

President Biden's 2025 Green Book Revenue Proposals *Estate Tax*

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Why Practitioners Should Care; What to Tell Clients

- The effective date of many of the proposals is at the end of 2024 or the date of enactment. It is possible that some of these provisions might be enacted as part of negotiations in Congress before the election. If the Democrats gain sufficient power in the election, they may force many or all these changes.
- If either of the above happens, there may be sufficient time to act before changes are effective.
- These changes will transform planning as we know it.
- Consider communicating to clients the gist of some changes and suggest that there may be some benefit to acting this year.

CAPITAL GAIN TAX REFORM

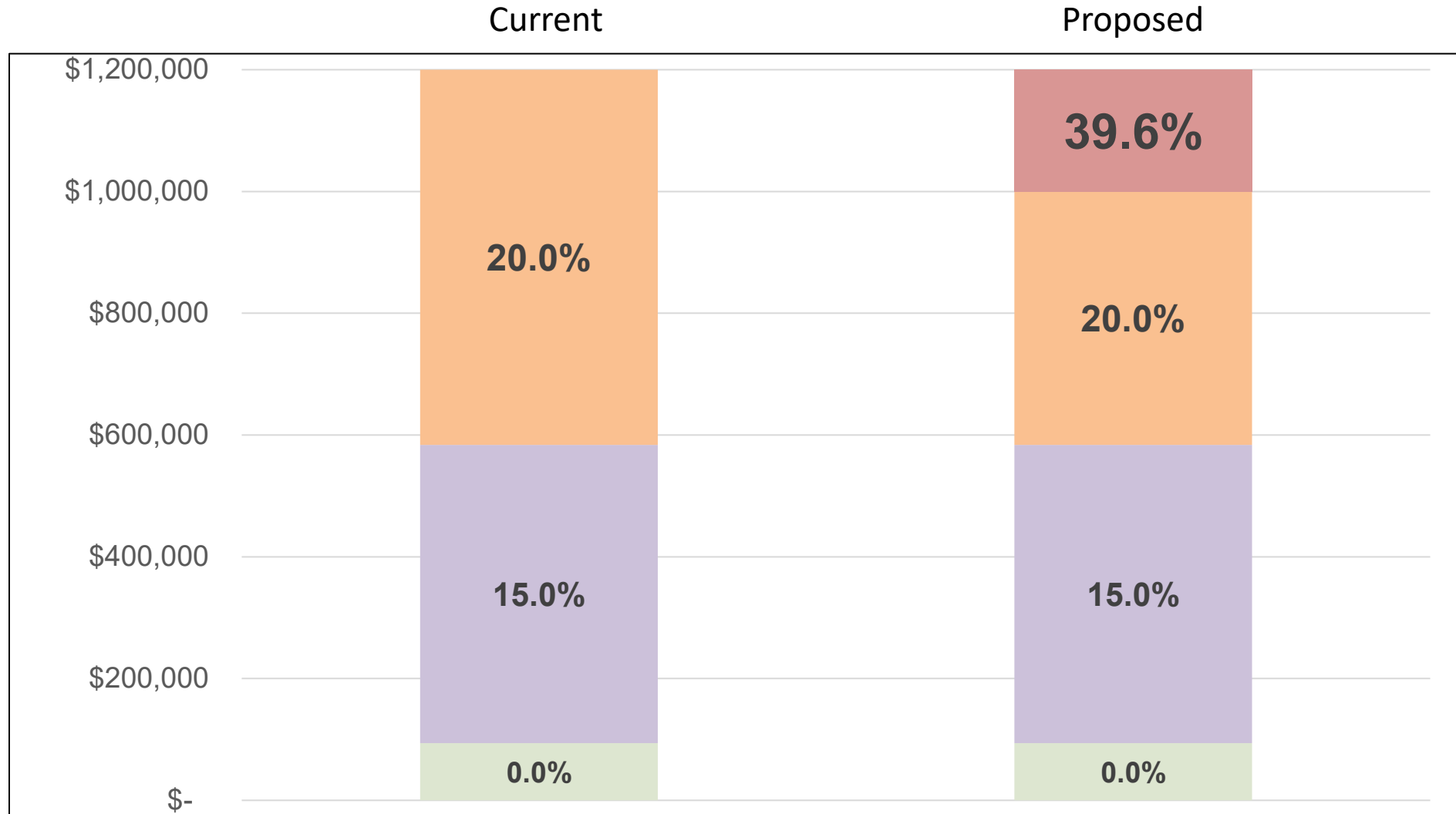
- **Eliminate the preferential long-term capital gains rate for income over \$1,000,000**
 - Would also apply to qualified dividends
 - \$500,000 MFS threshold
 - Thresholds indexed for inflation
 - Effective on the date of enactment



