



## BIDEN ADMINISTRATION'S 2024 FISCAL YEAR BUDGET PROPOSALS ONCE AGAIN THREATEN CHANGES TO THE ESTATE AND GIFT TAX SYSTEM

March 31, 2023

On March 9, 2023, the Treasury Department released its General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals (known as the Greenbook), to accompany President Biden's proposed budget for fiscal year 2024. As in the 2023 Greenbook, the proposals support drastic changes to the estate and gift tax system that would substantially impact planning for transfers of wealth.

Brief descriptions of the proposals that would most significantly impact estate and gift planning are as follows:

### Treatment of Property by Gift or on Death as Realization Events for Capitals Gains

- Carried over from last year's Greenbook, the administration proposes to repeal the "step up in basis" rule, which allows assets subject to estate tax at death to receive a basis adjustment for income tax purposes equal to the date of death value so that pre-death capital gains are wiped away. Under the proposal, transfers by gift or by death would be realization events that trigger capital gains tax to be due.
- The amount of the gain realized would be the excess of the asset's fair market value on the date of the gift or on decedent's date of death over the donor's or decedent's basis in that asset. That gain would be taxable income to the donor or decedent.
- There would be a \$5,000,000 indexed for inflation per person exclusion from gain realized on property transferred by gift or by death (with portability between spouses).
- Capital losses and carry-forwards from transfers at death would be allowed to offset capital gains and up to \$3,000 of ordinary income on the decedent's final income tax return, and the tax imposed on gains deemed realized at death would be deductible on the estate tax return of the decedent's estate, if any.
- Transfer to or from a trust or partnership would also be deemed recognition events (unless the trust was a revocable trust).
- The tax on non-liquid assets could be paid by over 15 years.
- The proposal would be applicable to gifts made after December 31, 2023 and for persons dying after December 31, 2023.

### Reporting of Estimated Total Value of Trust Assets and Other Information

- Most domestic trusts are required to file an income tax return, however, there is currently no requirement to report the nature or value of the trust assets.
- The proposal would require certain trusts to report information to the IRS.
- A new provision to this year's proposal would require each trust to report on its income tax return the generation-skipping transfer (GST) tax inclusion ratio of the trust at the time of any trust distribution to a non-

# CUMMINGS & LOCKWOOD LLC

- skip person, as well as information regarding any trust modification or transaction with another trust that occurred that year.
- The proposal would apply for taxable years ending after the date of enactment.

## Restrict Use of Defined Value Formula Clauses

- Taxpayers frequently use formula clauses in making gifts of interests of hard-to-value assets. These formulas include as a variable the value of property as finally determined for federal gift or estate tax purposes, permitting taxpayers to make transfers without incurring gift or estate tax if the value of the transferred assets is successfully challenged by the IRS.
- New to the 2024 Greenbook, the proposal would curtail the ability of taxpayers to utilize formula clauses by providing that if a gift or bequest uses a defined value formula clause that determines value based on the result of IRS involvement, then the value of the gift or bequest will be deemed to be the value that was reported on the gift or estate tax return.
- The proposal outlines two exceptions for when a defined value formula clause would be allowed for transfer tax purposes: (1) if the unknown value is determined by something else identifiable (other than the IRS determination), such as an appraisal that is performed within a short period of time after the transfer, or (2) if the defined value clause is used for estate tax purposes to define a marital or exemption equivalent bequest to utilize the decedent's remaining estate tax or generation-skipping tax exclusion amount.
- The proposal would apply to transfers by gift or on death occurring after December 31, 2023.

## Annual Exclusion from Gift Tax

- In 2023, an individual can give up to \$17,000 annually to any number of people without exhausting any portion of their lifetime exemption from estate and gift tax, provided the gift is of a present interest, rather than a future interest, in the gifted property.
- The proposal would eliminate the present interest requirement and instead, there would be a new category of transfers and an annual limit of \$50,000 per donor, indexed for inflation after 2024, on transfers of property in this category that qualify for the gift tax annual exclusion.
- The \$50,000 limit would not provide an exclusion in addition to the annual per-donee exclusion. Instead, it would be a further limit on those amounts that otherwise would qualify for the annual per-donee exclusion.
- The new category includes transfers to trusts, transfers of interests in passthrough entities, transfers of partial interests in property and other transfers which the donee cannot immediately liquidate without a right of withdrawal, put or other such rights.
- The proposal would be effective for gifts made after December 31, 2023.

## Limit the Duration of GST Exemption

- Currently, to the extent GST exemption is allocated to a trust, the trust can exist for multiple generations without being subject to GST tax, and trust distributions to grandchildren and more remote descendants will not incur a GST tax.
- The proposal would make the GST exemption applicable only to: (a) direct skips and taxable distributions to beneficiaries no more than two generations below the transferor, and to younger generation beneficiaries who were alive at the creation of the trust; and (b) taxable terminations occurring while any person described in (a) is a beneficiary of the trust. This proposal would apply on and after the date of enactment to all trusts subject to the GST tax regardless of the trust's inclusion ratio on the date of enactment.
- For all taxable years after enactment, the proposal would ignore any charitable interest for GST tax purposes, thereby causing taxable terminations to occur for trusts that rely on charitable interests as the only non-skip

# CUMMINGS & LOCKWOOD LLC

- beneficiary of a trust.

