Estate Planning Current Developments Supplement—Overview of the Fiscal Year 2023 Greenbook

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Introduction

This summary is a brief overview of some of the estate planning related provisions included in the Biden administration's "General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals" (popularly called the "Greenbook") released March 28, 2022. Many of these provisions are similar to items in the FY 2022 budget proposal that were not included in the Build Back Better Act passed by the House of Representatives and that is still pending in the Senate. The likelihood of many of these provisions being adopted in 2022 (obviously an election year) appears very remote, with near unanimous opposition among Republicans to many of these proposals and likely opposition from some Democratic Senators to some of the proposals.

The Biden administration describes the proposed budget as "cutting deficits and keeping the economic burden of debt low. The Budget's investments are more than fully paid for through tax code reforms requiring corporations and the wealthiest Americans to pay their fair share, closing loopholes, and improving tax administration."

1. Selected Business Taxation Provisions

a. **Increasing Corporate Income Tax Rate.** The corporate income tax rate would be increased from 21% to 28%.

b. **Preventing Basis Shifting.** The proposal would reduce the possibility of basis shifting by related parties through partnerships. "In the case of a distribution of partnership property that results in a step-up of the partnership's non-distributed property, the proposal would apply a matching rule that would prohibit any partner in the distributing partnership that is related to the distributee-partner from benefitting from the partnership's basis step-up until the distributee-partner disposes of the distributed property in a fully taxable transaction."

2. Strengthen Taxation of High-Income Taxpayers

a. **Increased Top Marginal Income Tax Rate for High Earners.** The top income tax rate would increase from 37% to 39.6% for taxable income over $450,000 for joint returns, $400,000 of unmarried individuals (other than surviving spouses), $425,000 for head of household filers, and $225,000 for married individuals filing separate returns (indexed after 2023). (The levels of taxable income at which the top 39.6% rate would apply are lower than the current brackets and lower than those in the FY 2022 budget proposal.)

b. **Reform Taxation of Capital Income.** The capital gain reform provision is practically identical to the proposal in the FY 2022 Greenbook.

(1) **Tax Capital Income for High-Income Earners at Ordinary Rates.** The proposal would tax capital gains and qualified dividends as ordinary income (top rate of 39.6% plus the 3.8% "Medicare" tax) for taxpayers having adjusted gross income over $1 million for gains required to be recognized and dividends received on or after the date of enactment. (The FY 2022 proposal would have applied this change to gains recognized after the "date of announcement" (presumably April 28, 2021).)

(2) **Treat Transfers of Appreciated Property by Gift or On Death as Realization Events.** The bold proposal in the FY 2022 budget proposal to treat transfers by gift or on death as realization events is repeated in the FY 2023 proposal. Various exceptions (also included in the FY 2022 proposal) apply for certain transfers between spouses and transfers to charity, gain on the sale of a residence (not just a principal residence) (up to $250,000 per person with portability for spouses), gain on the sale of tangibles (other than collectables), and gain on the sale of qualified small business stock. There would be an exclusion of $5 million (up from $1 million in the FY 2022 proposal) per person (portable between spouses), and deferred payment provisions would be available. Details of the FY 2022 Greenbook deemed realization proposal and planning implications are summarized in Items 2.j – 2.m of Estate Planning Current Developments

(December 2021) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

c. **Impose a Minimum Tax on the Wealthiest Taxpayers.** This provision is new in the FY 2023 Greenbook. Senator Wyden's "Billionaire Income Tax" proposal was discussed (for **one** day, on October 27, 2021) as a possible addition to the Build Back Better Act. That system would provide mark-to-market annual taxation of income from tradable property (such as stocks and bonds), and (ii) lookback taxation of income from nontradable property (a lookback charge [perhaps an interest charge on the deferred tax] would be applied to reduce incentives for the taxpayer to defer the sale of the assets). A taxpayer would be subject to the rules if she has either $100 million of income OR $1 billion of "applicable assets" in each of the prior three years (the income threshold could be satisfied in some years and the asset threshold could be satisfied for other years in the three-year test period). For a summary of the Billionaires Income Tax proposal, see Item 2.s. of Estate Planning Current Developments (December 2021) found **here** and Part 2.e of Ronald D. Aucutt, Washington Update: Pending and Potential Administrative and Legislative Changes (January 3, 2022) found **here**, both available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

