

2021 Tax Update: What to Tell Clients About the Estate Tax

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Now that the dust has settled from the 2020 election cycle, attention is turning to what could soon become the new reality of higher taxes. In 2021, the federal estate tax exemption sits at \$11.7 million per person, or \$23.4 million for a married couple, with a 40% tax rate on estate values exceeding that amount. Given these high exemptions, many clients with a net worth in the \$5 million to \$20 million range believe their estates won't be subject to the estate tax. What these clients have lost sight of is that nothing is forever, especially as it relates to taxes.

At some point in 2021, we are very likely to see legislation proposed that would significantly reduce the exemption from its current level. Yet, regardless of whether any such legislation is enacted into law, as discussed below in more detail, the exemption is already set to be reduced in 2026.

To gain a better understanding of what could happen with federal estate tax law, it is first necessary to examine the current political landscape. That backdrop leads to an analysis of what tax law change could be coming down the pike, along with a detailed review of what happens if no such change occurs.

Current Political Landscape

The 2020 election cycle resulted in the Democrats capturing control of the executive branch when Joe Biden defeated incumbent President Donald Trump. The Democrats also retained a slim majority in the U.S. House of Representatives. The runoff elections in Georgia on January 5, 2021, resulted in the Democrats winning two additional seats in the U.S. Senate. Republicans retained 50 Senate seats and Democrats now control 50 seats. However, the Vice President of the United States serves as the President of the Senate and casts a tie breaking vote. Newly elected Democratic U.S. Vice President Kamala Harris, therefore, gives the Democrats what amounts to a Senate majority.

Upon President Biden's inauguration, Democrats control the Presidency, the U.S. House of Representatives and the U.S. Senate. Barring an unforeseen need for a special

election to fill a congressional seat, this Democratic control will remain until at least the 2022 mid-term elections.

What Changes Could Be Coming

President Biden has not specifically stated a proposed estate tax exemption in his tax plan. Instead, he has indicated he would like for the estate tax to return to “historical norms”. Given that the estate tax exemption has been a moving target with its constant change over the last 40+ years, “historical norms” could have many different meanings. However, we may not need to search too deep to determine what President Biden is referring to.

During his presidency, all of President Obama’s budget proposals included a \$3.5 million estate tax exemption per person (\$7 million for a married couple) and a 45% estate tax rate. Additionally, during her 2016 presidential campaign, Hillary Clinton proposed a return to the estate tax law of 2009 which also included a \$3.5 million exemption per individual and a 45% estate tax rate. Many estate planning professionals believe that President Biden and a Democratic controlled congress will target this \$3.5 million exemption and are counseling their clients accordingly. A reduction to this level would dramatically increase the number of clients in need of estate tax planning.

What Happens if Nothing Changes

Many clients believe the current \$11.7 million estate tax exemption is permanent. However, the Tax Cuts and Jobs Act (TCJA) of 2017, which set this increased estate tax exemption, did so temporarily. The Senate passed this portion of the 2017 law through the budget reconciliation process which is designed to simplify passage of budget related issues. In doing so, the law sunsets at the end of 2025 and, effective January 1, 2026, we revert back to a \$5 million estate tax exemption (indexed for inflation). ***Thus, if no legislation is enacted to reduce the estate tax exemption sooner, it will still be reduced significantly in 2026.***

What to Tell Clients About the Estate Tax

Now is the time for attorneys, CPAs and financial & insurance professionals to discuss potential estate tax law changes with clients. These client discussions should, at a minimum, include the following points:

- History has taught us that the only certainty with tax law is change.
- The current Democratic stronghold likely means a significantly lower estate tax exemption as soon as 2021 and, even if that assertion is incorrect, the exemption is scheduled to be significantly reduced in 2026.

- There are many planning strategies available to reduce exposure of clients' estates to federal estate taxation. To determine a specific client's exposure to the tax, a detailed analysis should be performed. Once the potential exposure is determined, specific tax planning strategies may be considered.
- While there's a possibility that any new estate tax law could be enacted retroactive to 1/1/2021, ultra-high net worth clients should consider using their full lifetime gifting exemption today.
- For other high-net worth clients, it may be time to commence a gifting program utilizing \$15,000 annual exclusion gifts or to adjust existing gifting programs.

The writing is on the wall and change is likely coming. This probable change offers professional advisors an opportunity to be a true resource to their clients and to guide them down an appropriate planning path.