

## Possible Changes to Estate and Gift Tax Law

September 22, 2021

Last week the House Ways and Means Committee released a draft of proposed tax law changes to include in a reconciliation bill. While it is uncertain whether any of these proposals will be adopted – and if so in what form – several of the proposals would dramatically change common estate planning techniques and may require immediate attention.

**Grantor Trust Changes.** The most far-reaching proposal is to change the tax treatment of “grantor trusts.” A grantor trust is a trust for which the grantor remains liable for tax on all of the trust’s income, even if the grantor has no ownership or control over the trust assets so that the trust assets are not included in the grantor’s estate. Common examples of a grantor trust used in estate planning are a Grantor Retained Annuity Trust (GRAT), a Qualified Personal Residence Trust (QPRT), a Spousal Lifetime Access Trust (SLAT), many life insurance trusts (ILITs), intentionally defective grantor trusts used for gifting and sales of assets to children or other beneficiaries (IDGTs) and many other trusts intentionally structured for the grantor to make a completed gift while remaining liable for the income tax on the trust’s earnings.

Under the proposal, any assets owned in a grantor trust at the time of the grantor’s death would be included in the grantor’s taxable estate and subject to estate tax. Any distribution from a grantor trust during the grantor’s lifetime to anyone other than the grantor would be a taxable gift by the grantor. This makes the use of grantor trusts impractical for gift planning in the future. In addition, a future sale or exchange of assets with a grantor trust would be treated as a taxable transaction (as if it were with a third party), unlike the current law under which transactions between a grantor and their grantor trust are ignored for income tax purposes.

*Effective Date.* The new rules, if adopted as drafted, would be effective as of the date the legislation is enacted – which could be well before the end of this year and possibly any time after September 27, 2021. Existing grantor trusts would not be affected as long as no additional contribution is made to the trust. But any existing grantor trust to which a contribution is made after the effective date would be proportionately subject to the new rules.

*Actions Now.* If you have an existing grantor trust and do not intend to make any further gifts to it, you do not need to act. However, to protect the status of that trust, **you should not make any further contributions to the grantor trust after the Effective Date**, if the proposed legislation is enacted.

If you have an existing grantor trust and may want to make further gifts to it, you should consider making the gift now, before any new legislation is enacted.

If you have an existing grantor trust and may want to make further gifts to it, you might consider whether it is possible to change the trust from a grantor to a non-grantor trust so that you can make future gifts without incurring the negative consequences of the proposed law. That change does not need to be made before the Effective Date, but it does need to be done before any assets are added to the existing grantor trust after the Effective Date. If you are considering creating a new grantor trust, you should create and fund the trust now, before any new legislation is enacted.

If you are considering a sale or exchange of assets with your grantor trust, you should complete the transaction now, before any new legislation is enacted.

**Gift/Estate Tax Exemption.** The gift/estate tax exemption currently is \$10 million, adjusted for inflation (\$11.7 million in 2021). It is scheduled to revert to \$5 million, plus inflation, in 2026. The proposed law instead would make this change effective January 1, 2022, resulting in an exemption of about \$6 million in 2022.

*Effective Date.* January 1, 2022.

*Actions Now.* If you intend to make large gifts to use the temporarily higher exemption, you should do that before the end of this year.

**Valuation Discounts.** Most valuation discounts for interests in entities that are not regularly traded would be denied, except to the extent the entity has active business assets rather than passive assets.

*Effective Date.* Date of enactment of the legislation.

*Actions Now.* Any pending sales or gifts of interests in entities using discounted valuations should be completed now, before any new legislation is enacted.

We do not know if, or when, or in what form, the proposals outlined above may be enacted. However, because several of the proposals are effective as of the date of enactment, you may wish to accelerate gift planning or seek guidance for planning assistance in these unsettled circumstances.

## Questions? Contact:

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