Change in Control of Congress May Signal Seismic Shift in Future Estate Planning Opportunities

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Affluent individuals who have not already fully used their exemptions may wish to proceed sooner than later after considering potential risks of retroactive application of any tax change

Possible Rollback of Federal Exemptions to 2009 Levels

President Biden's tax plan would cut the federal estate, gift and generation-skipping transfer (GST) tax exemptions from $11,700,000 per individual ($23,400,000 per married couple) to their 2009 levels of $3,500,000 per individual ($7,000,000 per married couple) – and potentially drop the federal gift tax exemption as low as $1,000,000 per individual ($2,000,000 per married couple) – all without indexing. The Biden plan would increase the federal estate and gift tax rate from 40% to 45%, and eliminate the step-up in basis for inherited assets.

Treasury Secretary Janet Yellen has stated that she is not in favor of a wealth tax,[1] but is open to both reducing federal estate and gift tax exemptions and substantially limiting the availability of the step-up in basis on death. It's possible that could also mean a deemed realization of gains at death on certain appreciated assets in a manner that bears similarity to the Canadian tax system, subject to certain exclusions, deductions and exemptions.

Key members of the Biden administration have signaled a receptiveness to implement some of the proposals that were included in the Obama administration's "Green Book" that would limit the availability of the tax benefits obtained through such popular estate planning techniques as grantor retained annuity trusts (GRATs) and sales and "swaps" with intentionally defective grantor trusts (IDGTs). Such tax reform may also reduce or eliminate the availability of discounts for family-controlled entities that do not engage

[1] Senator Elizabeth Warren's wealth tax proposal in the "Ultra-Millionaire Tax Act" would seek to impose an annual 2% tax on wealth in excess of $50 million, and a 3% tax on wealth in excess of $1 billion.

in an active trade or business. Affluent individuals who have not already fully used their federal gift and GST exemptions, may wish to proceed sooner than later after considering potential risks of retroactive application of any tax changes and with adequate planning protections.

Covid Impact

Another reason why affluent individuals may wish to act sooner than later to effectively use their current federal gift and GST exemptions, is that the COVID-19 crisis has had a swift and stunning impact on the valuation of all classes of assets, ranging from marketable securities to closely held businesses. This impact, coupled with the current state of the market volatility and uncertainty, creates unparalleled but *temporary* estate planning opportunities for wealthy individuals to transfer wealth to children and more remote descendants with minimum gift and estate tax exposure. Before using any of the strategies described later in this alert, it is essential to gain insight into the impact of the COVID-19 disaster on the valuation of your assets, including business interests, and the prospect for recovery. Although it is currently difficult for many appraisers to quantify the full impact of the COVID-19 disaster on the valuation of many types of assets, it may be important to implement these strategies before assets regain value and/or the federal estate, gift and GST exemptions may be scaled back. Even if the exemptions are not reduced, it is better to implement gifts sooner rather than later to keep future appreciation and subsequent income out of your estate. Given the likelihood of increased auditing of gift and estate tax returns by the IRS recently proposed by the Democrats, attention to detail in the development, implementation and reporting of the gifting plan is paramount.

New York Considerations

Affluent New Yorkers should also bear in mind that New York adds back certain taxable gifts made within three years of death for estate tax purposes. New York does not currently impose a gift tax. It should be noted that legislation has recently been introduced in both houses of the New York legislature that would reinstate the New York gift tax and impose a separate inheritance tax. Indeed, there may be a need for New York to raise additional revenues if the Biden American Rescue stimulus plan does not provide enough federal funds for New York. New York residents may wish to embark upon gifting or leveraged transfer programs to start the three-year risk period and to permanently reduce their New York taxable estate to avoid the New York estate tax cliff. This cliff, which is built into the New York estate tax calculation, effectively wipes out the New York exclusion for wealthy New Yorkers whose estates exceed 105% of the exclusion amount in effect at the time of their death. Special considerations for New Yorkers are described later in this alert.