Deeper Thinking

- Encourages longer holding periods as the “exit cost” increases
- Encourages short-term trading by removing the one year holding period incentive
- Will cause a massive re-allocation of capital if enacted

MARRIED FILING JOINTLY



CAPITAL GAIN TAX REFORM

- **Treat transfers of appreciated property by gift or death as realization events**

- \$5,000,000 per-donor gain exclusion, unified for life and death gifts (inflation indexed)

- Exclusions portable to the surviving spouse (therefore, effectively the exclusion is \$10,000,000 per couple)
- Recipient's basis in gifts which use the exclusion would be fair market value

- The proposal would be effective to transfers after 12/31/24.

Deeper Thinking

- Will break-up large accumulations of capital – for better or worse
- Encourage more frequent realization events, by eliminating incentive to hold until death (could perhaps lead to better capital allocation in the economy)
- There may be a “mad-rush” to complete low-basis gifts before the effective date

Consider a client with low basis property. Should gifts be accelerated?
 Assume an asset with a value of \$1,100,000 and a basis of \$100,000.

	"Do Nothing"		Intervivos Taxable Gift (incurs gift tax, but no income tax)	
	Current Law	Proposal Enacted	Current Law	Proposal Enacted
Asset Value	\$ 1,100,000	\$ 1,100,000	\$ 1,100,000	\$ 1,100,000
Less: Basis	(100,000)	(100,000)	(100,000)	(100,000)
Less: Basis for Gift Tax Paid	-	-	(314,286)	(314,286)
Unrealized Gain	\$ 1,000,000	\$ 1,000,000	\$ 685,714	\$ 685,714
Income Tax Paid at Death	20.0% \$ -	\$ 200,000	\$ -	\$ -
Income Tax Paid at Gift*	20.0%			137,143
Built-in Tax Liability	20.0%	-	137,143	-
Total Income Taxes	\$ -	\$ 200,000	\$ 137,143	\$ 137,143
Taxable Gift	\$ -	\$ -	\$ 1,100,000	\$ 1,100,000
Taxable Estate (net of tax paid)	\$ 1,100,000	\$ 900,000	\$ -	\$ -
Gift Tax Due*	28.6% \$ -	\$ -	\$ 314,286	\$ 314,286
Estate Tax Due	40.0%	440,000	-	-
Total Transfer Taxes	\$ 440,000	\$ 360,000	\$ 314,286	\$ 314,286
Asset Value	\$ 1,100,000	\$ 1,100,000	\$ 1,100,000	\$ 1,100,000
Less: Total Income Taxes	-	(200,000)	-	(137,143)
Less: Total Transfer Taxes	(440,000)	(360,000)	(314,286)	(314,286)
Net to Family	\$ 660,000	\$ 540,000	\$ 785,714	\$ 648,571

*Note, paying gift tax or income tax during life reduces the size of the taxable estate by the amount of tax paid. This of course reduces the amount of estate tax due and therefore reduces the effective tax rate at transfer by about 28.5% (1/1.4).

