Proskauer

Personal Planning Strategies

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Act Now Before the Window of Opportunity Closes

By now you have probably heard that the House Ways and Means Committee introduced legislation a few weeks ago (see Let the Estate Tax Planning Games Begin - But Where Will They Land - the House Ways and Committee Has Spoken) that would essentially curtail the use of "grantor trusts" after the "date of enactment" of the proposed law. At this time, it is impossible to predict whether the legislation will pass and what it will look like if it does. However, if it passes in current proposed form, the grantor of a grantor trust would no longer be able to make gifts to such a trust or engage in transactions with such a trust, such as a "swap" of assets with the trust or a sale of assets to the trust for a note.

Our clients have established many "grantor trusts" over the years. Indeed, practically every irrevocable trust we have drafted is such a trust because such trusts contain a provision that allows a grantor to "substitute" or "swap" assets" of equivalent value with the trust. This means that a grantor can transfer assets to the trust in exchange for the trust transferring assets to the grantor, provided that the assets exchanged are of equivalent value. Alternatively, a grantor could "sell" assets to the trust for an interest only note. Because of the grantor trust status, these transactions are ignored for income tax purposes; in essence, the tax law considers the transaction as being made between an individual and himself or herself, meaning that there should not be any income tax consequences.

The benefit of doing an exchange or sale is to remove "appreciating" assets from the taxable estate. Thus, if an individual owns an asset that has more appreciation potential than an asset owned by the trust, or more than the nominal interest rate that would be charged on a note in a sale of assets for a note (less than 1% at this moment in time), then the time to act is NOW. The reason the transaction must be implemented now is that under the proposed legislation, if the transaction occurs after the date of enactment, all or a portion of the assets in the irrevocable trust would be included in the grantor's taxable estate upon his or her death. This result would obviously defeat the purpose of the transaction and be punishing from an estate tax perspective.

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