TDCAPITAL
EARNED TRUST

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TD Capital Management – Proposed and Potential Tax Law Changes

With the recent change in the White House and both houses of Congress now controlled by the Democrats, there is quite a bit of uncertainty about the future of income tax and estate tax laws, which are now some of the most taxpayer-favorable in history.

As the law currently stands, the estate tax exemption for an individual is $11.7 million for 2021. The exemption is indexed to increase with inflation until 2026, when the it will be reduced to $5 million adjusted for inflation back to 2011. The top estate tax rate is 40% and will continue at that rate into the future as the law now stands.

Biden and other Democratic representatives have discussed changing the tax laws to increase the amount of taxes paid by the wealthy. The new laws could raise the rate on capital gains tax as high as 39.6% for those earning $1 million or more and could reduce the estate tax exemption possibly as low as to the 2009 amount of $3.5 million and raise the tax rate to 45%. Another more controversial change under consideration would be to eliminate the step-up in basis of assets at death.

There are several types of trusts or techniques that can be used before the laws change to take advantage of the historically high exemption amounts combined with low interest rates.

- A spousal limited access trust (SLAT) is a trust set up by one spouse for the benefit of the other spouse during his/her lifetime, then for the benefit of their descendants. Gifts are made to the trust to use up one spouse's entire $11.7 million exemption amount before it is reduced.

- An intentionally defective grantor trust (IDGT) is an irrevocable trust that has the benefit of being ignored for income tax purposes from the grantor of the trust. Assets may be sold at a discount to the trust in exchange for a promissory note (with very low interest), and no capital gain or interest income will be recognized by the grantor or the trust. Any appreciation in the value of the trust assets does not affect the grantor's lifetime gift/estate tax exemption.

- A grantor retained annuity trust (GRAT) is a trust set up for a term of years and funded with cash to be invested or an asset expected to appreciate significantly. The trust must pay an annuity back to the grantor equal to the original value of the asset gifted to the trust plus a low amount of interest. Any appreciation greater than the annuity paid out is distributed gift-tax free to a trust for the grantor's descendants.

Annual gifts up to $15,000 per person can be still be made outright or through gift trusts to move assets out of your estate without reducing your estate tax exemption.

TD Capital is following the political discussions of tax law changes and will send out periodic updates to all clients. If changes are made, we may reach out to you directly to discuss how such changes affect your financial situation. Please do not hesitate to contact us with any questions.

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