KPMG

Family Office Insights

Why are individual taxpayers considering transferring wealth in 2021?

Many high net worth individuals who did not use up their lifetime gift exemptions in 2020 are considering doing so now in 2021. Here is why:

Recent election results

With Democrats having won both seats in the Georgia Senate run-off elections, they now control the House and the Senate (albeit by narrow margins), as well as the White House. This increases the possibility of legislative changes to the gift and estate tax rules. Some of the proposals put forth by President Joe Biden during the campaign (or proposed during the prior Obama/Biden administration that might be embraced by the Biden/Harris administration) would eliminate certain tax benefits, thus prompting wealthy taxpayers to focus on estate planning and consider making gifts at their earliest convenience. These proposals include:

- Reducing the enhanced gift exemption of $11.7 million to half that amount (approximately $5.7 million) or even less (e.g., the $1 million gift tax exemption applicable in 2009)
- Taxing unrealized capital gains at death or eliminating stepped up basis at death
- Treating gifts and bequests as sales resulting in gain recognition on transfer
- Limiting or eliminating the availability of valuation discounts for transfers of interests in closely held entities to family members
- Subjecting assets sold to grantor trusts to estate tax
- Limiting the duration of generation-skipping transfer tax-exempt status for trusts to 90 years
- Limiting the annual exclusion for gifts to trusts to a total of $50,000
- Requiring a minimum 10-year term for Grantor retained annuity trusts (GRATs) (which would make the mortality risk a more significant obstacle)
- Prohibiting tax-free exchanges between a grantor and their GRAT
- Requiring a minimum value for GRAT remainders of the greater of 25 percent of the contribution or $500,000 (which would eliminate the ability to zero out the gift associated with a GRAT)

It's far from certain what tax legislation ultimately might be enacted this year and what the details might be.[1] At this time, it appears that a "recovery" bill later this year might be a vehicle for some significant tax law changes and might include some revenue raisers to offset at least some of the costs of spending programs (such as investments in infrastructure). If tax increases are enacted this year, there is a risk (but far from a certainty) that some could be retroactive to the beginning of 2021.[2] Please see the KPMG report, Biden Administration and the 117th Congress; posssible tax legislation for more information about the potential tax legislative agenda of the Biden Administration and the Democratic-controlled Congress.

Enhanced gift exemption

Tax Reform increased the lifetime gift and estate tax exemption (as well as the generation-skipping transfer (GST) tax exemption) from $5 million to $10 million or an inflation indexed $11.7 million exemption, and couples will be able to use a total of $23.4 million in 2021, barring possible legislative changes. However, the increase is scheduled to sunset at the end of 2025, and as noted above, there is always the possibility that future legislation might be enacted that would reduce the enhanced exemption even sooner.

[1] Ultimately, what changes lawmakers decide to make, as well as when those changes are effective, can be expected to be affected by political, economic, and other factors—and some of those factors might weigh against significant retroactive changes. Effective dates can take a variety of forms and can be keyed off a variety of different dates, such as date of committee action, date of announcement, beginning or end of a taxable year, date of a binding agreement, date of death, etc.

[2] Although there is historical precedent, enactment of retroactive tax increases is a rare occurrence in nonabuse contexts.

Low interest rate environment

The Section 7520 rate used in connection with wealth transfer structures such as the GRAT is 0.6 percent for February 2021. This is sometimes referred to as the "hurdle" rate because it's the rate of return/appreciation the gifted assets need to exceed in order for the GRAT to successfully pass assets to the taxpayer's heirs without exposure to transfer tax. Furthermore, the mid-term applicable federal rate is 0.56 percent for February 2021. This is the rate used for many note-based gift structures (e.g., sales to intentionally defective grantor trusts). These are some of the lowest rates since the IRS began providing them nearly 30 years ago, and since it is unclear how long these historically low rates will be available, taxpayers are considering implementing such structures sooner rather than later.

Depressed asset values

Due to the economic impact of COVID-19, it is possible that some assets may currently be depressed in value. This may make it an opportune time to gift such assets while minimizing exposure to transfer tax, particularly if a rebound is expected.

All these factors create what might be an ideal time to make gifts. It is recommended that consultation with advisers begin now as typically attorneys, accountants, and appraisers would all need to be involved to execute the planning properly. As that takes time, and time may be of the essence, it is crucial that the process get started now if the intent is to have the gifting completed as early as possible.

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