Potential Estate Planning Implications of 2020 Election Results

10.19.20

With the election less than a month away, there has been significant discussion regarding potential tax law changes under a new administration. While no one can predict the future, we can certainly discuss what could happen if Joe Biden wins the presidency and the Democrats win four additional seats in the Senate to gain a majority in both the Senate and the House. We can also discuss strategies that you may consider implementing before the end of the year, in case these tax law changes materialize.

Potential Tax Law Changes

Below is a non-exhaustive list of potential tax law changes in the event of a Democratic sweep:

- Lower Transfer Tax Exemptions – Under current law, the estate, gift, and generation-skipping transfer (GST) tax exemptions are each $11.58 million per person, or $23.16 million per married couple. These large transfer tax exemptions are indexed for inflation through 2025. In 2026, however, the exemptions are scheduled to drop to $5 million per person, or $10 million per married couple, again indexed for inflation. Most pundits believe that Biden would attempt to reduce the transfer tax exemptions to $3.5 million per person, or perhaps even lower, before their scheduled sunset in 2026.
- Higher Transfer Tax Rates – The current tax rate for transfers in excess of a taxpayer's estate, gift, or GST exemption is 40%. In addition to lowering the exemption amount, the transfer tax rate could also increase, perhaps to 45% or higher.
- No Income Tax Basis Adjustment at Death – Currently, most assets that pass through a deceased taxpayer's estate receive an income tax basis adjustment, either up or down, to fair market value at the taxpayer's date of death. This can be extremely beneficial for highly appreciated assets, such as low-basis securities or a closely held business, as it wipes out all pre-death capital gain on the asset. Biden has proposed eliminating this basis "step-up" at death, which could result in substantially higher capital gains taxes on inherited assets.
- Taxation of Capital Gains at Ordinary Income Tax Rates – Long-term capital gains are currently taxed at a top rate of 20%. Biden has proposed taxing capital gains at ordinary income tax rates, meaning that the new top rate could be 39.6%, or potentially higher.
- Elimination of Other Popular Estate Planning Tools – The Democrats may also dust off old transfer tax proposals last seen during the Obama administration. For example, they could seek to eliminate short-term grantor retained annuity trusts (GRATs), restrict the use of valuation discounts, impose a term limit on GST trusts, and/or limit the use of grantor trusts in estate planning transactions.

If the transfer tax laws do change, it is fair to ask when these changes will take effect. It is also fair to ask whether such changes could be made retroactive from the date of enactment. While there is no guarantee, it seems highly unlikely that the tax laws will change before the end of 2020. Things become much less certain, however, when we move into 2021.

Year-End Planning Considerations

- Use "Bonus" Exemptions Before They Expire – If the transfer tax exemptions are decreased, either under a new administration or in 2026, taxpayers will face a "use it or lose it" scenario. In other words, taxpayers must use their "bonus" exemptions before they go away, or risk losing them forever. If a taxpayer elects to use his or her bonus exemption in 2020, the IRS has stated that there should not be a "claw back" if the exemption is decreased in 2021 or future years. Consequently, taxpayers who may have a taxable estate should consider utilizing their bonus exemptions while they still can.
- Use Popular Planning Tools Before They Are Eliminated – As stated above, it is possible that many popular estate planning tools, such as valuation discounts, GRATs, and other grantor trust techniques, may be eliminated

or at least heavily restricted. Taxpayers who have been considering these strategies should consider implementing them now before any potential changes in the tax laws.

- Take Advantage of Low Interest Rates and Depressed Asset Values – In many cases, wealth transfer planning works best when interests rates are low and asset values are depressed. Applicable federal rates (“AFRs”) are at or near historic lows, and many businesses have suffered severe economic losses as a result of the COVID-19 pandemic. In October 2020, the short-term AFR (for loans less than 3 years) is just 0.14%, the mid-term AFR (for loans between 3 and 9 years) is 0.38%, and the long-term AFR (for loans more than 9 years) is only 1.12%. The 7520 rate, which is used for GRATs and other strategies, is at an all-time low of 0.4%. These historically low rates certainly benefit new transactions, but also present an opportunity to enhance existing transactions by renegotiating lower interest rates for existing promissory notes.
- Build In Potential Access to Transferred Funds – Some taxpayers cannot afford to give away their full bonus exemptions, but could face significant transfer tax liabilities if the exemptions are lowered. For example, consider a married couple with a net worth of $20 million. This couple does not have a taxable estate today, but could owe substantial estate tax at the surviving spouse’s death if the laws change. To avoid giving away all of their assets, these taxpayers may need to “have their cake and eat it too” by implementing a strategy that utilizes the bonus exemptions before they expire, but allows potential access to transferred funds if they are needed in the future. For married couples, spousal lifetime access trusts (SLATs) continue to be viable planning tools. For single taxpayers, there are other strategies available to build in potential access to gifted property. Each taxpayer’s situation is different, of course, and our group has prepared a white paper discussing potential gifting strategies, which we would be happy to share upon request.
- Consider Accelerating Capital Gains – We typically do not recommend selling a business or harvesting capital gains just because the tax rates could change. Taxpayers with pending sales, however, may consider finalizing those sales in 2020 to take advantage of the 20% capital gains rate, just in case the tax laws change effective January 1, 2021.
- Do Not Wait Until December 31st – Waiting until the last minute to implement an estate planning transaction is never a good idea, and it is a particularly bad idea in 2020. Many professionals are anticipating a heavy caseload through the end of 2020, which may be further complicated by administrative difficulties associated with COVID-19. The time for having these conversations is now, so that taxpayers are not caught flat-footed after the 2020 election. Even if it makes sense to wait until after the election to make irrevocable decisions, preliminary planning can be done now to lay the groundwork for year-end transfers.

Conclusion

Although the tax landscape could change significantly in the coming months, we certainly encourage everyone to “look before they leap.” To that end, it is important to recognize that each person’s situation is unique and requires individualized analysis and advice.

Contacts:

John Bergner | 214.745.5289 | jbergner@winstead.com

Jeff Chadwick | 281.681.5960 | jchadwick@winstead.com

Cheryl Cain Crabbe | 281.681.5933 | ccrabbe@winstead.com

Christine Wakeman | 214.745.5471 | cwakeman@winstead.com

Jordan Ware | 512.370.2837 | jware@winstead.com