Comparison of Current Law and President Biden's Tax Plan

Under the Tax Cuts and Jobs Act[2] that was signed into law by Donald Trump in December 2017, the federal estate, gift and GST tax exemptions doubled as of January 1, 2018 from $5,490,000 in 2017 to $11,180,000 per person (and $22,360,000 for a married couple). These exemptions are indexed for inflation and have now surged to $11,700,000 per person ($23,400,000 per married couple) for 2021. There is a "catch" in the legislation. The TCJA was passed through the budget reconciliation process (described below). In order to fit within budget reconciliation constraints, it "sunsets" the doubling of the federal estate, gift and GST exemptions on January 1, 2026, reverting them to their pre-2018 exemption levels, as indexed for inflation.

The following chart summarizes the current state of the federal transfer tax system, its recent historical antecedents, and how the Biden tax proposal would change it:

[2] Public Law 115-97, also known as the "Tax Cuts and Jobs Act" ("TCJA").

Federal Transfer Tax

	Pre-TCJA Law *as of December 31, 2017*	**TCJA in 2021** *from January 1, 2021 through December 31, 2025*	**TCJA after Sunset in 2026** *as of January 1, 2026*	**Biden Proposal**
Estate, Gift and GST Tax Exemption Amounts	$5,490,000 per individual / $10,980,000 per married couple, as indexed for inflation	$11,700,000 per individual / $23,400,000 per married couple for 2021, as indexed for inflation after 2021	$5,490,000 per individual / $10,980,000 per married couple, as indexed for inflation	$3,500,000 per individual / $7,000,000 per married couple.[3]
Step-Up in Basis for Inherited Property at Death to Fair Market Value	Yes	Yes	Yes	No
Estate, Gift and GST Tax Rates	40%	40%	40%	45%

Likelihood of Enactment of Biden Tax Plan and Possibility of Retroactivity

As a result of the narrow victories in both of the Georgia Senate runoff elections, the Democrats now control both the legislative and executive branches. There is concern among high net worth individuals and their advisers that the federal estate, gift and GST exemptions could be cut in half to $5 million (plus indexing) or even to $3,500,000 as proposed by President Biden which was where the exemptions were when President Barack Obama took office. There is further speculation as to whether the Democrats might seek to make estate and gift tax changes retroactive to January 1, 2021. A retroactive reduction in the gift tax exemption to $5,000,000 or $3,500,000 (or as low as $1,000,000) could cause planning hazards by making otherwise gift tax free transfers retroactively subject to a significant amount of gift tax.

Although retroactive changes to the federal estate, gift and GST tax regime would likely withstand any constitutional challenges, the likelihood that such changes would be made retroactive to January 1, 2021 is generally considered to be low. The new Senate is evenly divided per party – with Democratic Vice President Kamala Harris holding a tie-breaking vote. A single dissenting vote among Senate Democrats – including among more moderate Democratic Senators such as Joe Manchin of West Virginia, who previously voted to repeal the federal estate tax – would be sufficient to sink such legislation.

Moreover, any such transfer tax legislation is likely to emerge through the budget reconciliation process. Budget reconciliation is a process that permits legislation impacting revenues and spending to pass the Senate with 51 votes rather than the 60-vote filibuster threshold for most other legislation, and thereby avoids numerous procedural hurdles. Significantly, the budget reconciliation process begins with the drafting and approval of a budget resolution setting parameters for revenues and/or spending for the fiscal year, and ***only one budget resolution can be approved for each fiscal year.***

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[3] It is unclear whether the Biden tax plan would provide for indexing of the exemptions and whether the gift tax exemption might possibly be rolled back to $1,000,000.

There are two opportunities for the Democrats to use reconciliation in calendar year 2021 because a FY 2021 budget resolution has not been processed by Congress, and an FY 2022 budget resolution will soon be available (although the actual reconciliation legislation for FY 2022 could not be effective prior to October 1, 2021). The Biden administration has indicated that there are several public policy initiatives of greater national importance on its agenda ahead of taxes such as COVID-19 pandemic relief and its vaccination rollout. The Democrats have resorted to the budget reconciliation process to pass the Biden stimulus plan, known as the American Rescue Plan Act of 2021. As we go to press, the Senate has approved the bill, sending it back to the House for expected approval any day now. This means that reconciliation will not be available for tax legislation until the fall.

