CUMMINGS & LOCKWOOD LLC

THE BIDEN ADMINISTRATION'S REVENUE PROPOSALS AGAIN INCLUDE CHANGES TO THE ESTATE AND GIFT TAX SYSTEM

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On March 28, 2022, the Biden Administration released its "General Explanation of the Administration's Fiscal Year 2023 Revenue Proposals." The document again supports several drastic changes to the estate and gift tax system in addition to changes to the income tax system.

The estate and gift tax proposals are as follows:

Capital Gains/Step up In Basis

- The administration is again proposing that the "step up in basis" rule be repealed. Under current law, assets subject to estate tax at death receive a basis adjustment for income tax purposes equal to the date of death value so that pre-death capital gains are wiped away. The step up in basis rule coupled with higher federal estate tax exemptions mean that many estates do not pay income tax or estate tax. Under the proposal, transfers by gift or by death would be realization events that trigger capital gains tax to be due. Any capital gains tax due at death would be deductible against the estate tax.
- 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).
- The administration is proposing that assets in trusts or partnerships shall be marked to market every 90 years beginning from January 1, 1940, meaning the first recognition event would be December 31, 2030.
- 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.
- These new rules would be applicable to gifts made after December 31, 2022 or for persons dying after December 31, 2022.

Grantor Retained Annuity Trusts

- In another repeat proposal, the administration proposes requiring Grantor Retained Annuity Trusts (GRATs) to have a minimum 10 year term.
- The maximum term of the GRAT would be the annuitant's life expectancy plus 10 years to avoid long term GRATs taking advantage of interest rate increases over time.
- The GRAT's remainder interest must be at least equal to the greater of twenty-five percent (25%) of the value of the assets transferred to the GRAT or $500,000 (capped at the value of assets transferred to the GRAT).
- Annuity payments could not decrease during the term.
- The grantor would be prohibited from tax free "swaps" during the term of the GRAT.
- The provision would be effective upon date of enactment.

Grantor Trusts

- One popular planning technique is for an individual (the "grantor") to make gifts to a "grantor trust" which, under current law, not only excludes the gifted assets from the grantor's taxable estate at death but allows the grantor to further reduce his or her taxable estate by remaining obligated to pay income taxes on income earned on the assets in the grantor trust. It is difficult to create many kinds of gifting trusts without having them treated as "grantor trusts."
- The proposal would treat the tax paid as an additional gift for gift tax purposes for trusts created after the date of enactment.
- Sales between a grantor and a grantor trust would be taxable events.

Valuation of Promissory Notes

- To avoid what the administration sees as an abuse, the discount rate of a promissory note must be the greater of the interest rate of the note or the applicable federal rate for the remaining term of the note.
- This is to prevent a taxpayer from selling assets in exchange for a promissory note at the AFR and then later claiming a discount on the value of the note.
- This would be effective for valuations after the date in which legislation was introduced.

Limit the Duration of GST Exemption

- Again, the Administration is proposing to limit the applicability of the GST exemption to two generations below the transferor or those alive at the creation of the trust.

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

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