December 20, 2016

# Milne Legal Press Release


## U.S. Estate Tax Dies Under Trump

President-Elect Donald J. Trump appears determined to repeal the United States (U.S.) Estate Tax when he is sworn into office as the 45th President on January 20, 2017.

If successful, President-Elect Trump's repeal of the U.S. Estate Tax would have a significant impact on U.S. decedents' estates, and as outlined below, even a greater impact on *non*-U.S. decedents' estates. Unlike U.S. decedents' estates which are subject to the Estate Tax on their worldwide assets, non-U.S. decedents' estates are only subject to the U.S. Estate Tax to the extent that such non-U.S. estates include "U.S. situs" assets, e.g., U.S. shares and U.S. real estate.[1] As discussed in more detail below, Milne Legal (ML) is of the view that the President-Elect's plan to eliminate the U.S. Estate Tax offers a more equitable approach to taxing decedents' assets than what exists under today's Estate Tax laws.

This Press Release will analyze the impact on both U.S. and non-U.S. estates if President-Elect Trump's plan is adopted and will suggest a few strategies for how best to move forward as we get closer to a Trump Presidency.

---

[1] See Treas. Reg. § 20.2104-1(a)(1) – (a)(5). "U.S.-situs" property includes: (i) real property located in the U.S.; (ii) tangible personal property physically located in the U.S. (including physical currency, automobiles, and artwork); (iii) shares of corporations organized in the U.S.; and (iv) intangible personal property, the written evidence of which is not treated as being the property itself, if it is issued by or enforceable against a U.S. resident, a U.S. corporation, or a U.S. governmental unit (this would include stock options enforceable against a U.S. corporation).

# I. Introduction

## A. U.S. Decedents' Estates.

The Estate Tax was first enacted in the U.S. in 1916 with a top estate tax rate of 10%.[2] Today, the U.S. Estate Tax has a maximum tax rate of 40% combined with a federal estate and gift tax exemption (i.e., the "unified credit") of $5.45 million per individual, or $10.9 million per married couple.[3] Inflation indexing will raise the exempt amount to $5.49 million in 2017 per individual and to $10.98 million per married couple.[4] The annual gift exclusion remains at $14,000 for 2017.[5]

This means a U.S. decedent (an individual who was either a U.S. citizen or whose "domicile" was the U.S. at the time of death)[6] may leave up to $5.49 million to his or her heirs without paying any federal estate or gift taxes. A surviving spouse may carry over each other's unused exemptions, allowing a couple to exempt almost $11 million ($10.98 million) from federal estate and gift taxes in 2017.

## B. Non-U.S. Decedents' Estates.

Under current Estate Tax laws, non-U.S. decedents are not entitled to the relatively large unified credit discussed above. Instead, a non-U.S. decedent's estate is allowed a nominal credit of USD 13'000, which exempts only USD 60'000 of U.S.-situs assets from estate tax. This USD 60'000 exemption may be

[2] The U.S. Estate Tax was enacted on September 8, 1916 under section 201 of the Revenue Act of 1916.

[3] IRC § 2010.

[4] See Rev. Proc. 2016-55 at: *https://www.irs.gov/pub/irs-drop/rp-16-55.pdf* whereby it states the following "For an estate of any decedent dying in calendar year 2017, the basic exclusion amount is $5,490,000 for determining the amount of the unified credit against estate tax under § 2010."

[5] Id.

[6] A U.S. decedent is a person who was either a U.S. citizen or whose "**Domicile**" was in the U.S. at the time of his or her death. "Domicile" is a common-law term that refers to a person's fixed and permanent place of abode. An individual's domicile is typically where the person intends to remain indefinitely, or where the person intends to return. U.S. Treasury Regulations define domicile as: "A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal." Treas. Reg. §20.0-1(b)(1), §20.0-1(b)(2).

increased by a U.S. Estate Tax Treaty, if applicable.[7] Proponents of the U.S. Estate tax often site the large unified credit available to U.S. decedents, stating that few U.S. estates are actually affected by the tax, but this is simply not the case for many non-US decedents whose estates are almost immediately impacted by the 40% tax.

All too often, ML has had the unfortunate experience of having to inform the heirs of a non-U.S. decedent's estate that a significant amount of U.S. estate tax is due because the nominal USD 13'000 estate tax credit has done little, of course, to protect the non-U.S. estate against the 40% estate tax.[8]

Of course, many will argue that this unfortunate result may be addressed beforehand with proper planning, but quite often, non-U.S. persons are simply not informed (after all it is a foreign tax to them)[9] of the harmful impact of the U.S. estate tax in order to carry-out the necessary tax planning prior to their death. With that being said, if President-Elect Trump repeals the Estate Tax in 2017, having to share this negative, and often surprising, information with the executors of non-U.S. decedents' estates, will be something of the past.

### C. Beneficiaries of the Transferred Assets.

Assets included in a decedent's estate receive a cost basis adjustment in the hands of the beneficiaries equal to the fair market value of the property at the time of the decedent's death.[10] This basis adjustment is usually referred to as a "step-up in basis," because assets tend to appreciate over time, but it is also possible that it could result in a decrease in basis if an asset has depreciated in value by the time of the decedent's date of death.

