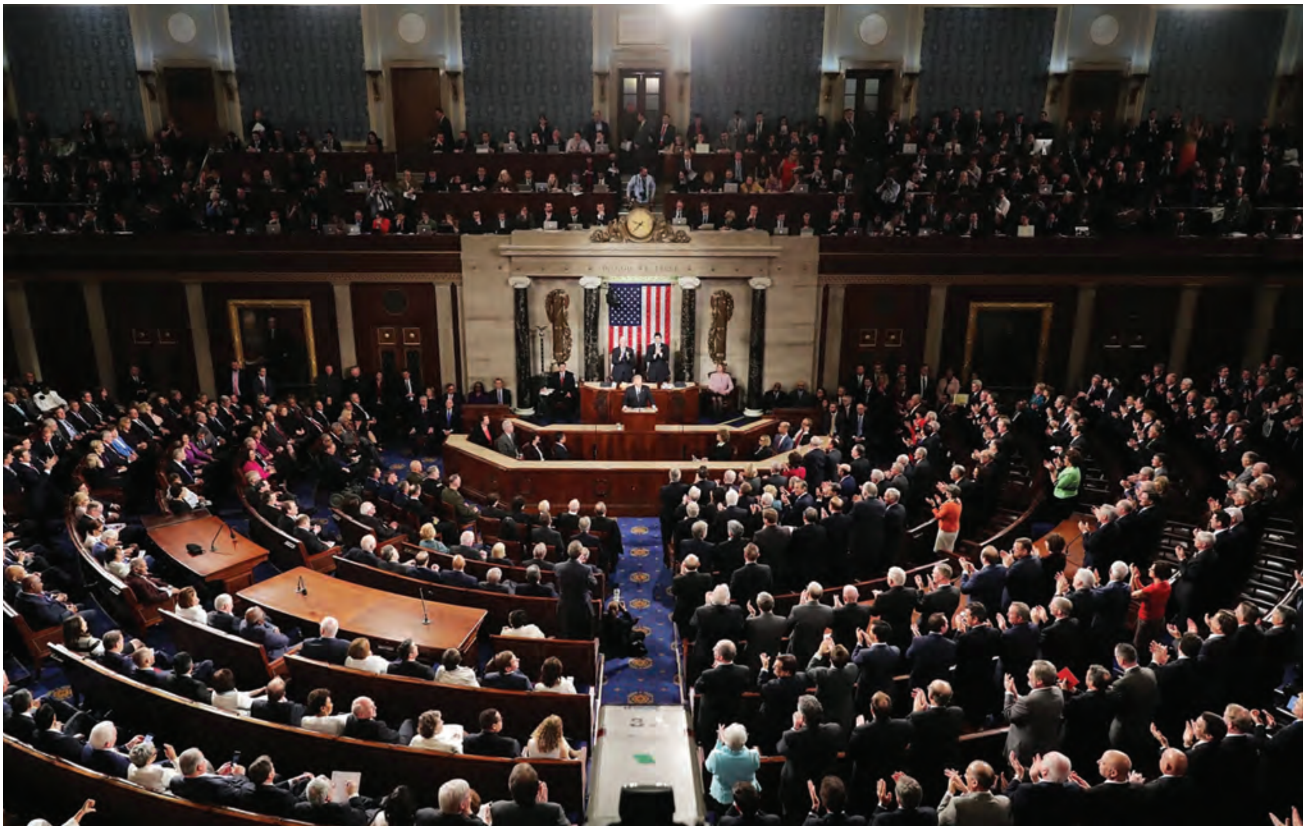
Biden Administration's Green Book Proposes Dramatic Estate Planning Changes

CPAs Should Consider the Potential Impact

By Martin M. Shenkman



The Biden Administration recently released its fiscal 2024 revenue proposal, which includes many dramatic changes that will affect most aspects of estate planning. The first reaction of many is that this will not be passed with a Republican-controlled House. Although that might be true, one should never say never when it comes to Congressional action. With debt ceiling negotiations looming, there is no telling what deals might be made, even deals that might include one or more of the Biden Administration's proposed estate tax changes. It is also important to note that many aspects of the administration's estate tax proposals have circulated in similar forms for many years. Thus, even if these changes are dodged this round, they might not be avoided forever.

It is unlikely that many individuals will be motivated to take significant planning action based on the Green Book. Many people rushed to plan in 2012, 2020, and 2021 in advance of harsh anticipated tax changes, none of which came to pass. Thus, most clients are likely to be skeptical of a communication from advisors to the effect of "plan now, before major harsh tax changes are enacted." Nonetheless, it would seem prudent for CPAs to caution clients about the proposals and that the implications should at least be considered. Some of the proposals will only be effective prospectively after the date of enactment. Others will affect every trust or plan no matter when done. So it would seem advisable to at least complete planning that makes sense before any of the laws might change. The following is only a brief overview of a portion of the many changes that have been proposed.

