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2021 ESTATE TAX PLANNING

POTENTIAL NEW REGULATIONS AND HOW THEY MAY IMPACT YOUR ESTATE PLANNING STRATEGIES

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Email us:
cpi@creativeplanning.com

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Lea Bailes

JD
Attorney

With new administration in the White House, upcoming changes have the potential to affect your 2021 estate planning. President Biden's proposal includes four main changes that may have estate tax planning implications:

1. Reducing the Lifetime Estate/Gift Tax Exemption

The lifetime estate/gift tax exemption refers to the total value of assets you may gift during your lifetime or leave following your death that is free from federal gift or estate tax.¹ Currently, the exemption is \$11.7 million per individual (\$23.4 per married couple filing jointly), but that amount is set to sunset on December 31, 2025, and return to the prior exemption of \$5 million per person. If adjusted for inflation, this amount would likely be between \$6 and \$7 million.

The president has informally proposed a decrease in the federal estate and gift tax exemption amount to either \$5 million per individual (\$10 million per married couple) or to the pre-Tax Cuts and Job Acts rate of \$3.5 million per individual (\$7 million per married couple).

2. Increasing the Estate Tax Rate

In addition to decreasing the lifetime exemption, the Biden administration could raise the estate tax rate to 43 percent. Some accounts indicate that a tiered tax rate scale may be implemented, with incremental tax rates as high as 70 percent for very large estates.²

3. Eliminating the Step-Up in Basis

As a corollary to the estate tax, assets generally receive a step-up in basis following the owner's death, regardless of whether or not taxes are due. This means that the tax basis of the asset is adjusted to fair market value at the time of the owner's death. This allows a beneficiary to sell an inherited asset without recognizing any gain on pre-death appreciation.

There is talk of repealing the step-up in basis, which means beneficiaries would not receive a new tax basis equal to the date-of-death value. As a result,

beneficiaries would pay capital gains taxes on all appreciation, both pre- and post-death, upon the sale of inherited assets.

Other countries impose a capital gains tax at death in lieu of an estate tax. At the time of death, any built-in gain is taxed. There is a small chance this approach could be adopted in the United States.

It's also possible to adopt a provision that allows beneficiaries to choose which type of tax structure applies to their inheritance. Such a benefit was in place in 2010 and was supposedly utilized by the Steinbrenner family to transfer the Yankees estate tax free following George's death.

4. Raising the Capital Gains Rates

It is possible that capital gains rates will be raised to an amount similar to ordinary tax rates. In which case, estate tax planning may become undesirable for low basis assets in some cases. Most transactions that remove an asset from an estate will, as a corollary, prevent a step-up in basis for the asset upon the owner's death. If the estate tax rate is significantly more than the capital gains rate, it makes sense to engage in transactions that avoid estate tax, even if there is a loss of the step-up. As the spread between the estate tax rate and the capital gains rate shrinks, it often makes less sense to avoid estate tax at the cost of losing the step-up.

Given these proposed changes, we are left with three main questions:

1. What is the likelihood of enacting these changes?

Even with Democratic control of the House and Senate, including the tax bill writing committees, there are certain Congressional hurdles that any proposed changes will need to overcome, and the balance of power still comes into play. Those opposed to President Biden's plan pushback and negotiations are likely. Even some proponents of President Biden's plan will push back on certain terms based on campaign commitments and the interests of their constituents. Changes may be coming, but they will likely not look exactly like any current proposal.

2. What will be the timing of any potential changes?

Assuming some version of President Biden's plan is enacted, timing and potential retroactivity are uncertain. Any changes enacted in 2021 will likely not be effective until January 1, 2022. If retroactive legislation is approved in 2021, it is possible for changes to

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be effective as of January 1, 2021.

For a retroactive law to be upheld, it must be rationally related to a legitimate legislative purpose. The bailouts received during the COVID-19 pandemic may be deemed sufficient to meet this requirement. However, there are legitimate reasons to argue that a retroactive decrease in the lifetime estate/gift tax exemption amount would unfairly prevent taxpayers from appropriately planning their affairs. Even some proponents of President Biden's plan will want to provide an opportunity for their major donors to modify their estate plans prior to the effective date of any changes.

The bottom line is that the timing of estate tax legislation remains uncertain, but it seems more likely that changes will be effective in the future rather than the past.

3. How should we plan for 2021 and beyond?

It's wise to continue utilizing your annual gift exclusion for gifts up to \$15,000 per donor, per recipient (\$30,000 per donor couple, per recipient). Over time, these gifts can accumulate to significant amounts. You can make payments directly to a provider to cover someone else's medical or educational expenses, and these payments are not counted toward your lifetime gift exclusion amount. Also, continue making charitable donations, as they do not decrease your lifetime exclusion.

Use Caution When Implementing Estate Tax Planning Strategies

Because there is some uncertainty as to whether any estate tax changes will be retroactively applied, it's wise to discuss gifting and estate planning strategies with your advisor in advance. Your advisor can inform you of any potential consequences of a retroactive change and help you implement changes that make sense based on your personal financial situation.

Key Takeaways

The bottom line? Don't panic and don't make any changes you may later regret. Impulsive estate planning moves made out of fear have the potential to impact your family for many years. While it's likely that upcoming changes will affect estate tax planning, we don't yet know exactly what changes will be made and when they will be effective.

We expect to have additional answers about tax legislation changes sometime this summer. As always, we will continue to keep you updated on how these changes may impact your financial and estate plans. Your advisor will guide you through a thorough review of your plans to determine the impact of any tax law changes based in your current situation, the types of assets available

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for transfer, family dynamics and financial outlook.

If you have questions about your estate plan or the potential consequences of new legislation on your financial future, we are glad to help. Creative Planning Legal is one of the largest estate planning law firms in the country with attorneys licensed to practice in a variety of states. Regardless of your specific situation, we are available to work with you to prepare a customized estate plan to meet your needs. Contact us today to begin your estate planning process.

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¹ There are certain gifts that do not reduce your exemption. Primarily, payments to educational or medical service providers on behalf of others and gifts to a person that do not exceed \$15,000 in a given calendar year. These gifting strategies are addressed later in this article.

² An estate tax rate of 70% seems incredibly high but it has been as high as 77% in the past.

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