



Summary of possible estate and gift changes under Biden Administration

REDUCTION OF LIFETIME ESTATE / GIFT TAX EXEMPTION AND INCREASE OF ESTATE/ GIFT TAX RATES (2009 LEVELS)

	Trump Administration	Biden Administration
Maximum Estate and Gift Tax Rate	40%	45%
Estate Tax Exemption	11,580,000	3,500,000
Gift Tax Exemption		1,000,000*
Annual Exclusion	15,000	13,000

**If used during lifetime, this amount is used against the \$3.5M estate tax exemption above leaving \$2.5M in exemption available at date of death*

ELIMINATION IN “STEP-UP” IN BASIS AT DATE OF DEATH

- Under current law, the income tax basis of assets owned by a decedent at the date of death generally receives a “step-up” to fair market value as of the date of death. This “step-up” enables heirs to sell inherited assets free of capital gains taxes if sold when received. Biden’s proposed plan is to eliminate this “step-up” in basis at death. Current proposals are unclear whether the heirs will receive carryover basis from the decedent or whether the estate will be taxed on the asset appreciation at death.

INCREASED CAPITAL GAINS TAX RATE & QUALIFIED DIVIDENDS FOR TAXPAYERS EARNING OVER \$1M TO 39.6% TAX RATE

- Currently under the TCJA, long-term capital gains and qualified dividends receive a preferential treatment with a tax rate maximum of 20% (not including Net Investment Income Tax of 3.8%). Biden plans to increase the long-term capital gains tax rate for high-net-worth individuals (individuals earning over \$1M) to 39.6% (not including Net Investment Income Tax of 3.8%).

SOME POPULAR PLANNING IDEAS:

- Utilizing low AFR rates:
 - o *Grantor Retained Annuity Trust (GRAT)*
 - o *Charitable Lead Annuity Trust (CLAT)*
 - o *Sale to Intentionally Defective Grantor Trust (IDGT)*
 - o *Intra family loans*
- Spousal Lifetime Access Trusts (SLATs)
 - o SLATS are a common tool to remove assets from your estate while maintaining control over those assets.
- Gifting Family Limited Partnership (FLP) interest
 - o Gifting of FLP interests allows removing more value from your estate through the use of discounts



Presidential Administration Changes What it means for your Estate and how you can protect your Assets

A new presidential administration comes with potential changes to the estate and gift tax. Joe Biden's proposed tax plan calls for dramatic changes to the estate and gift tax. It is uncertain if any of his proposed tax plan will become reality until the Senate is determined, but below is a summary of the potential changes in the estate and gift tax realm.

Biden's proposed plan seeks to reduce the lifetime estate exemption to \$3.5M and the lifetime gift exemption to \$1M, meaning that if an individual maximizes their lifetime gifting to \$1M under his administration, they will have \$2.5M remaining exemption at date of death. Biden also looks to increase the maximum estate and gift tax rate to 45% while decreasing the annual exemption to \$13,000 per individual. Biden's plan also calls for the elimination of "step-up" in basis at date of death, which would preserve any gain on appreciated assets so that either the estate or the heirs of the estate will be responsible for capital gains taxes on those assets' appreciation in value. The impact of this is further seen with the proposed increase in capital gains tax rates from 20% to 39.6% for individuals earning over \$1M.

It is advisable to strategize now and execute later – your course of action will depend on many factors such as your income, your cost of living, the composition of your assets, your gifting objectives and your comfort level. Make sure you can truly afford to make the gift without it having a negative impact on your lives.

REDUCTION OF LIFETIME ESTATE / GIFT TAX EXEMPTION AND INCREASE OF ESTATE/ GIFT TAX RATES (2009 LEVELS)

- Estate tax exemption = \$3,500,000
- Lifetime gift tax exemption = \$1,000,000*
- Annual gift tax exclusion = \$13,000
- Maximum estate tax rate = 45%
- Maximum gift tax rate = 45%

Under the Tax Cuts and Jobs Act (TCJA) as enacted under the Trump administration, the lifetime estate and gift tax exemption was set at an all-time high at \$11.58M in 2020 and \$11.7M in 2021. Biden's proposed plan could be retroactive to January 1st, 2021, reducing the \$11.7M exemption to \$3.5M. Further, Biden's proposed plan limits lifetime gifting to \$1M. *See following page for example*

** If used during lifetime, this amount is used against the \$3.5M estate tax exemption above leaving \$2.5M in exemption available at date of death*



Example 1: Person A passes away under the Trump administration and Person B passes away under the Biden administration. Both have gross estates of \$20M and both have not made any gifts during their lifetime. Person A pays \$4,057,000 less in estate taxes due to the higher exemption levels and lower estate tax rate.

