Steve Leimberg's Estate Planning Email Newsletter - Archive Message #3115	
Date:	**29-Apr-24**
From:	**Steve Leimberg's Estate Planning Newsletter**
Subject:	**Biden 2025's Green Book Proposals, if Enacted, Will Change Estate Planning as We Know It: Martin M. Shenkman, Jonathan G. Blattmachr, Robert S. Keebler, Thomas A. Tietz and Melissa Gonzalez**

There is no way to determine which, if any, of the Biden proposals will be enacted, and if so, when. It is clear that the Democrats have been proposing similar harsh tax changes for a long time, and at some point, some or many of these proposals may be enacted. With that risk, practitioners should consider advising wealthy clients to plan now. Clients need to understand that while plans should be structured to be as flexible as possible there are risks to incorporating the provisions necessary to achieve that flexibility). Any asset transfers, presumably to trusts, should be planned to give clients sufficient access so that they aren't harmed economically. Reiterate to clients that regardless of the tax changes that may occur, they may benefit from asset protection benefits. So, clients should plan while they can. The planning techniques practitioners have gotten accustomed to using might not be available in the near future.

In their commentary, **Martin M. Shenkman**, **Jonathan G. Blattmachr**, **Robert S. Keebler**, **Thomas A. Tietz** and **Melissa Gonzalez** provide members with their perspective on the Biden 2025 Green Book proposals.

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Planning. He is co-author with Georgiana J. Slade, Esq., and Diana S.C. Zeydel. Esq., of Bloomberg Tax Management Portfolio 836-3rd (Partial Interests--GRATs, GRUTs, and QPRTs (Section 2702)).

Robert S. Keebler, CPA/PFS, MST, AEP (Distinguished) is a partner with **Keebler & Associates, LLP** and is a 2007 recipient of the prestigious Accredited Estate Planners (Distinguished) award from the National Association of Estate Planners & Councils. He has been named by CPA Magazine as one of the Top 100 Most Influential Practitioners in the United States and one of the Top 40 Tax Advisors to Know During a Recession. Mr. Keebler is the past Editor-in-Chief of CCH's magazine, Journal of Retirement Planning, and a member of CCH's Financial and Estate Planning Advisory Board. His practice includes family wealth transfer and Steve Leimberg's Estate Planning Email Newsletter Archive Message #2854 Date:18-Jan-21 preservation planning, charitable giving, retirement distribution planning, and estate administration. Mr. Keebler frequently represents clients before the National Office of the Internal Revenue Service (IRS) in the private letter ruling process and in estate, gift and income tax examinations and appeals. In the past 20 years, he has received over 250 favorable private letter rulings including several key rulings of first impression. Mr. Keebler is nationally recognized as an expert in estate and retirement planning and works collaboratively with other experts on academic reviews and papers, and client matters. Mr. Keebler is the author of over 75 articles and columns and editor, author, or co-author of many books and treatises on wealth transfer and taxation, including the Warren, Gorham & Lamont of RIA treatise Esperti, Peterson and Keebler/Irrevocable Trusts: Analysis with Forms. Mr. Keebler is the Chair of the AICPA's Advanced Estate Planning Conference. He is a featured columnist for CCH's Taxes Magazine - Family Tax Planning Forum, Bob is also a contributing author to the American Bar Association's The ABA Practical Guide to Estate Planning.

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Melissa Gonzalez is a Partner at **Grassi** and a member of the firm□s Trust & Estate and Private Client Services practices. With extensive experience in fiduciary, estate and gift tax, she specializes in helping high-net-worth individuals plan and meet their tax mitigation and wealth preservation goals. As a certified public accountant and accredited estate planner, Melissa has deep knowledge of evolving tax law and its application to individuals, trusts, estates and gifting. She uses this expertise to help her clients stay ahead of compliance changes, identify tax planning opportunities and implement asset transfer strategies.

Prior to joining Grassi, Melissa was a partner at a national accounting firm, where she provided high-net-worth individuals and families with strategic trust and estate plans, customized to identify the most effective tax savings vehicles for their unique situations and goals. She has specialized expertise in income, estate and gift tax planning and wealth transfer plans. Outside the office, Melissa regularly gives back to her community. She serves as the Treasurer of the Board of the Moxxie Mentoring Foundation, which supports the professional and leadership development of young women. The organization awarded her the □Purple Pump Award□ for outstanding mentoring.

Melissa also actively supports the Leukemia and Lymphoma Society (LLS), raising more than $500,000 over the past seven years for the organization□s research into curing leukemia, lymphoma, Hodgkin□s disease and myeloma.A member of the New York State Society of Certified Public Accountants (NYSSCPA), Melissa sits on the society□s Estate Planning Committee. She is also a member of the American Institute of Certified Public Accountants (AICPA) and past president of the Board of the Estate Planning Council of Nassau County. Melissa holds a B.S. in Accounting from Bentley University.

Here is their commentary:

EXECUTIVE SUMMARY:

President Biden issued his budget proposal on March 11, 2024. The document□s full title is □General Explanations of the Administration□s Fiscal Year 2025 Revenue Proposals.□[i] It is commonly called the □Green Book.□ Similar proposals have been made by President Biden and lawmakers in the past, such as the significant changes proposed in the $2 trillion Democratic Social and Environmental bill at the end of 2021, which failed to be enacted.[ii] While many individuals may believe that with a divided Congress it is unlikely for any of Biden□s proposals to be enacted,

practitioners should caution their clients to □never say never.□[iii] If even some of these proposals are enacted into law, it could dramatically change the taxation of the wealthiest Americans and substantially reduce the wealth that will be able to be passed to future generations.

Considering the dysfunction that has been gripping the legislative branch recently, no one can predict what negotiations in Congress might result in. The volatility created by Congress□s need to employ continuing resolution stop-gap measures for Federal funding introduces additional opportunities for unexpected bipartisan deals that may include some of Biden's proposals. In addition, no one can predict the upcoming election. If either party is able to secure a majority in both legislative houses and the presidency, the changes they enact could be significant.

