2025 Budget Proposals

March 14, 2024

Take-Away: President Biden's 2025 Budget Proposal (the *Greenbook*) looks pretty much like his 2024 Budget Proposal as a source of new revenues. Many of its proposals will sound familiar.

Background: Earlier in March the Department of Treasury released its fiscal year 2025 revenue proposals. Many (if not most) of the revenue proposals reflect what was suggested for the 2024 budget, blissfully ignored by Congress. Perhaps the biggest difference is that this is an election year, and the re-election of President Biden and a change in the control of the House and Senate to the Democrats could bring many of the following proposals closer to reality to address mounting budget deficits. A 'quick-take' of some of the estate planning proposals include the following (I'll skip the effective dates, since these are only proposals at present, and there in no priority in the manner that they are presented:)

Annual Exclusion Gifts: There would be a 'new category' that limits to the total annual exclusions by a donor for certain transfers, e.g., to a trust, to $50,000 per year. This 'new' limit would not provide annual exclusions in addition to the annual per donee exclusion that current exists. Instead, it would be a further limit those amounts that otherwise would qualify for the annual per-donee exclusion. The $50,000 amount would be indexed for inflation after 2025. Example: Homer transfers assets in this 'new' category in a single year more than a total of $50,000 to a trust- the excess would be taxable, even if the total gifts to each individual donee beneficiary, Sally, and Bart, each did not exceed the $18,000 annual exclusion donee limit.

Top Income Tax Rate: The top income tax rate would increase to 39.6% for those taxpayers who earn $400,000 ($450,000 married) a year.

Dividends and Gains as Ordinary Income: Dividends and long-term capital gains would be taxed at ordinary income tax rates if the taxpayer's income exceeds $1.0 million.

1031 Exchanges: The exchange of like-kind real property would be treated similar to the sale of such property; however, the taxpayer could continue to defer up to $500,000 per taxpayer (or $1.0 million on a joint return.)

Depreciation Recapture: Depreciation recapture would be required on the sale of depreciable real estate, but only for those taxpayers with adjusted gross income that exceeds $400,000.

Retirement Plan Distributions: 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 amount. 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 additional required distributions would come first from Roth IRAs and then from designated Roth accounts.

Roth Rollovers: A high-income taxpayer would be prohibited 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. The high-income taxpayer would also be prohibited from rolling over amounts distributed from a traditional IRA or an employer qualified plan other than a designated Roth account into a Roth IRA or a designated Roth account.

IRAs: An IRA would be prohibited from holding an interest in a DISC or FSC that receives payments from an entity that is owned by the IRA owner. For this purpose, 10% would be substituted for 50% in the existing IRC 318 constructive ownership rules. If this new rule is violated the IRA would be deemed to have distributed *all* its assets.

IRA Statute of Limitations: The statute of limitations in the case of a substantial error in valuing IRA assets, e.g., self-directed IRAs that hold non-traditional investments, and for the excise tax on prohibited transactions, would be expanded from 3 years to 6 years.

Capital Gains on Transfers: Transfers of appreciated assets by gift or at death would be realization events. The capital gains tax at death would be deductible against the federal estate tax.

90-Year Market-to Market: Assets held in a Trust, or a partnership would be marked-to-market every 90 years, starting with January 1, 1944. Thus, the first recognition event would be December 31, 2023.

Valuation Discounts: No valuation discounts would be allowed for partial interests except for the assets that are used in an active trade or business. Transfers to, or from, a trust would also be recognition events. A transfer to a U.S. spouse would not be a realization event but would require a carryover basis.

Charitable Trusts: The transfer of assets to a split-interest charitable lead or charitable remainder trust would be taxable as a recognition event, except to the extent of the charity's interest. Regarding charitable lead annuity trusts (CLATs), a CLAT would be required to make level annuity payments over the term of the CLAT and that the CLAT's remainder interest be at least 10% of the value of the property contributed to the CLAT.

Sale of Principal Residence: While the exclusion for gain on the sale of a principal residence would continue to apply, the gain on the transfer of tangible personal property other than collectibles would not be excluded.

Qualified Small Business Stock: The IRC 1202 $10 million exclusion of gain with respect to the sale of qualified small business stock (a C corporation) would continue, unchanged.

Reduced Applicable Exemption Amount: There would be a $5 million per individual exclusion on property that is transferred by gift or at death; this exclusion amount would be indexed for inflation after 2024.

Portability: Portability between spouses of a deceased spouse's unused applicable exclusion amount would continue unchanged.

Family-Owned Businesses: The transfer tax on some family owned and operated businesses would be deferred until the interest is sold, or the business is sold, or the business ceases to be family owned and operated. The transfer tax on appreciated assets other than liquid assets could be paid over 15 years.

Wealth Tax: A minimum tax of 25% would be imposed on total income, including unrealized capital gains, on taxpayers with wealth over $100 million. This wealth tax for the first year could be paid in 9 equal annual installments, and for subsequent years the wealth tax could be paid in 5 equal annual installments. This wealth tax would become effective in 2025.

GRATs: A grantor retained annuity trust (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 GRAT's 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 to the GRAT. Annuity payments would not decrease during the GRAT term. The grantor of the GRAT would also be prohibited from engaging in tax-free exchanges of any assets held in the GRAT. In addition, any annuity payments from the GRAT could not decrease during the annuity-payment period.

Grantor Trusts: If the grantor trust is not fully revocable, sales between the grantor and the trust would be taxable, effective for sales on or after the effective date of enactment. The grantor's payment of the income tax on the trust's income and gains would be treated as a taxable gift by the grantor.

Valuation of Promissory Notes: The discount rate of the note for estate and gift tax valuation purposes would be limited to the greater of the interest rate of the note or the federal applicable rate (AFR) for the remaining term of the note.

Valuation Discounts: Intrafamily transfers of partial interests in property in which the family collectively owns at least 25% would be valued based on the interest's pro rata share of the collective fair market value of the interest held by the taxpayer and the taxpayer's family members. If the interest is in a trade or business, the passive assets of the business would be valued separately from the trade or business.

GST Exempt Trusts: The generation skipping transfer tax exemption (GSTT) would only apply to (i) direct skips and taxable distributions to beneficiaries who are no more than two generations below the transferor, and to younger generation beneficiaries who were alive at the creation of the trust, and (ii) taxable terminations that occur while any person described above is a beneficiary. The existing provisions that reset the transferor upon the payment of the GSTT would not apply, and existing trusts would be treated as having been created on the date of enactment.

Conclusion: There were many other *Greenbook* proposals that I skipped over, but these are enough to get you to start thinking about what might come our way in 2025 with new tax laws.