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# Hughes Hubbard & Reed

## What Do the New House Estate, Gift and Generation-Skipping Transfer Tax Proposals Mean For High Net Worth Individuals?

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**September 29, 2021** - In mid-September 2021, the House Ways and Means Committee advanced proposed legislation that could affect the estate plans of high net worth individuals and families. Led by Congressman Richard Neal of Massachusetts, the proposals would increase taxes on high-income families and corporations by approximately \$2.1 trillion over ten years. \$1.2 trillion of that revenue would be applied to cut taxes primarily for low- and middle-income families. The remaining revenue would go towards new domestic spending, such as education and family programs. Below is a brief summary of some key provisions of the proposed laws and suggestions for estate planning actions you can take now:

### **Transfer Tax Exemptions May Be Reduced**

Current Law: Under current U.S. tax law, each U.S. taxpayer has a “unified credit” which permits the taxpayer to transfer property free from federal gift or estate tax up to a specified “exemption amount.” The exemption amount for 2021 is \$11,700,000 reduced by the value of any gifts made during the taxpayer’s life that were previously subject to federal gift tax and the value of any other transfers the taxpayer makes at his or her death that are subject to federal estate tax. Federal tax law also imposes a generation-skipping transfer (“GST”) tax on, among other things, donative transfers of property by a transferor to “skip persons” (e.g. a grandchild or more remote descendant of the transferor). In 2021, the GST exemption amount per individual is \$11,700,000 reduced by any lifetime allocation of GST exemption to gifts. Under current law, these amounts are scheduled to increase annually until January 1, 2026, when the exemptions are scheduled to revert to \$5 million indexed for inflation

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### **Grantor Trusts May Be Included In The Grantor's Estate**

Current Law: Grantor trusts are trusts the income of which is taxable to the grantor rather than to the trust itself. Under current law, the benefits of grantor trusts include allowing the grantor to pay the income tax of the trust at a lower rate than would be applied if the trust paid its own income taxes and removing assets from the grantor's taxable estate to reduce estate taxes at the grantor's death by making, essentially, tax-free gifts to the trust of the payment of its income taxes.

Proposal: The property held in irrevocable grantor trusts will be included in the grantor's taxable estate. While prior contributions to existing irrevocable grantor trusts such as Grantor Retained Annuity Trusts ("GRATs") and Irrevocable Life Insurance Trusts ("ILITs") would be grandfathered from the new law and thus not includible in the grantor's taxable estate, irrevocable grantor trusts created **after the enactment of this law**, as well as contributions made **after the enactment of this law** to existing irrevocable grantor trusts would be includible in the grantor's estate for federal estate tax purposes. In addition, any distributions of trust property to beneficiaries other than the grantor and/or the grantor's spouse would be treated as taxable gifts.

Implication: Any future contributions to existing irrevocable grantor trusts and any contributions to irrevocable grantor trusts created **on or after this proposal becomes law** would be includible in the grantor's estate and subject to federal estate tax. It should be noted, however, that some experts expect the insurance lobby to attempt to carve out an exception for ILITs, which would then continue to be grantor trusts the property of which would not be includible in the grantor's estate.

Possible Action: Individuals who wish to create and/or contribute to GRATs, ILITs, or other forms of irrevocable grantor trusts should consider doing so as soon as possible to ensure such property will remain out of the individual's estate and, therefore, not subject to U.S. estate tax. It might be particularly tax-advantageous for individuals with existing ILITS to make substantial contributions to the ILIT **prior to the enactment of this law**. Such contributions could cover the ongoing premiums for the policies held by the ILIT so that those funds would avoid estate tax inclusion **after the date this proposal becomes law**. In addition, any grantor trust receiving contributions should include provisions that allow for the elimination of its grantor trust status quickly in case this law becomes effective prior to the funding of such trust. Note, however, that if grantor trust status is eliminated for a particular irrevocable trust, the assets of that trust may be deemed to be a gift made by the grantor to the trust for federal gift tax purposes.

### **Certain Valuation Discounts May Be Eliminated**

Current Law: Current U.S. tax law allows for certain discounts to be claimed on the valuation of entity interests. These discounts are beneficial because they reduce the value of the transferred interests which in turn reduce the U.S. transfer taxes imposed on the transfer of such interest.

Proposal: Under the proposed legislation, any "nonbusiness asset" held by an entity an interest in which is

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at their death, which could result in increased estate taxes on the individual's estate.

Possible Action: Any transfers of interests in entities that hold nonbusiness assets that you are otherwise contemplating should be completed **before this proposal becomes law**, because these provisions are intended to go into effect on **the date the law is enacted**.

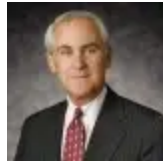
It is important to note that the Ways and Means Committee proposal could be amended further by Congress before the law is enacted, and it is possible that no law will be enacted. Every taxpayer's situation is different and you should consult us (or another advisor) about your particular plans.

If you are interested in maximizing the tax savings available to your estate plan prior to any significant changes in U.S. income, estate, gift, and GST tax laws, please contact us as soon as possible.

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