

September 16, 2021

House Ways and Means Committee Releases Proposed Changes to Estate, Gift and Trust Taxation

House Ways and Means Committee Chairman Richard Neal Released the Committee's Budget Proposal that Includes a Variety of Changes to Federal Estate, Gift and Trust Taxation

On September 13, 2021, the House Ways and Means Committee Chairman Richard Neal introduced tax provisions of the Committee's proposed budget, which proposes substantial changes to the Federal tax regime. The draft legislation includes numerous changes to the business, individual and international tax regimes, including corporate tax increases and individual income tax increases for certain high earners, as more fully described in our memorandum dated September 15, 2021. The draft legislation also includes major revisions to the estate, gift and trust tax regimes. This memorandum summarizes important features of the draft legislation related to estate, gift and trust taxation.

Some important features of the draft legislation in these areas are as follows:

- **Exemption Amount.** The draft legislation would reduce the lifetime exemption from estate and gift tax to \$5 million, adjusted for inflation since 2011 (in 2022 the exemption would be \$6.02 million). Notably, the proposed legislation would not impact the step-up in basis at death for inherited assets and would not impose taxes at death on unrealized capital gains, as the Biden administration had proposed. Estate and gift tax rates would stay the same as current rates, at 40%. The decreased exemption amount would take effect on January 1, 2022, so that individuals wishing to use the larger exemption amount currently available (\$11.7 million for an individual and \$23.4 million for a married couple) may do so before January 1, 2022.
- **Estate and Trust Income Tax Rates.** The top income tax rate for estates and trusts would be increased from 37% to 39.6% for trusts and estates with income over \$12,500, effective as of January 1, 2022. A 3% income tax surcharge would be imposed on a trust or estate's modified adjusted gross income over \$100,000. The top capital gains tax rate would be increased to 25%,

New York Washington, D.C. Los Angeles Palo Alto London Paris Frankfurt Brussels
Tokyo Hong Kong Beijing Melbourne Sydney

SULLIVAN & CROMWELL LLP

and such increase would apply retroactively to transactions completed after September 13, 2021, the date the draft bill was released (except for transactions pursuant to a binding contract entered into on or prior to such date).

- **Grantor Trusts.** The proposed legislation would dramatically change the tax treatment of grantor trusts, which are trusts that are deemed owned by the grantor or another person for income tax purposes, and would substantially diminish the use of grantor trusts created or funded after the date of enactment as estate planning tools. The following changes would apply:
 - The rules would be applicable to assets held in grantor trusts created after the date of enactment of the legislation or portions of a trust established before the date of enactment which are attributable to a contribution made on or after the date of enactment.
 - The proposed legislation would not apply to revocable trusts and should not affect the tax treatment of grantor trusts that have been created and wholly funded prior to the enactment of the legislation.
 - Assets of any grantor trust subject to the new rules would be included in the deemed owner's taxable estate at the grantor's death.
 - Distributions from a grantor trust subject to the new rules would be treated as a gift unless made to the grantor's spouse or in discharge of an obligation of the grantor. If the trust's grantor trust status is terminated during the grantor's lifetime, the assets would be treated as being gifted at that time by the grantor. A "proper adjustment" will be made with respect to assets of a grantor trust that are included in the grantor's taxable estate or treated as transferred by gift to account for amounts previously treated as taxable gifts by the grantor to the trust.
 - The proposed legislation would tax sales between a grantor trust subject to the new rules and its deemed owner the same way as sales to third parties. Under current law, sales between a grantor trust and its owner are not taxable events for income tax purposes. Under the proposed legislation, a sale or exchange (including an asset swap) between a grantor trust and its deemed owner would trigger tax on any unrealized gain.
 - Perhaps unintentionally, the proposed legislation as drafted would eliminate the benefits of many grantor trusts commonly used in estate planning, such as grantor-retained annuity trusts, qualified personal residence trusts and life insurance trusts.
 - The proposed changes would be effective as of the date of enactment of the legislation, which means there may be a limited opportunity to do planning with grantor trusts (e.g., creation of grantor-retained annuity trusts or new intentionally defective grantor trusts) before enactment.
- **Limitation on Valuation Discounts.** The proposed legislation would severely limit the ability to use discounts in valuing transfers of interests in entities holding passive assets for gift and estate tax purposes. Under the proposed legislation, if an individual transfers an interest in an entity by gift or at death, the value of any "nonbusiness" assets held by the entity (essentially, passive assets held, directly or indirectly, for the production of income that are not used in the active conduct of a trade or business) would be determined as if the individual had transferred such underlying assets directly and no valuation discount, such as a discount for lack of marketability or lack of control, would be permitted. Assets used in active businesses could still be discounted. The rules would apply regardless of whether the transferor or the transferor's family controls the entity. This provision would apply to transfers made after the date of enactment of the legislation.
- **Limitation on Qualified Small Business Stock Gain Exclusion.** The new provision would cap the gain that can be excluded by trusts and estates selling "qualified small business stock" at 50%. This limitation would apply to all sales occurring after September 13, 2021, except for sales entered into pursuant to a binding contract in place on or before such date.

SULLIVAN & CROMWELL LLP

The bill has been sent to the House Budget Committee to be consolidated with the work of other relevant committees. From there the “stapled” bill will be sent to the House Rules Committee where floor procedures are set and further revisions may be made by the Democratic leadership. Many of the provisions are expected to be subject to substantial negotiation with the Senate and are likely to be further revised. The full House of Representatives returns to session on September 20 and is scheduled to begin consideration of the bill on or shortly after September 27.

* * *

SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers or to any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.