

***FOXBORO CONSULTING GROUP, INC.***

– Business Valuation & Financial Advisors

15 Wall Street, PO Box 141, Foxboro, MA 02035-0141

Mobile: (508) 878-8390; Office: (774) 719-2236

E-mail: [adams.r@foxboro-consulting.com](mailto:adams.r@foxboro-consulting.com)

**“DO NOT BECOME THE APRIL FOOL” - ESTATE TAX, GIFT TAX, AND GENERATION-SKIPPING TRANSFER (“GST”) TAX REFORM IS NOW ONE-STEP CLOSER TO REALITY**

On March 25, 2021, Senator Bernie Sanders (I-VT) and Senator Sheldon Whitehouse (D-RI) introduced the “**FOR THE 99.5 PERCENT ACT**” which will dramatically, and historically change estate planning **by reducing** the federal estate and gift **tax exemptions**, increasing estate, gift, and GST tax rates, eliminating grantor retained annuity trusts (**GRATs**) and lack of discounts, and making assets in an intentionally defective irrevocable grantor trust includible in the estate, subject to certain important grandfathered provisions.

**THE TIME TO ACT IS NOW!**

The following is a summary of the changes.

1. Estate, Gift, and GST Exemptions:

The estate, gift and generation skipping tax exemption of **\$11,700,000** would be **reduced to \$3,500,000** in the case of estate taxes, and **\$1,000,000 in the case of gifts**.

The gift tax exemption would not be indexed for inflation, while the estate tax exemption would continue to be indexed for inflation.

The changes would be effective for decedents dying, and gifts made on, or after **December 31, 2021**.

Planning: This is a “**use-it-or-lose-it-now**” provision which means that your **\$11,700,000** exemption can be passed either by dying, or by making gifts.

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**Transfers must take place before the effective date of these changes. Now here is how the “Baby Boomer” generation – middle class, wealth grab shapes up!**

**2. Tax Rate Increases:**

Currently, the maximum gift, estate, and generation skipping tax rate is **40%**.

1. The Act changes the rate structure so that estates over \$3,500,000, but under **\$10,000,000** will be taxed at **45%**;
2. Over **\$10,000,000** up to **\$50,000,000** will be taxed at **50%**;
3. Over **\$50,000,000** but under **\$1,000,000,000** will be taxed at **55%**; and
4. Over **\$1,000,000,000** will be taxed at **65%**.

**Observation: The GST tax is the highest applicable federal estate tax, so a 65% tax will be imposed on generation skipping transfers.**

The Internal Revenue Service (IRS) and the “new world order folks” are clearly looking to **CONFISCATE** the wealth of the “**Baby Boomer**” generation, as well as the middle class!

Planning: For deaths occurring in 2020, where there is a surviving spouse and a QTIP trust, consider paying estate taxes on the first death, rather than the usual deferral of estate taxes until the death of the survivor.

**The rate structure is effective for deaths, gifts, generation-skipping transfers occurring after December 31, 2021.**

**3. Intentionally Defective Irrevocable Grantor Trusts (“IDIGTs”) – No Step-Up in Basis:**

The Act makes it clear in no uncertain terms, that assets in an intentionally defective irrevocable grantor trust (“**IDIGT**”) **will not receive a step up in basis** upon death, unless the property is includible in the gross estate of the transferor.

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**Comment:** Very few practitioners have supported this idea that assets in an IDIGT receive a step-up in basis notwithstanding not being includible in the gross estate.

This clarifies that the minority view will no longer apply.

**Planning:** Perhaps we now have close to statutory authority to step-up the basis of assets in an IDIGT on the death of the transferor even if the assets are not includible in the transferor's estate.

The amendments made by this section shall apply to transfers after the date of enactment.

#### **4. Valuation:**

The Act introduces new valuation rules designed to **minimize the use of discount planning**. First, non-business assets of an entity are to be valued as if the assets were transferred directly to the donee, with non-business assets being defined as: “any assets not used in the act or conduct of a trade or business”.

Second, **no discounts** shall be allowed by reason of the fact that the transferee does not:

(1) have control of such entity, or by reason of the lack of marketability the interest, if the transferor, the transferee, and “**members of the family**” of the transferor and transferee have control of such entity, or

(2) own the majority of the ownership interests (by value) in such entity.

A “**member of a family**” means with respect to any individual, an ancestor of such individual, the spouse of such individual, a lineal descendant of such individual, such individual's spouse, or a parent of such individual, or the spouse of any lineal descendant set forth above.

There is **an exception for real estate activities** where there is material participation, generally meaning more than 750 hours of active and continuous engagement in the enterprise. The exception however would not apply to triple net lease type holdings.

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The effective date of this provision shall apply to transfers after the date of enactment of the Act.