Practitioners may want to communicate with clients that given how costly and impactful Biden□s proposals could be, the safer and wiser course of action for those who seek to preserve wealth and pass it on is to plan now. Consider that the changes proposed zero in on many of the most common wealth transfer strategies. Clients should be informed that whether they planned years ago, plan now, or just wait, their options to shift wealth will be dramatically limited. Further, the proposals to increase income taxes on the wealthy will exacerbate the estate planning changes and reduce the efficiency of many common estate planning techniques. Also, when clients are planning for the 2026 reduction in the exemption amount, they might consider further planning while options remain possible. Finally, when clients are undertaking pre-2026 or other planning, practitioners might inform them that if the Green Book-like proposals are ever enacted, the planning they are undertaking may not accomplish the intended objectives (e.g., dynasty trust planning will be curtailed even if perpetual trusts are created by the GST and deemed realization proposals discussed below). The relevance of pre-2026 planning is discussed in greater detail below.

COMMENT:

Uncertainty Creates Planning Opportunity

If there is one thing that is certain at this point, it is that the future is unclear. Many clients may respond that they have heard this before, most recently in 2020 and 2021. However, since no one can predict what might

occur, clients may want to consider beginning to plan immediately. While that is no assurance of success, it is possible that any changes enacted may grandfather prior planning (although that is not the case with deemed realization and other dramatic changes the Green Book proposes).

If former President Donald Trump wins a second term and controls the House and Senate, he may seek to extend the 2017 Tax Act[iv] breaks for the wealthy. He may seek to go further and perhaps (maybe likely) will seek to repeal the estate tax. If President Joe Biden wins a second term and control over both the House and Senate, he will likely seek to enact his proposed changes to force the wealthy to contribute more to reduce wealth inequality, raise revenues to fund social programs, and decrease the wealth concentration. Keep in mind that President Biden had that control but Senators Manchin and Sinema prevented the changes from being enacted. (However, both Senators Manchin and Sinema are retiring.) Consider another possibility, that the election results could have one party controlling the House and the other the Senate with majorities that are so slim that perhaps little tax change might be enacted. Divided control might result in no new tax legislation, or it could result in negotiated changes as one party consents to a demand of the other in exchange for something it wants. Can clients possibly plan with this dramatic uncertainty? They can, but carefully.

Clients may respond with, □But isn□t the □wait and see□ approach wiser? See what the election brings, then try to predict?□ Unfortunately, similar to concerns raised in proposals made by the Democrats in 2021, waiting is not likely to be the prudent approach. Many of the provisions are listed as becoming effective after December 31, 2024. Yes, at the beginning of next year! If clients wait until after the election results in November, it is unlikely they will have the time to plan, draft, and implement wealth transfer techniques. Practitioners can engage clients in a conversation and ask them if waiting is a gamble they wish to take, considering the risks involved.

There is yet another facet to all of this. 32 million closely-held businesses and their beneficial owners (and substantial control persons) will have to file to comply with the Corporate Transparency Act (□CTA□) before the end of 2024 unless the recent challenge to its Constitutionality is upheld.[v] If the CTA filings remain the law, practitioners will be inundated with work on the CTA, potentially at the same time that clients are

clamoring for last-minute tax planning after the election. The likelihood of a client finding a practitioner able to assist them may be low.

Plan Now

Clients may wish to know which steps they should take now in light of Biden□s proposals and which they may wish to be ready to □pull the trigger□ on at a later point in the year when we may have more clarity. Creating grantor irrevocable trusts and making gifts to them before year-end might be prudent. For clients who are unsure if they want to do planning, they can establish a trust and put $1,000 in it. That way, as they get closer to any potential deadline (year-end 2024, the date of enactment of a new law, etc.), they will have the vehicle in place to quickly complete all planning they wish to do. That step may be prudent for clients to be able to complete pre-2026 use of bonus exemption planning as well. If a client had a privately-held business they would consider transferring to a trust, they can begin the process of appraising that business now, gather information needed, and make sure that they have an appraiser ready and willing to do the work if they choose to move forward.

Discuss with clients that as year-end approaches, the administrative hurdles to completing trusts (approval of any third-party institutions or banks that may serve as trustee, various powerholders signing the documents, establishing bank accounts, review of co-counsel if the trust is established in a jurisdiction where the practitioner is not licensed to practice, etc.) may become difficult, if not impossible, to complete. If clients do nothing but wait, they may not have time to contemplate or implement a trust plan properly.

For clients that choose to pursue the above course of action, practitioners may wish to consider a couple of concepts that may serve as guiding principles. Given the uncertainty, discuss with clients the need to plan with flexibility. Practitioners can incorporate mechanisms into any planning documents that give clients the flexibility to adjust for possible future developments. When clients do transfer substantial wealth to one or more trusts, practitioners can discuss with them the need to consider preserving reasonable access to trust assets if that may be potentially necessary for the client.

1. Instead of setting up a trust for descendants, clients can also name their spouse as a beneficiary (a spousal lifetime access trust, "SLAT"). If the client is not married but has a partner, that might take the form of a partner lifetime access trust ("PLAT"), or if the client is single perhaps a domestic asset protection trust ("DAPT"), hybrid DAPT or special power of appointment trust ("SPAT") may provide access as discussed below.
2. Include a power holder, in a non-fiduciary capacity, who can loan assets to the settlor (i.e., grantor) of the trust for adequate interest (but without adequate security). Note that this might trigger filing as a person with substantial control under the CTA if the trust owns interests in a reporting company.
3. Incorporate a provision that allows (but does not require) that the trustee reimburse the settlor for any income tax paid due to trust income.[vi]
4. Allow the trustee to make charitable donations from trust funds. This would give clients another way to make donations without using their personal funds.
5. For clients who do not wish to name their spouses as trust beneficiaries (or may not have a current spouse), practitioners can discuss creating a trust in one of the 22 US jurisdictions that protect so-called "self-settled" trusts,[vii] permitting the client to be a beneficiary of their own trust, a DAPT. However, practitioners may wish to caution clients that some commentators raise concerns about creating self-settled trusts for clients that live in jurisdictions that do not permit self-settled trusts, such as New York and New Jersey.[viii] If a client wants the flexibility of a DAPT but does not need to be a beneficiary immediately, they can consider a "hybrid-DAPT" provision, in which they provide a power holder in a non-fiduciary position with the ability to add individuals from a certain class, such as the descendants of the maternal grandparents of the settlor (which would include the client), as beneficiaries of the trust. This would give the client the flexibility of the potential to be named as a beneficiary in the future without being a beneficiary immediately. However, some commentators have also raised similar concerns with hybrid-DAPT provisions.
6. A further opportunity to discuss with clients is creating a "special power of appointment" trust ("SPAT"). In a SPAT, clients are not beneficiaries. Instead, clients provide three trusted individuals who are not beneficiaries or fiduciaries with the authority to make

distributions to anyone who is a descendant of the settlor's maternal grandparents (which would include the settlor).