While no one can know for sure what will happen, the later in the year that transfer taxes get addressed by Congress, the less likely it becomes that sufficient political capital will be mustered among Democrats to support making any such legislation retroactive to January 1, 2021. It is more likely than any changes in the federal estate, gift and GST tax laws would be prospective such as upon the date of enactment or January 1, 2022 – or even later depending on how long the legislative process unfolds.

Strategies to Protect Against Retroactive Reductions in the Federal Gift, Estate and GST Exemptions

Several planning strategies may be available to clients who wish to protect against incurring significant gift taxes in the case of a retroactive reduction of the gift tax exemption or increase in tax rate in 2021. These protective measures include the following:

QTIPable Trusts

As discussed below, with the *temporary* surge in the federal gift and GST exemptions to over $23 million per couple, spousal lifetime access trusts (“SLATs”) have become very popular planning vehicles for married couples who wish to use their exemptions but do not feel that they can part with upwards of $23 million of assets. These generally entail irrevocable trusts in which the grantor’s spouse is a discretionary beneficiary and may include children and more remote descendants as current or future beneficiaries. A variation on this theme would be a trust for the *sole* benefit of the spouse.

Trusts for a spouse can be structured to be eligible for a qualified terminable interest property (QTIP) election on a timely filed federal gift tax return (including extensions) by making the spouse the *sole* beneficiary of the trust during the spouse’s lifetime and requiring that all of the trust income be paid to the spouse at least annually. By doing this, the grantor would have until she or he files a gift tax return in 2022 (potentially as late as October 15, 2022 via an extension) to determine whether (and to what extent) to make a QTIP election. A QTIP election would be made to qualify the property transferred to the trust for the gift tax marital deduction and thereby protect against gift tax in the event that the gift tax exemption were retroactively reduced by subsequent legislation.[4] In the event that there is no retroactive reduction of the gift tax exemption, then the decision could be made NOT to make a QTIP election and thereby consume the grantor’s available gift tax exemption to remove property from both spouses’ gross estates.

QTIPable trusts also could be used where the subject of the gift is low-basis assets and there is a concern because of advanced age or poor health that either or both of the spouses could die before any new legislation is effective. Under those circumstances, it may be more desirable for the low-basis assets to be included in the beneficiary spouse’s estate to receive a step-up in basis under the current tax regime. Should the beneficiary spouse die, the trust would be intentionally qualified for the gift tax marital deduction and included in the deceased spouse’s estate.

Installment Sale or Loan in Lieu of Current Gift

Another option may be to sell, rather than gift, assets to an irrevocable grantor trust in exchange for a promissory note at the applicable federal rate (AFR). The benefit of doing this is that if the exclusion were retroactively reduced, the property transferred to the trust should not be subject to the gift tax. In contrast, if Congress ultimately does not retroactively reduce the exclusion for 2021, the grantor can forgive the debt by December 31, 2021 and complete the gift. If the note is forgiven in whole or in part, this strategy will apply the grantor’s remaining gift tax exclusion to the extent of the forgiven debt, thereby mitigating against the risk of incurring a gift tax. This is essentially a

[4] If a timely gift tax QTIP election is made, the assets of the trust would be included in the beneficiary spouse’s estate thereby deferring the estate taxation of the assets and allowing a step-up in the basis of the assets (assuming no subsequent legislation during the spouse’s lifetime eliminating the step-up).

"freeze plan," meaning that any appreciation in the sold assets would belong to the trust.

Disclaimer Trusts

A trust could be drafted making either an outright distribution to the grantor's spouse or creating a QTIPable trust for the benefit of the grantor's spouse, and provide that if property is disclaimed by the spouse, it would instead pass in trust for the benefit of the spouse (under an exception to the general rule governing qualified disclaimers under which the disclaimant cannot be a beneficiary of the recipient trust) and grantor's descendants. Under this plan, the gift presumably would be disclaimed by the spouse if Congress does *not* enact adverse retroactive legislation. There would be a 9-month window for such a disclaimer to be made, which means that such a trust that was established on or after April 1, 2021 could potentially provide protection against a retroactive reduction of the gift tax exemption for the entirety of 2021.

