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WEALTH MANAGEMENT/TRUSTS & ESTATES

# Planning Now: Possible Federal Transfer Tax Repeal

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*Special to the Legal*

Déjà vu all over again! The inauguration of President Donald J. Trump and seating of the Republican-controlled 115th Congress brings with it the renewed potential for repeal of the federal estate, generation skipping transfer and gift taxes. Just as the federal estate tax ends the celebration of its 100th anniversary, there is a renewed interest in repealing the "death tax" in Washington.

Given the expansive list of policy-priorities laid out during the Trump campaign, and the sparsity of detail regarding many of his tax proposals, it is not yet certain when and in what final form such repeal of the federal transfer tax system may take. This uncertainty is similar to that which preceded the repeal, albeit temporary, of the estate and GST taxes in 2010. The current prospect of repeal differs insofar as the details of the tax regime—i.e., carryover basis and continuation of the gift tax—that would take hold following the 2010 repeal was already well known to practitioners before it took effect.

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## BACKGROUND

As it turned out, the 2010 repeal of the federal transfer tax system was ultimately temporary with optional tax regimes applying for such year. In early 2013, and following another period of angst and uncertainty over the particulars of the transfer tax system that would apply after the sunset of the existing 2012 transfer tax rules, the current exemption levels and tax rates were adopted on which we have been advising clients for the past four years. In 2017, this generally means that a tax rate of forty percent is applied to the value of a decedent's taxable assets in excess of the applicable exclusion amount. The applicable exclusion amount is now at $5.49 million per individual (or nearly $11 million for a married couple), and will be adjusted upward annually for inflation if the transfer tax system remains in existence. Consequently, the proportion of decedent's estates that actually pay any federal estate tax is less than one percent. A somewhat larger proportion of estates are still required to file an estate tax return for various reasons, including for the purpose of making the spousal portability election. The amount

of tax revenue collected from these taxable estates (approximately $17 billion in 2015), is relatively insignificant in light of the total tax revenue collected by the federal government.

*For those that repeal would impact, planners should probably just 'do no harm' unless and until the details of the repeal (and any replacement regime) are finalized.*

Notwithstanding the small budgetary impact of repeal on the federal fisc, many still believe that it serves the important public purpose of stemming the tide of dynastic wealth in the United States. It is an open question whether this is in fact the case. Opponents of the transfer tax system counter that it results in double taxation, and that the costs of compliance and planning for avoidance outweigh the impact of the revenue generated. Again, there are competing arguments and evidence on both sides of these issues. The transfer tax system nevertheless appears headed for repeal, or at least substantial modification during the current congressional session.

## REPEAL UNCERTAINTIES

Both the Trump and congressional Republican proposals for repeal are light on details. The Republican "blueprint" for repeal of the estate and GST taxes does not address gift taxes, basis step-up under Code Section 1014, or whether an alternative capital gains tax might be imposed on the appreciated value of assets held at death. President Trump's campaign proposals included gift tax repeal, but he also suggested that carryover basis would be instituted subject to a limited $10 million step up to protect small businesses and family farms. Alternately, capital gains tax could be imposed at death subject to that $10 million exemption in much the same manner as Canada replaced its estate tax decades ago.

Adding to this uncertainty is the manner in which transfer tax repeal might need to be enacted. Republicans do not hold a filibuster proof 60-seat majority in the Senate. Transfer tax repeal may therefore have to be enacted through the budget reconciliation process. That process could result in a sunset date (usually 10 years) for the repeal legislation in order to comply with budgetary rules intended to minimize federal deficits. This would be similar to the sunset provisions that applied to the 2010 repeal under the EGTRRA legislation. It is also possible that a change in the controlling party in future federal elections would see the federal transfer tax system reinstated even if it is repealed currently.

Finally, both the Republican Congress and President Trump have put forth proposals for significant reform of the personal and corporate income tax regimes. Both of their proposals suggest significant cuts in both corporate and personal income tax rates, simplification and reduction in the number of personal income tax rates, and increases in standard deductions. Changes in the taxation of income from pass through business entities, international tax reform and repeal of the alternative minimum tax regimes are also on the table. With so many proposed changes, it is impossible to determine which changes will actually be instituted after the inevitable horse trading inherent in the legislative process takes place. Trying to forecast what the final outcome of all these proposed changes will be is like trying to read tea leaves through a shattered crystal ball.

## WHAT SHOULD PLANNERS DO?

First and foremost, the vast majority of our clients are unlikely to be impacted by federal transfer tax repeal regardless of the form it finally takes. For those clients, the care of minor children and surviving spouses, asset protection, competent management of the decedent's estate or any trusts, and long-term care and special needs planning, if applicable, will be at the forefront of the planning process. Many states, including Pennsylvania,

New Jersey and New York, continue to impose a separate estate or inheritance tax, and traditional planning for those death taxes will continue regardless of the fate of the federal taxes. Of course, income tax planning for basis step up and the handling of assets that generate income in respect of a decedent (IRD) will also continue to inform the process just as it does today.

For some higher net worth clients whose estates would potentially be subject to estate and GST taxes at death, repeal of the transfer tax system is merely a windfall for their heirs. For these clients—many of whom are self-made millionaires and small business owners—the tax tail has never wagged the dog. Their planning focus has been primarily on ensuring that younger generations will be productive and self-sufficient members of society. This non-tax focus is unlikely to be affected by any subsequent repeal.

Finally, for those clients for whom federal transfer taxes are a major factor in their planning, a cautionary approach to planning in these uncertain times is likely called for. Many of the estate planning techniques employed for these individuals are specifically designed to avoid incurring any gift or other transfer tax liability. Examples of these techniques include annual exclusion gifting, the use of grantor retained annuity and charitable lead trusts, and sales to intentionally defective grantor trusts. If already in process, it is likely that such planning should move forward as it will still have tangible benefits in the event of deferred repeal or later reinstatement of the transfer tax system. On the other hand, any planning that would result in the payment of gift or GST taxes presently should likely be put on hold pending further legislative developments.

In developing new Will and trust instruments for these higher net worth individuals, it is also important to retain as much flexibility as possible in the event of alternative tax regimes. For example, different dispositions may be provided for in the event that there are no federal transfer taxes for purposes of funding various testamentary trusts. Trust protectors can also be utilized to grant different rights to beneficiaries, such as enlarged powers of appointment, that would presumably take effect only if there are no estate or GST taxes then in effect. In short, if a client cannot or does not want to defer the development of new testamentary documents, then planners must consider not only the transfer tax system as it stands today but also account for the possibility of changed circumstances in the future at a time when the client may not be able to make further changes to those planning documents.

Assuming that repeal does occur, and regardless of the final form it does take, it will be incumbent upon estate planning practitioners and other advisors to craft estate plans for their clients that remain flexible in light of the prospective changes and carry out the intentions of our clients for the disposition of their assets. For many clients, repeal will not represent any change at all. For those that repeal would impact, planners should probably just "do no harm" unless and until the details of the repeal (and any replacement regime) are finalized. •