## Adjustment of Trusts' GST Inclusion Ratio on Transactions with Other Trusts

- A purchase by a GST-exempt trust of assets from, or a remainder interest in, another trust is a technique for leveraging the benefit of the GST exemption. The proposal would limit that leveraging opportunity by requiring a readjustment of the purchasing trust's inclusion ratio after each transaction.
- Specifically, the proposal would treat a trust's purchase of assets from, or interests in, a trust that is subject to GST tax (regardless of the selling trust's inclusion ratio), as well as a purchase of any other property that is subject to GST tax, as a change in trust principal that would require the redetermination of the purchasing trust's inclusion ratio when those assets (or trust interest) are purchased.
- The value of the purchased assets would be included in the total value of the trust in the denominator of the applicable fraction, and the value of only the portion of those assets excluded from GST tax immediately before the purchase would be added to the numerator of the fraction.
- A similar readjustment would be required following a decanting.
- The proposal would apply to all such transactions occurring after the date of enactment.

## Grantor Trusts

- The grantor trust rules have lent themselves to effective transfer tax planning by allowing transactions between the grantor and the grantor trust to be generally disregarded for income tax purposes and - by obligating the grantor to cover the tax liabilities attributable to the grantor trust's earnings thereby depleting the grantor's estate.
- Similar to last year, the proposal would treat income tax payments required to be made by the grantor under the grantor trust rules as taxable gifts to the trust going forward.
- A technical addition to this year's proposal clarifies that gifts to the trust cannot be reduced by the marital deduction, charitable deduction or various gift exclusions under Internal Revenue Code Sections 2503(b) and 2503(e).
- Transfers of an asset for consideration between a grantor and a grantor trust would also be regarded for income tax purposes, thereby making sales and payments in satisfaction of an obligation recognition events triggering a capital gain (losses would be disallowed).
- The proposal does not apply to revocable trusts.

## Grantor Retained Annuity Trusts (GRAT)

- In another repeat proposal, the administration proposes to eliminate short-term GRATs and so called "zeroed-out" GRATs, where the value of the retained annuity interest of the grantor is equal to the value of property transferred, resulting in a taxable gift at or near zero.
- The proposal would curtail the effectiveness of a GRAT by requiring: (1) GRATs to have a 10-year minimum term and last no longer than the life expectancy of the grantor plus 10 years and (2) the GRAT remainder interest (that is, the amount of the taxable gift) to have a value equal to the greater of 25% of the value of the assets contributed or \$500,000, but in no event greater than the full value of the assets contributed.
- The proposed change would apply to all GRATs created on or after the date of enactment.

## Charitable Lead Annuity Trusts (CLAT)

- The proposal would require that the annuity payments made to charitable beneficiaries of a CLAT at least annually must be a level, fixed amount over the term of the CLAT, and that the value of the remainder interest at the creation of the CLAT must be at least 10 percent of the value of the property used to fund the CLAT,

# CUMMINGS & LOCKWOOD LLC

- thereby ensuring a taxable gift on creation of the CLAT.
- The proposal would apply to all CLATs created after the date of enactment.

## Restriction of Valuation Discounts on Intrafamily Transfers

- Factors such as a lack of control and lack of marketability often warrant valuation discounts for transfers of illiquid assets.
- New to the 2024 Greenbook, the proposal would restrict discounts available under current law, valuing partial interests in non-publicly traded property transferred to or for the benefit of a family member as a pro-rata share of the collective fair market value of all interests in that property held by the transferor and the transferor's family members, with that collective value being determined as if held by a sole individual.
- The proposed rule would apply only to intrafamily transfers of partial interests in property in which the family collectively has at least a 25% interest in the whole.
- The proposal would apply to valuations as of a valuation date on or after the date of enactment.

## Recharacterization of Trust Loans as Distributions

- The proposal would recharacterize trust loans to beneficiaries as distributions for income and GST tax purposes.
- In addition, the proposal would treat a grantor's repayment of loans from a grantor trust as additional contributions to the trust for GST tax purposes.

## Valuation of Promissory Notes

- Carried over from last year's Greenbook, the proposal would impose a consistency requirement by providing that, if a taxpayer treats any promissory note as having a sufficient rate of interest to avoid the treatment of any foregone interest on the loan as income or any part of the transaction as a gift, that note subsequently must be valued for Federal gift and estate tax purposes by limiting the discount rate to no more than the greater of the actual rate of interest of the note, or the applicable minimum interest rate for the remaining term of the note on the date of death.
- The proposal would apply to valuations as of a valuation date on or after the date of enactment.

These are simply proposals put forth by the Biden Administration. We will be following any developments closely to see if any of these proposals make their way into legislation.

If you have any questions, please contact your Cummings & Lockwood attorney.