



WASHINGTON UPDATE

Pending and Potential Administrative and Legislative Changes

**Prepared for the
ACTEC Mid-Atlantic Fellows Institute
September 30, 2021**

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FISCAL 2022 BUDGET RECONCILIATION HOUSE WAYS AND MEANS COMMITTEE “BUILD BACK BETTER ACT” [p. 15-18]*

Chairman’s Mark (Sept. 12, 2021)

Committee Approval (Sept. 15, 2021)

* [Page numbers in square brackets refer to the accompanying paper, “Washington Update: Pending and Potential Administrative and Legislative Changes” (September 2021), available at <http://www.bessemertrust.com/for-professional-partners/advisor-insights.>]

Sample Income Tax Changes [p. 17-18]

- Top individual rate of 39.6%, beginning in 2022.
 - Taxable income over \$400,000 (\$450,000 joint, about \$13,450 for trusts).
- Surtax of 3% over \$5 million (\$100,000 for trusts).
- Capital gains in 39.6% bracket taxed at 25% after **September 13, 2021**.
- Trade or business exception eliminated for 3.8% tax.
 - “Modified adjusted gross income” over \$400,000 (\$500,000 joint, about \$13,450 for trusts).
- Qualified Business Income Deduction capped at \$400,000 (\$500,000 joint, \$10,000 for trusts).

Basic Exclusion Amount [p. 15]

- Doubled by the 2017 Tax Act.
 - From \$5 million to \$10 million (indexed).
 - \$11,700,000 in 2021.
 - 2018-2025 (“Sunsetted” January 1, 2026).
- “Sunset” accelerated to **January 1, 2022**.
 - \$6,020,000 in 2022 (projected by JCT staff).

Grantor Trusts & Transfer Tax [p. 15-16]

- New chapter 16, section 2901, would align transfer tax treatment with grantor trust treatment:
 - Value is included in grantor's gross estate.
 - Distributions are taxable gifts.
 - Termination of grantor trust status is a taxable gift.
- Only if the **grantor** is the **deemed owner**.
- Utility of grantor trusts' would almost entirely disappear.
- A grantor trust could not be used as the donee to simplify income tax treatment during a gift tax audit.

Grantor Trusts & Income Tax [p. 16]

- Section 1062 would **ignore grantor trust status** in determining whether a transfer is a taxable sale.
 - Nullifying Rev. Rul. 85-13.
 - Would apply to a §678 deemed-owned trust too.
- Examples:
 - Sale by a grantor to a grantor trust.
 - Sale by a beneficiary to a BDIT.
 - Exercise of a swap power.
 - Distribution in-kind to grantor of a 2020 GRAT.

Effective Date, Grantor Trust Changes

- New sections 2901 and 1062 would apply to:
 - trusts created
 - or portion of trust attributable to **“a contribution”**
 - **on or after date of enactment** (signed into law).
- Committee report: “The portion of the provision relating to sales and exchanges between a deemed owner and a grantor trust is intended to be effective for sales and other dispositions after the date of enactment.” [i.e., regardless when created or funded]
 - Footnote: “A **technical correction** may be necessary to reflect this intent.”

Value of Interests in Entities [p. 16-17]

- **Look-through** values for **nonbusiness** assets.
 - As if those assets had been transferred directly.
 - “No valuation discount shall be allowed.”
 - Interest itself valued without regard to such assets.
- Applies to gifts and deaths **after date of enactment**.
- Does not apply if interest is actively traded.
- Exceptions:
 - Assets **used in the business** and for reasonably required **working capital** (admittedly complex).
 - Passive assets not “held for the production or collection of income”?

Special Use Valuation [p. 17]

- Section 2032A (added in 1981) allows the estate tax value of real property used in a family farm or other family business to be its value in that farm or business use (even if that is not its “highest and best use”).
- There are **many technical tests** – “family,” “material participation,” continuity (5 of 8 years), share of adjusted gross estate (50% business, 25% business real property), etc. – plus **recapture** within 10 years.
- And a limit on the reduction in value:
 - **\$1,190,000** in 2021.
 - Would become **\$11,700,000** in 2022.

