Client Alert

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Estates, Trusts & Tax Planning

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Post-Election Estate & Tax Planning

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Following the results of the presidential election on November 8, the Estates, Trusts, and Tax Planning Group has been reviewing President-elect Trump's proposals for estate tax reform and giving careful consideration to how the proposals, if enacted, could impact our clients.

As noted below, there are several proposals that could have important consequences for estate planning. However, as it is not yet known whether the proposals will be implemented or even what the specific elements of the proposals will be, it is prudent to continue to take advantage of the estate and tax planning opportunities under existing laws.

The Trump Tax Plan

The President-elect's tax plan posted on donaldjtrump.org as of November 28, 2016 proposes the repeal of the estate tax, replacing it with a "capital gains tax" on estates over $10 million.

As written, the proposals raise a number of questions.

Since details of the proposed capital gains tax at death have not yet been provided, different interpretations of these general statements are possible.

The first is that death would be deemed a realization event triggering a federal capital gains tax on assets valued over $10 million. This is similar to the Canadian mark-to-market approach which is essentially the equivalent of death triggering a capital gains tax on appreciated assets. Assets above the $10 million threshold would be immediately subject to capital gains tax based on their value (most likely at the date of death or possibly the alternate valuation date). The tax having been imposed, those assets would acquire a stepped-up basis. It is possible that the first $10 million of assets would also receive a stepped-up basis, or possibly they would retain their original basis but avoid the tax on inherent gains.

The second possibility, generally credited to the Tax Foundation, is that the stepped-up basis would be available for the first $10 million in assets and carry-over basis would apply for all assets in excess of $10 million. The question remaining is how one would determine which assets would be included in the step-up and which would not be included.

There are also questions as to what exactly is meant by "over $10 million." Many commentators posit that under the proposals, every individual would be able to have an estate of $10 million before being subject to tax. Others have suggested that it is $10 million per married couple. This would actually produce an exemption that is less than the current exemption, which is presently $10.9 million per married couple.

It may be helpful to note that the possible capital gains tax at death in lieu of the estate tax should not discourage one from using their current gift tax exemption. Clients and planners always consider that a lifetime gift generally passes on the donor's income tax basis to the donee, eliminating the opportunity for a basis step-up in those assets at the donor's death. If a version of President-elect Trump's proposal is enacted, the step-up will be lost on those assets in excess of the applicable $10 million threshold whether given during life or at death. Thus, this potential disincentive to using one's available lifetime exemption for gift transfers for amounts in excess of the applicable threshold would be eliminated. This is especially relevant because there is no mention in President-elect Trump's proposals as to the future of the gift tax or generation-skipping transfer tax or the current $5.45 million exemptions for each.

Competing Tax Plans

The House Ways and Means Committee also has been working on a tax plan. The Committee's plan would totally eliminate the estate and generation-skipping transfer taxes. Under this plan, any asset held by an estate would receive the decedent's carryover basis. Like the Trump proposal, Committee's plan does not discuss any changes to the gift tax.

Other Year-end Planning Considerations

Proposed Section 2704 Regulations: On August 2, 2016, the Treasury Department released proposed regulations amending and expanding upon the current regulations to Internal Revenue Code Section 2704. The proposed regulations, if adopted, would limit or eliminate certain discounts currently recognized under the law that are used when valuing certain transfers of an interest in a family-owned or closely held business. The stated aim of the proposed regulations is to prevent specific perceived abuses of valuation discounts. Nevertheless, there is likely to remain the potential for some valuation discounts, such as for lack of control and lack of marketability, that reflect genuine economic realities.[1]

Unlimited Duration of the current GST Exemption: As currently written, the GST exemption may exempt property to which it is applied, including the appreciation on it, for an unlimited number of generations. This is an extremely valuable opportunity, especially when taken advantage of properly. It is unknown if this opportunity will continue to exist indefinitely, but given its value, it is prudent to apply this exemption without delay, preferably to assets held in a long term trust.

Sale to a long term trust for a note: Given the current low interest rates and the longevity of the current GST exemption, this transaction offers a valuable opportunity to leverage the use of gift and GST exemptions. As with other existing tax savings opportunities, this transaction is worth considering for many clients, while it is still possible to implement.

[1] For more information on the Proposed 2704 Regulations, please see the Pillsbury Client Alert from August 24, 2016

Conclusion

In uncertain times, it is important to continue planning for the laws as they are written. Fortunately, at this time it seems unlikely that the current estate tax exemption of $5.45 million (scheduled to rise to $5.49 million in 2017) will be lowered during the Trump presidency. We will continue to monitor the situation closely. In the meantime, we recommend contacting us at your earliest convenience if you are interested in discussing year-end planning opportunities.

*We would like to thank Senior Law Clerk Rebecca M. Gangi for her contribution to this alert.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the attorneys below.

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