NAEPC Journal of Estate & Tax Planning
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Steve Leimberg's Estate Planning Email Newsletter Archive Message #2880

Date:19-Apr-21

Subject: Andy Katzenstein, David Pratt, Brett Rosecan & Brittany Newell: Estate Planning in 2021 and Beyond - What if the "For the 99.5% Act" and the "STEP Act" Catch Fire – Will the Estate Planning Arena Survive?

"It is not so long ago that there were many Democrats vying to win the opportunity to run against former President Trump in the 2020 Presidential Election. Many of the candidates expressed their views regarding taxes imposed on the wealthy, such as the estate tax. In addition, there have been prior discussions in Washington about repealing or substantially revising techniques that wealthy individuals and families use to reduce their estate tax exposure.

Fast forward, nearly three months into a new Administration, we now have seen two proposals, the "For the 99.5% Act" and the "STEP Act," that would dramatically alter the estate planning landscape. The For the 99.5% Act, as its name suggests, is designed to affect only .5% of Americans i.e., the "ultra-wealthy" Americans, and STEP means "Sensible Taxation and Equity Promotion"; and while these proposals are just that – proposals, they give us a hint of what we can expect to be discussed and debated over the next several months.

This newsletter discusses the two proposals in detail, and includes a summary of the legislative process that would be followed for any tax legislation to become law. The authors also share some planning opportunities that advisors to the wealthy should consider now, and in the future."

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Here is their commentary:

EXECUTIVE SUMMARY:

On March 25, 2021, Senator Bernie Sanders (VT) and Senator Sheldon Whitehouse (RI) introduced the "For the 99.5% Act." Its provisions are broad and aggressive – the transfer tax exemptions would be reduced

significantly (back to 2009 levels – a $1 million gift tax exemption and $3.5 million estate/GST tax exemption), the rates would go up (45% for the "average" wealthy individual, and climbing up to 65% for the ultra, ultra wealthy) and many of the transfer tax reduction techniques that are currently allowed under the law would be effectively eliminated – grantor trusts, GRATs, discount planning, to name a few. Needless the say, the estate planning world, as we know it, would be rocked. From a timing perspective, changes to rates and the basic exclusion amount would be effective on January 1, ***2022***, which is obviously good news, given the concern about making gifts in 2021. But other provisions of the new law would generally take effect on date of enactment – which could be even sooner.

Four days later, on March 29, 2021, Senator Chris Van Hollen (MD), Senator Cory Booker (NJ), Senator Bernie Sanders (VT) and Senator Sheldon Whitehouse (RI) introduced the "Sensible Taxation and Equity Promotion (STEP) Act" (also referred to as the "STEP Act"). This bill is exactly what President Biden proposed during his campaign – the elimination of the step-up in basis rule at death coupled with treating death as a recognition event for income tax purposes. In general, the bill proposes that property should be treated as sold for its fair market value when transferred by gift, bequest or to a non-grantor trust.

It is impossible to predict whether these bills will pass in their current form. In addition to being overly aggressive, the legislative process can be complicated and, while the Democrats control the Congress, passing tax legislation is easier said than done. It should be relatively easy for the House to pass legislation, as the Democrats hold the majority, albeit by a slim margin. However, it is a different road in the Senate, as a majority of bills proposed in the Senate require a 60-vote super-majority in order to pass due to the legislative filibuster. Assuming that the filibuster would prevent easy passage of any tax legislation, the other option is a budget reconciliation bill, which is not subject to the filibuster and can pass with a simple majority of 51 votes. With Democrats holding 50 seats in the Senate, budget reconciliation has already proven to be a powerful measure of passing fiscal legislation quickly (as seen with the passage of The American Rescue Plan Act of 2021 after a 51-50 vote in the U.S. Senate and a party-line simple majority in the U.S. House).

