

New Tax Law in Our Future?

In this case, only time will tell

Plan Now: Gift, Estate and Generation-Skipping Transfer Tax Exemptions May be Reduced Next Year

As you know, the United States imposes three federal wealth transfer taxes: the gift tax, the estate tax and the generation-skipping transfer ("GST") tax. However, there are exemptions to the transfer taxes, and currently the exemptions are \$11,580,000 per person (or \$23,160,000 combined for a married couple). Under current tax law, on January 1, 2026 the transfer tax exemptions will revert to \$5,000,000, (indexed for inflation). However, as a consequence of the approaching election day in November, many commentators are theorizing the transfer tax system could be reformed much sooner. Indeed, many are suggesting that to help pay for the myriad of Covid-19 relief bills both enacted and under negotiation, there will be significant changes in all the tax laws (including the transfer tax laws) to become effective perhaps as soon as January 1, 2021!



Consequently, we are advising clients to consider utilizing their remaining transfer tax exemptions in the 2020 calendar year, to avoid the risk that the exemptions are reduced, and to take advantage of other available estate planning options set to expire or are ended.

For example, if you own assets worth \$10,000,000, you can transfer those assets (and all future appreciation) out of your gross estate for federal estate tax purposes to a trust for your spouse and children, without incurring any gift tax because of the current exemption. In comparison, if the transfer tax laws change retroactive to January 1, 2021, that same gift made 5 months from now would create a federal gift tax of approximately \$2,000,000 (assuming the rate stays at 40% and the exemption is reduced to \$5,000,000). Should that happen, most clients simply won't make the taxable gift (and thus will not incur the gift tax); however, those clients will have irrevocably missed the chance to save at least \$2,000,000 in tax for their families, as the assets will remain in the clients' estates and will be taxed when they die. Moreover, the estate tax will not only be on the assets themselves (which were not gifted) but also on any income and appreciation on those assets between now and when the client dies.

Also, presently, you may transfer assets at discounted values in order to leverage your exemption. If, for example, you own a company that is worth \$15,000,000, one might assume that a gift of a 99% interest in the company would be valued at \$14,850,000. However, the IRS recognizes that a willing purchaser may not necessarily be prepared to pay full value for an interest in a company that does not guarantee any right to dividends or other distributions of income, cannot be sold without rights of first refusal, and



cannot determine the price to be received in the event of such a sale. These discounts for "lack of control" and "lack of marketability" are widely accepted, but must be planned for carefully. In the event the IRS accepted a 30% valuation discount, then the value of the gift would not be \$14,850,000, but 70% of that value, or \$10,395,000. In other words, valuation discounting might allow you to convert a taxable gift made in 2020 to a nontaxable gift (assuming no prior use of exemption).



We believe the consequences of this possible change in the current federal transfer tax regime are sufficiently important to alert our clients and friends of the need to start planning now. If you wait until late November or December to use your exemption, there may not be sufficient time to execute on your plan. We are available to speak with you and/or your other advisors as to how these possible changes in the transfer tax laws may impact your current estate plans and business succession plans.