Planning 2024: Impending Legislation that Could Affect You

One of Lexington's primary responsibilities is to keep you well-informed of changes or potential changes in the law that could have a significant impact on your financial life and well-being and to identify strategies to address the changes.

As a result of the Tax Cuts and Jobs Act a/k/a 2017 Tax Act, the estate tax exemption rates are the highest they have been in history. In 2024, individuals are allowed an inflation adjusted exempt amount of $13,610,000 (and married couples a $27,220,000 exemption) and further adjusted for inflation in 2025, thereby allowing you to give away this amount during life or death, tax free. This means that to the extent you have not applied your full exemption to earlier gifts, you may apply it to gifts, gift-tax free.

However, on December 31, 2025, barring action by Congress, the exemption will revert to $5 million per individual, adjusted for inflation to an amount estimated to be between $7 million per person ($5 million per person, adjusted for inflation). This change will affect not only estates over the current exemption amount of $13.61 million but also those in the $7-$13 million range, as these estates will suddenly find themselves subject to taxation. Making lifetime gifts now to take advantage of the increased exemption amounts will remove not only your assets from estate taxation but also any appreciation on said assets.

Moreover, in March 2024, the Biden Administration issued its 2025 budget proposals called the "Green Book", which will impose additional tax burden on "the wealthy". Many of the proposals are scheduled to take effect after December 31, 2024; this further complicates planning.

- Thus, if Biden wins a second term and the Democrats control both the House and Senate, he is expected to allow the 2017 Tax Act provisions to lapse and revert to pre-2018 law and to seek laws that require the wealthy to contribute more to fund social programs and decrease the wealth concentration.
- On the other hand, if Trump wins a second term and the Republicans control both Houses of Congress, he is likely to extend the 2017 Tax Act provisions, many of which are favorable for the wealthy. He may even seek to repeal the estate tax.

If you wish to plan for the reduction in the exemption as well as changes in the law resulting from a possible Biden re-election, you should complete your planning before the end of 2024. This will entail understanding the current law, the law scheduled to be effective in 2026 and the Biden [Green Book} budget proposals. Therefore, if the Biden proposals are enacted in 2025,

with a January 1, 2025 effective date, you will not lose your ability to take advantage of the current law. On the other hand, if you don’t act, your options to shift wealth may be dramatically limited.

We look forward to helping you determining your course of action.

Summary of Key Proposals of 2025 Biden Budget [Green Book}:

Capital Gain Proposals
For taxpayers with more than $1 million of taxable income, the tax on long-term capital gains (currently between 0 and 20%) is proposed to increase to 39.6%.

In addition, the net investment income tax (Medicare Tax) is proposed to increase from 3.8% to 5%.

Recommendation. If your income is near the $1 million threshold and you have some flexibility as to the timing of a proposed sale, you may consider partial sales of the assets, to occur over a period of years. As a result, gain may be realized in lower income tax brackets over many years. Alternatively, consider electing
the installment method of reporting to spread the gain over many years and perhaps at lower rates, to avoid surpassing the $1 million dollar figure.

Gain on Gift or Death
Under current law, you generally do not recognize any taxable gain for income tax purposes when you make a gift of assets, or on death. This applies to outright gifts as well as gifts to grantor and non-grantor trusts.

Under the Biden proposals, such transactions would be subject to income tax, subject to a $5 million exclusion. However, *gifts of* property to your spouse in general, will not trigger gain. Thus, except with regard to gifts to a spouse, under the Biden proposals, if you gift appreciated assets during lifetime or at death (after taking into account the exclusion), it will trigger a 39.6% ordinary income tax to you, the transferor.

Recommendation. If you have both highly appreciated assets and assets that have not appreciated significantly, you may wish to consider bequeathing the appreciated assets to your spouse so that gain is deferred and non-appreciated assets to your children.

Recommendation. Review all trusts and the impact of the proposed rules. Complete swaps immediately if Biden wins the election.

