A STRATEGY SPOTLIGHT

Estate Tax Change and You

The U.S. estate tax has been around for a long time. In fact, the first federal tax imposed at death was introduced in 1797. Over the 223 intervening years, the estate tax has gone through many changes, including three repeals and re-enactments. With the passage of the Tax Cuts and Jobs Act (“Tax Act”) on December 22, 2017, the estate tax went through more changes — doubling the exemption to $10 million[1] (indexed for inflation).

What does that mean for your estate tax planning? The estate tax exemption has again increased, this time significantly. Will it remain at a high level, or will it change again with a new administration? A little history may provide some clues to help with your preparation. Planning based on potential estate tax changes should only be done after consulting your personal estate tax advisors. You should also consider the non-tax goals of your current planning in deciding whether to make changes to your estate plan.

[1] **Please refer to IRS.Gov for the most up to date information.**

HISTORY OF U.S. TRANSFER TAXES

Year Enacted	Year Repealed	Reason for Enactment
1797	1802	"Stamp Tax" enacted to increase naval presence for potential war with France
1862	1870	Inheritance tax enacted to raise money for Civil War
1898	1902	Estate tax enacted to finance Spanish-American War
1916	N/A	Estate tax enacted to finance World War I — never repealed

Early Transfer Taxes

As shown in the table above, prior to World War I, federal transfer taxes were used primarily to finance war efforts.

In 1906, President Theodore Roosevelt broke with the tradition of using transfer taxes to finance war efforts and proposed a tax on lifetime gifts and death transfers to limit the amount one person could transfer to another. His goal was to break up large concentrations of wealth. The proposal did not result in any immediate legislation.

Modern Estate Tax

It wasn't until 1916, when World War I caused revenues to fall, that an estate tax (similar to the present-day version) was imposed. It covered all property owned by the decedent at his or her death, certain gifts, and transfers that were made in contemplation of death. The exemption was $50,000, and tax rates ranged from 1% to 10% on assets over $5 million. After the war, the estate tax became "permanent." The period between its enactment in 1916 and the passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) saw numerous changes that were mainly focused on fluctuating tax rates, rising exemptions, and broadening of the property subject to the estate tax.

The gift tax was enacted in 1924, repealed in 1926, and reinstated in 1932. A generation-skipping transfer tax was enacted in 1976.

The only estate tax constant is change. If the estate tax is repealed, history shows it may not be repealed forever. A future Congress and president may reenact an estate tax, possibly with a lower exemption and higher rate than current law.

Economic Growth and Tax Relief Reconciliation Act (EGTRRA)

In 2001, Congress enacted EGTRRA, which increased the exemption to $5 million and reduced the maximum rate to 45% over nine years, from a $1 million exemption and top rate of 55%. It provided for the estate tax to be repealed in 2010. This was the first time since 1916 that legislation was passed to repeal the estate tax. However, EGTRRA also had a "sunset" provision, which provided that the estate tax would be reinstated in 2011 with a $1 million exemption and a 55% maximum rate. In effect, the estate tax was to be repealed for only one year.

Post-EGTRRA Developments[2]

Between 2001 and 2010, there were several attempts to make the 2010 repeal permanent. On December 17, 2010, Congress retroactively reinstated the estate tax for 2010 and provided for a $5 million exemption with inflation adjustments starting in 2011 and a top tax rate of 35%. This law was scheduled to last through 2012, when the pre-EGTRRA law would return. At the beginning of 2013, the American Taxpayer Relief Act (ATRA) was enacted. It made the 2012 estate tax law permanent, except that the top tax rate was increased to 40%. Currently, the estate tax exemption is $11.58 million (indexed for inflation) per person in 2020.

Under the Tax Cuts and Jobs Act of 2017 the estate exemption amount will continue to be based on an inflation-indexed $10 million amount but will revert to an inflation-indexed $5 million as of January 1, 2026.

What You Need to Know

Why does all of this matter to you? It matters because you may be thinking about changing your estate plan due to the large increase in the estate tax exemption. Some of those changes may include surrendering existing life insurance policies, unwinding irrevocable trusts and other parts of your estate plan, or not executing an estate plan at all.

This brief history of the estate tax shows the only constant is change. And, while the estate tax exemption was just increased, change in the future may be likely. It is possible that a future Congress and president may change it again, possibly with a lower exemption and higher rate than current law.

You should consult your personal estate tax advisors about whether to change your estate tax planning because of changes to the estate tax exemption. The other benefits provided by life insurance and irrevocable trusts should be considered when deciding whether to surrender or reduce current life insurance protection or terminate an irrevocable life insurance trust. If the estate tax exemption is lowered, you may not be able to purchase new life insurance due to your health or age.

It is impossible to predict what tax law changes will occur in the future. There are many demands on the federal budget. Hard choices will end up being made. What happens with the estate tax may be one of them. For you, implementing planning assuming your estate will never be greater than the current estate tax exemption or that the exemption will never change again, may not produce the results that you want.

[2] In 2010, estates could elect out of estate tax with stepped-up basis and into no estate tax with a carryover basis.

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AS6015 1219 CRN202110-255161