



**STRATEGIC**  
FINANCIAL GROUP  
PRIVATE TRUST SERVICES

**ESTATE PLANNING  
WHEN TIMES  
ARE CHANGING**

# TRUST CONNECTION CLIENT INSIGHTS

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A Monthly Report on  
Trust News and Information

MARCH 2021



## Estate Planning When Times Are Changing

It is often said that there are two absolutes in life: death and taxes. Add another absolute to that list...change. Now that the 2020 presidential election is behind us, many estate and tax law practitioners are anticipating broad tax law changes proposed by President Biden during his campaign. Experts are considering these potential changes to tax policies as revenue-generating proposals to address pandemic-fueled fiscal policies. Such reforms, if enacted, may upend traditional rules of the road for wealth planning and are cause for clients to proactively reconsider their current plans.

The key proposals concerning the tax and estate planning community for their clients are the following:

- Decrease in estate and gift tax exemption
- Estate tax rate increase
- Increase in tax rate on capital gains for high-income earners
- Elimination of the step-up in basis at death or death as a realization event
- GRATs
- Valuation discounts.

Here's a look at some of these proposed changes:

### Decrease in Estate and Gift Tax Exemption

The gift and estate tax exemption allows a set value of lifetime gifts and transfers at death to be made free of gift and estate tax. In January 2017, the exemption amount was \$5.49 million per individual, or \$10.98 million for married couples who properly transferred the unused portion of the exemption to the surviving spouse. The Tax Cuts and Jobs Act of 2017 ("TCJA") temporarily doubled the gift and estate tax exemption, subjecting fewer estates to estate tax and significantly decreasing the tax liability of many estates. The current estate and gift tax exemption of \$11,580,000 (\$10 million indexed for inflation) is scheduled to decrease on January 1, 2026, to \$5,000,000 (indexed for inflation). However, the exemption could decrease as soon as 2021 if made part of proposed tax reform.

The generation-skipping transfer (GST) tax is a separate tax that is levied when transfers are made to or for the benefit of someone two or more generations younger than the transferor, and such transfers are currently taxed at a rate of 40%.

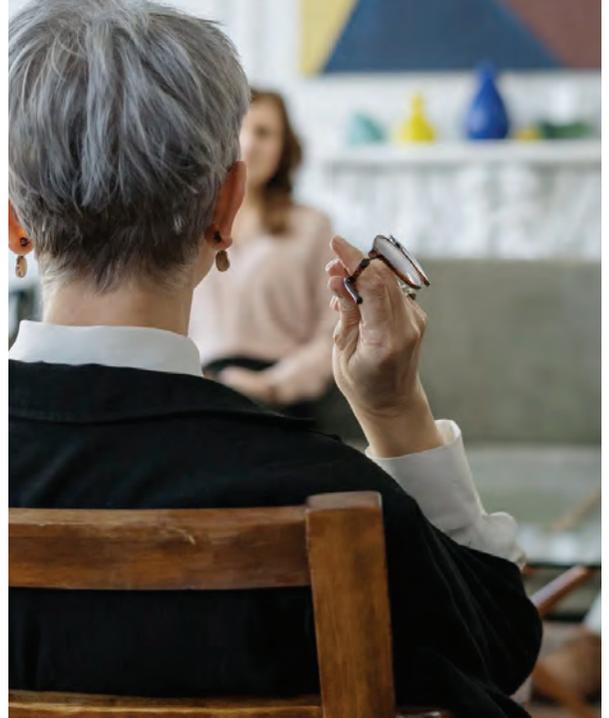




The current law provides for a separate GST tax exemption of \$11,580,000, and such a GST tax exemption level historically mirrors that of the estate and gift tax exemption. President Biden has commented that the exemption for the estate and GST tax could be made as low as \$3,500,000 per individual, while the exemption amount for gifts could be as low as \$1,000,000.

### **Estate Tax Rate Increase**

The new administration has proposed an increased tax to those estates in the top tax bracket from 40 percent to 45 percent. The decrease in exemption along with the increased tax rate for estates in the highest tax brackets could subject many more estates to tax liability and significantly increase the tax imposed on estates larger than \$2 million dollars.



