) are separately working on their own set of tax proposals (including some impacting family partnerships), which have not yet been released

KEY HOUSE PROPOSAL PROVISIONS

H.R.5376

- Grantor Trust Rules
- Transfer Tax Exemption Amounts
- Valuation of Non-Business Assets

TERMINATION OF TEMPORARY INCREASE IN UNIFIED CREDIT

Sec. 138207

- Ends the temporary increase in the unified credit against estate and gift taxes, reverting credit to its 2010 level of $5 million per individual, indexed for inflation
- Amount estimated to be $6.02 million in 2022
- **This would accelerate the scheduled reduction to exemption amounts that would otherwise occur on January 1, 2026**

Proposed Effective Date: January 1, 2022

OTHER RATE CHANGES

Sec. 138201, 138202, 138206

- Income Tax:
  - Increase in top marginal rate to 39.6%

  Proposed Effective Date: January 1, 2022
- Capital Gains:
  - Increase in long-term rate from 20% to 25% for taxpayers in highest tax bracket

  Proposed Effective Date: Most Sales after September 13, 2021
- Surtax: 3% surtax on Modified Adjusted Gross Income (MAGI) over certain threshold
  - $5 million for single taxpayer or married couple filing together
  - $2.5 million for married individual filing separately
  - $100,000 for estates and trusts

  Proposed Effective Date: January 1, 2022

CERTAIN TAX RULES APPLICABLE TO GRANTOR TRUSTS

Sec. 138209

- Adds section 2901, which pulls into a grantor's gross estate that portion of a trust of which grantor is the deemed owner under grantor trust rules
  - Grantor is treated as making a gift (i) of assets distributed from such portion to a beneficiary and (ii) of assets attributable to such portion if the grantor ceases to be treated as the owner under the grantor trust rules
- Also adds a new section 1062, which treats a transfer between a grantor trust and its deemed owner as the equivalent of a sale between the trust and a third party
- *Taken together, these changes in a sense would graft the grantor trust rules onto the federal transfer tax system*

Proposed Effective Date: Amendments would apply

- *Universally to trusts created on or after the enactment date*
- *To portion of trusts attributable to a "contribution" made on or after the enactment date*
- *To all sales and other dispositions between a grantor and a grantor trust after the enactment date*

KEY UNANSWERED QUESTIONS

- Will gift tax-free status of income tax payments on behalf of Intentionally Defective Grantor Trusts (IDGTs) survive?
- Apart from future gifts, what is a “contribution”?
  - Non-gift contributions such as distributions from other trusts and/or decantings?
  - Non-gift lapses of withdrawal rights under “5 and 5” limit?
- What is a “disposition”?
  - Would appear to pick up all transactions that would be taxable exchanges between unrelated parties — including in-kind payments to satisfy a pecuniary amount/liability
  - What about future loan repayments in cash on old-and-cold transactions under current grantor trust rules?

GRANTOR TRUST PROPOSALS – PRACTICAL CONSIDERATIONS

- The proposals may impact the following estate planning vehicles or tools:
  - Grantor Retained Annuity Trusts (GRATs)
  - Irrevocable Life Insurance Trusts (ILITs)
  - Qualified Personal Residence Trusts (QPRTs)
  - Annual exclusion gifts to Crummey Trusts
  - Trust decantings
  - Grantor reacquisition or substitution power
  - Installment sales

GRANTOR TRUST PROPOSALS – WHAT TO DO AMIDST UNCERTAINTY

- New IDGT/Dynasty Trusts to use exemption amounts, current valuation rules
  - Grantor or non-grantor?
  - Flexibility
- GRATs
  - New GRATs? Consider term and payment strategy
  - “Lock-in” or swap/substitution transactions to move cash or high basis assets into large GRATs
- Spousal installment sales (relying on Internal Revenue Code (IRC) Section 1041?)
- Establish credit facilities (third party or “family banks”)
- Pre-fund ILITs

GRANTOR TRUST PROPOSALS – WHAT TO DO WITH EXISTING STRUCTURES

- Mid-stream IDGT installment sales
  - Determine if cash payoff plausible
  - Refinance?
  - Convert to cash loan with new lender (including spouse to invoke Section 1041)
- Transfer GRAT remainder interests?
- Accelerate taxable transactions (in advance of higher rates)?
- Turn off grantor trust status (or have a game plan to do so)?
- Note low cost "turn off" option for trusts funded after new rules in place but before reduction of lifetime exemption amounts (deemed gift on termination with offset for gift made on funding)

GRANTOR TRUST PROPOSALS – WHAT WOULD WE DO UNDER THE NEW RULES?

- Non-grantor trusts (no Spousal Lifetime Access Trusts (SLATs) and consider whether Delaware Incomplete-gift Non Grantors (DINGs), Wyoming Incomplete-gift Non Grantors (WINGs), Nevada Incomplete-gift Non Grantors (NINGs), etc. will receive additional scrutiny and/or land on IRS no-ruling list)
- (Non-grantor) Charitable lead annuity trusts (CLATs) not GRATs
- Charitable remainder trusts not Individual Retirement Accounts (IRAs)
- Chapter 14 entity freezes not installment sales to IDGTs (depending on partnership law)
- 2503(c) trusts not *Crummey* trusts
- Trust modifications not decantings
- Life insurance partnerships (plus annual exclusion gifts to owners) not ILITs

VALUATION RULES FOR CERTAIN TRANSFERS OF NONBUSINESS ASSETS

Sec. 138210

- Would amend section 2031 by clarifying that when a taxpayer transfers nonbusiness assets, those assets should not be afforded a valuation discount for transfer tax purposes
  - Nonbusiness assets: Passive assets held for the production of income and not used in active conduct of a trade or business
  - Look-through rule: When one entity owns a 10% interest in another entity, the owner entity is treated as directly holding a ratable share of the assets of the subsidiary entity

Proposed Effective Date: Enactment Date

THANK YOU!

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