Practitioners should warn clients that they should not take any planning steps that they might regret if the estate tax is repealed. This is somewhat similar to the □buyer□s remorse□ that occurred after 2012 planning when the exemption did not decline in 2013 as anticipated. Considering the possibility of repeal or retention of the current high exemption, communicating with clients is protective of both the clients and the practitioners. For clients who may be uncomfortable transferring significant wealth to irrevocable trusts and would only consider completing transfers in case the Biden tax proposals are actually enacted, practitioners should warn clients to carefully weigh whether they should do anything. However, practitioners can educate clients that if they plan flexibly and incorporate provisions that provide them with a comfortable level of access, they may protect their assets from claimants. For some clients, asset protection may be beneficial enough to justify planning even if the estate tax is repealed.

Changes Coming in 2026 Even if Nothing is Enacted

When discussing with clients what planning steps to consider in light of the Biden budget proposal, practitioners may wish to raise the point that in 2026, many of the favorable tax changes enacted as part of the 2017 Tax Act will likely sunset. The gift, estate, and generation-skipping transfer (GST) tax exemption will be reduced to half the current exemption.[ix] Some clients should evaluate making gifts before the end of 2025 to secure the bonus exemption (that is, the full exemption before it is cut in half on January 1, 2026). For clients considering planning for the reduction in the exemption, why not try to complete that same planning before the end of 2024 in case the Biden budget gets enacted in 2025, and the provisions in the proposal with a December 31, 2024, effective date actually become effective? As indicated above, some of the Green Book changes would take effect on January 1, 2025.

Practitioners can remind clients that we live in one of, if not the, most litigious societies in history. That fact will not change, regardless of what happens in Washington. Planning to protect wealth from claimants remains a justification for planning. Currently, practitioners have numerous planning techniques to help clients accomplish their goals. For clients, it is a great time to pursue planning opportunities. If clients permit practitioners to

incorporate some of these techniques, it can enhance planning flexibility and provide a greater chance for the plan to achieve a client's goals. However, some of that flexibility may be lost for clients that choose to "wait and see." Discuss with clients the reasons to plan now, while planning prudently.

Changes to the Capital Gains Tax

President Biden's proposal would eliminate the preferential long-term capital gains rate when income exceeds $1 million. It is possible that any actual legislation might include a "cliff" so that once income is above $1 million, all income is taxed at the ordinary income tax rate, and the more favorable lower long-term capital gains tax rate is completely lost. In addition, President Biden wants the ordinary income tax rate to increase on top earners from 37% to 39.6%. That is almost double the 20% capital gains rate.

Therefore, this change would have harsh tax consequences on some clients. For example, for clients with closely held family businesses, the income from that once-in-a-lifetime sale could push them past the $1 million level. Those clients would lose the capital gains tax rate for that year and pay significant income tax. If this is enacted, it might be possible to complete transactions over time (e.g., structure sales so installments of 10% of the stock is sold annually) to realize gains in lower income tax brackets over many years. Clients could also consider employing the installment method of reporting to spread the gain out over many years and perhaps at lower rates. President Biden's proposals would also increase the Obama Medicare Tax rate from 3.8% to 5%. Hence, the combined effective rate could be as high as 44.6%.

If enacted, what might the repercussions of this change be? Consider that clients might hold investment assets for longer, as the cost to sell will increase substantially. For clients that are anywhere near the $1 million threshold, they may benefit from planning with their adviser team years in advance of a controllable sale to try to avoid surpassing the $1 million dollar figure if feasible.

Realization on Gift or Death

Under current law, clients gifting assets, or the death of a client, are not considered realization events for income tax purposes. President Biden�s proposal would change this historic foundation of tax law and would tax property transferred by gift or in death.

The proposal includes a $5 million exclusion, so it will only affect wealthier clients. However, for those clients it will be a costly sting that will change how they plan and what they do. For clients that wish to engage in asset protection through gifting appreciated assets to a trust for protection from claimants, that could potentially trigger an income tax cost. If the 39.6% ordinary income tax rate applied to these transfers, it would make these transactions impractical as clients would lose 40% of the value due immediate tax burdens. If state or local income taxes were also applied, the tax bite could be even greater. Many clients will prefer to take the chance with a possible future creditor than to significantly diminish their wealth immediately.

For clients whose estates are large enough to have to pay income tax on appreciated assets, when calculating the estate tax, the estate would get an estate tax deduction for the income tax paid. Even with this deduction, the overall tax burden would be very costly. For clients who live in a state with an estate tax, such as New York or Connecticut, the marginal overall death tax rate could be as high as 60-80%.

This is yet another reason, as mentioned above, highlighting the importance of having a plan in place and potentially having trusts already established.

Certain Tangible Assets Excluded from Realization Events

Tangible personal property (e.g., furniture) is excluded from the realization proposals. Collectibles (e.g., artwork), however, are not excluded. Also, the home exclusion of $500,000 for a married couple will remain available. Although, $500,000 may be of little import to many wealthy clients with valuable homes. The Code Section 1202 $10 million exclusion for certain small business corporate stock will remain available. These new rules, if enacted, could impact how clients invest and dispose of assets.