Estate Tax Return	Person A	Person B	Tax Differential
	DOD: 2020	DOD: 2021	
Gross Estate at Date of Death	20,000,000	20,000,000	
Less: Gifting During Lifetime	-	-	
Taxable Estate at DOD	20,000,000	20,000,000	
Less: Remaining Estate / Gift Lifetime Exemption	(11,580,000)	(3,500,000)	
Net Taxable Estate	8,420,000	16,500,000	
Maximum Estate Tax Rate	40%	45%	
Estate Tax incurred at Date of Death	3,368,000	7,425,000	4,057,000

Example 2: Person A and Person B both have a gross estate of \$20M. Person A gifts maximum lifetime exemption of \$11,580,000 under the Trump administration by the end of 2020. Person B decides to gift the \$11,580,000 in 2021 under the Biden administration. Person A incurs no gift tax on their 2020 gifting. Person B incurs gift tax of \$4,761,000 on their 2021 gifting. See calculation below:

Gift Tax Return	Person A	Person B	Tax Differential
	2020 Gifting	2021 Gifting	
Gross Estate Value	20,000,000	20,000,000	
\$11.58M Gift	11,580,000	11,580,000	
Less: Gift Lifetime Exemption	(11,580,000)	(1,000,000)	
Net: Taxable Gift	-	10,580,000	
Maximum Gift Tax Rate	40%	45%	
Gift Tax	-	4,761,000	4,761,000



Example 2 (cont.): Person A and Person B both pass away in 2023 under the Biden administration under a proposed 45% estate tax rate. Including the gift tax incurred above, Person A, who chose to gift up to their maximum lifetime exemption in 2020, saved a total of \$3,636,000 between estate and gift taxes. See calculation below:

Estate Tax Return	Person A	Person B	Tax Differential
Estate and Gift Tax over Lifetime	DOD: 2023	DOD: 2023	
Gross Estate Value	20,000,000	20,000,000	
2020 / 2021 Gifting	(11,580,000)	(11,580,000)	
Gross Taxable Estate	8,420,000	8,420,000	
Remaining Lifetime Exemption		(2,500,000)*	
Net Taxable Estate	8,420,000	5,920,000	
Maximum Estate Tax Rate	45%	45%	
Estate Tax	3,789,000	2,664,000	
Gift Tax paid on prior gifting	-	4,761,000	
Total Estate and Gift Tax Paid	3,789,000	7,425,000	3,636,000

* Person B started with \$3.5M in exemption available. Since they used \$1M of that exemption during their lifetime through gifting in 2021 as seen in the example above, only \$2.5M of the exemption remained at death.

ELIMINATION IN “STEP-UP” IN BASIS AT DATE OF DEATH

- Under current law, the income tax basis of assets owned by a decedent at the date of death generally receives a “step-up” to fair market value as of the date of death. This “step-up” enables heirs to sell inherited assets free of capital gains taxes if sold when received. There can be a significant amount of appreciation in the value of assets during the time between the date(s) the decedent first acquired those assets and the decedent’s date of death. Biden’s proposed plan is to eliminate this “step-up” in basis at death. Current proposals are unclear whether the heirs will receive carryover basis from the decedent or whether the estate will be taxed on the asset appreciation at death.
- Under the current provisions described above, not only does the ½ community property held by the decedent receive a “step-up” in basis but the ½ community property held by the surviving spouse also receives a “step-up” in basis to fair market value.
 - o For example, one share of Apple stock with a basis of \$20 and a fair market value of \$120 owned by husband and wife will receive a “step-up” in basis to the \$120 upon the first spouse to die. If the surviving spouse were to sell that share of Apple stock immediately upon receiving that “step-up” in basis, they would incur essentially no capital gains tax on that sale.
 - o The impact of this is seen dramatically when individuals own assets that have appreciated significantly in value over time. A common example of this would be the



appreciation in value of a family limited partnership (FLP). Below is an example of how an FLP has appreciated significantly over time and how the elimination of the “step-up” in basis will affect heirs receiving this asset.

	Step-up in Basis	No Step-up in Basis
Value of FLP at Date of Death	20,000,000	20,000,000
Less: Original Basis of FLP	(5,000,000)	(5,000,000)
Asset Appreciation	15,000,000	15,000,000
Basis at Date of Death	20,000,000	5,000,000
Gain on Appreciation of Assets	-	15,000,000

