Déjà Vu? Biden's Proposed 2024 Budget Would Bring Sweeping Changes to Estate, Retirement, and Tax Planning

On Thursday, March 9, the Treasury released its general explanations of the Biden Administration's $6.9 trillion budget for fiscal year 2024, known as the Greenbook. Its more than 80 revenue proposals include ones similar to the 2023 budget proposals, along with other, more novel approaches to revenue raising. Given the current divided Congress, the proposals are in some sense symbolic; at the same time, they are prospective indicators of the Administration's legislative priorities should President Biden seek and win another term in 2024, which would very nearly coincide with the upcoming "sunset" of the Tax Cuts and Jobs Act of 2017 in 2026.

Here are highlights of select provisions that would affect trusts, estates, and higher individual income earners:

Increase the Top Marginal Income Tax Rate for High Income Taxpayers

The top income tax rate is presently 37%, scheduled to revert to 39.6% in 2026. In 2023 this rate applies to taxable income over $578,125 (single filers), $693,750 (joint filers), and $14,450 (trusts and estates).

The Administration proposes to increase the top rate to 39.6% beginning in 2024. The top rate would apply to taxable income over $400,000 (single) or $450,000 (joint) in 2023 and would be indexed after 2024. No change to the top income bracket for trusts and estates is specified in the Treasury's general explanations.

Tax Rate on Qualified Dividends and Long-Term Capital Gains

The top income tax rate on qualified dividends and long-term capital gains is presently 20%. The Administration proposes to tax qualified dividends and long-term capital gains at ordinary income rates, with a top rate of 37% (or 39.6% if the top rate is increased), for taxpayers with income over $1 million, but only to the extent the taxpayer's income exceeds $1 million ($500,000 for married filing separately), indexed after 2024. This proposal would be effective as of the date of enactment.

Transfers of Appreciated Property

Under current law, there is generally a carryover basis for gifts and a basis step-up for transfers at death. The Administration proposes to treat transfers of appreciated property by gift or on death as income-taxable events. Any tax on capital appreciation at death would be a deductible expense of the decedent's estate – *not* a credit against estate tax.

To capture appreciation on assets held by entities rather than individuals, the Administration also proposes to tax gain on unrealized appreciation in a trust, partnership, or other noncorporate entity that is the owner of property if that property has not been the subject of a recognition event within the prior 90 years. This provision would apply to property held on or after January 1, 1942, that is not subject to a recognition event after December 31, 1941, so that the first recognition event would be deemed to occur on December 31, 2032.

Valuation discounts on transfers of business interests between or for the benefit of family members would be disregarded, although businesses in which the transferor plays an active management role would be exempt. Transfers to a trust (other than a wholly owned revocable trust) or partnership and in-kind transfers from these entities would also be recognition events.

Transfers to a U.S. spouse would receive a carryover basis, and transfers to charity would not be taxable. The current exclusion for gain on the sale of a principal residence would continue to apply. A $5 million per person exclusion on property transferred by gift or at death would apply, indexed for inflation after 2023, and the exclusion would be portable between spouses.

This change would be effective for gifts after December 31, 2023, for persons dying after December 31, 2023, and for property owned by trusts and partnerships on January 1, 2024.

Minimum Tax on Wealthiest Taxpayers

At present, gains are not taxable until realized and recognized, most often as the result of the sale of property. The Administration proposes to impose a minimum tax of 25% on total income, including unrealized capital gains, on taxpayers with wealth of over $100 million, even if no sale of property occurs.

This change would be effective beginning in 2024.

Grantor-Retained Annuity Trusts (GRATs)

The budget proposal would impose a minimum GRAT term of ten years and a maximum term no greater than ten years following the death of the annuitant. It would also require a beneficial remainder (gift amount) equal to the greater of $500,000 or 25% of the trust's fair market value at inception. In addition, annuity payments could not decrease over the term of the GRAT, and the grantor could not exchange GRAT assets for assets of equivalent value.

The proposal would require that the remainder interest in a GRAT at the time the interest is created have a minimum value for gift tax purposes equal to the greater of 25 percent of the value of the assets transferred to the GRAT or $500,000 (but not more than the value of the assets transferred).

The changes would be effective as of the date of enactment.

Changes to Treatment of Grantor Trusts

In the world of tax planning the term "grantor trust" refers to trusts whose settlor (or grantor) is the designated taxpayer for all items of income earned from trust assets. Many grantor trusts are also designed to be "intentionally defective." This simply means that for purpose of income taxes the grantor is still treated as the owner of the assets, but not for estate tax purposes. This type of tax treatment has several advantages, some of which the current proposed legislation would remove. Under the proposed budget, the following would apply:

- **Trust income taxes subject to gift tax treatment:** To the extent a trust grantor personally recognizes trust income, pays the tax owed, and is not reimbursed by the trustee, the tax payments are treated as gifts to the trust beneficiaries.
- **Disregarded sales:** Asset sales to irrevocable grantor trusts would no longer be disregarded for capital gains tax purposes, effectively ending the "estate freeze" technique of selling

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appreciating assets to an intentionally defective grantor trust (IDGT) in exchange for a promissory note.