How does one differentiate between personal effects and collectibles? Consider clients that have very valuable art collections. When clients wish

to transfer artwork to a child it appears under the current proposal that may trigger a gain on that gift of artwork. That could be a significant cash flow issue as there is nothing generating cash from the gift transaction with which to pay a tax. Would it be an option for clients to loan artwork to their children instead of gifting those pieces? Could that potentially be an option to get around this new tax rule? How supportable is a loan of tangibles versus a gift?

Consider the complications this could create for clients. If the artwork is loaned, how will that affect insurance? If the donor continues to own the art, and the donee has possession, that may complicate the insurance coverage both parties may need. Contrast that with a simple gift where the donee would ensure it post-gift. Transactions that practitioners may not consider complicated or requiring significant follow-up under current law may become incredibly complex if gain recognition on gifts is enacted. Further, practitioners may wish to keep in mind the interplay of other proposals made by President Biden and their complicating effects. For example, another proposal would treat loans from a trust to a beneficiary as a distribution, which may cause the income of the trust to be treated as shifted to the beneficiary. When viewed together, these proposals diminish flexibility in planning.

Gifts made to a non-grantor trust (a trust that pays its own income tax) would also trigger gain.

Gifts of property to the clients’ spouse, in general, will not trigger gain under the proposed deemed realization rules. This could create even more complexity in planning for blended families. For clients in a second or later marriage that have highly appreciated assets, there would be a significant tax incentive to bequeath those assets to their spouse to avoid gain on the client’s death. If the same assets are bequeathed to children from a prior marriage, that will trigger gain. For clients with a mix of both highly appreciated assets and assets that have not appreciated significantly, they could consider bequeathing the appreciated assets to their spouse so that gain is deferred and non-appreciated assets to their children. That process, however, will make the practitioner's job even harder as will drafting and planning become more complex and costly, which clients likely will not appreciate. The potential for problematic family interactions with these new rules could be exacerbated.

Transfers to charity would not generally be deemed recognition events. So, if clients gift appreciated stock to a public charity, there would be no gain. However, for any gifts made to any type of split-interest trust, there will be a realization on the non-charitable portion. This proposal would reduce the benefit of gifts made to a charitable lead trust (CLT), which under the Green Book would have to be structured so at least 10% is taxable, or a charitable remainder trust (CRT). Such transfers would trigger gain to the extent of the interests received by the non-charitable beneficiary. Practitioners often structure CRTs with the minimum tax law requirement of a 10% remainder interest to charity. That would cause 90% of the gain to be realized as the beneficiaries receive payments out of the charitable trust. Currently, the proposals do not have an exception for a split-interest charitable trust created for a spouse and charity. So, unless an exception is incorporated, it may be that gifts to spouses in a split-interest charitable trust would be taxable. If practitioners structure the split-interest trust to zero out the value of the taxable (i.e., non-charitable) portion, that may avoid immediate gain, other than the portion that cannot qualify (scheduled to be at least 10%).

Gain on Death

Any income tax paid by a decedent's estate on appreciated assets under the Biden proposal would be a deduction on the estate tax return. That would reduce the estate's estate tax burden, but the overall cost would remain hefty. If President Biden succeeds in raising the income tax rate, wealthy clients' estates could owe approximately 40% income tax on the gain realized on death and then a 40% estate tax on their assets reduced by the income tax paid. Clients must plan for the liquidity necessary to pay the new income and continuing estate tax costs. Also, it is appropriate for practitioners to remember that if the other proposed changes are enacted, the estate tax burden will be greater under the new tax system due to of the myriad of restrictions on planning options, resulting in larger taxable estates than under the current law. The overall tax burden for wealthy clients on death could be dramatically increased.

Gain on Distributions from, or Gifts to, Trusts

Under current law, no gain is realized when clients transfer assets to a grantor trust. If a trust distributes property to the client as settlor of the trust, e.g., the client swaps cash for property held by a grantor trust, no gain

should be recognized. Under the new proposal, contributions or gifts to, and distributions from, any irrevocable trust will be deemed income tax recognition events. This one change alone will eliminate the ability to use one of the most popular estate planning tools, the transfer of assets to a grantor trust that is not included in the settlor's gross estate. This change could end estate planning as we know it today.

Making distributions of appreciated property out of a trust, e.g., to the settlor of the trust, will eliminate the planning technique of swapping assets between the settlor and the grantor trust (that is, to substitute different assets into the trust for those already there). Under current law, clients can swap cash into an irrevocable trust and take back an appreciated asset of equivalent value with no adverse tax consequences. This swap could bring a highly appreciated asset back into the client's estate to obtain an income tax basis step up on death. If the asset remained in the trust, basis would not be increased at death, meaning that heirs would ultimately pay a capital gains tax. The new law's deemed realization of gain on distributions of trust assets would eliminate this valuable and common planning tool. Grantor trusts have been the keystone of most estate planning for decades. Critical to the use of grantor trusts is the ability to move assets into and out of the trust without any income tax consequences. That would be eliminated.

This change would also decimate another popular planning technique, grantor retained annuity trusts (GRATs) (see below). One key to the GRAT technique has been the ability to shift appreciated assets into a GRAT without a tax cost and for the GRAT to pay the settlor appreciated assets to satisfy the annuity that the trust owes the settlor. That will be eliminated.

Deferral for Family Businesses of Gain on Death

The proposal provides family-owned businesses with a safety valve from the new income tax gain recognition on death. The business will be permitted to elect to defer the tax on appreciation, with interest, until the business is sold or no longer family-operated. However, to get this benefit the IRS can require security for the payment deferred. This appears to mean that the IRS could place a lien on business assets to secure the payment of both the income tax and estate tax due on death. Consider the possible adverse impact of such liens on financing family business operations and other business matters. These dual costs on death,

especially for an illiquid asset like a family business, may create a significant incentive to use life insurance to provide liquidity.

Even incorporating life insurance into a client□s planning could be more nettlesome than under current law. The many other restrictions in the Biden budget proposal will restrict, if not undermine, the use of life insurance trusts when insurance policies are purchased as part of an estate plan. Grantor trusts will be restricted, annual gifts (as discussed below) will be capped at $50,000/year, and creating GRATs (which currently can be used to funnel assets into insurance trusts) will be impractical. These and other changes make the traditional approach to planning for life insurance held in an insurance trust limited.

