

Current Estate and Gift Tax Proposals in Congress

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The Internal Revenue Code has been a central focus of both taxpayers and tax advisers over the past two years. The recent 2017 Tax Cuts and Jobs Act ("TCJA") was the first major change to the Code since the Tax Reform Act of 1986. Many of the TCJA provisions benefit low- and middle-income taxpayers; however, the TCJA also provided tax benefits to high-income taxpayers. Some of these changes relate to estate and gift tax rates, exemptions, and exclusions. This discussion considers these salient provisions. Additionally, this discussion addresses current proposals in Congress that are intended to amend some of the TCJA benefits to high-income taxpayers. Although many of the proposals are targeted at curtailing the tax benefits provided to affluent taxpayers, some proposals attempt to redirect tax receipts from high-income and high-net-worth taxpayers to the middle class, infrastructure projects, and educational programs.

INTRODUCTION

The Tax Cuts and Jobs Act ("TCJA") was enacted into law on December 22, 2017. This landmark change to the Internal Revenue Code (the "Code") was particularly beneficial to wealthy taxpayers in the areas of estate tax and gift tax and reduced income tax burdens for some taxpayers, with the notable exception of certain higher earners in states with high state income taxes who saw their state and local tax deductions capped.

In recent months, various lawmakers—virtually all of whom opposed passage of the TCJA—have again suggested that the TCJA may be too generous to high-net-worth individuals and families.

Some lawmakers have suggested changes to the TCJA that would reverse certain aspects of the trust and estate tax statutes. Of these proposals, some are elaborate, while others are not yet fully developed. As issues of income inequality and the taxation of wealth continue to be debated, high-income and high-net-worth taxpayers should stay abreast of the current tax proposals in Congress.

This discussion summarizes the current TCJA and the current tax proposals in Congress as they relate to estate tax and gift tax matters.

CURRENT TCJA GIFT AND ESTATE TAX LAWS

Under the TCJA law, effective January 1, 2018, each person is granted an exemption of \$11.18 million from payment of U.S. gift tax and, to the extent not applied toward gift tax, U.S. estate tax. This exemption effectively shelters the taxpayer up to an aggregate amount of \$11.18 million in 2018, twice the amount that was applicable in the year before.

For each year after 2018, this exemption amount will be indexed to inflation. For tax year 2019, the exemption amount is now \$11.4 million. For married couples, exemptions can be aggregated. In 2019, this amount is \$22.8 million. The annual gift exclusion amount is set at \$15,000 and is not adjusted annually for inflation.

Taxable transfers of any amount that exceed the exemption amount then in effect are subject to a transfer tax of 40 percent under the TCJA. This is the same tax rate as was in effect prior to the TCJA.

However, absent additional legislation, this new exemption level will terminate on December 31, 2025, and revert thereafter to the unified credit amount in effect prior to the enactment of the TCJA, or \$5 million indexed for inflation after 2011.

Given the doubling of the gift and estate tax exemptions, as well as the lower income tax rate brackets, some legislators have criticized the taxpayer-friendly changes to the Code.

The following sections highlight the current proposals by members of Congress. Many of these proposals attempt to redirect tax savings to the middle class, infrastructure projects, and educational programs at the expense of high-net-worth taxpayers.

“ULTRA-MILLIONAIRE TAX” PROPOSAL

Elizabeth Warren is a Senator from Massachusetts. Senator Warren currently serves on the Senate Committee on Banking, Housing, and Urban Affairs; the Senate Committee on Health, Education, Labor, and Pensions; the Senate Committee on Armed Forces; and the Special Senate Committee on Aging. She is perhaps best known for her criticisms of Wall Street and the banking industry, and she was the leading advocate for the creation of the Consumer Financial Protection Bureau.

Recently, Senator Warren unveiled her tax plan entitled the “Ultra-Millionaire Tax.”

Senator Warren’s proposal would impose an additional tax on households with a net worth of \$50 million or more.¹ These households (approximately 75,000 in total) constitute the wealthiest 0.1 percent of Americans.² Under Senator Warren’s plan, these households would pay a 2 percent tax on every dollar of net worth in excess of the \$50 million threshold, and a 1 percent surtax (i.e., 3 percent total) on every dollar of net worth above \$1 billion.

No additional taxes would be imposed on the 99.9 percent of American households that do not reach the \$50 million net worth threshold.

