

Planning 2024: Impending & Potential Legislation that Could Impact 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 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 for 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 approximately \$7 million per person. 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 or the "Green Book" (the "Biden Proposals"), discussed below, with many of the proposals 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 the Biden Proposals, 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 Proposals. Therefore, if the Biden Proposals are enacted in 2025, with a January 1, 2025, effective date, your ability to take advantage of the current law would not be lost. On the other hand, if you don't act your options to shift wealth may be dramatically limited.

We look forward to assisting you in your planning. Please contact us by August 1, 2024 to determine your course of action

Summary of key Biden Proposals.

Capital Gain Proposals

For taxpayers with more than \$1 million of taxable income, the tax on long-term capital gain (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 gain over many years and perhaps at lower rates, to avoid surpassing the \$1 million dollar figure.

Finally, your investments should be reviewed to identify significant appreciation. We will be happy to assist you in doing so. Whether or not the capital gain tax rate increases, you should consider at this point harvesting (recognizing) embedded capital gains now. This would lock in the 20% tax rates rather than face the possibility of the higher marginal tax rates under the Biden proposals.

Realization of Income 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. Under the Biden Proposals, such transactions would be subject to income tax, subject to a \$5 million exclusion. Thus, 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. However, when calculating the estate tax upon a bequest, the estate would get an estate tax deduction for the income tax paid. Even with this deduction, the overall tax burden would be costly.

Exception. Gifts of property to your spouse, in general, will not trigger gain under the proposed deemed realization rules. Thus, even if you are in a second or later marriage and have highly appreciated assets, there is a significant tax incentive to bequeath those assets to your spouse on his/her death. If the same assets are bequeathed to children from a prior marriage, it will trigger gain.

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.

In addition or instead, to avoid gain, you may wish to make gifts to charity. If you make an outright gift of an appreciated asset, including stock, to a public charity, there is no gain and the asset is removed from your estate. Alternatively, you may make a gift to a charitable remainder trust (“CRT”) or to a charitable lead trust (“CLT”), referred to as “split interest trusts”.

Under a CRT, you transfer the property into the trust and designate a charity as the ultimate beneficiary. The trust then sells the property and re-invests the proceeds, providing you with a stream of income for a specified period (often your lifetime). At the end of the term, the remaining assets in the trust go to the charity. This approach allows you to make a significant charitable gift, get a tax deduction, and receive income—all from the same donation.

A CLT provides payments to one or more charities for a set period of time commencing at the time the trust is created. After the end of the trust term, the remainder of the trust is distributed to non-charitable beneficiaries—such as family members.

Under the Biden Proposals, if you gift assets to any type of split-interest trust, there’ll be realization on the non-charitable portion. Such transfers would trigger gain to the extent of the interests of the non-charitable beneficiary. Some commentators are of the opinion that there will be an exception for a split-interest charitable trust for a spouse and charity so that such interest would not be taxable.

Recommendation. If you are interested in charitable giving through charitable remainder or charitable lead trusts, please advise .It would be prudent to create the trust now and be ready to implement before the end of the year, to allow you to respond to changes in the law, if any.

Gain Recognition and Irrevocable Trusts

- *Gift To Non-Grantor Trust.* Currently, no gain is realized when you gift assets to a non-grantor trust (a trust that pays its own income tax).

Under the Biden proposals, gifts made to a non-grantor trust would trigger gain payable by the trust.

- *Gifts to Grantor Trusts.* Under current law, no gain is realized when you transfer assets to a grantor trust (a trust in which the grantor pays the tax on income earned by the trust). Further, under current law you may swap property from the grantor trust in exchange for property of equivalent value. The swap technique allows you to bring a highly appreciated asset back into your estate to obtain an income tax basis step up on your death.

Under the Biden Proposals, gifts made to a grantor trust would trigger gain. Further, swapping assets between the settlor and the grantor trust would also be a taxable event. Similarly, swapping a highly appreciated asset held by an irrevocable trust back into the grantor's estate to obtain an income tax basis step up on death, would not be possible. If the asset remained in the trust, basis would not be increased at death, meaning that heirs would ultimately pay a capital gains tax.

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

Gain Recognition for GST Trusts

The Biden proposal provides for a forced recognition event for property held in trust 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 3.8% net investment income tax.

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.

GST Transactions Between Trusts

To avoid the imposition of the GST tax on a non-GST exempt trust that has the potential to have as beneficiaries grandchildren and later descendants, the Trustee can shift the value of the non-GST-exempt trust into a GST-exempt trust by selling the assets it owns to a GST-exempt for a promissory note. Under current law, if both trusts are grantor trusts as to you, or the buying trust is a grantor trust as to the selling trust, no income tax should be triggered on the sale. Thereafter, any increase in value of the asset above the interest rate the buying trust pays the selling trust, could be outside the tax system.

Recommendation. If you face a situation in which it would be beneficial to transfer assets from a non-GST exempt trust to a GST-exempt trust, immediately complete this transaction if Biden wins the election, if not before.

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 Proposals

o Annual Exclusion. Gifts. Under current law, you may make annual exclusion gifts to an unlimited number of beneficiaries so long as the person receiving the gift has an unrestricted right to use or enjoy the gift for a specified period of time (i.e. a "present interest"). The current annual exclusion is equal to \$18,000 per beneficiary. If you are married, your spouse can make a similar gift, using his/her own assets. Alternatively, you and your spouse can consent to gift splitting, which means one spouse can

contribute the full \$36,000 and the other "0" or each of you can contribute a portion of the gift, so long as the combined gift does not exceed 2x the gift tax annual exclusion amount. When you split gifts, the IRS looks at the totality of those gifts to determine whether gift tax applies, rather than what each spouse contributed; Gifts are considered to be made equally by both spouses. The primary requirements in gift splitting is that you have been married to each other for the entire year and you consent to have any gifts made by either of you treated as being made by both of you and your spouse consents to have gifts split.

Under the Biden Proposal, annual exclusion gifts would no longer be subject to the present interest requirement and the annual amount a donor may gift is limited to an overall \$50,000 per donor per year.

Recommendation: Under current law, annual exclusion gifts to your children, grandchildren and other loved-ones can significantly reduce the size of your estate, thereby minimizing or avoiding future estate tax. Maximize your annual exclusion gifts now, using gift splitting where feasible, to avoid the possibility of the Biden restrictions on annual exclusion gifts. This will be especially important in 2026, when the exemption is reduced to \$5 million, adjusted for inflation.