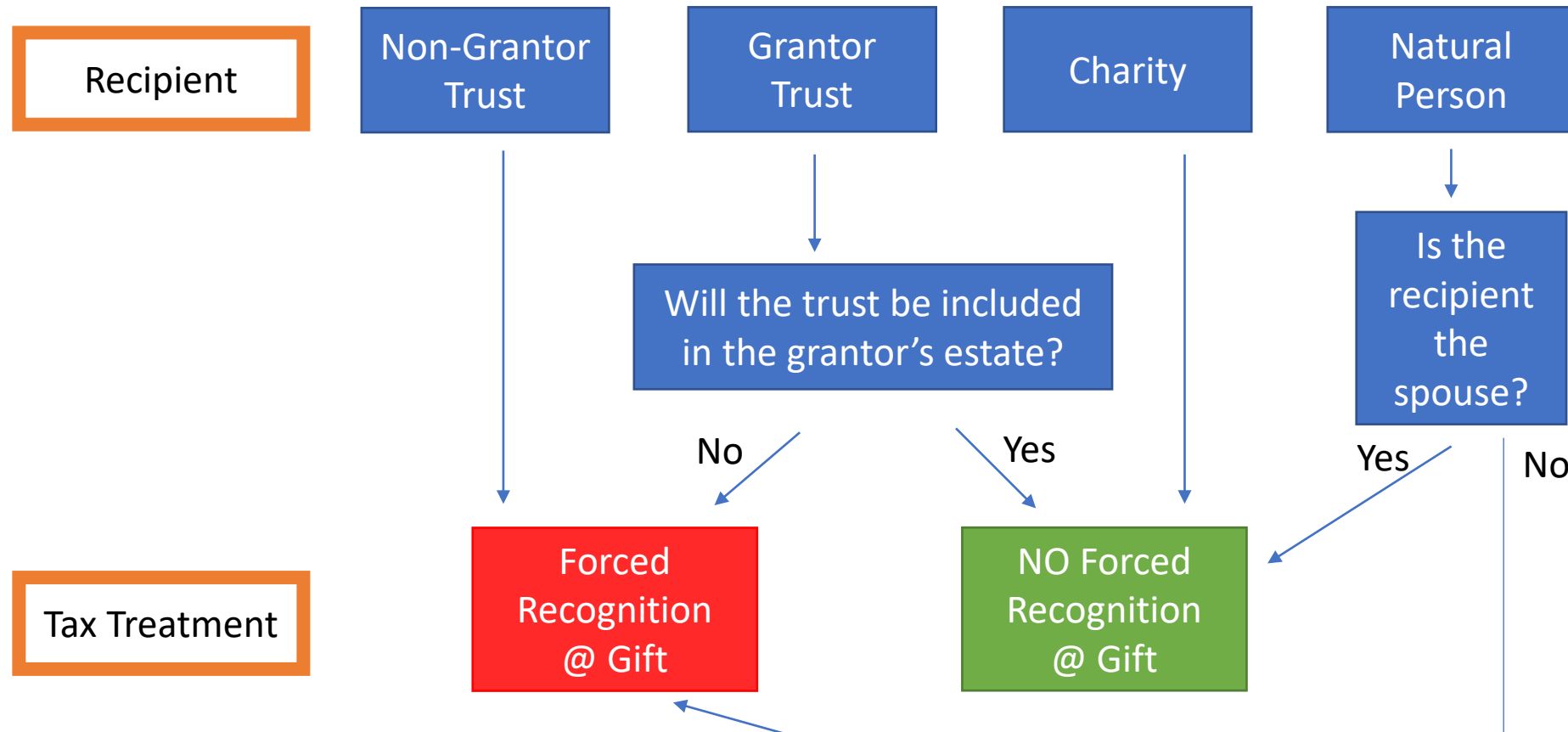
CAPITAL GAIN TAX REFORM

- **Treat transfers of appreciated property by gift or death as realization events**
 - All tangible personal property, such as furnishings and personal effects would be exempt (excluding collectables)
 - The \$250,000 per-person home sale gain exclusion would apply and be portable to the surviving spouse (effectively a \$500,000 exclusion)
 - The Section 1202 exclusion would also apply (recall the exclusion is \$10,000,000)