DEEMED REALIZATION PROPOSAL

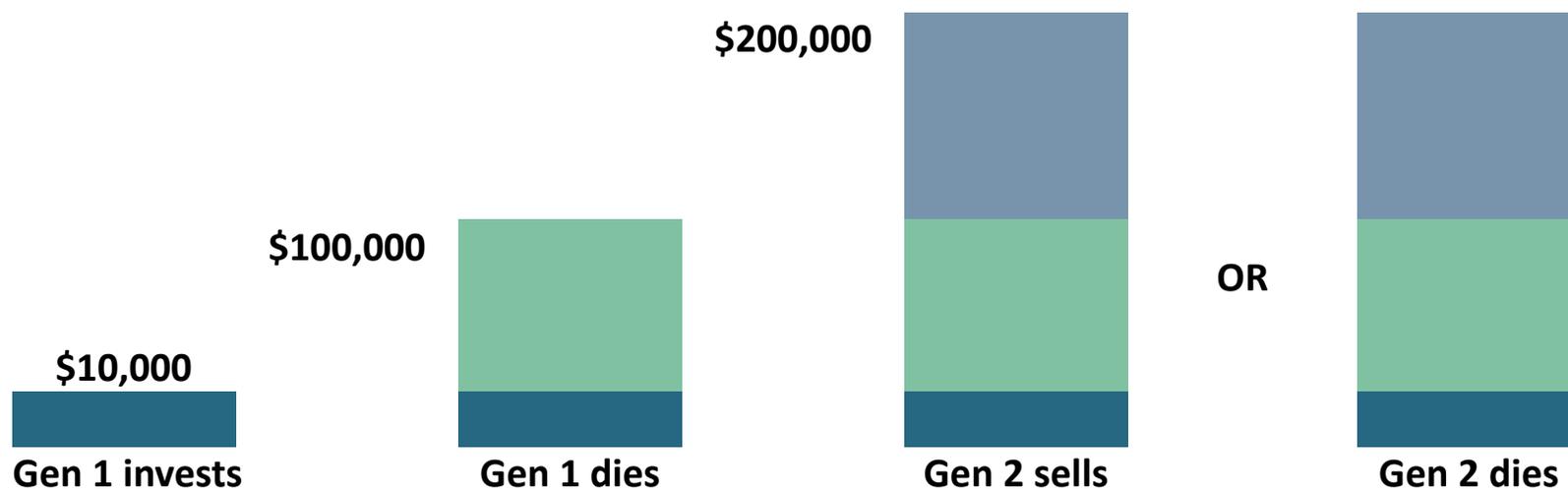
[p. 11-15]

**“General Explanations of the
Administrations Fiscal Year 2022
Revenue Proposals” (“Greenbook”)**

Greenbook Realization Highlights

- Effective **Jan. 1, 2022** (but no new “fresh start” basis).
- Gain = fair market value minus basis:
 - “Valued using the methodologies used for gift or estate tax purposes.”
 - But a “partial interest would be its proportional share of the fair market value **of the entire property.**”
- Losses at death offset gains + \$3,000 ordinary income.
- Reported “on the Federal gift or estate tax return or on a separate capital gains return.”
- Income tax **deductible for estate tax purposes.**
 - Rate on appreciation = $.396 + .4(1 - .396) = 63.76\%$

Illustration



Current Law:

20% Income Tax		\$20,000	
40% Estate Tax	\$40,000		\$80,000

Greenbook:

39.6% Income Tax	\$35,640	\$39,600	\$39,600
40% Estate Tax	\$25,744		\$64,160
Total	\$61,384 (61.4%)		\$103,760 (51.9%)

Exclusions

- Tangible personal property (other than collectibles).
- “Transfers by a decedent to a **U.S. spouse.**”
- Transfers to charity:
 - “Based on the charity’s share of the value transferred” in the case of a split-interest trust.
- Unified lifetime/at death exclusion of **\$1,000,000**:
 - Indexed for inflation after 2022.
 - “**Portable** to the decedent’s surviving spouse.”
- \$250,000 retained for residences (lifetime and death)
 - “Would apply to **all residences.**”
 - “**Portable** to the decedent’s surviving spouse.”