Economists estimate that Senator Warren’s tax proposal would raise approximately \$2.75 trillion in tax revenue over a 10-year period.³ Senator Warren’s plan also includes a 40 percent “exit tax” on the net worth above \$50 million of any U.S. citizen who renounces their citizenship.⁴

Some legal scholars have questioned the constitutionality of Senator Warren’s plan. Specifically,

Article I of the Constitution has been interpreted to prohibit taxes directly tied to an individual’s wealth, and some have suggested that the Ultra-Millionaire Tax would be a “radical expansion” of the federal government’s taxing authority.⁵

On the other hand, Senator Warren’s plan has received surprisingly widespread bipartisan support, with three online polls showing between 50 and 61 percent positive votes from both sides of the aisle.⁶

If implemented into law, it is likely that the Ultra-Millionaire Tax would be challenged in court, resulting in litigation that could take years to resolve.⁷

Beto O’Rourke, a former member of the House of Representatives who is currently running for president, has expressed support for Senator Warren’s Ultra-Millionaire Tax plan and stated that he would tax ultra-wealthy individuals to generate revenue for the country’s common benefit.⁸

In the past, Representative O’Rourke voted against repealing the federal estate and generation-skipping transfer taxes as well as reducing the top gift tax rate.⁹

More recently, he publicly opposed a bill to reduce individual income tax rates, noting that providing tax breaks to corporations and high-net-worth individuals would negatively affect the middle class.¹⁰

TOP MARGINAL TAX RATE REVISION PROPOSAL

Alexandria Ocasio-Cortez is a first-term Member of the House of Representatives from New York. Representative Ocasio-Cortez is the youngest woman elected to Congress in United States history and is a relative newcomer to politics. Within weeks of being sworn in, she released an income tax proposal which made news headlines.¹¹

Under the Representative Ocasio-Cortez proposal, an individual’s income after the first \$10 million of income would be taxed at a 70 percent rate. However, she has not yet elaborated on the proposed tax rates for income less than \$10 million.

While the 70 percent marginal rate may seem high in comparison to the U.S. current income tax system (which has a maximum rate of about 37 percent for income in excess of \$500,000), the U.S. has had similar tax rates in the not-so-distant past.

From 1957 through the 1970s, the highest marginal income tax rate was 70 percent or higher (topping out at a marginal income tax rate of 92 percent during President Eisenhower’s time in office).¹²

While some have expressed concerns that such a significant increase in income tax rates would do harm to the economy, the years with higher marginal income tax rates were actually a time of economic growth.¹³

The Representative Ocasio-Cortez proposal has gained support from well-respected economists, 59 percent of registered voters, and fellow newcomer to the House of Representatives Ilhan Omar.¹⁴

In fact, the Representative Ocasio-Cortez proposal could net the U.S. government an additional \$72 billion, or about 2 percent more, in revenue.¹⁵



“FOR THE 99.8% ACT” PROPOSAL

Bernie Sanders is a Senator from Vermont, and he is the longest-serving Independent member in congressional history.¹⁶ He released a comprehensive tax policy proposal in late January 2019 called the “For the 99.8% Act.”

Senator Sanders’s “For the 99.8% Act” tax plan includes decreasing the current federal estate tax exemption amount, currently \$11.4 million per person in 2019, to \$3.5 million per person (the federal estate tax exemption amount that was in effect in 2009). The plan also calls for raising the federal estate tax rate from 40 percent in 2019 to a progressive set of rates.¹⁷

The lowest proposed estate tax rate would be 45 percent on estates ranging in value from \$3.5 million to \$10 million, and the highest estate tax rate under the plan would be 77 percent on estates in excess of \$1 billion in value.¹⁸

The lifetime gift tax exemption, currently \$11.4 million per person, would be reduced to \$1 million per person.

The “For the 99.8% Act” also proposes to:

1. eliminate the generation-skipping transfer tax exemption for any trust set up to last more than 50 years,
2. extend the required terms for grantor-retained annuity trusts to a minimum of 10 years, and

3. “sharply” limit the annual gift tax exclusion amount.¹⁹

Currently, the generation-skipping transfer tax exemption is available for dynasty trusts lasting in excess of 50 years, there is no minimum term for grantor retained annuity trusts, and the annual gift tax exclusion amount is \$15,000 per donee per year.

Senator Sanders also intends to restrict valuation discounts on interests in family businesses and eliminate the so-called “loophole” which currently allows taxpayers to claim a lower value for an inherited asset for estate tax purposes than the value of the same asset that is claimed for income tax purposes to calculate the gain when the asset is sold.²⁰

Finally, the proposed Act virtually eradicates the transfer tax benefits of installment sales to defective grantor trusts.²¹

Based on recent legislative history, it is uncertain whether some of the provisions in the “For the 99.8% Act” would successfully become law. For example, there have been recent attempts to reduce the federal estate tax exemption amount and to extend a mandatory term for grantor retained annuity trusts, but none of these attempts has been successful.²²

In fact, currently, there are at least two bills before the House and one bill in the Senate that would completely repeal the federal estate tax.²³

There is also a bill before the Senate that would reduce the maximum estate tax rate from 40 percent to 20 percent.²⁴ None of these bills has been passed into law either.

AMERICAN OPPORTUNITY ACCOUNTS PROPOSAL

Cory Booker is a Senator from New Jersey—the first African-American Senator from New Jersey—and previously served as the mayor of Newark, New Jersey. Senator Booker was a Rhodes Scholar and is a graduate of Yale Law School.

