

How 2021 Is Shaping Up for Estate Planning Opportunities

by Michael D. Whitty

A FREEBORN & PETERS LLP CLIENT ALERT

Estate planning in the second quarter of 2021 provides continuing opportunities for clients seeking to preserve and transfer wealth while minimizing or avoiding gift and estate taxes. This Client Alert provides information on **three hot topics**:

1. Extended Deadline for Individual Income Tax Returns:

The IRS has announced the postponement of the due date from April 15 to **May 17, 2021** for individual income tax returns (Form 1040). Business entity returns and gift tax returns (Form 709) **were not postponed**, and first-quarter estimated tax payments are still due on April 15.

2. Retroactive Cuts in the Gift and Estate Tax Exemption During 2021 Are Now Less Likely: At the time this Client Alert was first published, it was believed that the Senate's use of the reconciliation procedure to pass the \$1.9 trillion relief bill in March means reconciliation (a procedure to avoid a filibuster in the Senate) couldn't be used again until the fourth quarter of 2021. However, on April 6, the Senate Parliamentarian advised that a revised budget resolution could use the reconciliation process for a second time in the same fiscal year, giving Senate Democrats at least one more chance before October. Nevertheless, the passage of several months makes the **predicted cut in the gift and**



estate tax exemption less likely to be retroactive to January 2021. Taxpayers wishing to use their currently large gift tax exemptions and/or to use other advanced wealth transfer techniques should **act before October 2021** to reduce the risk of missing opportunities because of changes that are prospective from the date of enactment

(or the even earlier date of legislation passing through committees).

All of our clients who are serious about reducing estate tax exposure should arrange a call to discuss how to best take advantage of the opportunities presented by current conditions of low valuations and lowest-ever interest rates, as well as the currently high estate and gift tax exemptions that will be reduced by the end of 2025, if not sooner.

3. Popular and Powerful Wealth Transfer Techniques May Be Curtailed by Congress (Part II): The Biden Administration and Democratic majorities in Congress have signaled an intent to cut back on or eliminate several powerful estate planning techniques and rules, including grantor retained annuity trusts (GRATs), income tax grantor trusts, valuation discounts on transfers of partial interests in family-owned entities, and the step-up of income tax basis on death.

Our prior 2020-21 Client Alerts ([found here](#), [here](#), [here](#), [here](#), and [here](#)) addressed other topics that remain current:

- Health Care Documents and Estate Plans in the Face of **Coronavirus**
- Planning for Retirement Accounts After the **SECURE Act** of 2019
- The New **Illinois Uniform Trust Code** and Its Effects on Trust Design

- Planning for Possible Changes in **Estate and Gift Tax Exemptions**
- Gift and Intra-family Loan Refinancing Opportunities with **Low Interest Rates**
- Popular and Powerful Wealth Transfer Techniques May Be **Curtailed By Congress** (Part I)

If any of these topics raises concerns or questions for you, contact one of the Freeborn & Peters LLP attorneys listed below.

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Read on for a more detailed assessment of 2021 estate planning opportunities.

Introduction: Early 2021 Moves by Biden Administration and Congress

The early moves by the Biden Administration and the Democratic majorities in Congress have demonstrated their willingness to focus on their party's priorities without having to bargain with Republicans to achieve bipartisan unity. The \$1.9 trillion spending package designated as coronavirus relief was a good example. Senate Democrats passed it using the **reconciliation** procedure, which avoids the Senate filibuster technique and makes it easier to pass bills with a bare partisan majority.

1. A Welcomed but Necessary Early Move: Postponement of the Deadline for Individual Income Tax Returns

On March 21, 2020, the IRS announced it would postpone the deadline for individual **2019** tax returns from April 15 to July 15, 2020, reflecting expected hardships for taxpayers and tax preparers in meeting the usual deadline just as coronavirus restrictions went into effect. The IRS has recently acknowledged a backlog of processing and reviewing 2019 tax returns. The IRS recognizes that there is no point in requiring individual 2020 tax returns to be filed by the regular deadline if the IRS can't start looking at them for several months anyway. The IRS also recognizes that individual taxpayers and their tax preparers are still facing challenges due to coronavirus restrictions.

Consequently, on March 17, 2021, the IRS released [IR-2021-59](#) to officially announce that the deadline for filing individual tax returns (including Forms 1040 for income tax) would be extended from April 15 to Monday, **May 17, 2021**. Additional extensions are still available by filing Form 4868, but that extended date will still be October 15 as with prior years. Gift tax returns (Form 709) and business entity tax returns do **not receive any extension** under this announcement, and individuals making an estimated tax payment for the first quarter of 2021 will still need to file those by April 15.

2. Gift and Estate Tax Planning in 2021 with a Reduced Risk of Retroactive Cuts

As noted in previous Client Alerts, the Biden Administration and its allies have signaled [an intent to make substantial cuts in the gift and estate tax exemptions](#), as well as raising the gift and estate tax rates.