Defined Value Clauses

Additional options involve making a gift that is subject to a defined value clause. This clause would allow any portion of the gift in excess of the donor's exclusion "as finally determined for federal gift tax purposes" to pass to charity, the grantor's spouse, a marital deduction trust, an incomplete gift trust, or some other recipient without being subject to gift tax. Such clauses are very common in testamentary planning, and can also be used in conjunction with sales to irrevocable grantor trusts. There are risks that should be assessed before using such "formula clauses" as the IRS has been successful in challenging the validity of certain types of such clauses.

Special Considerations for New York Residents — The Currently Expanded Federal Exemptions Give New Yorkers Greater Opportunities to Plan Ahead to Permanently Reduce Their New York Taxable Estates and to Avoid the New York Estate Tax Cliff

As we reported in several previous *Stroock Client Alerts*, New York State enacted legislation in 2014 reforming its estate and gift tax laws. One of the major changes of the 2014 New York tax law was the gradual increase of the New York State estate tax exclusion from $1,000,000 to the federal level, anchored, however, to the exemptions provided under then-existing federal tax law. As of January 1, 2021, the New York estate tax exclusion amount increased from $5,850,000 to $5,930,000. The New York estate tax exclusion amount is indexed for inflation with 2010 as the base year for this purpose. In addition, as previously noted, the law that added certain gifts made by a New York resident within three years of death to the estate, for estate tax purposes, has been extended through the end of 2025.

One of the reasons why New Yorkers should plan to maximize the use of both spouses' New York exclusion amounts is that New York does not recognize portability of a deceased spouse's unused exclusion amount to the surviving spouse as the federal law does. As a result, many New Yorkers will continue to incorporate credit shelter trusts or disclaimer trusts in their wills to maximize the benefits of both New York and federal law exclusion amounts.

A dramatic consequence to New Yorkers of the doubling of the federal estate tax exemption under the 2017 Tax Reform Act and the 2020 inflation adjustment is that there is now a $5,770,000 spread between the federal and New York State estate tax exemptions. Furthermore, the benefits of an increase in the New York exclusion amount are effectively denied to wealthier New Yorkers. There is a cliff built into the New York estate tax calculation, which quickly phases out the benefits of the exclusion if the decedent's New York taxable estate is between 100% and 105% of the exclusion amount available on the date of death. The cliff completely wipes out the benefits of the exclusion if the decedent's New York taxable estate exceeds 105% of the exclusion amount available on the date of death (the "New York estate tax cliff"). As a consequence, the increase in the New York estate tax exclusion amount only benefits individuals whose New York taxable estates fall below the New York exclusion amount in effect on the date of death. In addition, as mentioned above, the New York estate tax exemption is not portable to spouses for use on the survivor's New York estate tax return, in sharp contrast to the federal estate tax exemption. New York does not currently have a gift tax.

A comparison of the "spread" between the federal and New York State estate tax exemptions currently under the 2017 Tax Reform Act and as scheduled to sunset on January 1, 2026, is set forth below.

Spread Between Federal and New York State Estate Tax Exemptions

Date of Death	Federal Exclusion	New York Exclusion	Spread
January 1, 2021 to December 31, 2025	$11,700,000*	$5,930,000*	$5,770,000*
January 1, 2026 and beyond	$5,930,000**	$5,930,000*	~$0**

*based on 2021 inflation-adjusted amounts. Indexed for inflation for each year after 2021.

** In 2026, the New York estate tax exemption is actually scheduled to be slightly higher than the federal estate tax exemption due to differences in their respective indexing methodologies.

As a result of the dramatic spread between the federal and New York estate tax exemptions, decedents whose estates are below the federal estate tax exemption amount may still owe significant New York estate tax if their estates exceed the New York estate tax exemption amount. For example, if an unmarried New York resident dies in 2021 with an estate of $10,000,000 (assuming no lifetime gifts were made), he or she will owe no federal estate tax, but will owe $1,067,600 in New York estate tax (based upon current rates).