COMMENT:

<u>The For the 99.5% Act</u>

On March 25, 2021, Senator Bernie Sanders (VT) and Senator Sheldon Whitehouse (RI) introduced the "For the 99.5% Act." Its provisions, and some planning suggestions, are discussed below. From a timing perspective, it has an effective date of January 1, ***2022***, which is obviously good news, given the concern about a retroactive tax bill. Of course, this is only a proposal and anything can happen, but at this juncture, it is unlikely that any tax bill of this magnitude would have retroactive effect.[i]

1. <u>Basic Exclusion Amount/GST Exemption</u>. The bill proposes to reduce the basic exclusion amount to $3.5 million (with a $1M limit on lifetime gifts). There is no specific reference to a reduction in the amount of the GST tax exemption, but because IRC Section 2631(c) says the amount of the GST exemption is equal to the basic exclusion amount, a reduction in the GST tax exemption would also occur. It appears the inflation adjustment for the basic exclusion amount (and, therefore, for the GST tax exemption as well) has been eliminated. The proposed law amends "Paragraph (3) of section 2010(c) of the Internal Revenue Code of 1986 to read as follows…" and then states simply that "[F]or purposes of this section, the basic exclusion amount is $3,500,000." That language is in subparagraph (A) of Paragraph (3) of section 2010(c), and the inflation adjustment is in subparagraph (B). Significantly, there is no subparagraph (B) made part of Paragraph (3), effectively eliminating any inflation adjustment for the basic exclusion amount.

If 2020 was not busy enough for planners in anticipation of a change in 2021 under a Biden Administration, coupled with democratic control of the Congress, 2021 could be even busier. Many clients who were on the fence about using their exemptions did not pull the trigger and rolled the dice as the clock struck midnight and 2020 came to an end. Such clients now have a second opportunity, not to mention that the sheer number of potential clients will increase with a lower exemption.

It should be noted that President Biden's tax proposals during his campaign were silent regarding any proposed changes to the basic exclusion amount. However, in his plans to support women during COVID 19, he mentioned

that he would return the exemptions to 2009 levels, meaning a $3.5 million estate tax exemption and a $1 million gift tax exemption.[ii]

Last year, there were plenty of newsletters that discussed strategies for wealthy clients to use their exemptions in anticipation of a reduction in a Biden Administration.[iii] *Planners should advise clients who did not use their exemptions last year to do so this year, as it is likely that any reduction would not be retroactive, as mentioned above.*

In addition, and subject to the discussion below regarding the "federal" tax rule against perpetuities, it may make sense to make late allocations of GST exemption to trusts that are not otherwise exempt. Often there is a mismatch between the amount of gift tax and GST tax exemption used; in these cases, before the exemption is reduced, it should be used. This may require decantings or other methods to keep assets out of a beneficiary's taxable estate.

2. Rates. The bill proposes to raise the estate tax rates to 45% for individuals with a taxable estate of $3,500,000 to $10,000,000 (up from the current 40% rate). For taxable estates of $10,000,000 - $50,000,000, the rate would be 50%. For taxable estates of $50,000,000 - $1,000,000,000, the rate would be 55%. And, for taxable estates over $1,000,000,000, the rate would be 65%. There is no mention about a change in the gift tax rates specifically, but because IRC Section 2501(a) calculates the gift tax based on the tax "…computed under section 2001(c)," the gift tax rate is increased in the same fashion. And the same holds true for the GST tax, which is tied to the highest estate tax rate.

Transfer tax brackets are not new, even though we have been under a "flat" transfer tax rate since 2006 (i.e., cumulative transfers in excess of the exclusion amount are taxed at the highest applicable rate). Under the regime of transfer tax brackets, as in the "old days" when there were multiple brackets ranging from 37% to 55% and a $600,000 exemption, advisors may want to recommend that some estate tax is paid at the first death in order to take advantage of the lower tax brackets, which will result in lower overall transfer taxes. An easy way to do this is by making a partial QTIP election (or no election at all) and paying taxes at the lower rates on the non-QTIPped portion, which will keep such portion of the QTIP trust out of the surviving spouse's taxable estate. In addition, when it is likely that the deaths of spouses will occur in relatively close proximity to

each other, it will make sense to make a partial QTIP election (or no QTIP election at all) so that a previously taxed property tax credit can be "manufactured" on the second death relating to the surviving spouse's income interest in the non-QTIPped trust (and five or five power if one is included).

