THE FINAL COUNTDOWN TO 2022

November 8, 2021

As we transition into the homestretch of 2021, high-net-worth families face a level of legislative uncertainty not seen since 2012. At stake are many of the favorable conditions and planning tools that have become standard practice in the estate planning world for decades. Wealthy individuals should take into consideration potential policy changes and how these may affect their plans in the year ahead. The political uncertainty coupled with the magnitude of potential consequences for inaction has resulted in many families turning to their advisors for guidance.

What should families be concerned about on the estate planning front?

President Biden's proposals originally outlined over $3.5 trillion in spending, but the amount has since decreased to under $2B with calls from several factions to trim further to $1.5 trillion. While the number has not been finalized, the governmental spending would be funded by tax increases and the removal or reduction of numerous tools used by affluent families in their planning. If implemented, the changes could significantly reduce the amount of wealth passed down to future generations.

What do we know right now?

- The budget approval process is a complicated political procedure with many moving parts. Due to the complex nature of the process, it is highly likely that the final spending bills will differ from the initial versions. The efficient raising of tax revenue is only one factor among many in this process. Furthermore, the dollars raised in most of the estate tax measures will amount to a tiny fraction of the revenue required to "pay for" the spending measures in the Build Back Better (BBB) proposal.

- The current estate planning environment is incredibly favorable for high-net-worth families. Key components include:

- Generationally high estate tax exemption levels
- Low interest rates that increase the effectiveness of planning tactics
- Time proven attributes (and signaled grandfathering) of many estate planning tactics

- Aggressive revenue raising tactics like retroactive taxation and the taxation of unrealized gains at high levels of wealth have been publicly put forward and are part of the suite of options Congress is considering.

- If left untouched, most of the current gift and estate tax exemption levels are scheduled to sunset in 2025.

What is the current state of negotiations in Washington?
While negotiations are ongoing, the Biden administration has backed off the $3.5 trillion put forward by the House Ways and Means Committee. The latest Build Back Better (BBB) proposal contemplates a $1.5 trillion spending package. In stark contrast to the Ways and Means proposal, the BBB notably does not include:

- A significant reduction in the estate tax exemption amount from $11.7 million per person down to the indexed pre-TCJA rates level of $6 million per person
- Limitations on the use of grantor trusts
- The dismantling of valuation discounts for interests in passive, nonbusiness entities.

The latest proposal continues to avoid any substantive changes to the step-up in basis at death and the favorable tax treatment of carried interest.

However, beginning on January 1, 2022, a 5% tax will apply to individual taxpayers to the extent that they have income in excess of $10 million ($5 million if married but filing separately), and on trust and estate income exceeding $200,000 per trust or estate.

The bill also contemplates an expansion of the 3.8% net investment income tax (NIIT). Taken in conjunction with the reinstatement of the SALT deduction for some earners, this would drastically reduce the effectiveness of certain non-grantor trust tax planning.

Also of note, the bill limits the exclusion of gain from the sale of Section 1202 qualified small business stock (QSBS) to 50% of the gain realized for high earning taxpayers.

What should families do between now and the end of the year?

The first step is understanding the family's planning goals and what risks they hope to minimize. The following group of advisors should be consulted to properly formulate and implement an estate plan based on the family's objectives:

- Attorney for legal review and document drafting
- Accountant for tax advice
- Valuation firm(s) to confirm that asset values are properly supported in case of IRS or state scrutiny
- Fiduciaries such as trustees, investment advisors, distribution advisors, trust protectors, and insurance advisors to ensure the following:

- Structures such as LLCs are properly formed, registered with the State and have separate Tax IDs in place
- Planning vehicles are properly funded and unique assets like note payments and insurance premiums are paid and up to date
- Assets in the estate plan are located and properly titled
- As necessary, interested parties are notified so that their interests or impact on the estate plan are considered

With the legislative environment in such flux and few details coming from Congress, individuals should take advantage of established planning tools. This may include the use of gift exemption and grantor trust tools. Families should also consider building flexibility into their planning to deal with the changing tax landscape and future family changes. With the end of the year in view, the time to address these potential issues is now.

About the author:

FRAZER RICE, J.D., is Northeast Regional Director of Pendleton Square Trust Company, LLC, a leading independent trust company chartered in the State of Tennessee. Nothing in this article should be construed as providing legal or tax advice regarding your specific situation.