5. Grantor Retained Annuity Trusts (“GRATs”):

The Act requires that a GRAT have a minimum term of ten years, and a maximum term of the life expectancy of the annuitant plus ten years, and the remainder interest must not be less than an amount equal to the greater of 25% of the **fair-market value** of the trust assets or **\$500,000**.

Comment: Most GRATs are designed to zero out the gift and involve a series of two-year rolling GRATs. Both of these techniques will be eliminated which would effectively eliminate the use of GRATs in any meaningful way.

The GRAT transfer rules are effective for transfers made after the date of enactment.

6. IDIGTs – Includible in the Transferor’s Estate:

The Act would require that

(1) assets in a grantor trust be included in the grantor’s estate (unless the trust is grandfathered),

(2) distributions from a grantor trust during the life of the deemed owner would be considered a gift, and

(3) the assets of a grantor trust will be a gift if the grantor status is turned off during life. The Act would apply to trusts created after enactment but, this change would apply to transfers made to preexisting trusts after enactment.

**Observation:** This change will adversely affect the future funding of life insurance trusts since a life insurance trust typically involves funding on an annual basis. As additional contributions are made to the trust, these contributions would make some portion of the IDIGT is subject to the estate tax includability rule. It is unclear how this will work, but, if we assume that a trust owns a \$2,000,000 life insurance policy and 50% of the premiums were paid with gifts prior to the date of enactment and

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50% of the premiums were paid after the date of enactment, presumably 50% of the death benefit would be includible in the estate.

There is an exception to the grantor trust estate tax includability rules to the extent that the assets in the grantor trust were subject to gift taxes by either paying a gift tax or the use of the transferor's gift tax exclusion.

**Comment:** It is likely that a loan and/or a split-dollar type regime will be needed to fund life insurance trusts in the future, or the trust will require a large cash infusion to pay future premiums prior to the date of enactment.

## 7. GST Trusts (New):

Many states have repealed their state laws relative to the rule of perpetuities, so that assets in trust can remain in trust literally forever and avoid wealth transfer taxation forever.

The Act imposes a new 50-year term and provides that a “qualifying trust” must terminate not longer than 50 years after the date the trust is created. The Act even applies to existing trusts which will be deemed to have an inclusion ratio of one after 50 years of enactment. Any trust created after the date of enactment which has a term of more than 50 years will have an inclusion ratio of one.

A “qualifying **trust**” is defined as a trust that provides for a termination date not more than 50 years after the date of creation.

**Comment:** A trust with an inclusion ratio of one means that every distribution from the trust to a generation-skipping person (a grandchild or lower generation) will be subject to the highest applicable estate tax (40% now; 65% under the new Act).

The effective date of this section will be the date of enactment.

## 8. Annual Exclusion Gifts:

Currently, an individual can give away \$15,000 per donee with no limit on the amount of donees.

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The Act would limit annual gifts by a transferor to double the annual exclusion per the donor in the case of:

- a. a transfer in trust;
- b. a transfer of an interest in a passthrough entity;
- c. a transfer of an interest subject to prohibition on sale; and
- d. any other transfer of property that, without regard to withdrawal, put or other such rights in the donee, cannot immediately be liquidated by the donee.

The effective date of this section shall apply to any calendar year beginning after the date of enactment.

9. Other Crazy Proposals:

The good news is that these proposals do not include any changes with respect to the step up in basis rules other than to IDIGTs.

Nevertheless, Senator Chris Van Hollen (D-MD) introduced a bill on March 25, 2021, which would impose a capital gain tax on death.

Another bill introduced by Senator Ron Wyden (D-OR) would impose a tax on any increase in value of assets from year to year (so-called market to market).

**CONCLUSION**

While none of these proposals are law, there is great momentum for changes to the current estate, gift, and GST tax regime, and it is important to understand the proposed changes and to take appropriate action now.

Anyone with assets over **\$7,000,000** will be adversely affected, but there is time to plan.

Please contact us for more information about how to give away assets to preserve your **\$11,700,00** exemption, retain control, take advantage of discounts with non-voting shares and have access to the assets transferred through trust planning.

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**For Business Valuation & Real Estate Appraisal Services:**

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Valuation, Business & Financial Advisors

Attn: **Ronald Adams, CPA, CVA, ABV, CBA, BCA, CFF, CGMA, FVS**

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**For Trust & Estate Tax Planning Services:**

Cushing & Dolan, P.C.

Attorneys at Law

Totten Pond Road Office Park

375 Totten Pond Road, Suite 200

Waltham, MA 02451

Main: (617) 523-1555

Toll Free: (888) 759-5109

Fax: (617) 523-5653

[www.cushingdolan.com](http://www.cushingdolan.com)