

2021 Biden Plan Estate Planning Advisory

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After President-Elect Joe Biden's Electoral College victory over President Donald Trump, the nation's eyes were largely focused on the two US Senate run-off elections in Georgia, which determined the makeup of the US Senate for the coming years and, with that, affected the likelihood of the enactment of President-Elect Biden's tax agenda and other initiatives. Now that Democrat candidates Jon Ossoff and Raphael Warnock have won their respective elections, the Senate is divided 50-50, with any potential tie-breaking vote resting in the hands of Vice President-Elect Kamala Harris. As a result of these elections, many are left wondering how President-Elect Biden procedurally will go about enacting his various tax proposals and intentions (collectively, the "Biden Plan"), the likelihood of the enactment of the Biden Plan, whether the effective date of the Biden Plan could be made retroactive to January 1, 2021, and, if so, what can be done about this in the planning process. While the Biden Plan is comprehensive and contains proposals for individual income tax, taxes related to real property, and corporate tax reform (including increasing the top individual income tax rates, limiting deductions and taxing capital gains as ordinary income), this advisory is limited to the potential estate, gift and generation-skipping transfer (GST) tax reforms that President-Elect Biden has discussed.

Overview of President-Elect Joe Biden's Estate, Gift and Generation-Skipping Transfer Tax Plan

President-Elect Biden has expressed an intention to decrease an individual's federal estate tax exemption amount either to \$5 million per individual (and \$10 million for a married couple), perhaps indexed for inflation and perhaps not, or to the pre-Tax Cuts and Jobs Act amount of \$3.5 million per individual (and \$7 million for a married couple). This decrease in lifetime exemption could be coupled

with an increased top tax rate of 45 percent. Additionally, although Biden does not support a "wealth tax," and there has been no discussion of including a "wealth tax" in the Biden Plan, the Biden Plan might repeal stepped-up basis on death and, moreover, might tax unrealized capital gains at death at the proposed increased capital gains tax rates. While anything is possible, it should be noted that although transfer tax rates have gone up and down, transfer tax exemption amounts have never decreased before and prior attempts to repeal stepped-up basis on death have not been successful.

Likelihood of Enactment of the Biden Plan

Congressional Procedures

With the Democrats capturing Georgia's two seats in the US Senate in run-off elections, they will control both chambers of Congress, including their tax-writing committees. While this should give President-Elect Biden an easier path to pass much of his tax agenda, there are certain additional Congressional procedures that need to be considered before that happens.

In the Senate, subject to limited exceptions, it typically takes 60 votes to avoid a filibuster (which otherwise could delay or block legislative action). Although Democrats "control" the Senate, they hold only 50 seats. Barring filibuster repeal (which would be an unexpected change to the long-standing Senate rules), the support of at least some Republican Senators will be needed to achieve the 60 votes required to avoid a filibuster and allow tax reform legislation to proceed. That being said, there is also a process referred to as "budget reconciliation" by which some types of legislation (including certain tax measures) can be moved forward in the Senate with a simple majority vote.

The purpose of budget reconciliation is to provide a process by which Congress, once it has adopted a fiscal budget, can change existing spending and revenue laws to bring their application into conformity with the adopted budget. In other words, Congress must reconcile existing laws with the newly adopted budget. The Congressional Budget and Impoundment Control Act of 1974 provides for an expedited procedure in both the House and the Senate that limits debate to 20 hours, foreclosing the possibility of filibuster. Budget reconciliation cannot be used for all types of legislation. In President-Elect Biden's favor, however, the budget reconciliation process has been used since the late 1990s to enact revenue reducing legislation (i.e., tax decreases) and historically has been employed to achieve revenue increasing legislation (i.e., tax increases). While President-Elect Biden campaigned on his ability to work with lawmakers from across the aisle, it is likely that budget reconciliation may be attempted to advance his tax-based legislative policies, but it will succeed only if the entire Democratic caucus votes in favor of the proposed bill (which is by no means guaranteed).

Retroactivity

Assuming that some version of the Biden Plan is passed into law, one needs to consider its effective date. Typically, tax legislation is prospective, and might not be effective until January 1, 2022 or later (depending upon how long the enactment process takes). Sometimes, however, tax legislation is retroactive, in which case it would either be effective as of its date of introduction (which would in all events be sometime after the inauguration) or possibly even effective as of January 1, 2021.

Although many high-net-worth individuals are contemplating additional planning in 2021 to use more or all of their remaining estate, gift and GST tax exemptions before a potential reduction in those exemption amounts (currently \$11.7 million under each tax regime), one reason to proceed with some amount of caution is the possibility that any changes to these tax regimes may be retroactive to January 1, 2021. In other words, a retroactive reduction in exemption amounts to, for example \$5

million, could cause otherwise gift-tax free transfers retroactively to be subject to a large amount of gift tax. There is some precedent in previous court cases that suggests such a retroactive law lowering exemption amounts would be legal and constitutional, but it should be noted that this precise issue previously has not been litigated and its outcome would be uncertain. Still, much case law points to the fact that a retroactive change would be appropriate except in a situation where the taxpayer had no reason to think that the tax treatment would later change. Given the amount this topic has been discussed, such an argument that the taxpayer could not have foreseen the change may not be persuasive.