Gain Recognition for Generation Skipping Transfer Trusts (GST Trusts)

The Biden proposal provides for a forced recognition event for property held in GST trusts every 90 years. At year 90 any appreciation on the value of assets held in a trust will automatically have to be realized and income tax paid even if no sale or other transaction occurred. Under transition rules, older trusts will be unable to defer GST tax recognition for the full 90-years as new trusts will be able to do. The tax rate may be the new 39.6% maximum tax rate on individuals plus the 5% net investment income tax (increased from 3.8%).

Recommendation. When creating a new trust that is structured to last as long as possible, its state of formation and governing law should be a state that has trust and tax-friendly laws, such as Alaska, Nevada, South Dakota, Delaware, Tennessee, and New Hampshire.

Generation- Skipping Planning

The generation-skipping transfer (GST) tax exemption, similar to the estate and gift tax exemptions, will be reduced by half at the end of 2025. If you intend to make GST gifts, you should make them before the end of 2025 to secure the bonus exemption before it is lost on January 1, 2026. It is even more prudent to complete the planning and gifting before the end of 2024 in case the Biden Proposals are enacted in 2025 with a January 1, 2025, or December 31, 2024, effective date.

Duration of GST Exemption. In some states, the long-standing rule against perpetuity is still the law, which means a trust may only last 21 years after the death of the last beneficiary alive when the trust was created. Today, many states permit trusts to last much longer, such as 360 years (Tennessee) or even 1000 years (Florida). Thus, currently, if you create a trust in those states and distribute Generation-Skipping Transfer (GST) tax exemption to that trust equal to the gift amount, the trust can remain outside of the gift, estate, and GST tax systems, perhaps forever.

Under the Biden proposal, the duration of a GST exempt trust will generally be limited to no more than two generations below the transferor (i.e., your grandchild) unless younger generations (e.g., your great-grandchild) are alive at the time of the trust's creation. This will greatly limit dynasty trusts. There is no grandfathering for pre-existing plans.

Recommendation. Review your current wills and revocable trusts, to ensure that their assets will not pour into existing irrevocable trusts that have a shorter duration than if new trusts are created that include heirs born after the lifetime irrevocable trusts were created.

Miscellaneous Provisions of Biden Proposal

o Annual exclusion gifts. Under current law, individuals can gift annually $10,000 (of assets or cash), adjusted for inflation, which in 2024 is $18,000 or double that amount for married couples, to as many people as he or she wants without having to pay any taxes on the gifts.

The Proposals limit the annual amount a donor may gift to an overall $50,000 per donor per year. Gifts in excess of this amount would reduce your lifetime exclusion.

o The Proposals treat as a taxable gift the grantor's payment of the income tax on the income of a Grantor Trust (other than a revocable trust). Under current law, the grantor's payment of the income tax on income of a Grantor trust is not taxable.

o Currently, if you make a gift of a non-controlling interest in a business entity or its assets, the gifted interest or asset may be valued at a fraction of the total value. Under the Proposals the value of any partial interest in a closely held business transferred to a family member must be the pro-rata share of the aggregate fair market value. In other words, no more discounts.

o The Proposals require that every trust worth more than $300,000 (indexed for inflation) at the end of the year or whose gross income exceeds $10,000 (also indexed for inflation), report annually its net worth.

o The Proposals require any Generation-Skipping Trust to report on its annual income tax return its inclusion ratio at the time of any trust distribution to a non-skip person, and information regarding any trust modification or transaction with another trust that occurred during that year.

o The Proposals restrict the ability to use “defined value formula clauses,”, These clauses value a gift or bequest “as finally determined by the IRS” or “finally determined for federal tax purposes. Under the Proposals, effective in 2025, if a gift or bequest uses a defined value formula clause that determines value based on IRS involvement, then the value will be deemed to be the value as reported on the applicable gift or estate tax return.”

o The Proposals treat trust loans as distributions to the beneficiaries. Thus, a loan will have income tax consequence identical to that of a distribution.

Irrevocable Trusts in Estate Planning

Trusts will continue to be an integral part of estate planning. In general, using irrevocable trusts to hold the gifted assets can protect assets from creditors, based on the terms of the trust, control the disposition of the assets and create tax efficiencies. Since we have no certainty as to the taxation of trusts if Biden wins the election, using the current elevated exemption through lifetime gifting can reduce your estate, gift and generation-skipping transfer tax liability.

