Ways the Administration Wants to Modify the Tax Rules for Certain Trusts

Taxes are not just for individuals—they can impact certain types of trusts as well. Whether a trust pays its own taxes or whether the taxes are paid by the trust's beneficiaries or the trustmaker depends on several factors.

Grantor Retained Annuity Trusts

If the trust is a grantor trust (a type of trust where the trustmaker, or *grantor*, typically retains power or control over the money or property in the trust), then trust income is taxed to the trustmaker. Grantor trusts may be revocable or irrevocable. Irrevocable grantor trusts such as a grantor retained annuity trust (GRAT) are popular among high-income taxpayers. These are trusts where the trustmaker retains an annuity interest (a right to receive payments of income) in a trust for a term of years.

The Greenbook proposes to modify the tax rules for grantor trusts. Currently, estate planning tools such as GRATs and other grantor trusts allow taxpayers to substantially reduce their federal tax liabilities.[1] A GRAT is a type of trust where a trustmaker receives an amount annually for a term of years or for the trustmaker's lifetime, then the trust terminates and any remaining money or property in the trust is distributed to the trust beneficiaries. It is the position of the Biden administration that legislative changes need to be made "to close the existing loopholes and ensure the effective operation of Federal income, gift, and estate taxes."[2] This Greenbook proposal "would require that the remainder interest in a GRAT at the time the interest is created would need to be a minimum value for gift tax purposes equal to the greater of 25 percent of the value of the assets transferred to the GRAT or $500,000."[3] Also, "the proposal would prohibit any decrease in the annuity during the GRAT term and would prohibit the grantor from acquiring in exchange an asset held in the trust without recognizing gain or loss for income tax purposes."[4] In addition, the proposal would require a GRAT to have a minimum term of ten years and a maximum term set at the life expectancy of the annuitant plus ten years. It would also "provide that the payment of the income tax on the income of a grantor trust (other than a trust that is fully revocable by the grantor) is a gift."[5] The unreimbursed amount of the income tax paid would be considered a gift.[6] This proposal is the same proposal that was included in the 2023 Greenbook[7] and was previously included in Greenbooks from the Obama administration.[8]

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[1] Dep't of the Treasury, General Explanations of the Administration's Fiscal Year 2024 Revenue Proposal [hereinafter *General Explanations*] at 124, https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf.
[2] *Id*.
[3] *Id*. at 127.
[4] *Id*.
[5] *Id*.
[6] *Id*.
[7] Dep't of the Treasury, General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals at 40, https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf.
[8] Dep't of the Treasury, General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals, https://home.treasury.gov/system/files/131/General-Explanations-FY2016.pdf; and Dep't of the Treasury, General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals, https://home.treasury.gov/system/files/131/General-Explanations-FY2017.pdf.

Charitable Lead Annuity Trusts

Charitable trusts are also being targeted by the Greenbook proposals—particularly charitable lead annuity trusts (CLATs). A CLAT is a special type of charitable trust where the trustmaker selects a charity or charities to receive annual payments from the trust. The payments can be made either for the trustmaker's lifetime or for a predetermined number of years. Once the trust terminates, any remaining trust money or property is distributed to noncharitable beneficiaries. The Biden administration feels that "taxpayers often design the CLAT to have an annuity that increases over the trust term, thereby largely deferring the charitable benefit until the end of the trust term."[9] By using this and other tax planning techniques, it is possible to greatly increase the value of the trust remainder without incurring increased gift tax consequences. The Greenbook "would require that the annuity payments made to charitable beneficiaries of a CLAT must be a level, fixed amount over the term of the CLAT, and that the value of the remainder interest at the creation of the CLAT must be at least 10 percent of the value of the property used to fund the CLAT, thereby ensuring a taxable gift on creation of the CLAT."[10] This proposal has not appeared in prior Greenbooks, and it is unclear at this point in time how it will be received.

Loans from a Trust

Another Greenbook proposal modifying the tax rules of trusts "would treat loans made by a trust to a trust beneficiary as a distribution for income tax purposes, carrying out each loan's appropriate portion of distributable net income to the borrowing beneficiary."[11] Currently, with few exceptions, loans from a trust to a borrower do not result in tax consequences to the borrower.[12] Additionally, loans to a trust beneficiary would be treated as a distribution for generation-skipping transfer (GST) tax purposes under the proposal, "thus constituting either a direct skip or taxable distribution, depending upon the generation assignment of the borrowing beneficiary."[13]

In addition, "[t]o discourage borrowing from a trust by a person who is not a trust beneficiary but who is a deemed owner of the trust under the grantor trust rules, the proposal would treat a trust maker's repayment of a loan from a grantor trust as an additional contribution to the trust for GST tax purposes."[14] In some instances, "this new contribution (like any other contribution) would utilize GST exemption of the borrower(s), generate a GST tax liability in the case of a direct skip on such borrower(s) or their respective estates, or increase the trust's inclusion ratio."[15] The trust could be liable for the GST tax payable on such a deemed direct skip if it could not be collected from a deemed owner or a deceased deemed owner's estate.[16] This proposal would allow certain types of loans to be excepted from the application of the proposal, such as short-term loans or the use of real or tangible property for a minimal number of days.[17]

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[9] *General Explanations, supra* n. 1, at 127.
[10] *Id*. at 128.
[11] *Id*. at 129.
[12] *Id*. at 124.
[13] *Id*. at 129.
[14] *Id.*
[15] *General Explanations, supra* n. 1, at 129.
[16] *Id.*
[17] *Id.*

When a president submits a proposed budget, it is viewed as an invitation to begin policy debates with Congress. Many people feel the proposed budget for 2024 is “dead on arrival” due to discord between congressional Democrats and Republicans and that the chance of most proposals becoming law is remote. However, the Greenbook still serves as an indicator of the current administration’s goals and agenda. It is important to stay abreast of the latest proposals and discuss with your financial and legal advisors to understand how the proposals may impact you and your financial and estate planning.