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Subject: Brad Dillon - Yes, Democrats Could Enact Retroactive Tax Legislation Next Year with a Simple Majority Vote, So Plan Now or Forever Lose Your Exemptions!

"For our wealthier clients, a trust and estate professional's first order of business is typically convincing the client to adhere to one of the basic tenants of estate planning: use up your remaining gift and estate tax exemption amount as soon as possible. Indeed, I tell my students that adhering to that basic tenant is often the best tool in an estate planner's tool box. Among other benefits, utilizing the exemption to its fullest as early as possible shifts assets out of the donor's estate, along with any future appreciation attributable to that asset. It's simple, straightforward, and effective. And yet, there has never been a more urgent time in modern history to make use of the exemption, because there is a very real possibility that it, along with the aligned generation-skipping transfer tax exemption amount and potentially many other estate planning strategies, may be sharply curtailed, effective January 1, 2021, not 2022 or 2026.

While no one can predict with any certainty what the results of the congressional and presidential elections will be later this year, we know that tax reform is a top agenda item for Democrats, especially given the perceived need for additional revenue after spending trillions to combat a global pandemic and a severe economic downturn. Indeed, many Democrats have voiced their support for dismantling the Tax Cuts and Jobs Act of 2017, including lowering the gift and estate tax exemption to somewhere in the range of $3.5 million, a nearly 70% reduction from its current amount, and Joe Biden, the presumptive democratic nominee for president, has advocated for, among other things, eliminating the step-up in basis for capital gains.

What's more, under current congressional rules and procedures, raising revenue through tax increases is a much simpler process than lowering taxes, which often requires maneuvering through some challenging and arcane procedural hurdles. Raising taxes, however, would not require a filibuster-proof majority; rather, only 50 votes (and a democratic vice

president to break a tie) would be necessary should Congress choose to use budget reconciliation, a favored congressional process for enacting tax legislation. In addition, as has been done in the past, these rules could be enacted mid-year next year and applied retroactively to tax year 2021. Indeed, Supreme Court jurisprudence is unambiguous: such retroactive application of tax laws by itself does not run afoul of the Constitution. Given the what-appear-to-be increasing odds of a democratic majority in the Senate, a turnover in the White House, and the ease with which tax legislation that raises revenue can be enacted and applied retroactively, it is incumbent upon estate planning practitioners to urge their clients to plan this year, in 2020, while we can do so with any certainty."

Brad Dillon, J.D., LL.M., is a senior wealth strategist in New York, New York. He is also an adjunct professor of law at **Fordham Law School**, a frequent lecturer, and has published numerous articles in publications such as *Journal of Taxation*, *Trusts & Estates*, *Estate Planning*, and LISI.

Here is his commentary:

EXECUTIVE SUMMARY:

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While no one can predict with any certainty what the results of the congressional and presidential elections will be later this year, we know that tax reform is a top agenda item for the Democratic party, especially given the perceived need for additional revenue after spending trillions to

combat a global pandemic and a severe economic downturn. Indeed, many Democrats have voiced their support for dismantling the Tax Cuts and Jobs Act of 2017, including lowering the gift and estate tax exemption to somewhere in the range of $3.5 million, a nearly 70% reduction from its current amount, and Joe Biden, the presumptive democratic nominee for president, has advocated for, among other things, eliminating the step-up in basis for capital gains.

What's more, under current congressional rules and procedures, raising revenue through tax increases is a much simpler process than lowering taxes, which often requires maneuvering through some challenging and arcane procedural hurdles. Raising taxes, however, would not require a filibuster-proof majority; rather, only 50 votes (and a democratic vice president to break a tie) would be necessary should Congress choose to use budget reconciliation, a favored congressional process for enacting tax legislation. In addition, as has been done in the past, these rules could be enacted mid-year next year and applied retroactively to tax year 2021. Indeed, Supreme Court jurisprudence is unambiguous: such retroactive application of tax laws by itself does not run afoul of the Constitution. Given the what-appear-to-be increasing odds of a democratic majority in the Senate, a turnover in the White House, and the ease with which tax legislation that raises revenue can be enacted and applied retroactively, it is incumbent upon estate planning practitioners to urge their clients to plan this year, in 2020, while we can do so with any certainty.

COMMENT:

At the beginning of the year, several of the Democratic contenders for president, looking for ways to pay for their policy agendas, proposed sweeping tax reform. Nearly all of the proposals at that time settled on a new figure for the gift and estate tax exemption amount: $3.5 million, a nearly 70% decline from the current figure of $11.58 million. Presumptive democratic presidential nominee Joe Biden went further and proposed eliminating the step-up in basis provisions under code section 1014 for capital gains.[i] These proposals came prior to the coronavirus pandemic and the subsequent congressional spend of trillions of dollars to combat the fallout, engendering a new sense of urgency to raise federal revenues and leaving little doubt that a Democratic majority would set their sights on tax reform.

