Key Private Bank

Surviving the Death Tax:

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2021 Proposals May Challenge Estates

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"Our new Constitution is now established, everything seems to promise it will be durable; but, in this world, nothing is certain except death and taxes." -- Benjamin Franklin

The federal estate tax combines both of Franklin's predictions: dying and the possibility of having a tax levied upon death. The earliest known death tax dates to the ancient Egyptian empire, so the concept of an estate tax is by no means new. In the United States, the federal estate tax became permanent in 1916; subsequent presidential administrations have proposed or enacted changes. President Trump's signing of the Tax Cuts and Jobs Act (TCJA) in December 2017, brought the most recent change to the federal estate tax. With the TCJA, the federal estate tax exemption amount rose steadily from $5.49 million per person in 2017 to $11.7 million per person in 2021 ($23.4 million per couple). The caveat is that the higher exemption limits expire on December 31, 2025, and return to the pre-TCJA limits as indexed for inflation. The gift tax exclusion amount is the same, and the top tax on estates is 40%.

The new administration has ushered in the potential for tax changes before the 2026 expiration. Several proposals have been proffered, some of which may be retroactive to January 1, 2021. Senator Sanders (I-VT) proposes the For the 99.5 Percent Act, which calls for the estate tax exemption to be lowered to $3.5 million per person and the gift tax exemption to $1 million per person, marking a departure in unified gift and estate tax exemption amounts. Furthermore, Sanders would like to see the annual gift tax exemption amount reduced to $10,000 per year, per donee. The rate on estates over $3.5 million would increase to 45% and higher, reaching 65% for an estate over $1 billion! The effective date would be for persons dying after December 31, 2021.

Not to be outdone by her Senate colleague, Senator Warren (D-MA) proposes to initiate more taxes on the wealthy with the Ultra-Millionaire Tax Act. In this proposal, wealth over $50 million would incur an additional 2% tax, increasing to an annual 3% levy on wealth over $1 billion. The Sensible Taxation and Equity Promotion Act (STEP), proposed by Senator Van Hollen (D-MD), would alter the cost basis of assets inherited at death. Instead of the current step-up in cost basis wherein the acquisition cost for assets is valued as of the decedent's date of death, Van Hollen seeks to tax the unrealized gains received by beneficiaries. In his proposal, $1 million would be eligible for the step-up in basis, with an additional basis adjustment to $500,000 for a decedent's personal residence. Estates owing an estate tax could offset the estate tax with the income taxes paid on the non-stepped-up assets. Farms and illiquid businesses would be given an extension of 15 years to pay the capital gains liability.

Not all proposals seek to increase the estate tax: Senator Thune (R-SD) proposes eliminating the estate tax altogether with his Death Tax Repeal of 2021. While it is highly unlikely that Thune's proposal will make it into law, conventional wisdom suggests that one of the proposals will succeed.

While on the campaign trail, President Biden pitched his American Families Plan. In it, President Biden proposed to reduce the estate tax exemption amount to $3.5 million with a top tax rate of 45%, eliminate the step-up in cost basis at death, and double the top tax rate on capital gains to 39.6%.

The imposition of all three proposals would bring the total effective marginal tax rate to as much as 61%!

While the passage of all three proposals would be very unusual, it is likely that some form of the proposals will stick. Most pundits are betting on a reduction in the estate tax exemption amount to $3.5 million per person. This change could have a significant effect on decedents' estates, as the following scenario illustrates.

Example: Decedent has $25 million estate and passes away in 2021 with the current $11.7 million estate tax exemption amount and having made no previous taxable gifts.

Current Law	
Taxable Estate	$25 million
Federal Tax Payable	$5,320,000
Taxes as % of Estate	21.3%

Proposed $3.5 Million Estate Tax Exemption – With 45% Top Rate	
Taxable Estate	$25 million
Federal Tax Payable	$9,675,000
Taxes as % of Estate	38.7%

A fundamental issue for potential estate tax increases is whether the estate has enough liquid funds to pay the death taxes. The challenge may be compounded by states that impose an estate or inheritance tax. In terms of the potential for rising taxes and inflation, liquidity has never played a more important role.

For many families, life insurance strategies play a major role in providing much-needed liquidity at the time of wealth transfer and helping beneficiaries retain ownership of important assets.

The astute investor will want to plan for the laws that currently exist and legislation that may be enacted. Implementing estate planning strategies now before they are closed may enable you to protect assets for future generations.

For more information, please contact your Key Private Bank Advisor.

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