JOSH N. BENNETT ESQ, P.A.
JOSHBENNETT.COM

New Proposed Biden Tax Law Changes

The Administration recently released its fiscal 2023 revenue proposals. The key provisions affecting individual taxpayers are as follows:

Increase the Top Marginal Income Tax Rate for High Income Taxpayers

The top income tax rate is presently 37%, and is scheduled to revert to 39.6% in 2026. This rate presently applies to taxable income over $539,900 (single) or $647,850 (joint).

The Administration proposes to increase the top rate to 39.6% beginning in 2023. The top rate would apply to taxable income over $400,000 (single) or $450,000 (joint) in 2023, and would be indexed after 2023.

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 2023. This proposal would be effective after 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 realization events. The capital gains tax at death would be deductible against the estate tax.

The Administration also proposes to have assets in a trust or partnership be marked to market every 90 years beginning from January 1, 1940, so that the first possible recognition event would be on December 31, 2030. No discount would be allowed for partial interests. Transfers to or from a trust (other than a wholly owned revocable trust) or partnership would also be recognition events.

Transfers to a U.S. spouse would not be realization events, but would receive a carryover basis. Transfers to charity would not be taxable. Transfers to a split-interest trust (a charitable lead trust or a charitable remainder trust) would be taxable except to the extent of the value of the charity's interest.

The exclusion for gain on the sale of a principal residence would apply. Gain on the transfer of tangible personal property other than collectibles, would be excluded. The Section 1202 exclusion with respect to qualified small business stock would also apply.

There would be a $5 million per person exclusion on property transferred by gift or at death, indexed for inflation after 2022. There would be portability between spouses for this exclusion.

The tax on certain family owned and operated businesses would be deferred until the interest is sold or the business ceases to be family owned and operated.

The tax on appreciated assets other than liquid assets could be paid over 15 years.

This change would be effective for gifts after December 31, 2022, for persons dying after December 31, 2022, and for property owned by trusts and partnerships on January 1, 2023.

Minimum Tax on Wealthiest Taxpayers

At present, gains are not taxable until realized and recognized.

The Administration proposes to impose a minimum tax of 20% on total income, including unrealized capital gains, on taxpayers with wealth of over $100 million.

The tax for the first year could be paid in nine equal annual installments, and the tax for subsequent years could be paid in five equal annual installments.

This change would be effective beginning in 2023.

Grantor Retained Annuity Trusts

It is possible to create a short-term grantor retained annuity trust ("GRAT") in which the remainder interest has little or no value.

The Administration proposes that a GRAT would be required to have a minimum term of 10 years, and a maximum term equal to the life of the annuitant plus 10 years. The remainder interest must have a value at least equal to the greater of 25% of the value contributed to the GRAT or $500,000, but not more than the value of the assets contributed.

Under the proposal, the annuity payments could not decrease during the GRAT term, and the grantor would be prohibited from engaging in a tax-free exchange of any assets held in the trust.

This proposal would be effective upon enactment.

Grantor Trusts

The grantor trust rules for income tax purposes are not the same as the rules for inclusion in the gross estate for estate tax purposes.

Accordingly, it is possible to create a trust that is a completed gift for gift tax purposes, is not included in the estate for estate tax purposes, but which is a grantor trust for income tax purposes.

The Administration proposes that if a taxpayer creates a grantor trust that is not fully revocable, sales between the grantor and the trust would be taxable, effective for sales on or after the date of enactment.

In addition, the grantor's payment of the income tax on the trust's income and gains would be treated as a taxable gift, effective for trusts created on or after the date of enactment.

Consistent Valuation of Promissory Notes

At present, taxpayers may be able to take inconsistent positions as to the value of a promissory note. A taxpayer may sell an asset for a note with interest at the applicable Federal rate, and subsequently claim a valuation discount for the note.

The Administration proposes to require that the discount rate of the note for estate and gift tax purposes be limited to the greater of the interest rate of the note or the applicable Federal rate for the remaining term of the note.

The proposal would be effective for valuation dates on or after the date legislation is introduced.

Administration of Trusts and Estates

The Administration proposes various changes to improve the administration of trusts and estates.

For estate tax purposes, if there is no executor or administrator appointed, qualified and acting, any person in actual or constructive possession of any property of the decedent is considered a statutory executor. However, this concept only applies for estate tax purposes. The Administration proposes to expand it to other tax matters, and to allow the IRS to adopt rules to resolve conflicts among multiple executors. This change would be effective upon enactment.

An estate may elect special use valuation to reduce the value of the estate by up to $1,230,000. The Administration proposes to increase this limit to $11.7 million, effective for estates of decedents dying after the date of enactment.