What would it take to enact any new tax legislation, whether it be a decrease in the exemption amount, an increase of the capital gains tax rate to 39.6%, as Mr. Biden is calling for, or even a wealth tax, as potential vice presidential nominee Elizabeth Warren has touted? The answer is not much at all, at least for some less controversial proposals, such as a lowering of the exemption amount where there seems to be consensus amongst Democratic politicians. Passing tax legislation is a relatively straight-forward process, as long as there is an alignment of political parties between the House of Representatives, the Senate, and the White House. Political alignment of parties is the most difficult condition to meet, and the elections being held later this year pose many significant obstacles for both the Democratic and Republican parties in obtaining any alignment between the executive and legislative branches. Indeed, Republicans would have to pick up over 36 seats in the House of Representatives to obtain a majority there, and Democrats would need to gain at least four Senate seats to claim a majority in the Senate, neither being a small feat.[ii]

If Democrats can secure at least 49 Senate seats (assuming Bernie Sanders, a registered independent, votes along Democratic party lines), the process by which tax increases are enacted into law is relatively straightforward and, importantly, avoids any of the arcane procedural hurdles that become necessary when enacting tax decreases. Article 1, section 8 of the U.S. Constitution grants “the power of the purse” to Congress alone and requires that to become law, a bill must be approved by a majority of both the House and the Senate.[iii] Senate procedures, however, allow for unlimited debate, where any Senator may speak for as long as he or she wishes, effectively giving any Senator the power to block or delay legislation. This tactic, known as filibuster, can only be overcome by a three-fifths majority vote, or 60 senators, which forces debate to a conclusion, a process known as cloture. Filibuster rules create a difficult hurdle for a party to enact any controversial or outwardly partisan legislation. Nevertheless, there are at least three paths around the filibuster hurdle. First, a majority party could court members of the minority party to sign onto their bill, though tax reform is often a partisan issue and would likely pose a significant challenge to this path. Second, since Congress has plenary power over its own procedural rules, a majority party could exercise what has been called the “nuclear option” and eliminate filibuster procedures altogether, allowing for a bill to become law by a simple majority vote.[iv] Finally, budget reconciliation rules could be used to

overcome filibuster and allow a simple majority (or a tie broken by a the vice president) to enact tax legislation.

Budget reconciliation is the likely path Democrats would use to enact sweeping and potentially controversial tax legislation without a single Republican vote. The purpose of reconciliation is to provide a process by which Congress, once it has adopted a fiscal budget, can change existing spending and revenue laws to bring their levels into conformity with their adopted budget; in effect, they must *reconcile* existing laws with the newly adopted budget. The Congressional Budget and Impoundment Control Act of 1974 provides for an expedited procedure in both the House and the Senate that limits debate to 20 hours, foreclosing the possibility of filibuster. While the reconciliation process has been used since the late 1990s to enact revenue reducing legislation (i.e. tax decreases *a la* the Tax Cuts and Jobs Act of 2017), it has historically been employed to achieve revenue increases (i.e. tax increases). What's more, the additional procedural obstacles required to enact tax decreases using reconciliation, such as adhering to the so-called Byrd Rule or the pay-as-you-go, or PAYGO rules, both of which block increases in the deficit over a period of years, become moot when reconciliation is used to decrease the deficit by, for example, raising taxes. In short, a Democratic majority in the Senate (or a deadlock that could be broken by a vice president) would not encounter any constitutional or procedural hurdles in enacting sweeping tax reform in 2021.

The final step in a bill becoming law is determining the law's effective date. Generally, unless otherwise provided by law, an act becomes effective on the date of its enactment. However, nothing forbids Congress from determining a different effective date, including a retroactive effective date, even one that retroactively increases a taxpayer's tax liability in a given year. While the Constitution is silent on this issue, the Supreme Court has recognized that "the practicalities of producing national legislation" has made retroactive application of tax laws a "customary congressional practice."[v] There are grounds on which a taxpayer may challenge the constitutionality of retroactive tax laws, but those grounds are very narrow in scope. For example, a taxpayer may argue that the retroactive increase in her tax liability deprives her, under the Due Process Clause, of property without due process of law. The standard the Supreme Court uses in assessing these claims is whether the retroactive application is "supported by a legitimate legislative purpose furthered by rational means."[vi] This low

bar for judicial scrutiny has meant that the government has won most cases dealing with the retroactive application of tax legislation.