He introduced a bill to the Senate last fall called the “American Opportunity Accounts Act.”²⁵ Under Senator Booker’s plan, the Act would create a savings account for every American child upon birth. The child would not be able to access the funds in the account until he or she attained the age of 18 years, at which time the funds in the child’s account could be used for things such as college tuition or a down payment on a home.²⁶

The initial funding of the accounts (\$1,000 for each child at birth and up to \$2,000 per year depending on the child’s family’s income) would mainly come from increases in estate taxes and capital gains taxes.²⁷ Similar to Senator Sanders’ tax proposal, under Senator Booker’s plan, the federal estate tax exemption amount would be reduced to \$3.5 million, and estates valued between \$3.5 million and \$10 million would be taxed at a rate of 45 percent (5 percent higher than the current flat 40 percent rate).²⁸

For estates valued between \$10 million and \$55 million, the estate tax rate would be 55 percent, and for estates with values in excess of \$50 million, the estate tax rate would be 65 percent.²⁹

The American Opportunity Accounts Act also includes a minimum 10-year term for grantor-retained annuity trusts, reduces the annual gift tax exclusion amount to \$10,000, and limits the annual gift tax exclusion gifts allowable for each donor to \$50,000 (i.e., five donees).³⁰ The Act would increase the maximum capital gains tax rate from the current 20.0 percent to 24.2 percent.³¹

MIDDLE CLASS TAX CUTS AND REFORMS PROPOSALS

Other congressional leaders, including Senators Kamala Harris and Kirsten Gillibrand, have proposed changes to the TCJA to focus more on the middle class, while clawing back the additional exemptions provided to high-net-worth individuals under the TCJA.

Kamala Harris is a first-term Senator from California. She serves on the Senate Committee on the Budget, the Senate Committee on the Judiciary, the Senate Committee on Homeland

Security and Governmental Affairs, and the Senate Select Committee on Intelligence. Senator Harris was previously Attorney General of California.

Last fall, Senator Harris proposed a nearly \$3 trillion tax plan called “the LIFT the Middle Class Act.” The plan centers on tax breaks for middle class and working class families.³²

Under this plan, the federal government would provide tax credits that match each individual’s earnings up to \$3,000 (\$6,000 for married couples).³³

These credits would be phased out for those with higher earnings and would not be available at all to individuals who do not have income.³⁴ These credits would be funded by levying a new tax on large financial institutions and effectively repealing the TCJA of 2018.³⁵

More recently, Senator Harris proposed a \$315 billion increase in federal spending to provide public school teachers with significant raises.³⁶

To offset the cost of this plan, which was released in mid-March 2019, Senator Harris is reported to be considering a proposal to lower the \$11.4 million federal estate tax exemption amount and/or limiting tax-saving estate planning vehicles such as grantor retained annuity trusts.³⁷

Kirsten Gillibrand is a Senator from New York, with a professional background as an attorney in New York City. Prior to her service as a senator, Senator Gillibrand was a Member of the House of Representatives from upstate New York.

In the past, Senator Gillibrand has supported increasing tax deductions for charitable giving, providing tax cuts to businesses that provide jobs, and expanding and improving the child care tax credit.³⁸ Senator Gillibrand also has introduced legislation to provide property tax relief to homeowners.³⁹

EDUCATION AND INFRASTRUCTURE REFORM PROPOSALS

Amy Klobuchar has been a Senator from Minnesota since 2007, and she worked as a lawyer prior to her political career. Senator Klobuchar has proposed reforming and simplifying the tax code to close so-called “wasteful loopholes.”⁴⁰

In the past, Senator Klobuchar has voted against raising the federal estate tax exemption at least twice.⁴¹

Senator Klobuchar recently published a major policy proposal to fix the country’s broken infrastructure. This proposal calls for repairs to dilap-

idated roads, improvements to facilities in public schools, the expansion of public transit, and the modernization of America's airports, seaports, and waterways.⁴²

Under this plan, Senator Klobuchar proposes directing \$650 billion of federal funding to pay for the repairs needed to improve our infrastructure. To cover the costs of these expansive refurbishments, Senator Klobuchar has suggested, among other fundraising plans, raising the corporate income tax rate from 21 percent to 25 percent.⁴³



SUMMARY AND CONCLUSION

Whether for the benefit of the middle class, the infrastructure of the United States, or the education system of the country, legislators are contemplating means of taxation to support these initiatives from high-income and high-net-worth taxpayers.

Towards the end of 2012, when the estate tax exemption was scheduled to decrease from \$5 million to \$1 million, many wealthy individuals rushed to adjust their estate plan and make last minute gifts in order to take advantage of the higher exemption amount while it was still available. With potentially significant changes to the Code again on the horizon, it may be prudent for high-net-worth individuals to take precautions now, rather than adopt a wait-and-see approach.

It would behoove high-net-worth individuals to pay close attention to the tax policies being debated. In fact, there appears to be a significant focus on taxing high-net-worth individuals by increasing tax rates and surtaxes and reducing the available tax exemptions.

As is always the case when there is a potential change to the Code, individuals should review their current estate plans for any adjustments that may be necessary or beneficial to reduce potential tax liabilities and to take advantage of current tax loopholes that may be closed in the near future.

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