There is a special estate tax lien for 10 years from the date of a gift, or from the date of death. The Administration proposes to extend the lien during any deferral or installment period for unpaid estate and gift taxes.

Trusts do not presently have to report the value of their assets. The Administration proposes to required trusts with an estimated value over $300,000 or gross income over $10,000 to report their value.

Limit Duration of GST Exemption

Each taxpayer has a GST exemption. The GST exemption is $12,060,000 for 2022, and is indexed for inflation. It is scheduled to drop to one-half of its current level, indexed for inflation, beginning in 2026.

The common law rule against perpetuities is lives in being plus 21 years. Some states have a 90-year statutory rule against perpetuities.

In recent years, approximately one-half of the states have either repealed their rule against perpetuities or lengthened the permissible period of time under the rule against perpetuities, in some cases to as long as 1,000 years.

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.

Tax carried interests as ordinary income

A partner may receive an interest in future partnership profits (a profits interest or carried interest) for services. To the extent the partnership recognizes long-term capital gain, the partner will reflect his or her share of the gain as long-term capital gain. Gain on the sale of a partnership interest is generally also capital gain.

Income attributable to a profits interest is generally subject to self-employment tax, except to the extent the partnership generates types of income that are excluded from self-employment taxes, such as capital gains, certain interest, and dividends.

The Administration proposes to tax as ordinary income a partner's share of income on an investment services partnership interest (ISPI) in an investment partnership if the partner's taxable income from all sources is over $400,000. In addition, partners in such investment partnerships would be required to pay self-employment tax on such income. Finally, the gain on the sale of an ISPI would be ordinary income if the partner is above the income threshold.

Repeal Section 1031 exchanges

Owners of appreciated real estate used in a trade or business may defer gain on the exchange of the property for other real property of a like kind.

The Administration proposes to treat the exchange of such property similar to sales of real property. However, a taxpayer could continue to defer the gain up to $500,000 per taxpayer ($1 million on a joint return).

This change would be effective for exchanges completed in taxable years beginning after December 31, 2022.

Depreciation Recapture for Real Estate

Section 1245 generally provides for depreciation recapture upon the sale of most depreciable assets. However, depreciation recapture for real estate is generally governed by Section 1250. Under Section 1250, there is generally no depreciation recapture on the sale of real estate.

The Administration proposes to require depreciation recapture on the sale of depreciable real estate. This change would not apply to taxpayers with adjusted gross income under $400,000 ($200,000 for married filing separately).

This change would be effective for depreciation after December 31, 2022, and sales after December 31, 2022.

COMMENT:

The Administration's revenue proposals are not law, nor even a bill. Given that the Senate is equally divided between the parties, and the House is nearly equally divided between the parties, attempting to predict tax legislation is difficult. However, these revenue proposals are worth watching. Some of them may be enacted soon. Some of them may be enacted eventually. Some of them may never be enacted.

What was not included

The Administration's Revenue Proposals are noteworthy for what was not included.

The Obama Administration's revenue proposals for fiscal year 2017 included provisions to repeal the treatment of net unrealized appreciation in employer securities, increase the estate and gift tax and GST tax rates, reduce the estate and gift tax exclusion amounts and the GST exemption, include sales to intentionally defective grantor trusts in the grantor's estate, limit the use of the gift tax annual exclusion and *Crummey* withdrawal powers, and reduce the benefit of certain tax expenditures.

These provisions were not included in the Administration's revenue proposals for fiscal year 2023.

If Congress does nothing, the estate and gift tax exclusion amount and the GST exemption, presently $12,060,000, will revert to pre-2018 levels in 2026. Except for a change in the method of indexing, the pre-2018 levels are 50% of the current level.

The Administration's Revenue Proposals also do not include the repeal of the Section 199A deduction with respect to qualified business income. This provision was enacted as part of the Tax Cuts and Jobs Act of 2017, and is scheduled to expire at the end of 2025. Presumably the Administration didn't want to increase taxes on small businesses.

The Administration's Revenue Proposals do not include the repeal of the $10,000 limit on the deduction of state and local taxes (SALT). This provision was also enacted as part of the Tax Cuts and Jobs Act of 2017, and is scheduled to expire at the end of 2025. Democrats are divided on the repeal of the limit on the SALT deduction since most of the benefit of the deduction before 2018 went to high income taxpayers.

The Administration's Revenue Proposals generally do not include provisions to expand the net investment income tax and the self-employment tax.

Please call us at 954-779-1661 to discuss how the new proposed tax law changes may affect your estate plan should they become law.

Josh N. Bennett ESQ, P.A. | Law office of Josh N. Bennett, ESQ | 954 779 1661 | josh@joshbennett.com | www.joshbennett.com