New Yorkers whose estates are within the 100% – 105% "cliff" range, or even whose estates only slightly exceed the New York estate tax exemption amount, may consider gifting such amount as would bring his or her taxable estate below the New York estate tax exemption amount. As an example, an unmarried New Yorker who has assets with a current value of $6,280,000 and is in relatively good health, may wish to consider gifting $350,000 at this time to his or her children or other intended beneficiaries. If such person dies after January 1, 2021, when the New York exclusion amount is $5,930,000 or greater, with a taxable estate of $5,930,000, his or her estate will owe no New York or federal estate tax. In contrast, if the gift is not made and the person dies in 2021 with a taxable estate of $6,280,000, the estate will owe $535,600 in New York estate tax (based upon current rates). To summarize, by making a gift of $350,000 today, this individual can save his or her beneficiaries over $500,000 in New York estate tax. This recommendation should not be affected by any subsequent changes to the federal estate, gift and GST tax laws.

A further benefit to New York residents making lifetime gifts within the parameters of the expanded federal exemption is the ability to permanently move assets out of the New York taxable estate without incurring any state-level gift tax. Because New York has no gift tax (although a three-year add-back applies), New Yorkers have the ability to permanently insulate gifted property from New York estate tax and may have the added benefit of reducing their New York taxable estate below the applicable exclusion amount on the date of their death. For some, this also can avoid the confiscatory impact of the New York estate tax cliff. For example, a gift of $11,700,000 by a New York resident can potentially save from $1,319,600 to $1,872,000 (depending on the total size of the taxable estate) of New York State estate tax. The New York estate tax savings could potentially be doubled if both spouses were to fully use their federal exemptions by making lifetime gifts.

The potential tax savings of such a gifting program should also be considered in tandem with the temporary expansion of the federal estate, gift and GST tax exemptions before the federal exemptions revert to pre-2018 exemption levels on January 1, 2026. If one were also to factor in the sunset of the doubling of the federal estate, gift and GST tax exemptions on January 1, 2026, back to pre-2018 exemption levels, the combined federal and New York State estate tax savings from such gifts at this time would be increased by another approximately $2,316,000 for an individual and $4,632,000 for a married couple, for a total of more than $3,600,000 for an individual and more than $7,200,000 for a married couple, as compared to persons who do not embark on a gifting program and allow their expanded federal exemptions to revert to pre-2018 exemption levels on January 1, 2026.

Potential Federal and New York Tax Savings in Gifting up to Federal Exemption

Amount of Gift Before 2026	Minimum New York State Estate Tax Savings	Federal Estate Tax Savings for Death After 2026	Combined Federal and New York Estate Tax Savings for Death After 2026
$11,700,000, for an individual	Approximately $1,319,600	Approximately $2,316,000	Approximately $3,635,600
$23,400,000, for a married couple	Approximately $2,639,200	Approximately $4,632,000	Approximately $7,271,200

As always, the potential estate, gift and GST tax savings should be weighed against the potential loss of the step-up of income tax basis for assets included in a decedent's taxable estate (assuming that the Biden proposal to eliminate the step-up in basis is not enacted).

Popular Wealth-Transfer Techniques to Leverage Expanded Federal Gift and GST Tax Exemptions Remain Viable – At Least For Now!

Individuals who wish to reduce or eliminate future estate and GST taxes may consider maximizing their use of the increased federal gift and GST tax exemptions before the exemptions revert to pre-2018 levels on January 1, 2026 (unless reduced sooner by new legislation). Strategies that are attractive include dynasty (generation-skipping) trusts, spousal lifetime access trusts ("SLATs"), grantor retained annuity trusts ("GRATs"), intra-family loans and sales to intentionally defective grantor trusts ("IDGTs"). Each transaction must be handled with proper professional guidance to ensure that the transaction is carried out properly. Brief explanations of these estate planning techniques are set forth below.

