Future Tax Laws?

Quick-Take: Nothing is *permanent* when it comes to taxes.

Background: Less than a year ago Congress passed the One Big Beautiful Bill Act (OB3) which increased the applicable exemption amount to $15 million per person and pretty much locked-in the federal income tax rates under the 2017 Tax Act. We were told that the OB3 tax law changes were *permanent*. But no one really believes that these taxes are really permanent, or that they can plan their estates knowing that these tax laws will never change. Anyone reading the headlines these days knows that Congress may be forced to act to increase revenues with a trillion dollar 4-month war just behind us, or a $1.2 trillion federal defense budget before Congress, or building a new $600 million White House ballroom, or facing the 2032 shortfall in the Social Security trust fund. It is a mistake to assume that the tax laws currently on the books are *permanent* and that they will be with us for the next decade or longer.

States- Canaries in the Mine? While the OB3 keeps federal income taxes low, and it protects even more estates from federal transfer taxes, a quick look around the country tells us that states are not idly sitting by while federal entitlement programs and grants are cut back. Consider the following: (i) New York's governor and the City's mayor just proposed a pied-a-terre tax on second homes valued at more than $5 million when there is no resident who lives permanently in New York City: (ii) the State of Massachusetts imposed a 4% surtax on taxable income of more than $1 million (indexed for inflation) applied to individuals, estates, and trusts; (iii) the State of Washington imposed a 9.9% tax on household income that exceeds $1.0 million; and (iv) the citizens of California will vote on a Billionaire Tax Act this November which would impose a one-time 5% tax on the *assets* of billionaires, the wealth tax revenue from which would be used to shore-up the drop in California's federal healthcare funding stipend. It seems clear that there is a trend among the 'blue' states to raise taxes from wealthy individuals to replace the loss or reduction of federal programs or grants. In short, states seem to be willing to step up and fill the tax revenue void that has resulted from the DOGE cuts and the OB3.

Federal- Pending Bill: While it is not yet one year old, we already have Bills filed in Congress to change many of the OB3 provisions. One proposal, called the Strengthen Social Security by Taxing Dynastic Wealth Act [S.4196, 119th Congress (2025-2026) – I guess no one was interested in a ‘catchy’ acronym for this Bill]] would make significant changes to the federal transfer tax system. As a generalization, the Bill’s provisions would alter the OB3 transfer tax provisions and return them to those that were in place in 2009. Key provisions of this Bill, if enacted, would:

Reduce the federal transfer tax exemption **from $15 million to $3.5 million** per person.

Possibly **limit *portability*** of an unused exemption between spouses.

Increase the highest federal transfer tax rate **from 40% to 45%.**.

Separate the federal gift tax from the federal estate tax and **limit the lifetime gift tax exemption amount to $1.0 million per person.**.

Use the ‘new’ tax revenues created by these changes to **fund the Social Security shortfall** that is projected for 2032.

Impact on Estate Planning: If we accept the reality that low taxes are never really *permanent,* and that changes are most likely to be made by a future Congress, then how we approach estate planning should also change. After OB3, and it’s $15 million applicable exemption amount (coupled with *portability*) the focus of estate planning shifted from avoidance of federal estate taxes to positioning a decedent’s assets to obtain a basis step-up on the owner’s death. While admittedly it is highly unlikely that the Bill’s proposed changes just summarized will become law while Mr. Trump remains in office, 2028 is not that far away. Assuming that the Bill’s tax proposals were enacted, that would impact of how estate planning is currently discussed with clients.

Client Complacency: If you agree that tax laws are never *permanent,* advisors will initially have to deal with client complacency who believe the promise that the OB3’s changes are *permanent*. Clients still need to plan, and they need to add flexibility to their planning documents, e.g., trusts, to be nimble for either the trustee or the beneficiary to respond to changes in the tax rules.

Marital and Credit Shelter Trusts: With a reduction in the federal transfer tax applicable exemption amount, the complacency generated by *portability* of a $15 million transfer tax exemption between spouses might disappear. With a much smaller applicable exemption amount, or a dollar limit placed on the amount a deceased spouse's unused exemption amount (DSUEA) that can be *ported* to their survivor, credit-shelter trusts might come back in vogue. A QTIP trust for a surviving spouse might now be structured with a *Clayton* provision that permits the trustee to identify the amount that qualifies for the federal estate tax marital deduction. A marital deduction trust funding formula should include a spousal disclaimer that moves assets directed to the marital trust to a credit shelter trust for the surviving spouse if *portability* is somewhat curtailed.

Lifetime Wealth Shifting Strategies: If the gift tax applicable exemption amount is reduced from $15 million to $1.0 million per person, then some of the old techniques to shift wealth might be revisited. Currently with a $15 million federal transfer tax exemption, the focus is on positioning a basis adjustment to assets on the decedent's death. With a much lower $3.5 million transfer tax exemption, or a gift tax exemption that is 'capped' at $1.0 million, there should be an increased interest in the use GRATs, QPRTs, family limited partnerships with their valuation discounts, or the sale of appreciated assets to an intentionally defective grantor trust (IDGT.) Instead of large lifetime gifts to irrevocable trusts, the settlor might fund those trusts over time with *Crummey* withdrawal rights to avoid 'wasting' the settlor's limited 'lifetime' federal gift tax exemption.

Powers of Appointment and Basis Planning: With the current focus on basis planning, many trusts are now drafted giving a beneficiary, or an elder person, a testamentary general power of appointment, (sometimes called 'upstream planning' to force estate inclusion to gain the basis adjustment on the powerholder's death. Those estate inclusion strategies may have to be revisited, or re-written with formulae powers of appointment, to avoid unintended federal estate taxes on the powerholder's death. Another alternative might be to give a trust director of the trust the authority to change, or eliminate, a testamentary general power of appointment that was given to an 'upstream' older powerholder if the presence of that power of appointment would cause federal estate taxes in the powerholder's estate.

GST: Since the GST exemption cannot be *ported* to a surviving spouse, a donor may want to use his/her current GST exemption ($15 million) now while the large exemption is available, especially if a dynasty-type trust has been considered in the past. Alternatively, a spouse might add a 'reverse QTIP election) to a marital trust for their survivor, where the deceased spouse's unused GST exemption can be exploited with the QTIP trust.

Fund Dynasty Trusts and SLATs Now: Just like the planning that occurred prior to the OB3, if a dramatic drop in the applicable exemption amount is on the horizon, now would be a good time to fund a dynasty-type trust or a spousal lifetime access trust (SLAT) with assets to consume the settlors currently large transfer tax applicable exemption amount on the settlor's $15 million GST exemption amount.

Review Formula Provisions: Existing estate plans with dollar amount bequests tied to the decedent's currently high applicable exemption amount will need to be revisited in order to avoid an unexpected estate tax if the decedent's planned exemption drops from $15 million to $3.5 million.

Conclusion: Tax laws never remain static, which is why planning devices like trusts need to be as flexible as possible with their terms. With wealth disparity being the focus of progressive legislators around the nation (with many planning on a Blue Wave come this November), it is hard to believe that many wealth transfer strategies, like *grantor* trusts, will not come under attack. The key point is that clients should not stop planning based on the promises that they heard back in the summer of 2025 that the OB3's tax law changes are *permanent*.

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