

House Ways and Means Committee Throws Its Hat Into the Estate Tax Reform Ring

Recently, the House Ways and Means Committee released its proposal to fund the \$3.5 trillion "Build Back Better" reconciliation spending package. As expected, the proposal takes aim at several estate planning opportunities and vehicles that wealthy individuals have traditionally utilized to reduce gift and estate tax. The most significant estate planning provisions of this proposal are summarized below, however, it is important to note that this proposal is far from final. In fact, the proposal is the third piece of legislation introduced this year that would significantly impact high-net-worth estate planning (we wrote about the STEP Act and the For the 99.5% Act, the previous two legislative proposals, [here](#)). In addition, this newest proposal follows the release of and differs significantly from President Biden's "Greenbook," which details the administration's top priorities with respect to tax reform and revenue generation. A brief summary of the relevant provisions of the Greenbook is included below.

While some of the proposals have overlapping elements, they vary significantly in their approach to estate tax reform. For example, the STEP Act and the Greenbook proposals focus heavily on revenue generation via income tax, such as taking aim at capital gains tax rates and taxing appreciated assets at death. Conversely, the For the 99.5% Act and the newly released proposal from the House Ways and Means Committee takes direct aim at the estate tax regime, proposing significant reductions in the gift and estate tax exemptions. Notably, three of the four proposals include significant changes to grantor trust planning (see below) and so it seems likely that major changes to these very popular estate planning vehicles may be imminent.

House Ways and Means Committee Proposal to Fund the Build Back Better Act

1. Gift and Estate Tax Exemption. The proposal would reduce the gift and estate tax exemption from \$10 million per person (as indexed for inflation) to \$5 million per person (as indexed for inflation). Under current law, this reduction is already scheduled to occur on January 1, 2026, and the proposal would accelerate that change to the beginning of next year. It is anticipated that the inflation indexed amount would be approximately \$5.85 million per person as of January 1, 2022. The exemption reduction

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will not be retroactive, meaning a taxpayer can take advantage of the increased exemption amount before the end of this year without risk that the IRS will impose gift or estate tax on such transfers.

2. Grantor Trusts. The use of "grantor" trusts will also be severely limited under the House Ways and Means Committee's proposal. Under current law, a taxpayer (the grantor) can create an irrevocable trust (such as a "dynasty trust") that is removed from his or her taxable estate for estate tax purposes but is taxed to the grantor for income tax purposes. This allows the grantor to supercharge estate tax planning by paying the income tax on behalf of the irrevocable trust and by selling appreciated assets to the trust in a tax-free exchange. If enacted, the proposal will pull the assets owned by the irrevocable trust into the grantor's taxable estate and will eliminate the grantor's ability to sell appreciated assets without paying capital gains tax. In addition, it will treat any distributions from a grantor trust to the beneficiaries as gifts from the grantor. Surprisingly, existing grantor trusts would be allowed to retain their tax benefits and the law would only apply to "future transfers" occurring after the enactment of the law.
3. Valuation Discounts. Under the proposal, taxpayers will no longer be able to take valuation discounts for gift and estate tax purposes on entities holding passive assets not used in an active trade or business. A few examples of passive assets include cash or cash equivalents, stock in corporations and real estate. For example, a "holding company" (such as an LLC that holds real estate or a family partnership that holds marketable securities) would no longer qualify for valuation discounts such as minority control or lack of marketability. These discounts reduce the value of assets, sometimes by as much as 50 percent, which in turn allows donors to leverage more of their gift and estate tax exemptions (or reduce the tax payable). This change will only be effective as to transfers occurring after the enactment of the law.

Greenbook Proposal

1. Capital Gain Events. President Biden proposes to treat gifts or bequests of appreciated property as taxable events, meaning donors will owe capital gains tax at the time of transfer. Transfers to spouses or charities are not included. In addition, there is a \$1 million per donor exclusion, which is indexed for inflation.

2. End of Basis Step-Up. Since bequests at death will be treated as recognition events, the basis step-up is effectively ended. Under current law, if an individual holds appreciated property at death, the beneficiaries receive a basis step-up to the fair market value at that time. Under the Greenbook, death is treated as a recognition event, meaning capital gains tax is calculated using the decedent's original basis.
3. Capital Gain Rates. For individuals with income in excess of \$1 million, capital gains will be taxed at ordinary income rates. The highest rate would be 43.4 percent (39.6 percent top income tax rate plus 3.8 percent net investment tax rate).

As mentioned above, it remains to be seen which of these proposals will survive and whether the legislation that is ultimately enacted closely mirrors its proposed form. Given this uncertainty, it is essential to proactively take advantage of the favorable laws currently in effect. In particular, high-net-worth individuals who can afford to lock in their current gift and estate tax exemptions by making significant lifetime transfers should consider doing so immediately. Pairing this planning with the use of a grantor trust makes sense now more than ever.

If you would like more information regarding estate planning opportunities and strategies, please contact [Matthew Ackmann](#), [Kelsey Berns](#), your Reinhart attorney or a member of Reinhart's [Trusts and Estates Practice](#).

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