Special Rules for Trusts and Entities

- For “a **grantor trust** that is deemed to be **wholly owned** and **revocable** by the donor,” gain taxed:
 - to deemed owner on any asset **distributed** (except to the deemed owner or “U.S. spouse” or in discharge of the deemed owner’s obligation).
 - on all assets “at the deemed owner’s **death** or at any other time when the trust **becomes irrevocable.**”
- For other trusts (and **partnerships and other non-corporate entities**), gain taxed:
 - on “transfers **into** and distributions in kind **from**”
 - beginning in 2030, for any asset held, but not the subject of a recognition event, for the last **90 years.**

Targeted Relief Provisions

- “Payment of tax on the appreciation of certain family-owned and -operated **businesses** would not be due until the interest in the business is sold or the business ceases to be family-owned and operated.”
- A “**15-year** fixed-rate payment plan for the tax on appreciated assets transferred at death, other than liquid assets ... and ... businesses for which the deferral election is made.”
- The IRS would be authorized to require reasonable **security** “at any time ... from any person, and in any form, deemed acceptable by the IRS.”

Administrative Provisions

- Deduction for the full cost of related **appraisals**.
- Imposition of liens.
- Waiver of penalties for underpayment of estimated tax attributable to deemed realization at death.
- Right of recovery of the tax on unrealized gains.
- Rules to determine who selects the return to be filed.
- **Broad regulatory authority**, including
 - reporting on the decedent's final 1040, and
 - **“rules and safe harbors for determining the basis of assets in cases where complete records are unavailable.”**

Revenue Estimates

- 39.6% rate on capital gains and proposed deemed realization of capital gains together estimated to raise **\$322.485 billion** over the next 10 fiscal years.
- Including \$1.241 billion for Fiscal Year 2021 (which ends **September 30, 2021**).
 - From estimated income tax payments by Sept. 30 because of capital gains recognized after April 28?
 - The only Greenbook proposal estimated to have an effect on revenues in Fiscal Year 2021.

Congressional Rumblings [p. 7-11]

- Deemed realization proposals in Congress (3/29/21):
 - H.R. 2286, Rep. Bill Pascrell, Jr. (D-New Jersey).
 - “Sensible Taxation and Equity Promotion Act” (“STEP Act”), “discussion draft,” Sen. Chris Van Hollen (D-Maryland).
- Notable differences from Greenbook approach:
 - Test for trusts includability in gross estate, not revocability.
 - Taxation of appreciation in other trusts not deemed owned:
 - Every 30 years in H.R. 2286.
 - Every 21 years in STEP Act.
 - Very broad annual reporting to IRS for trusts in STEP Act.
 - No mention of partnerships.
 - **January 1, 2021 effective date in STEP Act.**

OTHER BILLS IN CONGRESS

“For the 99.5 Percent Act” [p. 2-7]

- S. 994, Sen. Bernie Sanders (I-Vt.), March 25, 2021.
- Introduced by Sen. Sanders in every Congress since 2010.
- Top 65% estate tax rate (over \$1 billion), **effective 1/1/2022.**
- Increased special use valuation and conservation easement exclusion limits, **effective 1/1/2022.**
- No stepped-up basis for assets in grantor trusts.
- Look-through value and no discounts for non-business assets.
- GRATs to have at least 10-year term and 25% gift tax value.
- Conformed gift and estate tax treatment for grantor trusts.
- No GST exemption if trust may exceed 50 years.
- Limited annual exclusion for gifts not outright, **eff. 1/1/2022.**

More Estate Tax Repeal Bills [p. 11]

- S. 617, Sen. John Thune (R-S.D.), March 9, 2021.
- H.R. 1712, Rep. Jason Smith (R-Mo.), March 9, 2021.