For example, if you bought stock for $200,000 in 2005 and it has a fair market value of $1 million on the decedent's date of death in 2017, the $800,000 built-in appreciation escapes capital gains taxation when distributed to a beneficiary due

---

[7] For example, the U.S.-Switzerland Estate and Inheritance Tax Treaty allows for an exemption in excess of the general USD 60'000 if the non-U.S. decedent is, at the time of his death, a "citizen of or domiciled in Switzerland." *See Article III of the United States-Switzerland Estate and Inheritance Tax Treaty (signed in 1951 and ratified in 1952).*

[8] It is difficult to explain that the same U.S. tax code that encourages foreign investment, e.g., see the portfolio interest exemption that exempts non-U.S. persons from paying withholding tax on their U.S. sourced interest income, then disadvantages the same group of non-U.S. persons by allowing them only a USD 13'000 credit against the U.S. estate tax, i.e., the U.S. tax code encourage non-U.S. persons to invest in the U.S. during their lifetime and then disadvantage them with a high U.S. estate tax at the time of death.

[9] After all, the U.S. estate tax is a foreign tax to non-U.S. persons so it makes perfect sense that many non-U.S. persons would simply not be aware of the foreign tax in order to carryout proper planning in advance of death.

[10] IRC § 1014.

to the beneficiary's step-up in basis—but it would be subject to the Estate Tax if the fair market value of your taxable estate is above the exempt amount discussed above.

## II. The Trump Presidency = Death to the Estate Tax

President-Elect Donald J. Trump stated the following during his 2016 campaign run for the Presidency:

> "American workers have paid taxes their whole lives, and they should not be taxed again at death."[11]

On President-Elect's website it currently lays out his proposal for repealing the Estate Tax:

> "The Trump Plan will repeal the death tax, but capital gains held until death and valued over $10 million will be subject to tax to exempt small businesses and family farms. To prevent abuse, contributions of appreciated assets into a private charity established by the decedent or the decedent's relatives will be disallowed."[12]

House Ways and Means Committee Chairman Kevin Brady stated the following:

> "I look forward to working with President-elect Trump on legislation to permanently bury the death tax once and for all. For too long, this tax has threatened family owned businesses… It's time to move forward with pro-growth tax reform that fully repeals the death tax and replaces it with a tax code built for growth." [13]

Although it is widely expected that President Donald J. Trump will seek to repeal the Estate Tax soon after he is formally sworn into office on January 20, 2017, one can't help but notice that his proposed plan to repeal the tax offers a

---

[11] According to available statistics, only about 0.2 percent of Americans — roughly 2 out of every 1,000 people who die — owe any estate tax, because the first $5.45 million of a person's estate is entirely exempt from the gift and estate transfer taxes. See Chuck Marr, Brandon Debot, and Chye-Ching Huang, "Eliminating Estate Tax on Inherited Wealth Would Increase Deficits and Inequality," Center on Budget and Policy Priorities, updated April 13, 2015

[12] *https://www.donaldjtrump.com/policies/tax-plan*

[13] See the following link at CNBC: *http://www.cnbc.com/2016/11/21/who-wins-if-trump-repeals-the-estate-tax.html*

compromise for Democrats who would otherwise strongly oppose his efforts. The compromise included in President-Elect's plan is structured to preserve the capital gains taxation[14] on the decedent's assets by *not* allowing the beneficiaries to take the favorable step-up in basis on the assets they receive from the decedent's estate. To preserve the capital gains tax, the beneficiary would retain the historical cost basis that existed in the hands of the decedent at the time of his or her death and any built-in appreciation in the transferred assets would be subject to taxation at the time the beneficiary chooses to sell the assets on some date in the future.

For example, assume you inherited AT&T shares from your father which he purchased several years ago for $2. At the time of his death, the fair market value of the shares was $40.[15] The chart below reflects the tax treatment to the beneficiary under current law (the step-up in basis) and the tax treatment under President-Elect's proposed plan (no step-up in basis), assuming a 20% capital gains tax:

**Step up vs. no step up**

| | Sale price per share | Cost basis | Capital gain per share | Tax per share |
|---|---|---|---|---|
| Step up | $40 | $40 | $0 | $0 |
| No step up | $40 | $2 | $38 | $7.6 |

Source: CNBC

The chart above shows the built-in capital gain that would be transferred to the beneficiary at the time of the decedent's death but no tax would be due until the shares are sold by the beneficiary at some date in the future. At such time, the beneficiary would calculate the capital gains tax by taking the FMV on the date the beneficiary sells the AT&T shares over the inherited cost basis of $2.

## III. Milne Legal's Reaction

With a Republican controlled House of Representatives and Senate, ML expects President-Elects' proposed plan to repeal the Estate Tax to be enacted and signed into law in 2017. Although we must wait and see what actually takes place, ML encourages its clients not to transfer any assets to potential beneficiaries that would trigger today's gift tax if the transfer can otherwise wait

[14] Although subject to a lower capital gains tax rate of 20% if held for over a year.

[15] This example was provided by CNBC news at: *http://www.cnbc.com/2016/11/21/who-wins-if-trump-repeals-the-estate-tax.html*

until a decision has been made on Trump's proposed plan. Further, if drafting a trust today, it would be advisable to provide the trustee with enough flexibility to adjust favorably if Trump's estate tax proposal becomes law.

**Dustin W. Milne**
*Managing Partner*

*"ML believes that repealing the Estate Tax and replacing it with a law which postpones any taxation on the decedent's transferred assets until such time as the beneficiary sells the assets, presents a more equitable approach than what exists under current Estate Tax laws. Such laws force many executors to sell the estate's assets in order to generate enough cash to pay the 40% tax. The favorable timing difference built into Trump's proposed plan to postpone any taxation on the estate's assets until the beneficiary chooses to sell the assets, is a game changer."*

If you have any questions regarding any of the President-Elect's tax proposals and how they may affect your tax planning strategies, please don't hesitate to contact Milne Legal.

* * * *

You may contact Milne Legal in Zurich, Switzerland at +41 44 214 6752 or at milnelegal.com.