



Last-Minute Estate Tax Changes

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Advisors throughout the financial services industry, including financial planners, estate attorneys and tax consulting CPAs, are all nervously watching the tax proposals that are working their way through Congress.

Why nervous? For one thing, at this late hour, it is very difficult to make plans or last-minute changes to mitigate any tax changes—like moving deductions and income from one tax year to another, and especially making estate planning decisions that would help people save their heirs from significant tax obligations.

The estate planning implications are especially severe for a certain group of higher-net-worth individuals. Under the proposal, the amount exempted from federal estate taxes would drop from \$11.7 million per individual to somewhere around \$6 million. Anything over that would be taxed at a 40% rate.

One popular remedy for reducing estate taxes is to create a grantor trust, where a person or couple move some part of their net worth into a trust vehicle, taking it out of their estate, and still remain the owner of the assets in the trust for income tax purposes. The grantor(s) pay taxes on the income generated in the trust, which gets even more money out of their estate and raises the value of the trust to the heirs—who are not having to pay those income tax obligations. In addition, under current rules, if an asset appreciates inside the trust, the grantor who put that asset into the trust can buy it back out without tax consequences and hold it until death, creating a step-up in basis that would avoid capital gains taxes.

Under the proposed legislation, that simple estate-planning technique would be off the table—possibly as soon as January 1 of next year. At that point, assuming the tax proposal passes Congress in the next month and a half, the full value of the assets in a grantor trust would be included in the grantor's estate. And any sale transactions between the grantor and the trust would be subject to income taxation as if the transaction had been executed with a third party. Moreover, any distribution from a grantor trust to any beneficiary other than the grantor or the grantor's spouse would be treated as a taxable gift to the recipient.

The same limitations would be imposed on a spousal lifetime access trust, another common vehicle for people to move money out of their estate. The SLAT, as professionals refer to it, would collect assets from one spouse for the income benefit of the other spouse—but once again, if it is established after the date of enactment of the proposed law, all of those assets would be included in the grantor’s estate at death, and be subject to estate taxes.

Grantor Retained Annuity trusts, where the grantor puts money into a trust and receives annuity payments back, and qualified personal residence trusts, where the family would put the family home into trust on behalf of the heirs, would be similarly affected. Under the proposed law, these assets would be included in the grantor’s estate at death.

There is still time for people with more than \$6 million in wealth to set up and fund a grantor trust or SLAT, a grantor-retained annuity trust or qualified personal residence trust. But that time could be running out.

Sources:

<https://www.dwt.com/insights/2021/10/federal-estate-tax-changes-2022>

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Jeffrey Broadhurst
MBA, CFA, CFP
Broadhurst Financial Advisors, Inc.



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Our emailing address:
1911 W Point Pike, POB 301
PA 19486, United States

Contact us:
Phone: (215) 325-1595
Email: jeff@broadhurstfinancial.com