For example, in United States v. Carlton, the Court upheld a retroactively-applied federal estate tax law that curtailed the use of a deduction for proceeds of a sale of stock to an employee stock ownership plan. The deduction came about in the Tax Reform Act of 1986 but was amended 14 months later in 1987 to close a perceived loophole. The amendment applied retroactively, as if it had been incorporated into the 1986 Act. The Supreme Court, in upholding the amendment, noted that there was no apparent "improper motive" on the part of Congress, nor any "illegitimate or arbitrary purpose" in making the amendment retroactive.[vii] Despite that the amendment was enacted in a separate tax year, the Supreme Court noted that the period of retroactivity was permissible. What's more, a taxpayer's claim that they have relied on the tax law as it existed at the time is "insufficient to establish a constitutional violation"[viii] unless the taxpayer has no expectation that a particular transaction will be taxed, such as in the case of a wholly new tax (e.g. a wealth tax). And just to be sure, it is well established jurisprudence that taxation does not fall within the Constitution's Takings Clause, which provides that private property cannot be taken for public use without just compensation.

Specifically, the courts have ruled that retroactive transfer tax increases do not violate the constitution. In Quarty v. United States, the taxpayers challenged a retroactive increase in the estate and gift tax rates. Prior to 1993, the top estate and gift tax rates were 53% and 55%, respectively. The top rates dropped to 50% on January 1, 1993, but then Congress retroactively restored the prior rates in August of 1993. The taxpayers argued, among other things, that the retroactive increase violated the Fifth Amendment's Due Process and Takings Clauses. The Ninth Circuit held that the increase in rates for a retroactive period of eight months was a rational means to raise revenue.[ix] Dismissing the taxpayers' argument that an estate could never be fully administered and closed if the amount of tax owed could never be finally determined, the court held that a period of just eight months did not present such a possibility.[x] Finally, responding to claims that the taxpayer had relied on the decreased rate and that the rate increase was a taking of property without just compensation, the court, adhering to precedent, noted that the tax change was merely an increase in the rate of an existing tax, not a wholly new tax.[xi]

If Democrats are able to garner the votes for a decrease in the gift and estate tax exemption amount or an increase in the rates (or any other tax changes they may seek to enact), there would be almost no obstacles to enacting any legislation retroactively, as long as it is done in relatively short-order and not applicable to a “wholly new tax,” such as a wealth tax. In fact, even if a democratically-led Congress did not enact legislation until several months into their term, or even quite possibly until 2022, the retroactive application of the law to January 1, 2021 would almost certainly be deemed constitutional under current jurisprudence. Finally, a taxpayer could not use reliance as an argument, since a lowering of the exemption or an increase in rates is simply a readjustment of a well-established transfer tax regime, not a wholly new tax.

Like many practitioners, I have been urging clients to take advantage of this unprecedented environment to plan. With gift and estate tax exemption amounts at an all-time high, interest rates at an all-time low, and asset values depressed across many asset classes, it truly is our moment as trust and estate professionals to help our clients minimize their estate tax liability and protect their assets from potential creditors. Of course this historic time unfortunately coincides with a global pandemic, economic uncertainty, and domestic and civil unrest. It is natural that many clients will want to challenge our insistence that the time to plan is now, and for some, it may make sense to wait. However, for many clients, if not most, the time really is now.

To summarize: no, we may not have until the end of 2025 to utilize these exemptions. As the prospects for Democrats in November rise, so too do the prospects of a significantly altered and much less favorable environment for estate planning. No, clients may not have until the end of 2021 to utilize the exemptions. Tax reform is top of mind for many Democrats, including Joe Biden, and even if they take up to a year after coming into office to enact tax legislation, there are effectively no constitutional or procedural hurdles in making that legislation retroactive to January 1, 2021. And finally no, clients should not wait and see what happens in November to begin planning. Estate planning professionals, accountants, expert appraisers, banks, charitable institutions, and nearly everyone else necessary to effectuate a sophisticated estate plan will likely be overwhelmed (think 2012 fiscal cliff) if Democrats win a sufficient number of seats in the Senate and take the White House in November. The time really is now, and all of our clients need to know this.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Brad Dillon

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CITATIONS:

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[i] https://taxfoundation.org/joe-biden-tax-plan-2020. Mr. Biden does not currently propose a lowering of the gift and estate tax exemption amount as many other Democratic candidates have called for.

[ii] Rather than prognosticate on the outcome, I leave the reader to draw their own conclusions.

[iii] Article 1, section 7, clause 2.

[iv] For a full discussion of the procedure for exercising the nuclear option, *see* Dillon, "Budget Reconciliation: Procedure and Possibilities for Permanent Tax Reform," JTAX, April 2017.

[v] United States v. Carlton, 512 U.S. 26, 33 (1994).

[vi] Id. at 31.

[vii] Id.

[viii] Id. at 34.

[ix] 170 F.3d, 961, 969 (9th Cir. 1999).

[x] Id.

[xi] Id.