TRUSTS UNDER ATTACK – THE LEGISLATIVE LANDSCAPE

Authors
Nina Krauthamer
Wooyoung Lee

Tags
Biden Tax Proposals
Corporate Transparency
Pandora Papers
Trusts

Reducing perceived wealth disparity in the United States has become a major political goal of the Biden Administration and the Democratic Party. That goal, together with the goal of increased transparency concerning ownership, have resulted in a number of legislative proposals, which, if enacted will fundamentally alter tax planning regimes for the wealthy. This article explores some of these recommendations and their effects.

PANDORA PAPERS/ENABLERS ACT

In an unprecedented leak, The Washington Post and the International Consortium of Investigative Journalists ("I.C.I.J.") gained access to more than 11.9 million confidential documents maintained by trust and corporate services providers around the world. The records, known as the Pandora Papers, revealed that that foreign political and corporate leaders or their family members moved money and other assets from long-established tax havens to U.S. trust companies. The investigation identified 206 U.S.-based trusts linked to 41 countries.[1]

The response was immediate. In the United States, a bipartisan bill was introduced in the House of Representatives on October 6, 2021. Named the "Establishing New Authorities for Business Laundering and Enabling Risks to Security (ENABLERS) Act," the Enablers Act, would amend the 51-year-old Bank Secrecy Act by requiring the Treasury Department to create basic due diligence rules for American "gatekeepers" who facilitate the flow of foreign assets into the United States. Gatekeepers include art dealers, investment advisors, real estate professionals, lawyers, accountants, trust or company service providers, public relations professionals, dealers of luxury vehicles, money service businesses and other similar professions.

The U.S. Treasury Department would be authorized to create basic due diligence rules on source of funds. A basic due diligence program could be as simple a requirement as asking if suspicious funds are the proceeds of a crime. The new rules would be effective for 2023 and affected reporting persons would have until June 30, 2024 to have required programs in place.

The "temporary" exemption in place since 2002 for real estate professionals and sellers of luxury cars, ships, and aircraft from anti-money laundering programs would be removed and the U.S. Treasury Department would be required to create anti-money laundering rules for these industries. Attorneys who use a paid service provider to set up companies (and therefore avoid becoming financial institutions) would be exempt from the anti-money laundering rules.

---

[1] See, generally, the International Consortium of Investigative Journalists website, icji.org.

© Ruchelman P.L.L.C., 2021. All rights reserved.

Title insurers in a handful of large American cities are required to collect beneficial ownership information (actual ownership) for residential real estate purchase in all cash (*i.e.*, non-mortgage) transactions. This would be expanded nationwide and would also apply to commercial real estate, within 90 days of enactment.

THE CORPORATE TRANSPARENCY ACT

On January 1, 2021, Congress passed the Corporate Transparency Act ("C.T.A.") as part of the overall 2021 National Defense Authorization Act and under the scope of the Anti-Money Laundering Act of 2020 ("A.M.L.A."). The C.T.A. requires (i) the establishment of new federal beneficial ownership reporting requirements for certain U.S. domiciled or active entities, including foreign entities that operate in the U.S., and (ii) FinCEN's maintenance of a federal database for the beneficial ownership information collected. Noncompliance with the C.T.A. can result in significant civil and criminal penalties.

The C.T.A. defines "beneficial owner" to mean, with respect to an entity, an individual who, directly or indirectly, through any contract, arrangement, understanding, relationships, or otherwise, exercises "substantial control" over the entity or owns or controls not less than 25% of the "ownership interests" of the entity. Reported information will include full legal name, date of birth, current residential or business street address, and a unique identifying number from an acceptable identity document or a unique identity number generated by FinCEN.

The C.T.A. requires the Secretary of the Treasury to promulgate regulations under the C.T.A. not later than one year after the enactment of the C.T.A. (*i.e.*, not later than January 1, 2022). For any reporting company that has been formed or registered before the effective date of the Treasury regulations, such reporting company is required to submit to FinCEN the required beneficial ownership report not later than two years after the effective date of such Treasury regulations. For any reporting company formed or registered after the effective date of the Treasury regulations prescribed under the C.T.A., such reporting company is required to submit to FinCEN the required beneficial ownership report at the time of formation or registration.

Law enforcement for foreign countries (*e.g.*, Interpol, Europol) may get access to the information. In addition, information may be provided to Federal government agencies, including those with law enforcement, national security, intelligence and applicable financial regulatory missions (*e.g.*, Justice Department, F.B.I., Treasury Department (for tax administration purposes), Federal Reserve Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency), State, local or tribal law enforcement agencies with an appropriate court order, and certain financial institutions.