You may want to consider using one of the following trusts before year end:

• ***Dynasty a/k/a Generation-Skipping Transfer Trust (GST)***. Generation skipping tax is a federal tax, in addition to, the gift and estate tax, on a gift or bequest to beneficiaries who are two or more generations below you, the grantor. This typically happens when a grandparent gifts assets to their **grandchildren** or great grandchildren. Although the children’s generation is being “skipped” for estate tax purposes, they may be trust beneficiaries, having access to the income – and to some extent principal – of the assets placed in the GST. A GST allows you to preserve your family’s wealth over multiple generations while preventing the family’s assets from being subject to estate taxes twice. Further, as an irrevocable trust, any assets held within the trust are considered separate from your personal estate and therefore are difficult to access in case of any litigation against you.

• ***Spousal Lifetime Access Trust ("SLAT").*** Instead of setting up a trust for descendants, you can name your spouse as a beneficiary, with your descendants or other persons as concurrent or subsequent beneficiaries. A SLAT is an irrevocable trust created and funded by a spouse (the "donor spouse") for the benefit of the non-donor spouse, and generally the donor spouse funds the trust with assets equal to all or a portion of his or her remaining lifetime exclusion. A benefit of a SLAT is that the donor spouse can also benefit from the property he/she gifts to the trust as long as the non-donor is alive and the two remain married. This indirect benefit is achieved because the non-donor spouse is the primary beneficiary. SLATs are generally structured as grantor trusts, with the trust's taxable income taxed to the donor spouse. As long as the donor spouse is alive, the couple need not submit a separate tax return for the SLAT.
The value of the property the donor spouse gifts to the SLAT, including future appreciation of the property, is removed from the donor's estate and the non-donor spouse's estate except to the extent of distributions.

A similar trust may be created by a donor who is not married but has a partner. The donor spouse can name the partner as a beneficiary (Partner Lifetime Access Trust ("PLAT").

• ***Domestic Asset Protection Trust ("DAPT")****.* A DAPT is a type of trust that protects your assets from lawsuits, creditors and other legal action. Importantly, it allows you to be a beneficiary of your own trust. Such trusts may be created in one of 22 US states, with Alaska, Nevada, Utah, South Dakota and Delaware generally regarded as having laws that are the friendliest to debtors. To establish the required connection to the desired DAPT state, one trustee must reside in the state where the DAPT is created, at least some of the trust administration must be in that state, and distributions from the trust must go through a third-party distribution trustee (i.e. you cannot serve as a distribution trustee); however, you may serve as an investment trustee, to control how the trust assets are invested.
DAPTs can hold cash, securities, real estate, business assets and other assets.
If you do not want or need to be a beneficiary immediately, you can consider a "hybrid-DAPT". A hybrid-DAPT grants a named power holder, in a non-fiduciary position, the ability to add certain individuals, such
as the descendants of your maternal grandparents (which would include you), as beneficiaries of the trust. This would give you the potential to be a beneficiary in the future without being a current beneficiary.

• "***Special Power of Appointment" Trust ("SPAT")****.* You would not be a current beneficiary of the SPAT but the Trust would allow you to name one or more individuals who are not beneficiaries or fiduciaries with authority to make distributions to anyone who is a descendant of your e.g., maternal grandparents (which would include you).

• ***Additional Trust Provisions to Consider:***
o Name a person to serve in a non-fiduciary capacity to loan Trust funds to you for adequate interest (but without adequate security).
o Allow (but not require) the trustee to reimburse you for any income tax paid resulting from trust income.
o Grant the trustee to make charitable donations from trust funds, thereby enabling you to make donations without using your personal funds.

Conclusion

At this point, it is impossible to predict the outcome of the election. If even some of these proposals are enacted, it could dramatically change estate planning strategies, change your taxation, and substantially reduce the wealth that you will be able to pass to future generations. Therefore, the safer course i is to plan now, presumably using some of the techniques we discussed above.