Accordingly, while the law appears to suggest that a change to the estate and gift tax regime may be applied retroactively to January 1, 2021 (if such legislative act is enacted within a reasonable time, such as calendar year 2021), there are, on the other hand, legitimate arguments that suggest a retroactive decrease in exemption amounts unfairly would prevent taxpayers from the opportunity to plan their affairs — and penalize those who attempt to undertake such planning — and so such retroactive treatment could be disallowed. Regardless of whether such a retroactive change in exemption amounts would be constitutional, it also is important to consider whether Congress would even attempt to make a new law retroactive. Although we are still evaluating the current political landscape, which inherently is an ongoing matter, our general view is that the political forces at play likely would not be supportive of a retroactive law given the Democratic control of the Senate by the slimmest of margins (in other words, there is not likely to be strong support for a retroactive law, but it is impossible to foresee how legislative negotiations will play out). Therefore, although it is possible that a retroactive change to the gift and estate tax regime can be legitimate, because the law is not entirely clear on this issue and political pressure suggests it is not a high priority, at present, it seems questionable that any change in exemption amounts would be applied retroactively. More likely, any change in law that is passed in 2021 would be effective on a forthcoming date, such as January 1, 2022. That said, due to the uncertainty of what laws might change and when they would take effect, we recommend all individuals contemplating additional 2021 estate and gift planning to contact an experienced estate planning professional to navigate the various issues, and to take action sooner rather than later to get a planning strategy in place.

Counteracting Buyer's Remorse

If reductions to the gift, estate and GST exemption amounts are made retroactive to January 1, 2021, is there anything that can be done for individuals who made gifts in 2021 prior to the enactment of these changes in law? Individuals contemplating such gifts should speak with an experienced estate planning professional to discuss certain techniques that can be considered to unwind estate planning in order to avoid an unintended gift or GST tax. For example, the individual could consider disclaimer planning, including allowing one beneficiary of a trust to disclaim on behalf of all trust beneficiaries. This should provide the designated beneficiary with nine (9) additional months to disclaim the gift and, if the designated beneficiary does so, the result should be that the gifted assets are returned to the donor without using any of the donor's gift and/or GST exemption.

Individuals could also consider planning with qualified terminable interest property (QTIP) elections. A married person could make a gift to a trust for the benefit of a US citizen spouse that would qualify for the marital deduction if a QTIP election is made or, if no election is made, would instead pass to a non-qualifying trust for the spouse that would use up the donor spouse's lifetime exemption. This provides the donor spouse with flexibility either to make the QTIP election or not in the following calendar year when the related gift tax return is due, depending on whether any reduction of the gift and/or GST exemption amount is made retroactive to January 1, 2021.

Finally, an individual could consider making gifts utilizing a formula transfer clause. The donor would make a gift of a fractional interest of an asset where the numerator is the donor's available exemption on the date of the gift and the denominator is the fair market value of the gifted assets, as finally determined for federal gift tax purposes. If the exemption amount on the date of the gift is retroactively reduced, the formula should "self-correct" so that the donor only gives away an amount equal to the donor's available exemption on that date.

Takeaway Observations

As the last four years in general, and the last four weeks in particular, graphically have demonstrated, anything is possible. But panicked responses or knee-jerk reactions to what might happen never make sense. It is, of course, likely that taxes will go up. But in trying to assess the likelihood of dramatic or radical changes to existing tax laws, and the timing of any such changes, in order to make reasoned decisions, it may be helpful to keep the following in mind:

- Joe Biden is a moderate Democrat.
- The Biden Plan is a proposal that Biden campaigned on in order to garner as many votes as possible from voters ranging from moderate to liberal. It does not mean, once he is inaugurated, that he will necessarily propose every aspect of the Biden Plan.
- Biden has a lifelong track record of forging compromises across both sides of the aisle.
- Even in the absence of compromise, it is not clear that 100 percent of the Democrats in the Senate would support extreme or retroactive tax changes (there are a few "conservative" Democrats that may vote against it).
- While everyone should be vigilant and prepared, there likely will be time to assess any proposed legislation and consider your options.
- Countries in the rest of the world have been imposing wealth taxes, making expatriation more penal and requiring public registers of beneficial ownership. All of those items are absent from the Biden Plan.
- As important as trying to anticipate change is, no one can predict the future. At least as important, if not more so, will be promptly and thoroughly reviewing your estate plans once change is enacted to make certain the plans still function as intended, in order to forestall dashed expectations and/or intra-family litigation.

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