House Tax Proposal Would Restrict Grantor Trust Planning: What You Need To Know Now

By The Trusts & Estates Group

On September 13, the House Ways & Means Committee proposed new tax provisions as part of the Build Back Better Act. The proposal includes many substantial tax changes that would affect personal income tax and business tax planning–including raising the top personal income tax rate to 39.6 percent, increasing the maximum tax rate on long-term capital gains to 25 percent, and adding a 3 percent surtax on noncorporate taxpayers with annual income exceeding $5,000,000.

Two specific provisions of the proposal would have a dramatic impact on estate tax planning, including gifting to irrevocable trusts:

- The proposed bill cuts the per-spouse gift/estate tax exemption (currently $11,700,000 and scheduled to rise next year to $12,060,000) in half, effective January 1, 2022.
- The proposal radically changes the treatment of grantor trusts (including life insurance trusts, spousal lifetime access trusts, grantor retained annuity trusts, and grantor charitable lead annuity trusts). Grantor trusts funded with initial or additional gifts after the bill's enactment date (which may occur before January 1, 2022) would become subject to estate tax in whole or in part.

The proposed changes particularly hurt individuals who have created irrevocable life insurance trusts and who continue to fund premium payments on trust-owned policies through annual gifts (including by direct payment of policy premiums). If the bill becomes law, such gifts will cause an increasing portion of the policy proceeds (and any other trust assets) to be taxable at the grantor's death–exactly the result that insurance trusts are created to avoid.

If you believe that you will not be subject to estate taxes even if some portion of your trust assets (including life insurance) is included in your taxable estate–bearing in mind that the proposed legislation cuts the federal exemption to roughly $6 million per spouse starting in 2022 (and that other changes may occur before your demise)–you don't have to worry about this issue.

However, if you want to make sure that your trust's assets avoid estate taxes, you won't want to make any gifts to that trust on or after the date this provision is enacted into law. Instead, if you have the wherewithal and the inclination (and still have sufficient lifetime gift exemption under current law) you can make a large, tax-free gift to your trust before the enactment date to fund future premiums. Otherwise, we expect to start looking into some combination of lending and partnership strategies to help clients fund future premiums that previously had been funded through annual gifting.

If you are not in the habit of making annual trust gifts but are considering creating a new grantor trust or adding assets to an existing grantor trust, you should make sure to complete that planning before this proposal becomes law.

To be clear: This is only *proposed* legislation. It is far from certain that the bill will pass in its current form. However, we want to make sure that our clients and friends are aware of the issue and the available options in advance of the proposal's potential passage.

Contact

Please contact the listed attorney for further information on the matters discussed herein.

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