- Similar to past efforts over the last 2 or 3 decades.

- Gift tax retained:
 - 35% rate.
 - Permanent \$10 million exclusion amount, indexed since 2011 (that is, \$11.7 million in 2021).

2021-2022 TREASURY-IRS PRIORITY GUIDANCE PLAN (September 9, 2021)

“Gifts and Estates and Trusts”

1. Estate Tax Closing Letters [p. 20-21]

- Since June 1, 2015, closing letters have been available only on request.
- Notice 2017-12: Transcript code “421” and the explanation “Closed examination of tax return” can “serve as **the functional equivalent of an estate tax closing letter.**”
- New Reg. §300.13 (Sept. 27, 2021) establishes a \$67 user fee for obtaining an estate tax closing letter.
- A “one-step, web-based procedure” is envisioned.

2. Consistent Basis Rules [p. 21-28]

- Enacted July 31, 2015.
- Various bills since Sen. Sanders' in 2010 [p. 23].
- Regulations proposed in March 2016 [p. 25-27].
- Modestly helpful exceptions [p. 25].
 - Certain TPP (other than collectibles).
 - Cash, IRD, assets sold by executor.
- Some disappointments and exasperations [p. 26-27].
 - Report **all** assets 30 days after 706 is filed.
 - **Zero basis** for after-discovered assets, omissions.
 - For **all assets** if it would have made 706 necessary.
 - Requirement for **donors** to report **retransfers**.

Consistent Basis Rules, continued

- Then appeared under the heading “**Burden Reduction**” in the 2020-2021 Plan [p. 28].
- Guesses about what that meant:
 - Walk-back of the 30-day deadline.
 - More exceptions and more effective exceptions.
 - Maybe relaxation of the retransfer rule.
 - Possibly even relief from the zero basis rule.
- Predictions for the Biden Administration:
 - Probably not much different.

3. Anti-Anti-Clawback Regs. [p. 28-33]

- Anti-clawback regulations proposed in November 2018 and finalized in November 2019.
- Preventing clawback after 2026 (or 2022) sunset for gifts made before then.
- Preserving portability elections.
- Warning of future **“anti-abuse” additions to the regulations regarding inclusion under section 2036, etc.** [p. 31-33].

4. Alternate Valuation [p. 33-35]

- Proposed “anti-*Kohler*” regulations (**April 25, 2008**) would have **ignored** certain intervening events in determining alternate value **six months after death**.
- Public comments criticized “artificial assumptions.”
- Reproposed Regulations (Nov. 18, 2011) would treat certain intervening events as dispositions, triggering alternate valuation as of that date.
- Example: Post-death formation of limited partnership (Prop. Reg. §20.2032-1(c)(5), Example 1).

5. Section 2053: Present Value [p. 35]

- From section 2053 regulations of **October 2009**.
- Proposed regulations provided for deduction of:
 - **Noncontingent** obligations: **present value**.
 - **Contingent** obligations: **dollar-for-dollar** as paid.
- Comments criticized that distinction as inequitable.
- Treasury agreed the issue “**merits further consideration**,” and reserved Reg. §20.2053-1(d)(6) for that issue.

- Could consideration spill over into ***Graegin loans***?

7. GST Exemption Allocation [p. 36-38]

- Section 2642(g)(1) added to the Code by the 2001 Tax Act to allow late GST exemption actions.
 - **Notice 2001-50** allows “**9100 relief.**”
- Proposed regulations in 2008 would be exclusive
 - “Nonexclusive list of factors” with more weighing
 - “Detailed affidavits” from “[e]ach tax professional who advised or was consulted ... with regard to **any aspect** of the transfer, the trust, the allocation of GST exemption, and/or the election under section 2632(b)(3) or (c)(5).”
- Also “**Burden Reduction**” in the 2020-2021 Plan.
- Prediction: Need for affidavits walked back.