INCREASED CAPITAL GAINS TAX RATE & QUALIFIED DIVIDENDS FOR TAXPAYERS EARNING OVER \$1M TO 39.6% TAX RATE

- Currently under the TCJA, long-term capital gains and qualified dividends receive preferential treatment with a tax rate maximum of 20% (not including Net Investment Income Tax of 3.8%). Biden plans to increase the long-term capital gains tax rate for high-net-worth individuals (individuals earning over \$1M) to 39.6% (not including Net Investment Income Tax of 3.8%).
- If you have assets that you are considering selling in the next year or two, you may want to consider selling sooner rather than later to lock in the lower long-term capital gains rate.
- Continuing with our example above, if an heir sells the assets upon receipt, we have calculated the tax differential under the two administrations showing that the tax saved by receiving a “step-up” in basis is \$5,940,000:

	Step-up in Basis	No Step-up in Basis	Tax Differential
Sales Proceeds	20,000,000	20,000,000	
Basis at Date of Death	20,000,000	5,000,000	
Gain on Sale	-	15,000,000	
Approximate Capital Gains Tax Rate	20%	39.60%	
Capital Gains Tax on Sale	-	5,940,000	5,940,000

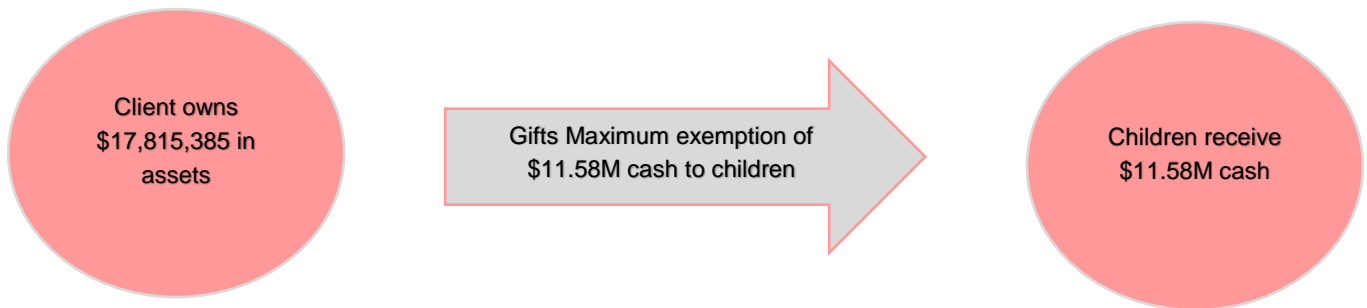
SOME POPULAR PLANNING IDEAS:

- Utilizing low AFR rates:
 - o *Grantor Retained Annuity Trust (GRAT)* – Annuity payments are made to the grantor of the trust during the trust term. At the end of the term, any appreciation in asset value in excess of the Sec. 7520 rate passes to the beneficiaries free of gift tax. This is a popular planning tool for highly appreciating assets.
 - A common planning tool is use of a zeroed out GRAT whereby the present value of the annuity stream is equal to the value of the property transferred into the trust without using any of the grantor's lifetime exemption.
 - If the grantor dies within the GRAT term (typically 2 years), the assets would revert back to the grantor's estate.
 - o *Charitable Lead Annuity Trust (CLAT)* – Functions in the same manner as a GRAT as described above except the annuity payments are made to a charity rather than the grantor. At the end of the term, any appreciation in excess of the Sec. 7520 rate passes to the beneficiaries free of gift tax.
 - It is a common planning tool for individuals who are philanthropic.
 - It removes the asset from the estate.
 - o *Sale to Intentionally Defective Grantor Trust (IDGT)* – Initially the gain on the sale to the trust is disregarded because it is a sale to a grantor trust. Any appreciation in the value of the assets that occurs within the trust grows income tax free.
 - Interest rate on the note for the sale must be equal to or greater than the current applicable AFR rate. Interest income on the payments do not have to be picked up as income by the grantor.
 - Benefits can be more significant when it is a sale on a discounted asset.
 - o *Intra family loans* – Beneficial in low AFR environments. If the assets purchased by the loan appreciate more than the interest rate on the loan, the spread accrues to the borrower on a gift tax free basis.
 - Typically, will have interest only payments and then a balloon payment at the end of the loan.
- Spousal Lifetime Access Trusts (SLATs) – SLATs are a great way to use all remaining exemption without losing access to the assets. One spouse would create an irrevocable trust for the benefit of the other spouse with separate property. You can create separate property by executing a partition agreement. The beneficiary-spouse is able to receive distributions from the SLAT. Later, the beneficiary-spouse can create a SLAT for the benefit of the grantor of the first trust.
 - o Careful considerations must be made to ensure the trust agreements are not identical. If they are identical, the IRS could potentially challenge that no gift was made.
 - Examples of ways to differentiate the trusts:
 - o Make the trustees different
 - o Fund with different assets
 - o Use different beneficiaries
 - o Create at different dates
 - o Use different distribution standards
 - o If properly executed, the assets placed into the trusts will be outside of both spouses' estates.
 - o Another key benefit of a SLAT is that it protects assets from creditors
 - o Example: Husband and wife are in their mid-forties, each owning 50% of a family business in the form of a limited partnership which they expect to grow in value over the coming years. They also each own 50% in an investment portfolio which is