Deeper Thinking

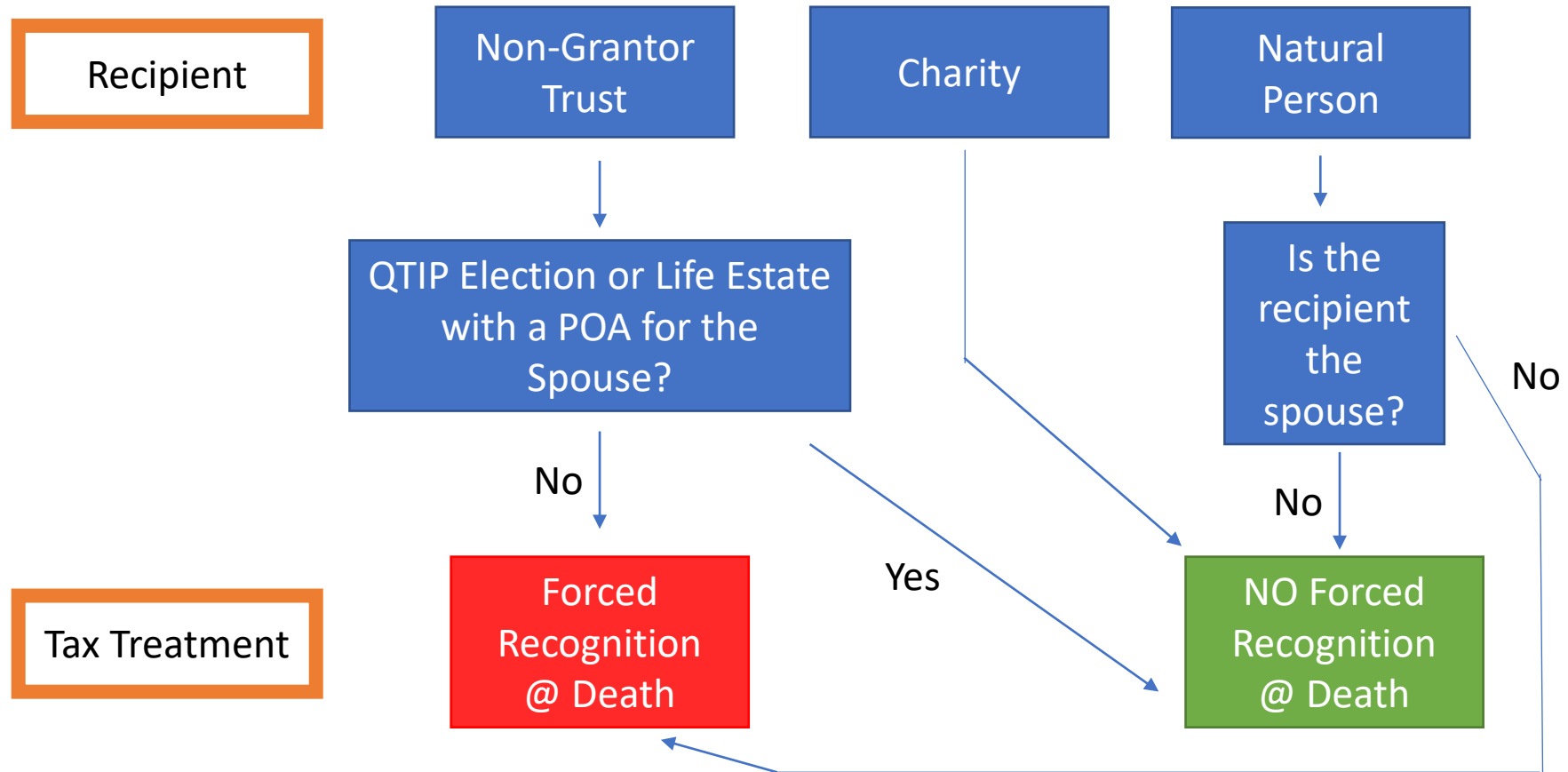
- Incentivizes large homes and long holding periods to capture the \$500,000 exclusion
- Incentivizes organizing any new family business ventures as corporations to capture the \$10,000,000 exclusion

Forced Recognition @ Gift



The STEP Act of 2021, Proposed New IRC 1261

Forced Recognition @ Death



The STEP Act of 2021, Proposed New IRC 1261

CAPITAL GAIN TAX REFORM

- **Treat transfers of appreciated property by gift or death as realization events**
 - Transfers to charity would not be a deemed recognition event (except the non-charitable portion of a split interest trusts)
 - Transfers to a surviving spouse would not be a deemed recognition event

Charitable Trusts

- Prior proposals either allowed contributions to split interest trusts without a recognition event, or included the entire transfer as a recognition event – this new middle ground restores the viability of the strategy
- Consider that the calculated value of the CRT remainder interest can be as little as 10% and a non-grantor CLAT can be “zeroed-out.” Therefore, a large portion of the unrealized gain used to fund a split interest trust would incur tax and this would only be partly offset by the charitable deduction.

CAPITAL GAIN TAX REFORM

- **Treat transfers of appreciated property by gift or death as realization events**
 - Capital losses allowed to net gains, but the \$3,000 ordinary income limit would apply
 - An estate tax return deduction would be available for income tax attributed to forced recognition at death (IRC § 2053)

CAPITAL GAIN TAX REFORM

- **Treat transfers of appreciated property by gift or death as realization events**
 - Contributions to & distributions from trusts would be deemed recognition events
 - Wouldn't apply to distributions from a grantor trust to the deemed owner

CAPITAL GAIN TAX REFORM

- **Treat transfers of appreciated property by gift or death as realization events**

- Deferral Elections:

- Family owned and operated business can elect deferral, with interest, until the business is sold or no-longer family operated
- 15-year fixed rate payment plan for the tax on non-liquid assets transferred at death
- IRS authorized to require security

Could taxpayers have both an estate and income lien on the same property?

