

PRESENTED AT

**17th Annual Changes and Trends Affecting
SPECIAL NEEDS TRUSTS**

February 18-19, 2021
Live Webcast

Estate Tax Planning and SNTs

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ESTATE TAX PLANNING AND SNTs

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I. Why are We Talking About Estate Tax Planning?

Most of us who attend this conference either draft or administer Special Needs Trusts. Our clients want to provide for their loved one with disabilities, while retaining eligibility for government assistance. The Special Needs Trust (“SNT”) allows our clients to accomplish this goal. Some clients ask us if they must pay gift tax when they fund the SNT while they are living. They may ask us if the property that will fund the SNT upon their death will be subject to estate tax.

But wait. If your clients are wealthy enough to be concerned about gift or estate tax, then their child won’t need government benefits, right? The parents will leave sufficient funds to the child so that they have no financial need for needs-based benefits. This may be true in 2020 when the estate tax exemption was \$11.7 million per person, but it may not be true going forward, as the estate tax laws could be dramatically changed in the near future.

With Joseph Biden as the President and the Democrats with a slim majority in both the House and the Senate, President Biden’s tax plans have a higher chance of being enacted. He has not made clear proposals about the estate tax changes, but he may propose lowering the estate tax exemption to \$3.5 million to \$6 million per person and increasing estate tax rate to 45%. His plan includes eliminating the step-up in basis for inherited assets and higher capital gains tax rates, which could result in higher capital gains taxes for the heirs.

Estate tax exemptions could soon be lowered

It is quite possible that the estate tax exemption will be lowered in the near future, which means that we as estate planning attorneys may be doing more estate tax planning for families with children with disabilities. However, many tax planning techniques could be detrimental to beneficiaries receiving government benefits. Crummey withdrawal rights and disclaimers, for example, could disqualify them from SSI or Medicaid. This paper explores how estate tax planning affects benefits eligibility and possible solutions to avoid negative outcomes.

II. Transfer Taxes

A. Transfer Tax Overview

Transfer taxes may be imposed when property is transferred from one person to another. The transfer can be a lifetime gift or a bequest upon death. A gift tax is imposed on lifetime gifts, while estate tax is imposed when the transfer occurs upon death. The generation-skipping transfer (“GST”) tax is imposed on a transfer during life or upon death that skips a generation (for example to grandchildren). The GST tax is in addition to gift/estate tax, so the beneficiary who is two or more generations below the donor may pay double transfer tax.

The U.S. has a “unified” tax, which means that the transfer tax rate for lifetime gifts, gifts upon death and generation-skipping transfers (“GST”) are the same. Each person has a gift/estate tax and GST exemption of \$11.7 million in 2021. The maximum tax rate for transfers over the exemption amount is 40% in 2021.

To compute the tax, all lifetime gifts (in excess of the Annual Exclusion Amount, described in the next section) are added and the exemption is applied to them first. If there is any exemption left, it is applied toward the estate tax.

The current large exemption amount is set to expire at the end of 2025, when it is set to drop down to \$5 million adjusted for inflation after 2010. Congress, however, can change the exemption amount prior to 2026.

B. Terminology

The “**Exemption Amount**” refers to the gift/estate/GST estate tax exemption. This is the amount that can be transferred free of gift and estate tax. The general rule is that the portion of the estate/gift that exceeds the Exemption Amount is subject to estate tax. The IRS calls this the applicable exclusion amount or basic exclusion amount, but I won’t use that term as it is too similar to the Annual Exclusion Amount.

The “**Annual Exclusion Amount**” is the amount an individual can gift to another without using up their Exemption Amount.

Although not grammatically correct, I will use the pronoun “they” or “their” instead of “him or her,” “himself or herself,” or “his or hers.” For example, “the client’s goal may be to reduce their estate tax” instead of “the client’s goal may be to reduce his or her estate tax.” This is to make the sentences flow more smoothly.

C. Estate Tax

Your client’s goal may be to reduce their estate taxes. Federal estate tax is imposed when the decedent’s taxable estate exceeds the Exemption Amount. When one spouse passes away, there is no estate tax owed by the surviving spouse, under the marital deduction rule (if the surviving spouse is a U.S. citizen). You may use bypass/marital trusts in your estate plan for the married

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First appeared as part of the conference materials for the
17th Annual Changes and Trends Affecting Special Needs Trusts session
"Estate Tax Planning and SNTs"