Senate Democrats passed their \$1.9 Trillion spending package designated as coronavirus relief using the reconciliation procedure, which avoids the Senate filibuster and enables passing bills with a bare partisan majority. A tax bill that does not represent enough of a compromise to garner significant bipartisan support would have to wait for the next reconciliation opportunity. The flip side of this coin is that a tax bill that relies on using the reconciliation procedure can be completely one-sided, as no bipartisan compromise is then necessary.

It was previously believed (and was reported in the first edition of this Client Alert) that the reconciliation tool can only be used once in a fiscal year, meaning that the Democrats would not have another reconciliation option during this fiscal year ending September 30, 2021. However, on April 6, Senate Parliamentarian Elizabeth MacDonough

advised that a revised budget resolution could use the reconciliation process for a second time in the same fiscal year. This ruling gives Senate Democrats at least one more chance to use the reconciliation option before October.

As an indicator of where Congress and the Biden Administration may be heading, several senators led by Bernie Sanders and Elizabeth Warren have filed the [“For the 99.5 Percent Act”](#) that would drop the transfer tax exemptions to where they were in 2009: \$3.5 million for estate taxes, and only \$1 million for gift taxes. Transfer tax rates would be increased as well, from the current 40% flat rate to graduated rates from 45% to 65%. Other provisions would restrict powerful estate planning techniques as discussed in Part 3 below. As drafted, this bill’s changes would be effective from **date of enactment**.

Because a substantial retroactive cut to the gift tax exemption is unlikely to garner enough bipartisan support to avoid a filibuster, and because the Democrats’ next opportunity to use the reconciliation option will be in the **last** quarter of 2021, the likelihood for a retroactive cut in the gift tax exemption is substantially lower than commentators were estimating in January. Taxpayers who wish to use their currently large gift tax exemptions can do so in the second and third quarters of 2021 with a fair amount of confidence that cuts to the gift tax exemption will not be retroactive (although the [protective techniques](#) described in our prior Client Alert should still be considered).

However, tax changes do not have to wait until the start of a new calendar year to go into effect. Tax changes can be made prospectively from the date of enactment, and in some cases have been made prospectively from the even earlier date when a tax bill passed through either the House Ways and Means Committee or the Senate Finance Committee. We advise taxpayers who wish to use their currently large gift tax exemptions to monitor the progress of tax bills in Congress and **to act by the end of September 2021** (and be prepared to act even earlier) to reduce the risk of missing out on this great opportunity. Taxpayers should schedule preliminary discussions with advisors soon, and develop a plan of action.

3. Popular and Powerful Wealth Transfer Techniques May Be Curtailed by Congress

The new administration has proposed, and the new Congress will be predisposed, to cut several powerful estate tax savings techniques and rules: grantor retained annuity trusts (“GRATs”), income tax grantor, valuation discounts, and basis step-up on death. Most of the following proposed changes are included in provisions of the recently filed [“For the 99.5 Percent Act”](#) referred to in Part 2 above:

GRATs. GRATs allow a donor to shift the growth in an appreciating asset (especially a volatile asset) to beneficiaries of the donor’s choice with minimal or no gift tax. The Biden Administration and the new [“For the 99.5 Percent Act”](#) have proposed requiring GRATs to have a substantial taxable gift (unlike the current rule which allows them to be zeroed-out, and not have any taxable gift), and to have a minimum ten year term, both of which would greatly reduce GRATs’ effectiveness.

Valuation Discounts. It is a matter of economic and financial certainty that a willing buyer would pay a willing seller less for a fractional interest in a company than that fraction multiplied by the value of the entire company. That willing buyer-willing seller standard is the applicable standard for gift and estate tax valuation. Nevertheless, legislators and activists who seek to increase taxes on the wealthy have characterized valuation discounts for lack of control and for lack of marketability as loopholes when applied to family-owned enterprises and investment entities. The Biden Administration (like the Obama Administration before it) and the [“For the 99.5 Percent Act”](#) proposes largely eliminating such valuation discounts for family-owned entities, with some exceptions for operating entities and their working capital.

Grantor trusts are trusts that are treated for income tax purposes as if their assets and investments still belonged to the grantor who contributed them. Some irrevocable trusts are structured to be grantor trusts, in a way that the trust assets are out of the grantor’s taxable estate for estate tax purposes and a completed gift for income tax purposes, but still taxed to the grantor for income tax purposes. This can be a very powerful tool, because the grantor can pay the trust’s income tax without that being treated as an additional gift to the trust. The Biden Administration and the [“For the 99.5 Percent Act”](#) proposes to include grantor trusts in the grantor’s taxable estate, which would greatly discourage their use.

Step-Up in Basis at Death has been the general rule for decades, and allows estate beneficiaries to receive estate assets with a tax basis marked-to-market as of the decedent's date of death. This provides both a tax benefit for appreciated assets, and a simplification benefit as the estate does not have to prove the decedent's basis. The Biden Administration proposed eliminating the basis step-up at death and replacing it with a rule to recognize unrealized capital gains at death, which would impose taxes on millions of families, including those who do not have to pay estate taxes. While that proposal is not part of the "[For the 99.5 Percent Act](#)", it is included in a separate bill, the "[STEP Act](#)," filed by Sen. Chris Van Hollen of Maryland. The STEP Act would also impose capital gains on irrevocable trusts every 21 years.