CAPITAL GAIN TAX REFORM

- **90-year Periodic Deemed Recognition Events**

- Forced recognition event for property held in trust, partnership, or other non-corporate entities every 90-years
- All property acquired on January 1, 1944, or earlier, would have a deemed recognition event on December 31, 2033.

Deeper Thinking

- Will break-up large accumulations of capital – for better or worse
- Will encourage more frequent realization events

Executor Definition

- Current Law: Inconsistent definition creates administrative difficulties
 - Proposal: Expressly allow the executor to do anything on behalf of the decedent regarding their pre-tax liability
 - Definition to be moved to a new code section
- Effective Date: Upon enactment, regardless of the date of death

Special Use Valuation Adjustment

- Current Law: \$1.39M reduction (2023 figure) in the value of certain real property.
- **Proposal: Increase the reduction to \$14M.**
- Effective Date: Estates of decedents dying on or after the date of enactment.

Estate Tax Liens

- Current Law: Estate tax lien duration limited to 10-years.
- Proposal: Eliminate 10-year limitation.
- Effective Date: New and existing liens after the date of enactment

Trust Asset Reporting

- Current Law: Does not require reporting the value of assets in trust.
- Proposal: Require certain trusts to report certain identifying information and estimated assets values.
 - This would apply to trust with assets in excess of \$300,000 or gross income in excess of \$10,000 (both indexed for inflation).
 - Regardless of income or value, trusts would also be required to report with its annual income tax the GST inclusion ratio of the trust.
- Effective Date: Taxable years ending after the date of enactment.

Defined Value Clauses

- Current Law: Gifts are often made using a *Wandry* clause which allows for adjustment of a gift made if its later discovered the value of the gift was greater than intended.
 - These clauses are often written such that the re-valuation event is an audit.
- **Proposal: Fix value as reported on returns.**
 - Exceptions:
 - (a) The unknown value is determinable by something identifiable other than activity of the IRS, such as an appraisal which occurs within a reasonably short period of time after the date of the transfer (even if after the due date of the return).
 - (b) The defined value formula clause is used for the purpose of determining a marital or exemption equivalent bequest at death based on the decedent's remaining transfer tax exclusion amount.
- **Effective Date: Transfers after December 31, 2024.**

Simplified Annual Exclusion Gifting

- Current Law:
 - Allows for annual tax-free gifts of \$18,000 (2024 figure) from one person to another.
 - This allows a large family to make significant intergenerational gifts.
- Proposal: Add a \$50,000 per donor limitation (indexed for inflation after 2025).
 - Going forward, both limitations would apply in parallel to limit annual exclusion gifting.
- Effective Date: Gifts made after December 31, 2024.

GST Exemption Duration

- Current law: No limitation to the duration a trust can remain GST exempt and may states have limited the application of the rule against perpetuities.
- **Proposal – Limit the exemption to:**
 - Generally, no more than two generations below the transferor (i.e. grandchild).
 - Younger generations (i.e. great-grandchild) alive at trust creation.
(this would include taxable terminations)
- **Effective Date: On and after enactment to all trust subject to the GST.**

GST Exemption Duration

- Current Law: Section 2653 resets the generational assignment of trust beneficiaries once the GST tax has been imposed, treating younger generations as being the first generation below that of the transferor (thus transforming beneficiaries which were originally skip-persons when the trust was funded to non-skip persons)
- Proposal: Eliminate this favorable generational assignment determination.
- Effective Date: On and after enactment to all trust subject to the GST.

GST Exemption Duration

- Current law: GST exemption lasts for the trust's duration
- **Proposal – Trusts existing at enactment:**
 - Deem pre-enactment trusts as created on the date of enactment and the deem grantor to be in the generation above the oldest living generation of trust beneficiaries on the date of enactment
 - Therefore, the GST exemption of existing trusts would only shield distributions to two generations below the deemed grantor or younger generations alive the date of enactment
- Effective Date: Date of enactment.