The term "reporting company" under the C.T.A. means, subject to certain exclusions, "a corporation, limited liability company, or other similar entity" that is (i) created by the filing of a document with the secretary of state or similar office under the laws of a state or Indian tribe or (ii) formed under the law of a foreign country and registered to do business in the United States by the filing of a document with the secretary of state or similar office under the laws of a state or Indian tribe. A trust (other than certain business trusts) does not appear to be considered a reporting company at this time. There are other exclusions, including an exclusion for an entity that (i) employs more than 20 employees on a full-time basis in the United States, (ii) filed in the previous year federal income tax returns in the United States demonstrating

© Ruchelman P.L.L.C., 2021. All rights reserved.

more than $5 million in gross receipts or sales in the aggregate, including (a) other entities owned by the entity and (b) other entities through which the entity operates, and (iii) has an operating presence at a physical office in the United States.

Many trusts (foreign and domestic) own assets through single-member LLCs, treated as disregarded for tax purposes. Those LLCs will be subject to this new law. A trust would not appear to be subject to the new law, although there is discussion among experts whether forthcoming regulations will expand the scope of the new law to include trusts.[2] Many other countries require trusts to report information about trusts (including beneficial ownership) to a centralized registry.

PROPOSED TAX LEGISLATION

In an effort to provide funding for an expansive Democratic agenda, several tax proposals would have the effect of increasing taxes on wealthier individuals and trusts. These proposals are constantly changing, but may include the following, and may, in certain instances, be applicable this year.

"In an effort to provide funding for an expansive Democratic agenda, several tax proposals would have the effect of increasing taxes on wealthier individuals and trusts."

Tax Increases

Rates (Original Proposal)

The top individual income tax rate for taxable incomes will be increased from 37% to 39.6%. A 3% surtax will be imposed on those individuals with a modified adjusted gross income in excess of $5 million, and in excess of $100,000 for estates and trusts. The 3.8% Net Investment Income Tax would be expanded to apply to all income not subject to the 3.8% Medicare tax on wages and self-employment income. The maximum tax on long-term capital gains and dividends would increase to 25% for taxpayers having taxable income over $1 million. This could result in a possible 31.8% tax including the 3.8% net investment income tax and the 3% surtax, if applicable, and over 40% for residents in high tax states (such as New York, New Jersey and California).

These significantly higher taxes could impact decisions to accumulate income in many dynasty trusts, particularly those established by foreign individuals as exempt from generation skipping transfer tax.

Revised House Proposal

A new 5% surcharge would be imposed on individuals with a modified adjusted income in excess of $10 million and an additional 3% surcharge for modified adjusted gross income over $25 million. Modified adjusted gross income is calculated before charitable and mortgage interest deductions. For estates and trusts, the same rates apply at modified adjusted gross income over $200,000 and $500,000, respectively. This could result in a rate of tax on capital gains of 28.8% to 31.8%. The 3.8% Net Investment Income Tax would be expanded to apply to all income not subject to the 3.8% Medicare tax on wages and self-employment income, and for taxpayers with taxable income of $400,000 or more ($500,000 for taxpayers filing jointly), income derived in the ordinary course of business, or active business income, will be subject to the 3.8% tax.

---

[2] See "Foreign Money Secretly Floods U.S. Tax Havens. Some of It is Tainted," *The Washington Post*, October 4, 2021.

© Ruchelman P.L.L.C., 2021. All rights reserved.

Lower Estate Tax Exemption

The exemption for estate, gift, and generation skipping transfer ("G.S..T.") tax of $11.7 million will revert back to $5 million (as indexed for inflation, approximately $6.02 million indexed for inflation in 2022, as of January 1, 2022.

Revised Plan: Not included.

Changes to Grantor Trust Rules

Assets held by grantor trusts (for income tax purposes) will be included in the estate of the grantor at death. Distributions from grantor trusts to beneficiaries during the grantor's lifetime (and trust terminations during lifetime) will be treated as gifts from the grantor. These proposals, if enacted, could largely eliminate the utility of grantor retained annuity trusts ("G.R.A.T.'s"), spousal limited access trusts ("S.L.A.T.'s"), qualified real property trusts ("Q.P.R.T.'s") and insurance trusts as tax efficient estate planning techniques to remove property and appreciation on such property from a grantor's estate. Sales or exchanges of property between a grantor trust and its grantor would be taxable, eliminating the ability to remove the appreciation on assets from a grantor's estate through income tax-free sales by a grantor to a grantor trust.

Revised Plan: Not included.

Valuation Rules

One proposal includes a change to the rules applicable to valuation of entity interests owned at death or transferred by gift. There would be no valuation discounts for estate and gift tax purposes on nonbusiness assets (cash, stock, debt, annuities, and real property, (other than certain real property used in a real property trade or business, which includes development, management, leasing, construction, or management businesses) held in entities. This would eliminate most valuation discounts for entities, other than assets used in an active business.

Revised Plan: Not included.

FURTHER THOUGHTS

It is clear that profound changes are coming to increase tax on wealthy individuals. There has been considerable pushback on a number of these proposals. Most recently, discussion regarding a possible wealth tax on wealthy individuals has reemerged, but it appears to have been shut down by moderate Democrats. Proposals change frequently, and it is difficult to predict what changes may ultimately be enacted.

prepared for informational purposes only and is not intended to constitute advertising or solicitation and should not d, or taken as legal advice. Reading these materials does not create an attorney-client relationship.