GST Tax Exemption Time Limits. Under current law, a trust can avoid the generation-skipping transfer tax ("GST Tax") by allocating GST Tax exemption, and that trust could avoid GST Tax for hundreds of years (if not forever) if it is in a jurisdiction that has repealed or severely limited the Rule Against Perpetuities. The "[For the 99.5 Percent Act](#)" proposes making a trust subject to GST Tax at the highest rate every fifty years, with existing trusts **not** grandfathered from this change.

Gift Tax Annual Exclusion Cap. Current law allows a donor to make gifts of \$15,000 per donor, per donee, per year, for an unlimited number of beneficiaries. Taxpayers with larger families have been able to shift more wealth with the gift tax annual exclusion under its current form, than those with smaller families. The Obama Treasury Department and the Biden Administration proposed to limit the aggregate amount of gift tax annual exclusions a taxpayer can use in a given year, capping it at a total of **\$50,000**.

Capping Size of IRAs. The Biden Administration has proposed limiting the size to which IRAs or other retirement accounts may grow, or assessing taxes or penalties to accounts that exceed those limits.

Wealth Tax. Sen. Elizabeth Warren has filed [legislation](#) to impose an annual wealth tax of 2% on assets in excess of \$50 million, and 3% on assets in excess of \$1 billion.

Bottom Line: Taxpayers who are serious about wanting to reduce the estate and gift tax cost of transferring wealth to their beneficiaries should **act now** while exemptions remain high and powerful tax-saving techniques are still available.

REMINDER - INCENTIVE FOR CHARITABLE GIVING: One item from the 2020 CARES Act that is still effective for 2021 is the deduction (only for cash gifts to public charities, excluding donor advised funds) available for taxpayers who take the standard deduction and do not itemize deductions on their income tax returns. The December 2020 tax bill increased the amount to \$300 per individual filer and \$600 for married couples filing jointly.

April 2021: The Section 7520 rate is 1.00%				
The AFRs are as follows	Annual	Semi-annual	Quarterly	Monthly
Short-term (up to 3 years)	0.12%	0.12%	0.12%	0.12%
Mid-term (3 to 9 years)	0.89%	0.89%	0.89%	0.89%
Long-term (over 9 years)	1.98%	1.97%	1.97%	1.96%

4. Interest Rates Still Low, but Trending Upward

The IRS released the April 2021 Applicable Federal Rates on March 16, 2021, which reflected a trend toward slightly increased rates since the September 2020 rates that were the lowest since the rates began to be issued. These rates are "safe harbor" rates used to assure there is no imputed additional interest for income or gift tax purposes.

As discussed in greater detail in our [June 2020 Client Alert](#), these rates offer savings not only for clients seeking to reduce estate tax exposure, but also for clients seeking to reduce their family members' interest expenses through

refinancing. While the rates have been on a slightly upward trend since September, they remain low when considered in historical context, and future rates may be much higher once the Federal Reserve ever sees a need to combat inflation.

The techniques that use the Applicable Federal Rates to provide estate and gift tax savings include intra-family loans and loan refinancing and installment sales to grantor trusts. All these techniques remain valuable for transfers that shift future growth and appreciation without gift taxes, at least until Congress curtails those techniques.

In addition, the low Section 7520 Rate provides opportunities for certain techniques, validated by the tax laws, which use this rate to compute the present value of a retained or charitable interest. These techniques include the grantor retained annuity trust ("GRAT") and the charitable lead annuity trust ("CLAT"), described in detail in our [June 2020 Client Alert](#).

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Michael Whitty is a Partner in the Corporate Practice Group. He concentrates his practice in estate planning, taxation, and estate and trust administration. Michael represents business owners, principals of venture capital and private equity funds, key executives, investors, and other high net worth individuals in planning for the preservation and transfer of their wealth.

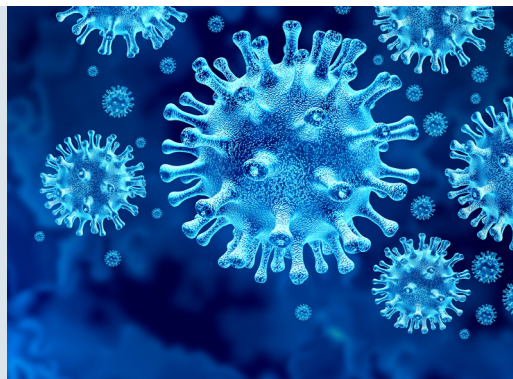
Freeborn's Response to COVID-19

Freeborn & Peters COVID-19 Task Force, with dozens of COVID-19 related Client Alerts and links:

<https://www.freeborn.com/practice/covid-19>

Bill Russell's White Paper on client result using a GRAT:

<https://www.freeborn.com/perspectives/real-life-example-transferring-growth-without-gift-tax>



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