The Greenbook FY 2023 proposes a somewhat similar but different approach of applying a minimum tax of 20% of total income, generally inclusive of unrealized capital gains, for taxpayers with wealth (i.e., assets minus liabilities) greater than $100 million. Taxpayers could choose to pay the minimum tax liability in equal annual installments over nine years for the first year of minimum tax liability and over five years for subsequent years. The minimum tax payments would be treated as a prepayment to be credited against subsequent taxes on realized gains to avoid taxing the same amount of gain more than once. Taxpayers with wealth over the $100 million threshold would have to report annually the total basis and total estimated value of assets in each of specified asset classes. Relief provisions would be included to avoid having to obtain annual valuations of non-tradable assets. Taxpayers treated as illiquid (with tradable assets constituting less than 20% of their wealth) could elect to include the unrealized gain only for tradable assets in determining the annual minimum tax, subject to a deferral charge upon, and to the extent of, the realization of gain on any non-tradable assets (not to exceed 10% of unrealized gains). No estimated payments would be required for the minimum tax. The proposal would be effective for tax years beginning after 2022.

According to the Credit Suisse Global Wealth Databook 2021, almost 30,000 families in the U.S. have assets more than $100 million. (That would seem consistent with the Biden administration's estimate that the Billionaire Minimum Income Tax would apply to .01% of Americans.) The administration estimates that the tax would raise $360 billion over ten years. Interestingly, Gabriel Zucman, an economist from the University of California at Berkeley, estimates that the top **ten** American billionaires would pay at least $215 billion in tax in total over the next decade under this new tax regime.

The constitutionality of such a new tax on unrealized growth would likely be challenged in court.

3. Estate and Gift Proposals

a. **Modify Income, Estate and Gift Tax Rules for Certain Grantor Trusts.**

(1) **GRATs.** Restrictions on GRATs would include (1) a 10-year minimum term, (2) a maximum term of life expectancy of the annuitant plus ten years, (3) a remainder value at least the greater of 25% of the amount contributed to the GRAT or $500,000 (up to the value of property in the trust), (4) a prohibition on any decrease in the annuity during the GRAT term (which otherwise might be used to reduce the amount includable in the grantor's gross estate if the grantor dies before the end of the GRAT term), and (5) a prohibition on the grantor acquiring an asset from the GRAT in an exchange without recognizing gain or loss on the exchange. This provision would apply to trusts created on or after the date of enactment.

Observation: Clients should not necessarily rush to create GRATs before a statute might be enacted, because the trust would recognize gain if the annuity payments could be satisfied only with appreciated assets of the GRAT, as discussed in the following paragraph. (The gain recognition risk could be minimized by using a longer term GRAT so the annuity amounts could be low enough to be satisfied out of income from the GRAT assets.)

(2) **Recognition of Gain on Sales Transactions With Grantor Trusts.** For other than trusts fully revocable by the deemed owner, "the transfer of an asset for consideration between a grantor trust and its deemed owner" would result in the seller recognizing gain. This would apply both to sales and to transfers in satisfaction of an obligation (such as an annuity or unitrust payment) with appreciated property. This provision would apply to all transactions after the date of enactment.

(3) **Payment of Income Tax by Deemed Owner as Gift.** The deemed owner's payment of income tax on the grantor trust's income would be a gift by the deemed owner unless the deemed owner is reimbursed by the trust during the same year (but the annual reimbursement of such taxes would likely create a risk of including the grantor trust assets in the grantor's gross estate under §2036). This provision would apply to all trusts created on or after the date of enactment (which could provide an incentive to create and fund grantor trusts before the date of enactment).

(4) **Planning Implications of Grantor Trust Provisions.** The Greenbook FY 2023 proposal does not treat the value of grantor trust assets as being included in the grantor's gross estate (as provided in the September 15, 2021, version of the House Ways and Means Committee version of the Build Back Better Act). (The estate inclusion provision resulted in vehement objections from the life insurance industry regarding the effect on existing life insurance trusts in light of the necessity for continuing contributions to the trust to pay life insurance premiums.) While the value of grantor trust assets would not be included in the gross estate, the Greenbook proposal would remove the two huge tax advantages of grantor trusts -- (1) the grantor's payment of income taxes as a gift tax free transfer and (2) the ability of the grantor to enter into sales, swaps, or other transactions with the trust without being treated as an income tax recognition event.

(5) **Consistent Valuation of Promissory Notes.** Loans with an interest rate equal to the AFR are not treated as gifts under §7872, but the lender may take the position that the note should be discounted for gift tax purposes on a later re-transfer or for estate tax purposes at death because the interest rate is lower than a commercial rate. Section 7872 authorized the issuance of regulations to address the estate valuation of notes, and proposed regulations were promulgated but have never been adopted.