approximately of the same value. Due to their age, they don't want to lose control over the assets, but they also want to get the assets out of their estate before they appreciate in value. Husband creates separate property through a partition agreement of 50% ownership interest in the limited partnership while wife creates separate property through a partition agreement of 50% ownership interest in the investment portfolio. Husband creates SLAT for the benefit of wife and names her trustee, funding the SLAT with his separate property ownership of the limited partnership. At a later date, wife creates a SLAT for the benefit of husband, naming bank as trustee, funding the SLAT with her separate property ownership of the investment portfolio.

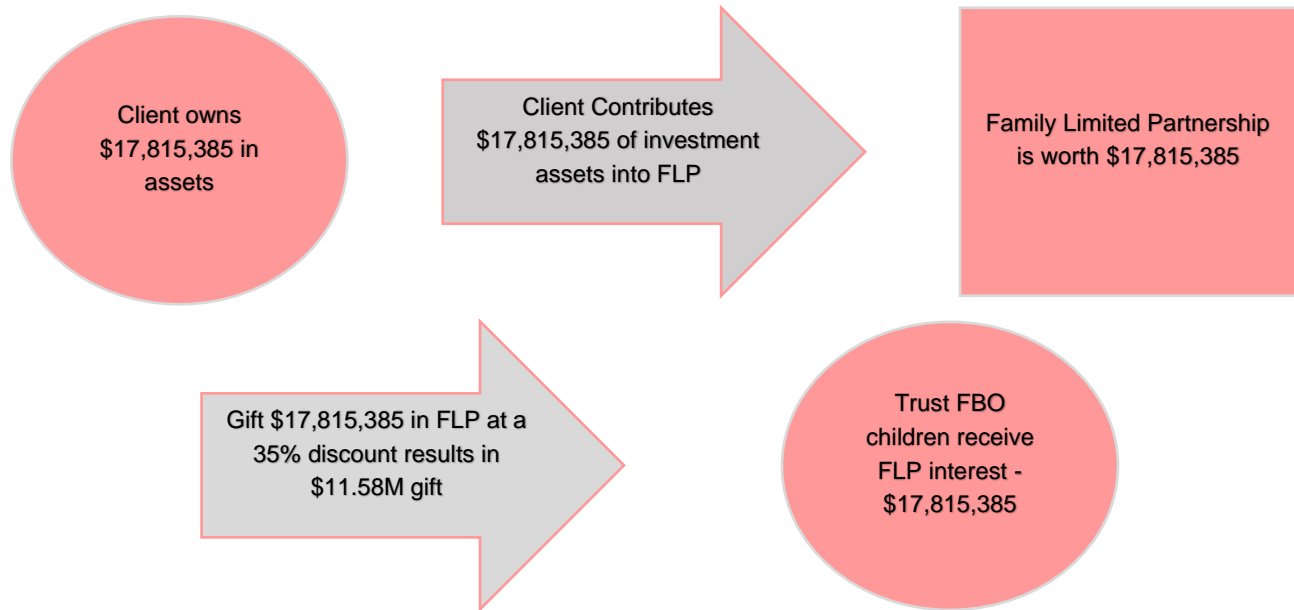
- Gift of Family Limited Partnership (FLP) interest – Gifting of FLP interest is used to maximize lack of control and lack of marketability discounts. Depending on the circumstances, we've seen discounts up to 35%. To illustrate the savings through use of discounts on gifting of partnership interests, see below.
 - Below are two examples. The first example shows a client who is not maximizing the use of his exemption by foregoing the use of discounts on the valuation. The second example illustrates how the client was able to maximize use of his exemption through the use of discounts on the value of the transferred assets.

Example A: Client gifts cash of their maximum lifetime exclusion amount directly to their children.



Example B illustrated on following page

Example B: Client creates FLP to hold assets. Client creates trust for the benefit of children and grandchildren. FLP is valued utilizing discounts for lack of control and lack of marketability. Client transfers FLP interest at a discounted value to the trust.



With FLP planning, client was able to transfer \$6,235,385 additional value to the children's trust without incurring any gift tax. Furthermore, the client was able to get over \$17M out of his estate. If the client were to choose to apply his generation skipping transfer tax exemption to the trust, he would be able to transfer the interest to not one but two generations tax free.

In conclusion, if estate planning has not been done or has not been done properly, the consequences can be significant as seen in the above examples. Now is the time to review your estate plan and determine whether any adjustments need to be made to protect your wealth and provide for future generations.