

ADVISOR INSIGHTS: Proposed Legislation Dramatically Threatens Estate Planning Strategies

On Monday, September 13, 2021, the U.S. House of Representatives Ways and Means Committee released draft legislation to fund President Biden's broader "Build Back Better" initiative. The draft legislation contains a number of provisions that, collectively, would create a seismic change in the estate planning world.

What is a Grantor Trust?

For decades, Grantor Trusts have been a vital part of many estate plans. At a high level, the defining feature of a Grantor Trust is that, for income tax purposes, the trust and the Grantor (the creator of a trust) are viewed as one and the same. Essentially, the income of a Grantor Trust, along with any deductions or credits, flows up to the Grantor and is reported on the Grantor's personal income tax return.

This treatment can provide a number of potential benefits. One benefit is that, compared to the income tax brackets for individuals (e.g., single filers, joint filers, etc.), the income tax brackets for trusts are substantially compressed. For instance, in 2021, the top ordinary income tax bracket of 37% kicks in for trusts once they have more than \$13,050 of taxable income. By contrast, the 37% top rate doesn't apply to single filers until taxable income exceeds \$523,600, and to joint filers until taxable income exceeds \$628,300.

Another potential benefit of Grantor Trusts is that since the Grantor Trust and the Grantor are considered one and the same for income tax purposes, many transactions between the two

that would otherwise be subject to income tax do not create a taxable event. For example, under current law, a “sale” of an appreciated asset from a Grantor to a Grantor Trust does not generate any capital gains, since, for income tax purposes, there has been no change in ownership.

Finally, a Grantor Trust can be drafted such that even though the income of the trust is still taxable to the Grantor, the assets within the trust are removed from the Grantor’s taxable estate for estate tax purposes. All fully revocable trusts are, by their very nature, Grantor Trusts. But under the current tax regime, certain Irrevocable Trusts can also be structured as Grantor Trusts.

More specifically, through creative planning and careful drafting, estate planning attorneys can create trusts that can, for example, protect assets from the cost of long-term care or reduce estate taxes, but while still achieving favorable income tax treatment (because the income generated by the trust is still taxable to the Grantor).

Proposed changes to the Grantor Trust rules

The proposed legislation includes a number of provisions that take direct aim at a variety of commonly employed Grantor Trust planning strategies:

- Grantor Trust assets would be included in the value of the Grantor’s gross estate
- Distributions would be treated as gifts when made during the Grantor’s lifetime from a Grantor Trust to individuals *other* than the Grantor and/or the Grantor’s spouse
- The Grantor and the Grantor Trust would be treated as separate taxpayers with respect to “any transfer of property” between them

Collectively, these changes could greatly affect the Grantor Trust planning strategies that estate planning attorneys have used for years.

It seems that the draft legislation would set the effective date of these changes as of the *date of enactment*, which could be as early as a few days, weeks, or even months from now. Which means that any trust created on or after the date of enactment would be subject to the new, much more restrictive Grantor Trust rules. Additionally, any portion of an existing trust (in existence before the date of enactment) that receives contributions made on or after the effective date would also be subject to the new rules.

So, simply put, there may be an *extremely limited window of time* in which individuals can create, execute, and fund various kinds of Grantor Trusts that could help protect their assets from the cost of long-term care or reduce a future estate tax liability under the current rules.

The proposed legislation has the potential to dramatically reshape the estate tax planning environment.

Who will this article benefit? If you know a client or prospect who is considering placing their assets into an Irrevocable Trust to reduce their estate taxes or to protect their assets from the cost of long-term care, the advice is clear to *act now*. There may be opportunities for your clients to plan now before the potential change comes into effect.

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This article was inspired by the content in "Grantor Trust Estate Planning Strategies To Implement Before The Biden Tax Proposals Take Effect".