### **Elimination of the Step-Up Basis at Death**

The new administration has proposed an increased tax. Another possible policy change includes the elimination of the basis “step up” at death, which has the potential to affect more taxpayers than the reduction of the tax exemptions. For decades, assets have been valued at the time of the owner’s death, even if the value had increased or appreciated. For example, if your mother bought a house for \$500,000 but at the time of her death the house is worth \$900,000, the gain on that house is \$400,000. However, that gain is wiped out when that asset is passed on to her heirs because the base value has “stepped up” to \$900,000, and thus no capital gains tax is owed. This treatment applies to any asset, from real estate to securities to partnership interests. If the total value of the estate is less than the current exemption level, then your mother would also not need to pay any estate tax.

In contrast, if the current administration eliminates the basis step-up rule, this means that that gain could now be recognized upon transfer. If gain is recognized, it could potentially cause significant tax consequences for people inheriting assets with high appreciation values.

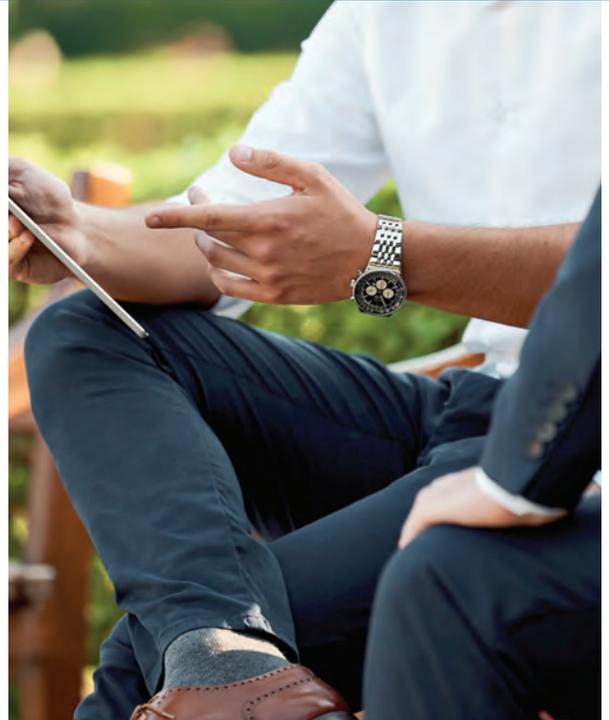


## Valuation Discount Changes

Clients and practitioners currently enjoy the use of valuation discounts when transferring interests in closely held business in the form of a lack of control discount and a lack of marketability discount. In prior administrations, the Treasury released proposed regulations that would sharply restrict the use of these valuation discounts but were not enacted. In 2019, legislation was introduced that would limit the effect on the application of these discounts as well. It is likely that we will see similar restrictions on discounts as part of future tax law changes.

## GRATs

Furthermore, grantor retained annuity trusts (GRATs) are useful estate planning strategies during low-interest-rate environments. The grantor retains an annuity for the term of the trust, and any assets remaining when the trust terminates pass on to other beneficiaries. For gift tax purposes, the grantor makes a gift equal to the remainder value of the trust, which is determined by the annuity amount and a factor published monthly by the IRS. Under current law, many practitioners draft GRATs to generate a gift at or near \$0 and provide for a trust term as little as two years. By doing so, the grantor uses no gift tax exemption in the transaction and receives his or her money back in only two years. In other words, there is little downside to creating a GRAT, and the upside is the potential for a large tax-free gift to the remainder beneficiaries of the GRAT if the assets appreciate. In recent years, lawmakers have introduced legislation that would heavily limit the appeal of GRATs, such as requiring a minimum GRAT term of 10 years and a retained interest that would produce a gift equal to the greater of 25% of the trust assets or \$500,000.



## So, how does one plan for the unknown?

It is nearly impossible to know whether President Biden's proposals will ever become law. It is also difficult to know when changes will actually occur, particularly in light of the current pandemic and economic crisis, which continues to take center stage right now and the foreseeable future. What is likely is that changes will be made that will affect estate planning. What is critical is to discuss the potential impacts of these proposed changes with your trusted advisors every 12-18 months if you aren't already doing so.



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