Dynasty (Generation-Skipping) Trusts

Through coordinated use of their federal gift and GST tax exemptions, individuals can create trusts with an aggregate value of up to $11,700,000 ($23,400,000 per married couple), which may benefit several generations of descendants while insulating the assets from gift, estate and GST taxes. These are sometimes referred to as "***dynasty trusts.***"

The creator of the trust would allocate GST tax exemption to the trust and fund the trust with assets likely to appreciate in value. Those assets would then be removed from the estate of the creator of the trust, and would not be included in the estate of his or her children and grandchildren, allowing the trust to grow free of transfer taxes for multiple generations. In addition to mitigating the impact of transfer taxes, a dynasty trust can help shield a family's assets from creditors, claims in the event of divorce and poor decisions of future beneficiaries.

Spousal Lifetime Access Trusts ("SLATs")

Dynasty trusts may be structured to give the grantor's spouse access to the trust as a discretionary beneficiary of trust income and principal. Such trusts with spousal access rights are sometimes referred to as "spousal lifetime access trusts," or "SLATs." The trust also can include children and grandchildren as beneficiaries.

As with the dynasty trust, GST tax exemption can be allocated to the trust and future appreciation on the SLAT assets are shielded from transfer taxes. Such trusts can provide additional comfort that transferred wealth would still be available for a married couple if needed down the road through distributions to the spouse. The assets essentially can serve as a "rainy day fund" while allowing one to take maximum advantage of the new tax laws.

Alternatively, as discussed earlier in this alert, trusts for the sole lifetime benefit of the spouse can be structured to be eligible for a qualified terminable interest property (QTIP) election on a timely filed federal gift tax return (including extensions) by making the spouse the sole beneficiary of the trust during the spouse's lifetime and requiring that all of the trust income be paid to the spouse at least annually. By doing this, the grantor would have until she or he files a gift tax return in 2022 (potentially as late as October 15,

2022 via an extension) to determine whether or not (and to what extent) to make a QTIP election. A QTIP election would be made to qualify the property transferred to the trust for the gift tax marital deduction and thereby protect against gift tax in the event that the gift tax exemption were retroactively reduced by subsequent legislation. In the event that there were no retroactive reduction to the gift tax exemption, then the decision could be made not to make a QTIP election and thereby consume the grantor's available gift tax exemption to remove property from both spouses' gross estates.

Grantor Retained Annuity Trusts ("GRATs")

Grantor Retained Annuity Trusts ("GRATs") are a popular technique used to transfer assets to family members without the imposition of any gift tax and with the added benefit of removing the assets transferred into the GRAT from the transferor's estate (assuming the grantor survives the initial term which can be as short as two years). GRATs take on added significance in a time of extreme market turbulence where there is opportunity to take advantage of funding a GRAT when there is a downswing in values.

In a GRAT, you transfer assets to a trust, while retaining the right to receive a fixed annuity for a specified term. The retained annuity is paid with any cash on hand, or if there is no cash, with in-kind distributions of assets held in the trust. At the end of the term, the remaining trust assets pass to the ultimate beneficiaries of the GRAT (for example, your children and their issue or a trust for their benefit), free of any estate or gift tax.

The GRAT can be funded with any type of property, such as an interest in a closely held business or venture, hedge fund, private equity fund or even marketable securities. It could also be used for an investment in a special purpose acquisition vehicle, or "SPAC."[5] The most important consideration is whether the selected assets are likely to appreciate during the GRAT term at a rate that exceeds the IRS hurdle rate (an interest rate published by the IRS every month). The value of the grantor's retained annuity is calculated based on the IRS hurdle rate – the lower the IRS hurdle rate, the lower the annuity that is required to zero out the GRAT. The hurdle rate is 0.8% for transfers made in March 2021. If the trust's assets appreciate at a rate greater than the interest rate, the excess appreciation will pass to the ultimate beneficiaries of the GRAT free of any gift tax. Thus, any asset that you think will grow more than 0.8% a year may be a good candidate for funding a GRAT.