<u>Trust Will Have Periodic Gain Recognition Events</u>

The Biden proposal provides for forced recognition events for property held in trust every 90 years. At year 90 any appreciation on the value of assets held in a trust will automatically have to be realized and income tax paid, even if no sale or other transaction occurred. Transition rules have been provided for older trusts so that they will not be able to wait a full 90 years as new trusts will be able to do. For example, any trusts created before 1944 will have a recognition event and report gain in about nine years (approximately 2034). The tax rate may be the new 39.6% maximum tax rate on individuals plus the 3.8% (as discussed above, proposed to increase to 5%) net investment income tax. That is almost 44%, and if there is state and local tax, the marginal overall rate could be 50%+. Most state income tax systems follow the federal rules. So, if gain is imputed in year 90 on a federal level, it will likely be deemed to have occurred for state income tax purposes as well. Some trustees may choose to move trusts out of high-tax states years before the gain-triggering event to at least try to avoid the state income tax even if they cannot mitigate the federal imputed income tax.

Practitioners should consider discussing with clients when creating a new trust or even in the administration of existing trusts the potential benefits of a trust that lasts as long as possible (despite the 90-year realization rule), that has situs in a trust and tax-friendly state, and that the state permits self-settled trusts, i.e., domestic asset protection trusts (DAPTs). These states have more favorable laws, robust and flexible administrative trust

companies, etc., which provide clients with more flexibility when administering trusts designed to last for generations.

An additional point for practitioners to raise with clients is when preparing their estate plans; they should consider using a revocable trust instead of a will as their primary dispositive document. That may make moving a trust formed at the clients' death (a testamentary trust) to a state with favorable trust income tax rules easier. For an inter-vivos trust that has not been subject to an action that causes it to come under a court□s jurisdiction, in many states court approval may not be needed to make any kind of change or change the trust's situs. Note that retirement assets cannot be transferred to a revocable trust without triggering gain. Other assets, like professional corporations, may face legal restrictions on transfer to a trust. An alternative is to have client□s wills admitted to original probate in another state. Certain states, including New York, Alaska and, perhaps, some other states, permit this action. Revocable trusts are private, wills are public and probate courts are significantly backed up in many states.

With the prospect of an approximately 40% income tax on trust income, the ability to shift wealth down generations will be substantially limited. This will inhibit dynastic planning, which has been one of the themes of estate planning for decades.

Who is an Executor?

Under current law, gaps, confusion, and inconsistency can exist regarding who is the personal administrator or executor to take certain actions on behalf of an estate. That has created administrative difficulties for both clients and the IRS. The new law would allow the executor to do anything regarding the decedent's tax liability on behalf of the decedent and specify who will be considered the executor for certain purposes.

Special Use Valuation

For farmland and certain real estate used in a closely held family business, current law permits that property to be valued using special rules that will reduce the estate tax value. These provisions reduce the need to liquidate family farms or real estate used in a family business to pay estate tax. But under current law this benefit is capped at about $1.4 million of property. The new law will increase this amount to $14 million. That is $28 million for

a married couple. This is one of the most favorable changes proposed in President Biden□s budget.

There are strict and detailed requirements that have to be met to qualify for this exemption. For example, the property must be an actual working farm that is basically operated by the family. This benefit may be so significant, especially if the estate tax exemption is cut in half in 2026 to about $7 million; anyone owning property that might qualify may focus on planning to qualify for the benefit. Further, it may even become worthwhile for others to invest in such assets if they can realistically qualify for this enhanced tax break. Consider that the average value of a family farm might only be about $1.5 million.[x]

Consider how the Biden budget proposal disparately affects different types of assets. Some asset classes have a better tax result under the changes, others are significantly curtailed. Collectibles are going to be a real issue with the potential to trigger tax on gifts. Section 1202 corporate stock and farmland could become especially beneficial assets to own. However, practitioners should remember that to fall under that provision, the business must have been a C corporation from its inception. All of these and other changes will make planning more nuanced and complicated and, in many cases, unfair between different clients depending on the types of assets they own.

Trust Reporting

President Biden□s proposals will enact new trust reporting rules for trusts with more than $300,000 in assets or gross income in excess of $10,000. These thresholds are so modest that virtually every trust will be impacted.

Trustees will have to report the value of trust assets to the IRS annually. Clients, trustees, and beneficiaries are all going to be very uncomfortable having to disclose this information. The trust□s generation-skipping transfer (GST) tax inclusion ratio will also have to be reported. For clients who have had qualified advisers preparing proper gift tax returns (Form 709) every year they made gifts, and maintaining trust records, this may not be a significant complication. However, for many trusts, the trustees and even the accountants helping with trust income tax returns may not have the information to establish the trust□s ratio. Reconstructing it for an old trust could be costly and complicated.

Consider that the CTA has created new and burdensome reporting on entities and trusts that own certain interests in entities or that have certain control over entities.[xi] The reporting requirements under the CTA are invasive, and the term, beneficial owner is incredibly misleading due to the fact that there are two different tests to determine who qualifies. It is not just individuals who own interests in the entity (25% or more, either directly or indirectly); it could be anyone who has substantial control of the entity, which is a very complex and a somewhat uncertain term. When trusts own interests in entities, pursuant to the CTA every single person named in the trust could be assumed to be a beneficial owner for reporting purposes. Otherwise it may require a very complex process trying to figure out who in the trust qualifies. The CTA requires beneficial owners to use their home address, not a PO box and not an accountant's office address. The reporting company will have to file a copy of each beneficial owner□s driver's license or passport and disclose their Social Security numbers.

The CTA is focused on business entities (partnerships, corporations, limited liability companies, etc.), and trusts are only affected if they have interests in reporting entities. The Biden budget proposal would add another layer of reporting for almost all trusts on top of the CTA burden.

Consider that under the Biden proposal, trusts may have to report the assets/net worth held in the trust, which was not required under the Corporate Transparency Act. How will the trustee value a piece of raw land or a vacation home that's been in the family for decades or longer? The clear trend is that the government is seeking to require the reporting of confidential and sensitive information, and most will be uncomfortable with the privacy concerns and complexity this creates.

