RUSHFORTH FIRM LTD. NEVADA TRUST ADVICE	**POSSIBLE 2021 TAX CHANGES** *Planning for a Major Paradigm Shift*

Summary

Significant changes to the federal estate, gift, and generation-skipping transfer tax laws might be triggered if the 2020 election results in the control of the House, Senate, and Presidency by Democrats.

A. STATUS QUO

A.1 Transfer Taxes. Lifetime gifts and death-time transfers are subject to the federal gift and estate tax of 40% if the total amounts transferred exceed the "applicable exclusion amount". In 2020, the applicable exclusion amount for the federal estate and gift tax is $11,580,000. For purposes of the federal generation-skipping transfer tax ("GST tax") – a tax that is triggered when transfers during life or at death involve grandchildren and lower generations – the "GST exemption" is the same amount. These exclusion and exempt amounts are currently indexed for cost-of-living adjustments and increase each year.

A.2 Capital Gain Tax. The capital gain tax is imposed on the gain between the sales price of a capital asset (e.g., securities, real estate, and business interests) and the original cost of that asset ("income-tax basis"). Under current law, when a person dies, the income-tax basis for all capital assets is adjusted to reflect the current market value of those assets as of the date of death. This is often referred to as the "stepped-up basis" because capital assets generally appreciate; however, the basis adjustment also applies to assets that have gone down in value. Under current law, those inheriting the capital assets would report a capital gain only for post-death appreciation.

A.3 Valuation Discounts. The tax on gifts and estates is calculated based on fair-market value, which is calculated based on what a "willing buyer and a willing seller" who are unrelated would agree upon.

(a) Using that rule, when a transfer of a fractional interest in real estate or a minority interest in a business, the valuation takes into consideration "discounts" for "lack of marketability" and "lack of control" because an unrelated buyer would take those factors into account. So, when gifts are made to children or other beneficiaries– directly or in trust – it is common to have an appraisal determine those discounts so that a lower gift-tax or estate-tax value can be shown on the appropriate tax return.

(b) For example, if a couple has a business that has an appraised value of $1,000,000 and they give away non-voting interests to their children equal to 10% of the business, the pro rata value would be $100,000. A discount for lack of voting control and a discount for lack of marketability might apply. Discounts can range from 20% to more than 40%, depending on the nature of the business, the types of assets involved, the terms of the governing documents (e.g. bylaws, operating agreement, or buy-sell agreement), and applicable state law. If an appraiser determines that the valuation discount is 30%, $70,000 would be reported as the value of the gift of the couple's gift tax returns.[1]

A.4 GRATS. Under current law, grantor retained annuity trusts (GRATs) are permitted to have a near-zero value, allowing highly appreciating assets to be given for a lower gift-tax value. GRATs are permitted to have an annuity term as short as two years, which allows for some creative planning to be done to reduce gift and estate taxes.[2]

B. DEMOCRAT "TRIFECTA"

B.1 Transfer Taxes. If the 2020 general election gives the Democrats control of the House of Representatives, the Senate, and the Presidency, federal tax laws will most undoubtedly change, perhaps resulting in an applicable exclusion amount and GST exemption of $3,500,000 and a graduated tax rate that could be up to 77%. One proposal has suggested limiting the exclusion for lifetime gifts to $1,000,000. The proposals also include the elimination of any cost-of-living adjustment, which means that their impact will be reduced over the years as the cost of living increases.

B.1 Capital Gain Tax. Democrats have proposed to either:

(a) Eliminate the income-tax basis adjustment at death; or

(b) Require the estate of a decedent to pay the capital gain tax on capital assets as if the capital assets had been sold for their date-of-death value. The calculation of the gain would be done using the decedent's income-tax basis without adjustment.

B.2 Valuation Discounts. Some tax proposals would eliminate any valuation discounts.

B.3 GRATs. It has been proposed that GRATs have a minimum annuity term of ten years and have a minimum gift-tax value of at least 25% of the trust assets or $500,000, whichever is greater.

C. PLANNING OPPORTUNITIES

C.1 2020 Gifts. There are good reasons to make significant gifts in 2020.

(a) Making gifts of business interests, including investment-holding limited-liability companies, can take advantage of valuation discounts for gifts made in 2020.

(b) Gifts made to GRATs in 2020 also make sense, particularly because of the current low-interest environment.

(c) Those who can give $11,580,000 now without affecting their lifestyle should consider doing so. A 2020 gift of $11,580,000 will eliminate the tax on the amount that would be exposed to tax under any new law. The gift of $11,580,000 now will eliminate the tax on the difference between $11,580,000 and the reduced exclusion

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[1] See https://rushforthfirm.info/pdf/ep-bus-entity.pdf for more information about gift-giving with business interests.

[2] See https://rushforthfirm.info/pdf/gratmemo.pdf for more information about GRATs.

amount. So, if the new exclusion amount is $3,500,000, the tax on 8,080,000 is being saved, which would be $3,323,000 if the tax rate is 40%.

C.2 Estate-Plan Updates. This is a good time to review your estate plan to see if it will accomplish your objectives if the tax law changes are made.

(a) If you have a will or living trust that makes allocations or creates subtrusts based on the applicable exclusion amount, you may want to evaluate how a change in that exclusion will impact your planning.

(i) For example, many trusts established for married couples create a marital trust and an exclusion trust (or decedent's trust) based on a formula that uses the applicable exclusion amount.

(ii) To eliminate the estate tax at death, some individuals have provided for the applicable exclusion amount to go to their children or other beneficiaries, with the balance going to qualified charities. If the exclusion amount is reduced, the amount going to the non-charitable beneficiaries will be reduced, and it may be desirable to adjust the formula.

(iii) For a married couple that has an estate plan that leaves everything to the surviving spouse should consider having the trust divide into a marital trust and an exclusion trust if their combined net worth is in excess of $3,500,000. That will defer all taxes to the survivor's death, and it can allow the exclusion amount to grow during the survivor's lifetime.

(b) Some trusts have been designed so that the portion that is exempt from the GST tax is held in a discretionary "dynasty trust" that is both a "generation-skipping trust" (i.e., exempt from the estate tax) and a spendthrift trust (i.e., exempt from the claims of creditors), with the non-exempt portion being distributed outright. If the GST exemption is reduced, that will potentially mean that more of the trust will be distributed outright and not protected by creditors. This, too, should be re-evaluated.

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