6. More on GST Exemption [p. 35-36]

New this year, Item 6 is described as “Regulations under §2632 providing guidance governing the allocation of generation-skipping transfer (GST) exemption **in the event the IRS grants relief** under §2642(g), as well as addressing the **definition of a GST trust** under §2632(c), and providing **ordering rules** when GST exemption is allocated in excess of the transferor’s remaining exemption.”

8. Transfers from Expatriates [p. 38-41]

- HEART Act, effective **June 17, 2008**:
 - Mark to market upon expatriation (§877A).
 - Succession tax on donees and legatees (§2801).
- Announcement 2009-57 (**July 16, 2009**) promised that the due date for reporting and paying the tax would be a “reasonable period of time” after the issuance of guidance.
- Regulations were proposed **September 10, 2015**.
- This project first appeared in the 2008-2009 Plan, but was dropped during the Trump Administration.
- Now it’s back, but it won’t be easy!

9. Actuarial Tables (§7520) [p. 41]

- New in the 2018-2019 Plan.
- The current mortality tables, based on 2000 census data, became effective **May 1, 2009**.
- Section 7520(c)(2) mandates revision of the tables at least once **every ten years**.
- Thus, this project appears to be that routine revision, to reflect 2010 census data and be effective as of **May 1, 2019**.
- Transitional relief may be provided.
 - 2009: 2-month grace period **after** tables published.

Omissions from Past Guidance Plans

- Omitted from the 2021-2022 Plan [p. 41-42]:
 - Basis of assets in a grantor trust.
- Omitted from the 2017-2018 Plan [p. 43-45]:
 - Valuation of promissory notes.
 - Gift tax effect of defined value clauses.
 - Material participation by trusts and estates under section 469.
- Omitted in the Obama Administration [p. 46-50]:
 - Private trust companies as fiduciaries.
 - Decanting.

THE REGULATORY PROCESS IN THE TRUMP ADMINISTRATION (AND BEYOND?) [p. 18-19]

Executive Order 13789 (April 21, 2017)

- Directed identification of “all significant tax regulations issued ... on or after January 1, 2016 ... “that
 - (i) impose an **undue financial burden** on United States taxpayers;
 - (ii) add **undue complexity** to the Federal tax laws; or
 - (iii) **exceed the statutory authority** of the Internal Revenue Service.”
- This led to the withdrawal of the proposed regulations under section 2704 on October 20, 2017.

The Regulatory Process

- Also directed Treasury to “review and, if appropriate, reconsider the scope and implementation of the existing exemption for certain tax regulations from the review process set forth in Executive Order 12866 and any successor order.”
- This led to a Memorandum of Agreement (MOA) of April 11, 2018, **reviving the application of many of the requirements of Executive Order 12866 (Sept. 30, 1993) to tax regulations.**

For Each Significant Regulatory Action

- Give the Office of Information and Regulatory Affairs
 - “[t]he **text** of the draft regulatory action, together with a reasonably detailed description of the **need** for the regulatory action and an explanation of **how** the regulatory action will meet that need” and
 - “[a]n **assessment** of the **potential costs and benefits** of the regulatory action”which OIRA has **45 days** to review (unless OIRA and Treasury agreed to 10 business days “[t]o ensure timely implementation of the Tax Cuts and Jobs Act of 2017”).

If Annual Effect Is \$100 Million or More

- “An assessment, including the underlying analysis, of
 - **benefits*** anticipated from the regulatory action ...;
 - **costs*** anticipated from the regulatory action ...; and
 - costs and benefits of potentially effective and reasonably feasible **alternatives** to the planned regulation ... and **an explanation why the planned regulatory action is preferable to the identified potential alternatives....**”

* “with, to the extent feasible, a **quantification**”

- The public must be informed of this assessment and of any resulting substantive changes to the draft.

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