Valuation Adjustment Mechanisms

The focus of much of estate planning has been the transfer of hard-to-value assets like interests in a family business or real estate. An issue that occurs with all such property is what is the fair market value?

Even when clients have their business professionally appraised, the IRS could challenge the appraisal of a gift of that business as being undervalued. An increase in the gift valuation, if the increase causes the gift to exceed the clients remaining gift exemption, could result in a 40% gift

tax. Practitioners have endeavored to reduce that risk for clients by employing special valuation mechanisms. One technique, for example, is to structure a transaction so that instead of clients transferring a percentage interest in a business entity, they instead transfer a fixed dollar amount worth of the asset. That way, if the IRS challenges the value, they have only made a gift of that value, not a percentage interest. That should avoid any unintended gift tax. The IRS has long disfavored this mechanism (sometimes called a "Wandry" clause) as they assure that if the IRS is successful in an audit, no tax can be collected. The use of these mechanisms makes the administration of the tax system extremely difficult because the IRS spends resources on audits to accomplish nothing. The Biden budget would eliminate the use of these mechanisms. This is all rather unfair as clients transferring interests in marketable securities have no valuation risk. But those transferring interests in real estate or a closely held business do. This is similar to the comment made earlier that there is a considerable discrepancy in how different assets will be treated under the Biden proposal, which will make planning more complex.

Thus, for clients that own hard to value assets, practitioners should discuss the need to plan before these proposals, if passed, would become effective, which would be just a little more than a year from now.

Annual Exclusion Gifts

The annual exclusion permits anyone to give away $18,000 each year to as many individuals as they choose. For clients with 20 heirs, they could gift $360,000 annually. For married clients, they could give a combined $720,000 annually. For trusts that are drafted with a right of withdrawal for beneficiaries, clients can gift the annual exclusion amount to the trust on behalf of the beneficiary. This would necessitate additional administrative steps, such as the trustee giving the beneficiaries notice that they can withdraw the money if they wish (i.e., permitting "Crummey" rights of withdrawal). Assuming the beneficiaries do not withdraw the funds, all the gifted assets remain in the trust, and there are no gift tax consequences.

The Biden budget would cap annual gifts at no more than $50,000 per donor. So clients, along with their spouses, would be limited to giving away $100,000/year or being forced to use whatever remains of their lifetime exemption. If their lifetime exemption is exhausted, future gifts above the $50,000 cap would trigger gift tax.

Many clients have life insurance plans where large policies are held in trusts that rely on the ability to transfer more than $50,000 annually to the trust to pay premiums. It could be difficult for them to give enough cash to the trust to pay the premiums if this change is enacted. Practitioners should consider warning clients of this possibility and that they should consider planning now. Consider creating grantor retained annuity trusts (GRATs) that can pass assets into a non-GST exempt insurance trust as the remainder beneficiary. The Biden proposals would emasculate GRATs, so now may be the last time clients can use the technique to leverage gifts. Clients should plan on funding any large insurance plans now because the law will make it very difficult to do it if enacted.

Restriction on Duration of GST Exemption

Traditionally, a trust could only last for a limited period of time. For example, 21 years past the death of the last beneficiary alive when the trust was created (the rule against perpetuities). In some states, this is still the case. However, many states have modernized their trust laws, permitting trusts to last for a very long time. If you create a trust in those states and allocate generation-skipping transfer (GST) tax exemption to that trust equal to the gift amount, the trust can remain outside of the gift, estate, and GST tax systems, perhaps forever.

The Biden budget proposal will limit the duration of a trust GST exemption to no more than two generations below the transferor (i.e., the grandchildren) and for members of younger generations (e.g., the great-grandchildren) alive at the time of the trust's creation. This would greatly limit dynastic planning. Existing plans will be substantially altered. There is no grandfathering for pre-existing plans. So, even clients who created a trust a decade ago believing it should be outside the estate tax system forever would be affected by this proposal. The effective date of this change is the date the new law is enacted.

Practitioners should consider advising their clients that they might need to revise their wills, and revocable trusts if they have them. If those documents pour assets into existing irrevocable trusts, those existing trusts may have a shorter duration before GST tax is applied than if new trusts are created, which may then include heirs born after the lifetime irrevocable trusts were created. That could require heirs to maintain double the number

of trusts (i.e., each irrevocable trust may have a different GST tax realization date, preventing consolidation), adding to costs and complexity.

Consider the aggregate impact of the various Biden proposals. GST exemption can only last two generations, distributions from or gifts to trusts will be income tax realization events, and assets clients manage to transfer into a trust with all these limitations will be subjected to a deemed realization event and income tax every 90 years. Overall, the Biden proposals will substantially hinder the ability of the wealthy to transmit wealth through the generations. That, no doubt, is one of the goals. The government is clearly saying we were not interested in dynastic planning.

Proposals Effectively Eliminate Grantor Retained Annuity Trusts (GRATs)

GRATs are an estate planning mechanism that can facilitate shifting appreciation out of clients' taxable estates without incurring gift tax and with limited downside risk if the plan fails. For almost all cases, the Biden proposal will eliminate the use of this technique with various harsh new restrictions.

The proposals will require the remainder interest of a GRAT to have a minimum gift tax value equal to the greater of 25% of the value of the assets transferred to the GRAT, or $500,000 (but not more than the amount transferred). That change alone will make GRATs impractical in most situations. However, the proposal goes further. It would also prohibit GRATs from having a duration or term shorter than 10 years, a term greater than the life expectancy of the annuitant, plus 10 years. Further, there could not be any decrease in the annuity amount paid. Income tax-free exchanges with the trust would trigger income tax. When all of these changes are considered, GRATs would effectively be eliminated for all but unusual situations. For clients that may potentially benefit from GRATs (e.g., to leverage value into an insurance trust to meet future premiums because of the restrictions on annual gifts discussed above), they will need to complete them before the enactment. Since no one can predict that, practitioners should consider informing clients that the timing for planning is the sooner, the better. In addition, practitioners may wish to advise clients to plan sufficient cash flow in the GRAT to avoid the need to make annuity payments in kind.