GRATs

- Current Law: GRATs allow the taxpayers to shift appreciation out of their taxable estate tax-free with limited downside risk.
- Proposal – Require the remainder interest have a minimum gift tax value equal to the greater of:
 - 25% of the value transferred
 - \$500,000 (but not more than the amount transferred)
- The proposal would also prohibit:
 - A term shorter than 10-years
 - A term greater than the life expectancy of an annuitant, plus 10-years
 - Any decrease in the annuity
 - Income tax-free exchanges with the trust
- Effective Date: Trusts created on or after the date of enactment

Grantor Trust Swaps

- Current Law: Allows a grantor trust and its deemed owner to swap assets of equal value tax-free and thereby maximize the value of the “step-up” in basis at death.
- Proposal: For grantor trusts which are not fully revocable, the proposal would treat an asset transfer between the trust and grantor as regarded for income tax purposes.
- Effective Date: Recognition required for all swaps on or after the date of enactment

“Tax-Burn”

- Current Law: Allows a deemed owner of a grantor trust to pay the income tax attributable to trust assets without incurring gift tax.
- Critical Wealth Transfer Strategy Today
- Proposal: Provide that payment of income tax of an irrevocable grantor trust is a gift deemed to occur on December 31 of the year in which the income tax is paid (or earlier if grantor status terminates).
- Effective Date: Income taxes paid on behalf of a grantor trust for all trusts created on or after the date of enactment.

GST and Transactions Between Trusts

- Current Law: Allows sales between trusts which can increase family assets held in a GST exempt trust
- **Proposal: Treat transactions between trusts as a change in principal which requires redetermination of the trust's inclusion ratio**
 - Purchased assets would be added to the denominator of the applicable fraction – but only assets already exempt from the GST before the transaction would be included in the numerator
 - Would also apply to assets received pursuant to a decanting
- **Effective Date: All such transactions occurring after the date of enactment.**

Health and Education Trusts (HEETs)

- Current Law: Including a charitable organization as a permissible distributee may prevent a taxable termination subject to GST tax.
- Proposal: Ignore trust interests held by tax-exempt organizations for purposes of the GST and thereby not prevent a taxable termination.
- Effective Date: Taxable years beginning after the date of enactment.

CLAT Annuity Modification

- Current Law: Annuity can to be structured favorable to the taxpayer (e.g. back-end loaded, aka “shark-fin,” to reduce present value)
- **Proposal:**
 - Annuity payments to charity be a level and fixed amount over the term
 - The remainder interest to be at least 10% of value thereby assuring a taxable gift at creation
- Effective Date: CLATs created after the date of enactment.

Trust Loans

- Current law: Beneficiary loans are generally not taxable.
- **Proposal: Treat beneficiary loans as a distribution**
 - For income tax purposes, this would carry out DNI
 - For GST purposes, this would be considered a direct skip or taxable termination; however a refund would be available if the loan is repaid
- **Proposal: Treat repayment of a loan to a deemed owner of a grantor trust as an additional contribution (to discourage such borrowing).**
- **Effective Date: After the year of enactment to both new loans and loans renewed or renegotiated.**

Promissory Note Valuation

- Current law
 - Loans are considered to be at market rates (and therefore do not incur gift tax) if the interest rate is at least equal to the Applicable Federal Rate (AFR) for the loan term.
 - However, if the loan remains outstanding at the taxpayer's death or is later gifted, the appraised value of the loan can be less than the remaining principal.
- Proposal
 - Valuation consistency requirement: Discount rate must be no more than the greater of: (1) The actual rate of interest (AFR when lent) on the note, or (2) The current AFR for the remaining term.
 - For valuation purposes, remaining term of the note must be shortened if there is a reasonable likelihood it will be repaid sooner than the stated due date.
- Effective Date: Valuation dates on or after the date of enactment.

Fractional Interest Valuation

- Current Law: Fractionalizing ownership allows families to introduce valuation discounts to reduce tax liability.
- **Proposal:**
 - Revise Section 2704(b) to provide the value of a partial interest in non-publicly traded property transferred to a family member would be the pro-rata share of the collective fair market value.
 - Family members for this purpose would include the transferor, the transferor's ancestors and descendants, and the spouse of each described individual.
 - Interests in trades and business would remain subject to valuation discounts; only “passive assets” would be subject to pro-rata treatment
 - Rule would only apply to intrafamily transfers of partial interests in property in which the family collectively has an interest of at least 25% of the whole.
- **Effective Date:** Valuation dates on or after the date of enactment.

CONCLUSION