Who Is an Executor?

The definition of who will be deemed an "executor" would be broadened substantially, and rules would be provided to determine who will fill that role if there is no will naming such a person. The new and enlarged executor role would be applicable for all tax purposes, and would authorize such an executor to do anything on behalf of the decedent in connection with the decedent's pre-death tax liabilities or other tax obligations that the decedent could have done if still living. This might simplify matters for CPAs trying to identify who can sign a tax filing or take other actions. It might also create significant issues if that person becomes responsible for addressing foreign reporting requirements, income taxes, and more.

Special Use Valuation

The real estate used in family farms, ranches, or businesses would qualify to be subjected by election to be treated as special-use property so that the value could be reduced for estate tax purposes by up to $13 million, from about $1.3 million currently. This would be a huge advantage for farm, ranch, and qualifying business land that could change estate planning for affected taxpayers.

Trust Reporting

Under current law, complex or non-grantor trusts have to file income tax returns. Some grantor trusts are merely reported on the grantor's Form 1040 and no reporting is made. The Green Book would require trusts with more than $300,000 in net worth or more than $10,000 of income to file new reports disclosing asset values and detailed information on trustees. These disclosures, while still vague, seem to be part of a trend towards the government requiring more reporting and detailed reporting for entities (e.g., the Corporate Transparency Act) and, now, trusts. Whether or not this change is made into law, it will likely continue being re-proposed until it is enacted. If this reporting becomes law, it is not clear if the filings will be on expanded Form 1041 or new forms; if not on the 1041, attorneys—not CPAs—might be more likely to handle this compliance. If any such proposal is enacted, many individuals will be enraged by yet more compliance demands and especially by the potential complexity and invasiveness of these filings.

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Defined Value Mechanisms

The proposal would ban defined value mechanisms from use. These techniques endeavor to avoid an unanticipated gift tax based on an audit adjustment of the value of non-marketable assets, such as interests in a family business that are transferred to a trust. The concept behind many of these techniques is that a dollar value, not a percentage interest, is transferred. If a taxpayer transferred $10 million of value of LLC interests—not, say, 40% of the LLC—if there is an audit adjustment, the percentage of membership interests that have passed to the taxpayer's trust will change, but the dollar value will stay fixed; arguably, then there can be no gift tax triggered. The IRS has long disliked these mechanisms, and the Biden Administration has proposed legislatively eliminating them. This would create a considerable inequity for taxpayers who hold hard-to-value assets such as real estate, closely held businesses, or art, as contrasted with individuals who own marketable securities. The potential impact of this change is such that individuals with substantial holdings of hard-to-value assets might choose to complete planning before a potential law change.

Goodbye, Annual Exclusion Gifts?

The IRS has long disliked taxpayers making large numbers of annual gifts to trusts and using Crummey (annual demand) powers to qualify those gifts for the annual exclusion. An individual with many children, grandchildren, nieces, and nephews—say, 30 in total—could gift $17,000 × 30 to a trust and move a massive amount of wealth outside of their estate. The proposal would eliminate the present interest requirement (no more need for a Crummey power) to qualify for the gift tax annual exclusion. That is a good thing for taxpayers, but it would cap all gifts at an aggregate of $50,000 per year per donor. For most individuals, this would exceed annual gifts they would make; but for many wealthy clients, this could undermine a foundation of their annual gift plans, disrupt life insurance trust planning, and much more. Although wealthy individuals could "wait and see," it may be more prudent to plan now to shift wealth to trusts if the client's plan requires large ongoing annual gifts.

End of the Dynasty Trust?

The trend for most trust planning for many years has been to create long-term trusts limited only by a period that state law limits trust duration. The trusts have been, to the extent available, allocated the generation-skipping transfer (GST) exemption so that the funds in the trust can grow outside the transfer tax system for their duration. This technique would come to an end if the Green Book GST rules were enacted. One of the proposals basically limits the benefit of the GST exemption for only as long as the life of any beneficiary no younger than the donor's grandchild. This could mean substantial GST tax due in the future on trust assets that will require liquidity planning well in advance. Furthermore, with so many trusts built on this assumption, undoubtedly there will be legal and other issues that must be confronted; many have not anticipated such a dramatic change in trust documents.

Will GRATs Disappear?

Grantor Retained Annuity Trusts (GRAT) have been a common estate planning tool for years, but the Green Book would effectively end the widespread use of GRATs. It would require that the remainder interest in a GRAT have a minimum gift tax value of the greater of 25% of the assets or $500,000. There could be no decrease in the annuity during the GRAT term. The grantor would recognize gain on exchanging assets with the trust. A GRAT would have a minimum term of 10 years and a maximum term of the life expectancy of the annuitant, plus 10 years under the proposed changes. ■

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