

They're Back: (Some of) President Biden's 2021 Tax Proposals

In the final months of 2021, as President Biden's "Build Back Better" legislative agenda stalled in Congress, many observers predicted some of its provisions would be re-introduced in separate pieces of legislation. This now seems to have come true: on Monday, March 28, the Biden Administration released its \$6 trillion budget for the federal government's 2023 fiscal year, which begins October 15. On the same day, the Treasury released its general explanations of the budget's revenue proposals, known as the Greenbook. Both contain provisions very similar to ones that were abandoned last year.

It's important to point out what's *not* in the proposed budget: an early sunset of the \$10,000,000 (indexed for inflation) unified credit equivalent against gift and estate tax, and the controversial former proposal to include irrevocable grantor trusts in their settlors' estates under certain conditions. Those may return in some form in the future but are not on the table currently.

Here are highlights of select provisions that are included:

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 2022 this rate applies to taxable income over \$539,900 (single filers), \$647,850 (joint filers), and \$13,450 (trusts and estates).

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. 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 2023. 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 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 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 2022, and portability between spouses for this exclusion. 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, most often as the result of the sale of property. 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, even if no sale of property occurs.

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 (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 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 appreciating assets to an intentionally defective grantor trust (IDGT) in exchange for a promissory note.
- **Special Note:** Unlike the 2021 Build Back Better proposals, the proposed budget would **not** require inclusion of trust property in the estate of the grantor.

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.

Conclusion

Even if only a portion of the current proposals become law, there will 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.

Respecting the second proposal, it 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, 2023, 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 2022. Married couples can give up to \$24,120,000 between them this year.

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