Other factors to take into account in selecting the assets to be gifted are whether the assets currently have a low valuation or represent a minority interest (which may qualify the assets for valuation discounts for lack of control and lack of marketability under current law).

Generally, the GRAT is structured so as to produce little or no taxable gift. This is known as a "zeroed out" GRAT. Under this plan, the annuity is set so that its present value is roughly equal to the fair market value of the property transferred to the GRAT, after taking into account any valuation discounts. There is virtually no gift tax cost associated with creating a zeroed out GRAT.

Other benefits of a GRAT bear mentioning. The transfer to a GRAT is virtually risk-free from a valuation perspective. If an asset for which there is no readily ascertainable market value is transferred to a GRAT and the IRS later challenges the value that you report for gift tax purposes, the GRAT annuity automatically increases in order to produce a near zero gift. Accordingly, there is essentially no gift tax exposure. It should be noted, however, that GRATs generally do not provide the same opportunity for leverage for GST tax purposes that other estate planning techniques can provide in connection with transfers to or for the benefit of grandchildren or more remote descendants.

There may be no better time than the present to consider GRATs: the IRS hurdle rate remains low; the market is volatile; and valuation discounts are available.

It is possible that the Biden administration will seek to revive certain "Green Book proposals" made during the Obama administration that would require a 10-year minimum term for GRATs and would establish a minimum taxable gift requirement for them, such as 25% of the value of the property transferred to the GRAT. Given the possibility that this proposal may find its way into subsequent proposed legislation later this year, it may be beneficial to consider using longer-term GRATs to lock in the GRAT benefits under current law before any such potential legislation may be enacted. For individuals who wish to implement

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[5] In its simplest form, a SPAC is a shell company that raises capital in the public markets with the sole intention of finding and merging with a target operating company. A SPAC goes public without having identified any specific target to acquire. Instead of analyzing the assets of the SPAC—since the assets, post-IPO, consist almost entirely of cash—investors make their investment decision by evaluating the strength of the sponsor and its likelihood of consummating a compelling acquisition. SPACs in the context of real estate are discussed in the following Stroock client alert: https://www.stroock.com/news-and-insights/spacs-and-real-estate.

plans using multiple GRATs, it may be desirable at some point to fund several GRATs with cash and "put the GRATs on the shelf" for future investing opportunities.

Income Tax Considerations

GRATs, SLATs and certain dynasty trusts mentioned above also enjoy an income tax advantage.

A GRAT or a SLAT is a "grantor trust," and a dynasty trust can be structured as a grantor trust, meaning that you must pick up all items of income, credit and deduction attributable to the trust property on your personal income tax return. Being saddled with the income tax liability may seem like a burden, but it is actually a great estate planning advantage, in that it allows the trust property to grow income tax free for the beneficiaries, while reducing your estate gift tax free.

Another important feature of a grantor trust is that the trust can permit the grantor to swap personal assets with assets in the trust. This can be a very valuable technique for income tax basis planning.

Intra-Family Loans

Another technique that works very well in a low interest rate environment is an intra-family loan. Each month the IRS publishes interest rate tables that establish the lowest rate that, if properly documented, can be safely used for loans between family members without producing a taxable gift. Currently, these interest rates are near historic lows. For March 2021, the short-term rate for loans of up to three years is 0.11%; the mid-term rate for loans of more than three years and up to nine years is 0.62%; and the long-term rate for loans exceeding nine years is 1.62%. Funds that are lent to children, or a trust for the benefit of children, will grow in the senior family member's estate at this extraordinarily low interest rate, essentially creating a partial estate freeze plan. Those funds, in turn, can be put to use by the junior family member to purchase a residence or may be invested in a manner that hopefully will beat the hurdle interest rate.

Making a loan to a trust for your children may be even more advantageous than making a loan outright if the trust is intentionally structured as a grantor trust for income tax purposes. Ordinarily, the interest payments on the note must be included in your taxable income, but if the payments are made by a grantor trust, they will have no income tax ramifications to you.