CCA 202152018 states that a valuation adjustment mechanism, including a spillover to a GRAT, did not work because the taxpayer acted in bad faith. The taxpayer’s appraisal failed to take into account that offers were already on the table.[xii]

Swap or Substitution of Assets

A hallmark of many grantor trusts is the right, given to the settlor, to swap assets with the trust. As the settlor to the trust and its deemed owner, the settlor can swap assets of equal value (typically cash) tax-free for trust assets (usually appreciated assets). This puts appreciated assets back into clients’ estate and thereby increases the value of the basis adjustment “step-up” at death.

For any grantor trust that is not fully revocable, the Biden proposal would treat an asset transfer between the trust and settlor as regarded for income tax purposes (that is, it would be an income-taxable trade). That will make the basis step up on assets held inside trusts impossible to achieve in virtually all cases. Also, swapping to revise or restructure clients' estate plans will be nearly impossible. For example, the settlor may have put business assets into a trust and have named certain beneficiaries, i.e., the settlor’s son, running the business. Years later, the settlor’s son changed his mind and wanted to do something completely different. Settlor’s daughter, who had nothing to do with the business when the trust was created, is now running the business. Under current law, you can swap the business outside of the trust back into the settlor’s name, putting different assets in the trust. This would permit the settlor to implement a new plan to transfer business interests to the settlor’s daughter. Biden’s proposals remove flexibility in planning for personal reasons, not just for tax planning.

Encourage clients to review all trusts before enactment and consummate any swaps they wish to make before then. The big-picture theme of the Biden budget proposal is to restrict almost every technique that estate planners use, indirectly restricting many others, to prevent wealth transmission.

Tax “Burn”

When clients create a grantor trust, clients pay income tax on any trust income. That odd-sounding consequence is one of the most powerful

wealth-shifting devices practitioners have had in their toolkits for decades. It allows a deemed owner of a grantor trust to pay the income tax attributable to trust assets without incurring a gift tax, permitting trust assets to appreciate without income taxes, reducing the growth.

President Biden□s proposal provides that the settlor's payment of income taxes on income earned by 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). This is yet another restriction/cost being created to restrict current estate planning strategies. So, in addition to the income tax burn on trust income, the settlor would have to pay a gift tax of 40% on top of that.

This new rule only applies to trusts created after the new law is enacted. Practitioners should caution clients to create any grantor trusts they may need as part of their planning sooner rather than later.

Currently, practitioners have the ability to include a tax reimbursement clause in grantor trusts in case the tax costs become too much for clients to bear. However, based on a recent IRS ruling (CCA 202352018), these provisions should be included in the trust at inception because if one is incorporated later, such as through a decanting, the IRS will argue the change will trigger adverse tax consequences.[xiii] While some states allow for tax reimbursement even if the trust document is silent, changing situs to obtain that result may also be viewed by the IRS as an act that triggers a negative tax consequence.

One of the key problems of income tax reimbursement clauses is that even if they are included from inception in the trust if the settlor is given reimbursements too often (which no one can define), the IRS can argue that the settlor had an implied agreement with the trustee to get reimbursed, therefore retaining an interest causing the whole value of the trust to be considered in the settlor□s estate. Practitioners may consider advising clients to use an institutional trustee as that may reduce the risk of this tax problem. One option, perhaps, to avoid that result would be to have the original trustee resign and have a new trustee (who was not even aware of the trust) complete the reimbursement or have an independent corporate trust company appointed as trustee, which will be able to establish there was no such agreement.

GST Transactions Between Trusts

Consider clients that have a trust that is not generation-skipping transfer (GST) exempt. When that trust passes to the client□s grandchildren (skip persons), a GST tax could be triggered. However, if planning is implemented wherein value is shifted out of the non-GST-exempt trust into a GST-exempt trust, that tax cost might be avoided. Currently, practitioners can achieve this through planning wherein the trustee of the non-GST-exempt trust could sell assets it owns to another trust that is GST-exempt for a promissory note. If both trusts are grantor as to the settlor, or the buying trust is grantor as to the selling trust, no income tax should be trigged on the sale. Thereafter, any appreciation in value of the asset (e.g., a family business) above the interest rate the non-GST exempt purchasing trust pays the GST-exempt selling trust, could theoretically be outside the tax system forever.

Biden□s proposal includes a provision that would treat this type of transaction as a GST transfer, requiring the recalculation of the inclusion ratio. This change would be effective the date of enactment. That might suggest recommending to clients that if they have non-GST exempt trusts, complete any such transactions now.

Loans to Trust Beneficiaries

Loans have been a flexible trust administration tool for trustees to provide benefit to trust beneficiaries without reducing the principal of the trust. It has been common for trusts to loan beneficiaries money for several reasons. In many cases, loaning money can have a tax advantage. For example, if a trust is non-GST exempt, and the clients want to provide economic benefit to a lower-generation skip person, a distribution could trigger a GST tax. If the trustee instead loans money to the beneficiary or perhaps buys a personal use asset like a house and lets the beneficiary use it, the tax might be avoided or deferred. It's also been a common planning tactic for a trust that's in a favorable no-tax state that wants to provide money to a beneficiary in a high-tax state to loan money to the beneficiary instead of making a distribution.

The Biden proposals will eliminate these techniques. It will treat loans in the same manner as a distribution so that the portion of trust income based on the value of the amount of all loans and distributions will be attributed to the

beneficiaries who receive the benefit. Once the law is enacted, the trustee can no longer loan a beneficiary without an income tax consequence identical to that of a distribution. The new rule will require that a loan pass out distributable net income (DNI). As most states follow federal tax law, that may also create taxable income in the state where the beneficiary lives.

