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Changes May Lie Ahead for Certain Wealth Transfer and Succession Planning Strategies

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In March, the Department of Treasury issued the administration's 2015 fiscal year revenue proposals for the federal government. Those proposals are described in *General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals*, often referred to as the "Green Book". The Green Book included several interesting revenue proposals with respect to estate and gift tax provisions, which, if enacted, would have significant adverse effects on many techniques currently used for wealth transfer and succession planning.

While these Green Book proposals may or may not ever become law, at a minimum, interested persons must be made aware of Treasury's ideas for compromising heretofore successful wealth transfer and succession planning strategies. Advance notice of these proposals can be of significant assistance, for example, to baby boomers as they are considering any one of the numerous different strategies for passing wealth and family businesses to the next generation. Some of the Green Book proposals are as follows:

- **Restore the Estate, Gift, and Generation-Skipping Transfer Tax Parameters in Effect in 2009**

Currently, the top transfer tax rate is 40 percent and the exclusion is $5.34 million, indexed for inflation, per person, and the unused portion of the exclusion is portable (i.e., can be transferred to a surviving spouse).

Under the Green Book proposal, beginning in 2018, the estate, generation-skipping transfer and gift tax parameters as applied during 2009 would be made permanent. The top tax rate would be 45 percent and the exclusion would be $3.5 million for estate and gift taxes, and $1 million for gift taxes. There would be no indexing for inflation. While portability would be maintained, it would be limited during the surviving spouse's life to the amount of remaining exemption the deceased spouse would have applied to his or her gifts made in the year of his or her death.

- **Grantor Retained Annuity Trust (GRAT)**

A GRAT is an irrevocable trust funded with assets expected to appreciate in value, in which the grantor retains interest in an annuity for a term of years that the grantor expects to survive. At the end of the term of years, the assets remaining in the trust are transferred to (or held in further trust for) the beneficiaries.

Currently, to the extent the GRAT's assets appreciate at a rate that exceeds the statutory interest rate used for valuing the grantor's retained annuity interest, that appreciation is transferred to the GRAT (and its beneficiaries) free of gift tax. A series of short-term GRATs (e.g., two or three years) is particularly effective in transferring value gift-tax free.

Under the Green Book proposal, a GRAT would be required to have a minimum term of 10 years and a maximum term of the life expectancy of the annuitant plus 10 years. The proposal would also include a requirement that the remainder interest have a value greater than zero at the time the interest is created and would prohibit any decrease in the retained annuity during the GRAT term. Although a minimum term would not prevent "zeroing-out" the gift tax value of the remainder interest, it would increase the risk that the grantor fails to outlive the GRAT term and thus loses any anticipated transfer tax benefits.

- **Coordinate Certain Income and Transfer Tax Rules Applicable to Grantor Trusts**

Currently, sales of appreciating assets to a grantor trust provides a technique for freezing the value of such assets, with no realization of the gain in such assets at the time of transfer by the seller/grantor, and permits the seller/grantor the opportunity to continue to fund the trust by paying the applicable income taxes owed by the trust without making additional gifts. This technique is particularly effective with non-voting stock of a family-owned S corporation, provided the corporation has the cash flow to fund the debt service arising from the sale (which is a typical way to pay for the stock).

Under the Green Book proposal, should a person who is a deemed owner (under the grantor trust rules) of all or a portion of a trust engage in a transaction with that trust that constitutes a sale, exchange, or comparable transaction that is disregarded for income tax purposes by reason of the person's treatment as a deemed owner, then the portion of the trust attributable to the property received by the trust in that transaction (including all retained income therefrom, appreciation thereon, and investment thereof, and net of the amount of consideration received by the person in that transaction) will be (i) subject to estate tax as part of the gross estate of the deemed owner, (ii) subject to gift tax at any time during the deemed owner's life when his or her treatment as a deemed owner of the trust is terminated, and (iii) treated as a gift by the deemed owner to the extent any distribution is made to another person (except any discharge of deemed owner's obligation to the distributee) during the life of the deemed owner. The transfer tax imposed by this revenue proposal would be payable from the trust.

- **Simplify Gift Tax Exclusion for Annual Gifts**

The use of the annual gift tax exclusion, which is currently allowed for an unlimited number of donees, in a variety of wealth transfer techniques (e.g., irrevocable life insurance trust) is prevalent.

Under the Green Book proposal, a new defined category of transfers (without regard to the existence of any withdrawal or put rights), would impose an annual limit of $50,000 per donor on the donor's transfers of property within this new category that would qualify for the gift-tax annual exclusion. The "present interest" requirement would be eliminated. Thus, a donor's transfers in the new category in a single year in excess of the total amount of $50,000 would be taxable, even if the total gifts to each individual donee do not exceed $14,000.

Based on the foregoing Treasury revenue proposals, it would be prudent for any person contemplating wealth transfer and succession planning strategies (such as baby boomers as referenced earlier) to keep these proposals in mind as those strategies are being customized for the person's particular facts and circumstances. Please contact any one of the attorneys in the Firm's Tax Group should you wish to discuss wealth transfer and succession planning strategies that may be appropriate for you.