As with changes to valuation discounts, the new grantor trust rules would take effect on the date of the law's enactment.

Limit Duration of "Dynasty" Generation-Skip Trusts

The administration proposes that the GST exemption would only apply 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 above is a beneficiary. The provisions resetting the transferor upon the payment of GST tax would not apply, and existing trusts would be treated as having been created on the date of enactment.

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.

Adjust a Trust's GST Inclusion Ratio on Transactions with Other Trusts

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 – in effect, the non-GST-exempt character of the purchased assets carries to the purchasing trust.

The proposal would apply to all applicable transactions occurring after the date of enactment.

Modify the Definition of a Guaranteed Annuity from a Charitable Lead Annuity Trust (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, thereby ensuring a taxable gift on creation of the CLAT.

The proposal would apply to all CLATs created after the date of enactment.

Limit Annual Exclusion Gifts

The proposal would limit the tax-free transfer of annual gifts in trust and certain outright gifts of business interests to a total amount of $50,000 per year, even if the total gifts to each individual did not exceed $17,000.

The proposal would be effective for gifts made after December 31, 2023.

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Special Distribution Rules on High Income Taxpayers with Large Retirement Account Balances

The Administration proposes special distribution rules on high income taxpayers with large retirement account balances.

A high-income taxpayer with vested account balances over $10 million as of the last day of the previous year would have to distribute at least 50% of the excess.

In addition, if the vested account balances exceeded $20 million, the taxpayer would have to distribute the lesser of the excess above $20 million or the amount held in Roth IRAs or designated Roth accounts.

For this purpose, a high-income taxpayer is one with modified adjusted gross income over $400,000 (single) or $450,000 (joint).

The taxpayer may choose the source of the distributions, except that if the vested balances are over $20 million, the additional distributions must come first from Roth IRAs and then from designated Roth accounts.

This change would be effective for taxable years beginning after December 31, 2023.

Limit Rollovers and Conversions to Designated Roth Accounts or Roth IRAs

This provision would prohibit a high-income taxpayer from rolling over to a Roth IRA an amount distributed from a traditional IRA or an eligible retirement plan other than a designated Roth account.

It would also prohibit a high-income taxpayer from rolling over amounts distributed from a traditional IRA or an employer plan other than a designated Roth account into a Roth IRA or a designated Roth account if any part of the distribution includes a distribution of after-tax contributions (other than contributions to a designated Roth account).

These rules would eliminate Roth conversions and “back-door” Roth conversions for high-income taxpayers.

For this purpose, a high-income taxpayer is one with modified adjusted gross income over $400,000 (single) or $450,000 (joint).

This change would be effective for distributions made after December 31, 2023.

Expansion of Tax on Net Investment Income (NIIT)

Individuals with modified adjusted gross incomes over a threshold amount are subject to a 3.8% tax on net investment income, used by the federal government to help fund Medicare. The threshold is $200,000 for single and head of household returns and $250,000 for joint returns. Net investment income generally includes interest, dividends, rents, and certain passive business income, among other items. Currently, S corporation shareholder-employees and distributions to limited partners who claim the Section 1402(a)(13) statutory exclusion for limited partners do not pay the 3.8% NIIT. The proposal would expand the NIIT base to ensure that all pass-through business income of high-income taxpayers is subject to either the NIIT or existing self-employment Medicare contributions tax.
The proposal would be effective for taxable years beginning after December 31, 2023.

Increased Tax Rate on Net Investment Income (NIIT) for Certain Taxpayers

According to the Medicare trustees’ current projections, the program will become seriously underfunded beginning in 2028. The proposed budget would address this by increasing the additional 3.8% Medicare tax rate (discussed above) by 1.2 percentage points to 5.0% for taxpayers with more than $400,000 of earnings, indexed for inflation. The proposal would be effective for taxable years beginning after December 31, 2023.

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Conclusion

Unlike President Biden's prior budget proposals, this one was delivered to a Republican-controlled House of Representatives, prompting some commentators to doubt its overall viability. However, as noted above, it contained nearly 80 different revenue proposals, and this article has covered only a few of them. No one can say how budget negotiations may actually play out; even if only a portion of the current proposals become law, there could be significant impacts on clients' planning now and far into the future. The proposals with the broadest impact would be the increase in the personal income tax rate and the forced gain realization on property transferred by gift or at death.

The forced gain realization on gratuitous property transfers would provide a $5,000,000 (as adjusted for inflation) exclusion from the imposition of capital gains taxes on transfers during lifetime or at death, and transfers to charity or a spouse would not be subject to these rules. It would also have an effective date of January 1, 2024, so there is still time to act for those considering lifetime transfers.

The most straightforward action wealthier clients can take now is to work with their tax and legal advisors to explore making maximum gifts before the end of the 2023. Married couples can give up to $25,840,000 between them this year.

If you have an estate planning opportunity in these uncertain times, Prudential's Advanced Planning team is here to help. We look forward to being of assistance, and can be reached at 800-800-2738, Option 4 for Life Insurance support.

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