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## Trump and the Death Tax

Donald Trump's tax plan calls for elimination of the "death tax," which refers to the federal estate and generation-skipping transfer ("GST") taxes, and may include the federal gift tax. His plan also calls for imposition of a tax on capital gains held until death and valued over \$10 million, including gains on assets passing to family-controlled private charitable foundations.

Given the Republican margins in both the House and Senate, estate tax repeal should have support, likely as part of a broader tax reform effort. Last year the House passed the latest in a series of bills calling for elimination of the estate and GST taxes, but not the gift tax.

The gift tax is viewed as a backstop to the income tax; it prevents people from freely moving assets back and forth to shift income to a taxpayer in a lower bracket. The 2015 House bill set the gift tax rate at 35% with an inflation-indexed \$5 million exemption. That bill also left in place the current income tax basis step-up for assets acquired from a decedent.

The climate is now right for estate tax change in whatever form it might take, although it is far from assured, and there is plenty of uncertainty as to timing and design. There are several possibilities—

- The estate tax and GST tax could be repealed immediately, with the gift tax left in place as a backstop to the income tax, and with carry-over basis (that is, limited or no basis step-up on capital assets acquired from a decedent). This is the regime that was fully phased in, albeit briefly, in 2010.
- The estate tax and GST tax could be repealed immediately, the gift tax left in place, and basis step-up left in place. This would have been the result under the 2015 legislation that passed the House.
- The estate tax, GST tax and gift tax could be repealed immediately, with either carry-over basis or basis step-up remaining in place.
- The estate tax, GST tax and gift tax could be replaced entirely with an income tax imposed on unrealized capital gains on assets held at death. A regime like this is currently in effect in Canada. Such an approach would likely allow a dollar-based exemption (the Trump plan calls for taxing gains exceeding \$10 million) as well as an exemption for marital transfers. The realization-on-death approach would likely include a realization-on-gift rule as well, so lifetime transfers of appreciated property (but not cash) would be subject to income tax. To prevent avoidance through the use of trusts, there could also be a deemed disposition of trust assets and resulting capital gains on a regular basis (in Canada there is a deemed disposition every 21 years).
- Any of these approaches could be phased in over time, or phased in subject to a 10-year sunset provision.

The Trump plan calls for broad tax reform, and any effort to change the current federal transfer tax system is likely to be part of the broader reform effort. Although the Republicans have a slight majority in the Senate, they will have to deal with the possibility of filibuster, which can be overcome only by a 60-vote majority. However, a filibuster cannot block a budget reconciliation bill, and tax legislation could be included in such a bill and passed with a simple majority vote. Another Senate obstacle is the Byrd Rule, which requires a 60-vote majority to pass any legislation

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that significantly increases the federal deficit beyond a 10-year period (this is the reason the estate tax repeal enacted as part of the Bush tax cuts was subject to a 10-year sunset period).

A complete repeal of the federal transfer tax system would result in a windfall for the wealthiest American families and would present great opportunity to place assets in trust to protect them from a reinstated transfer tax system down the road. However, we think this is unlikely, and we anticipate a more revenue-neutral reform of the transfer tax system.

More immediately, the Trump victory makes it possible that the IRS and Treasury's August 2016 proposed regulations under Section 2704 will never see the light of day in final form. Those proposed regulations restrict valuation discounts for interests in family controlled entities. A hearing is scheduled on December 1, 2016, but it is unlikely that the regulations will be issued in final form before President-elect Trump takes office on January 20, 2017, and these regulations are unlikely to continue to be a priority for the IRS while he remains in office.

We advise that clients continue with their ongoing planning efforts. Although change may come, the nature and timing are uncertain. However, we would advise against any planning that would result in adverse consequences if there is substantial change. For example, in most cases we would not recommend proceeding with any transaction that includes paying a federal gift tax.

Please contact your advisor at Ropes & Gray with any questions.