This will complicate trust administration. If a loan also triggers income tax to the beneficiary, if the trustee is trying to get specific funds to a beneficiary, the amount loaned or distributed (since they will be treated the same) may have to be increased (grossed-up) to provide the beneficiary enough money to pay the new income tax cost and leave them with enough net funds for the intended purpose (e.g., a down payment on a house). What if a trust has three beneficiaries? One beneficiary wants to buy a home, and the trustee wants to give her a million dollars to buy the home. The other beneficiaries are younger, and the trustee is obviously, logically, concerned about maintaining equality between the various beneficiaries of this pot or sprinkle trust. The trustee might prefer to loan the money to the beneficiary being helped because if that loan has to come back, even with interest, in effect, the trustee has arguably not been unfair to the other beneficiaries. However, now that the loan will create a negative income tax cost, which has to be factored into the planning as well, maintaining parity between beneficiaries may be more difficult.

Discounts

Under current law, if clients make a gift of a non-controlling portion of a business entity or assets, the interest or asset given may be discounted so that it is appraised at a fraction of the total value. These valuation discounts have been the bedrock of many estate plans. Discounts (and the tax burn discussed above) have been fundamental to how affluent clients have shifted value out of their estates and outside of the estate tax system.

The Biden proposal will revise Code Section 2704(b) to provide that the value of any partial interest in closely held business transferred to a family member must be the pro-rata share of the aggregate fair market value. Effectively there would be no more discounts. This restriction will apply to intrafamily transfers of partial interests in property in which the family collectively has an interest of at least 25% of the whole. For purposes of

this new rule, family members would include the transferor, the transferor□s ancestors and descendants, and the spouse of each.

For clients whose estate plans might benefit from valuation discounts, practitioners should encourage clients to evaluate consummating that plan before the Biden proposal is enacted.

<u>Conclusion</u>

There is no way to determine which, if any, of the Biden proposals will be enacted, and if so, when. It is clear that the Democrats have been proposing similar harsh tax changes for a long time, and at some point, some or many of these proposals may be enacted. With that risk, practitioners should consider advising wealthy clients to plan now. Clients need to understand that while plans should be structured to be as flexible as possible there are risks to incorporating the provisions necessary to achieve that flexibility). Any asset transfers, presumably to trusts, should be planned to give clients sufficient access so that they aren't harmed economically. Reiterate to clients that regardless of the tax changes that may occur, they may benefit from asset protection benefits. So, clients should plan while they can. The planning techniques practitioners have gotten accustomed to using might not be available in the near future.

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

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[i] The document can be viewed at https://home.treasury.gov/system/files/131/General-Explanations-FY2025.pdf, accessed on March 29, 2024.

[ii] For a discussion of proposals made by Senator Sandors, Senator Van Hollen and President Biden in 2021, see Biden And Van Hollen And Sanders, Oh My: Lions And Tigers And Bears And Taxes, Oh My!, by Martin M. Shenkman, viewable at https://www.forbes.com/sites/martinshenkman/2021/06/23/biden-and-

van-hollen-and-sanders-oh-my-lions-and-tigers-and-bears-and-taxes-oh-my/?sh=4aa3eaec15a7, accessed on March 29, 2024.

[iii] The proof of that is that more recently, on March 20, 2024, Senators Ron Wyden and Angus King introduced □The Getting Rid of Abusive Trusts Act□ to effectively eliminate Grantor Retained Annuity Trusts (GRATs) with proposals similar to some of those contained in the Green Book.

[iv] More formally referred to as □An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget□) on Dec. 22, 2017. For an article discussing trust planning after the TCJA, see Trusts & Estates, □Trust Planning After the New Tax Law,□ Martin M. Shenkman and Jonathan G. Blattmachr, pages 13-17 (February 2018).

[v] Nat□l Small Bus. United v. Janet Yellen, Case No. 5:22-cv-1448-LCB.

[vi] This is especially important to include at the outset as CCA 202353018 suggests adverse tax consequences if this is to be added later via a decanting.

[vii] As of March 2024, the jurisdictions that permit self-settled trusts are: Alaska, Alabama, Arkansas, Connecticut, Delaware, Hawaii, Indiana, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming. On March 12, 2024, the Wisconsin Senate passed Bill 667 to allow the creation of domestic asset protection trusts under Wisconsin law. Wisconsin is the 22nd state to have such legislation.

[viii] For an article that discusses some concerns that have been raised regarding DAPTs, see Leimberg Information Services, Inc., □DAPTs & Klabacka - At the Intersection of Estate Planning and Family Law,□ by Sandra D. Glazier, Martin M. Shenkman & Alan Gassman, Asset Protection Planning Newsletter #357 (February 1, 2018).

[ix] In 2024, the Federal gift, estate, and GST exemption is $13,610,000 ($10 million inflation-adjusted from 2011) and will be reduced to approximately $7,000,000 in 2026 ($5 million inflation-adjusted from 2011).

[x] In 2022, the median U.S. farm household had $1,376,404 in wealth. An analysis of farm household wealth can be viewed at https://www.ers.usda.gov/topics/farm-economy/farm-household-well-being/income-and-wealth-in-

context/#:~:text=Farm%20Household%20Wealth%20and%20Income&text=In%202022%2C%20the%20median%20U.S.,of%20residence%20or%20intermediate%20farms, accessed on March 30, 2024.

[xi] For a detailed analysis of the CTA□s reporting requirements, see Leimberg Information Services, Inc., □Corporate Transparency Act: Implications to Estate Planning,□ authored by Abigail O'Connor, Martin M. Shenkman and Jonathan G. Blattmachr, Business Entities Newsletter #280 (October 23, 2023).

[xii] For additional discussion regarding CCA 202152018, see Leimberg Information Services, Inc., □CCA 202152018: Lessons for a Multi-Disciplinary, Collaborative Approach to Planning,□ authored by Ashley Case, Joy Matak, Matthew Rak & Martin M. Shenkman, Estate Planning Newsletter #2940 (March 2, 2022).

[xiii] For a discussion of the chilling effect CCA 202352018 may have on use of decanting to modify irrevocable trusts, see □IRS Memo Has Chilling Effect on Irrevocable Trust Modifications,□ authored by Yaser Ali and Martin Shenkman, at https://www.wealthmanagement.com/estate-planning/irs-memo-has-chilling-effect-irrevocable-trust-modifications, accessed on March 30, 2024.