Alternatively, depending upon one's circumstances, it may be more advantageous for senior family members to put some of their expanded federal gift and GST tax exemptions to work by making cash gifts to facilitate the prepayment of existing loans to family members and to trusts established for the benefit of family members.

Sales to Intentionally Defective Grantor Trusts

A sale to an intentionally defective grantor trust ("IDGT") can be an extremely effective planning strategy that takes advantage of the current market conditions. In the case of a sale of a minority interest in an entity or a fractional interest in real property, valuation discounts can also be leveraged. You would create an IDGT for the benefit of your children, grandchildren and more remote descendants. If there is an existing IDGT, all the better.

An IDGT provides two independent planning opportunities. First, you will pay the income tax on the income generated by the trust, including capital gains tax, thereby allowing the trust to grow for your children and their issue unencumbered by the income tax, while reducing your estate. In addition, you may engage in transactions with an IDGT without any income tax consequences.

For example, you can sell low-basis property to an IDGT without recognizing a gain. An ideal way to lock into valuation discounts would be to sell a minority interest in a closely held business or venture to an IDGT. That minority interest can be sold at a price taking into account discounts for lack of control and lack of marketability.

Under this plan, you would sell property to the trust and take back a note with fixed payments of interest and principal. Any property can be sold to an IDGT, but ideally the property would have a low current valuation, good prospects for appreciation and features that enable it to qualify for valuation discounts. If the principal on the note equals the fair market value of the property sold, no taxable gift results. In addition, if the assets appreciate in value above the interest rate on the promissory note, the excess growth in value may be used to retire the principal of the debt, leaving valuable property for your children free of transfer tax. In addition, by making a small gift to the IDGT and allocating GST tax exemption to the IDGT, the appreciation also can continue to grow for multiple generations free of transfer tax.

Individuals who have previously exhausted their exemptions through prior gifting, may want to leverage their gifting and the valuation discounts

even further. This can be done through new sales to grantor trusts or, where appropriate, by making cash gifts to facilitate the prepayment of existing installment obligations to senior family members from prior sales, before the expanded federal exemptions revert to their pre-2018 levels on January 1, 2026.

As mentioned above, the interest rates that can be used for this purpose are currently extraordinarily low. Unlike with GRATs, however, such plans may have valuation risks that need to be considered, particularly if the property sold is an interest in a closely held business or venture. Under certain circumstances, the temporarily expanded federal exemptions can be used as a cushion against valuation risks and against a valuation adjustment on audit. A senior family member can sell an interest in a closely held business or another hard to value asset to an IDGT, leaving a cushion for a valuation adjustment on audit. At the expiration of the three-year statute of limitations, the donor will have certainty as to his or her remaining exemption and can utilize the remaining exemption to "top off" additional gifting before January 1, 2026, when the federal exemptions revert back to pre-2018 levels. Therefore individuals should embark on such a plan as soon as possible.

As mentioned above, it is possible that the Biden administration will seek to revive certain "Green Book proposals" made during the Obama administration that would limit the ability to use transactions with IDGTs to keep subsequent appreciation outside of one's estate for estate tax purposes. Such tax reform may also reduce or eliminate the availability of discounts for family-controlled entities that do not engage in an active trade or business. So there is a potential benefit to planning with IDGTs at this time before any such potential legislation may be enacted.

Taking Advantage of Extraordinary Planning Opportunities Now

Under the TCJA, the federal gift, estate and GST tax exemptions have increased to $11,700,000 on January 1, 2021 ($23,400,000 for a married couple), allowing individuals vast but temporary multi-generational estate planning opportunities to use these exemptions through lifetime gifting before the exemptions revert to their pre-2018 levels on January 1, 2026, or sooner in the event of new tax legislation. Coupled with the significant market volatility and depressed values of some closely held business interests as a result of the COVID-19 disaster, and very low interest rates, this may be the right time to implement certain planning strategies. Selecting the optimal wealth transfer technique and the right assets to gift are of paramount importance.

Stroock's Private Client Services Practice Group continues to monitor all developments out of Washington and New York. We would be pleased to guide you in the selection and implementation of the right plan to meet your objectives.

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