The 2015-2016 Priority Guidance plan included this as a regulatory project, and it was continued in the Plans for 2016-2017, 2017-2018, and 2018-2019.

(a) A project described as "Guidance on the valuation of promissory notes for transfer tax purposes under §§2031, 2033, 2512, and 7872" first appeared in the 2015-2016 Plan, but was dropped in the 2017-2018 Plan (the first Plan in the Trump Administration).

(b) This project was joined in the 2016-2017 Plan by an item under the subject of "Financial Institutions and Products" described as "Regulations under §7872. Proposed regulations were published on August 20, 1985." When the promissory notes project was dropped from the subject of "Gifts and Estates and Trusts" in the 2017-2018 Plan, that item under "Financial Institutions and Products" remained. It was carried over to the 2018-2019 Plan, but dropped from the 2019-2020 Plan.

Rather than following through on the existing statutory authority to adopt regulations addressing the issue, however, the Treasury is now proposing a legislative solution which would limit the discount rate used to value the note for estate tax purposes "to 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 provision would apply to valuations as of a valuation date on or after the date of introduction.

b. **Miscellaneous Trust and Estate Tax Provisions.** The following items in the FY 2023 Greenbook were not included in last year's (FY2022) Greenbook.

(1) **Expanded Definition of Executor.** The definition of executor would move from §2203 to §7701 of the Code, and the authorized party could act for all tax purposes (including with respect to pre-

death tax liabilities). This would apply after date of enactment regardless of a decedent's date of death.

(2) **Special Use Property.** The limit on the reduction in value of special use property would increase from $750,000 (indexed, $1.23 million in 2022) to $11.7 million, applicable for decedents dying on or after the date of enactment.

(3) **Extension of 10-Year Estate and Gift Tax Lien.** The automatic 10-year lien for estate and gift tax would be extended during any deferral or installment period for unpaid estate and gift taxes. This provision would apply for existing 10-year liens and for the automatic lien that applies for gifts made or estates of decedents dying on or after the date of enactment.

(4) **Reporting of Estimated Value of Trust Assets.** Trusts would be required to file with the IRS annual reports including the name, address, and TIN of each trustee and grantor of the trust, and general information with regard to the nature and estimated total value of the trust's assets (which might be satisfied by identifying an applicable range of estimated total value on the trust's income tax return). The reporting requirement would apply to taxable years ending after the date of enactment for trusts valued over $300,000 or with gross income over $10,000.

c. **Limited Duration of GST Exemption.** GST exemption allocations would apply only to:

(1) direct skips and taxable distributions to beneficiaries no more than two generations below the transferor (for example, to grandchildren but not to great-grandchildren of the transferor) and to younger generation beneficiaries who were alive at the creation of the trust; and

(2) taxable terminations occurring while any persons described in (1) is a beneficiary of the trust.

Therefore, trusts would not continue to be exempt for the full life of the trust (i.e., throughout the applicable rule against perpetuities period) but only for the life of any first- or second-generation beneficiary or any younger generation beneficiary who was alive at the creation of the trust. "Pour-over trusts" (as described in §2653(b)(2)) created from a trust (whether under the trust instrument or under a decanting authority) would be treated as having the same date of creation as the initial trust.

This provision limiting the duration of the allocation of GST exemption would apply retroactively to existing trusts, but the proposal is that "a pre-enactment trust would be deemed to have been created on the date of enactment" for purposes of determining the duration of the GST exemption.

d. **Not Included.** The FY 2023 Greenbook proposals do not include the following measures that were in the September 15, 2021, House Ways and Means Committee version of the Build Back Better Act:

- A reduction of the estate and gift exclusion amount prior to 2026;
- New §2902 including grantor trust assets in the grantor's gross estate; and
- Special valuation provisions for nonbusiness assets in entities.

4. Other Selected Miscellaneous Provisions

Other miscellaneous provisions include:

- Taxing "carried interests" as ordinary income;
- Eliminating real estate like-kind exchanges for gains in excess of $500,000 ($1 million for joint returns); and
- Limiting the use of donor advised funds (DAFs) to avoid the private foundation annual payout requirement (i.e., distributions from a private foundation to a DAF would not be a qualifying distribution unless the DAF makes a qualifying distribution of those funds by the end of the following taxable year).

The first two of those provisions are repeats from the FY 2022 Greenbook; the third provision is added in the FY 2023 proposal.