LIFE INSURANCE PLUG #1 – LIFE INSURANCE IS VERY OFTEN USED TO PROVIDE LIQUIDITY TO PAY ESTATE TAX. AND, WITH A MARRIED COUPLE, A SURVIVORSHIP (SECOND-TO-DIE) POLICY IS TYPICALLY USED, AS IT IS LESS EXPENSIVE THAN A POLICY ON ONE LIFE (ASSUMING ALL OTHER THINGS ARE EQUAL, SUCH AS INSURABILITY). IF IT IS CONTEMPLATED THAT ESTATE TAX WILL BE PAID UPON FIRST DEATH, IT WILL BE NECESSARY TO CONSIDER BUYING LIFE INSURANCE THAT WILL PAY UPON THE FIRST DEATH.

3. <u>No Basis Step-Up for Certain Grantor Trust Assets</u>. The bill proposes to amend IRC Section 1014 by inserting language that does not allow a basis step-up (or step-down) for property in a grantor trust that is not included in the transferor's gross estate. It appears that this proposal would grandfather existing grantor trusts, provided that additions are not made to the trust after the effective date.

While there are some tax lawyers who believe there is authority to conclude that assets in a grantor trust which is not included in the grantor's estate should receive a step-up in basis upon the grantor's death, the general consensus of the estate planning community is that the assets held in such a trust do not receive a basis step-up for income tax purposes. This proposed change in the law merely states the obvious. Perhaps there are heirs who have taken the position they would receive a basis step-up in this circumstance, and IRS is simply trying to shut that down.

The For the 99.5% Act, as further discussed below, would cause assets the decedent sold to a grantor trust after the effective date of the law to be included in a decedent's taxable estate. Such provision, coupled with this provision of the For the 99.5% Act, would be the worst of all worlds – estate tax inclusion of the grantor trust assets and, perhaps, no basis step-up for

those assets. These provisions will need to be coordinated before they can both become law.

4. Limits on Discounts. Limits will be placed on valuation discounts. The focus seems to be on eliminating discounts for entities that own assets such as stocks, bonds and cash. In general, the new rules would eliminate any discounts for lack of control and lack of marketability for certain transfers of entity interests that consist of "non-business assets"; a non-business asset is one that is not used in the active conduct of a trade or business. If an entity holds business assets and non-business assets, when valuing the entity, a taxpayer could discount the entity but not that portion consisting of non-business assets. There are two "passive assets" for which a discount would be allowed: (a) reasonably required working capital held by the business and (b) real estate in which the transferor materially participates. Other "passive assets" are specifically excluded from being treated as used in an active business, including cash or cash equivalents, stock in a corporation or any other equity, profits, or capital interest in an entity, evidences of indebtedness, annuities, assets other than a patent, trademark or copyright which produces royalty income, commodities, and collectibles. There is also a "look-through" rule which says the assets of an entity owned by a subsidiary entity of which the parent owns at least 10% (i.e., 10% of the vote or value of the entity) are treated as being directly owned by the parent entity – this seems to be part of the proposed legislation to allow holding company interests to receive discounts when transferred so long as the subsidiary assets are used in an active business. Note that the limit on discounts would only apply, however, if the transferor, transferee, and members of the family (as defined in IRC Section 2032A(e)(2)) of the transferor and transferee have control of such entity or own the majority of interests (by value) in such entity.

Similar to the death of the grantor trust, this rule would essentially eliminate discount planning. In August of 2016, the Treasury Department proposed overly broad regulations that also would have been the final nail in the coffin for most discount planning. However, before the IRS could review and respond to the comments, on April 21, 2017, former President Trump issued an Executive Order to reduce tax regulatory burdens and, in response, on June 22, 2017, the Treasury identified eight "offending"

regulations, including the proposed regulations regarding valuation discounts; they were officially withdrawn on October 2, 2017.

But practitioners should have known that valuation discounts had a short life expectancy and this rule, if passed, would be their death knell. Again, wealthy clients who want to consider discount planning should do so sooner rather than later.

Interestingly, the proposal does not address discounts related to transfers of partial interests in real estate not held in entities. Wealthy real estate clients will need to focus on transferring partial interests in real estate on a discounted basis.

The proposal eliminates discounts for lack of control and lack of marketability. Other discounts would seem to survive – for example, the "blockage" discount. Perhaps appraisers will come up with other discounts that can still be utilized (e.g., "COVID discounts").

5. Changes to GRAT Rules. Changes are made to GRATs. The minimum GRAT term would be 10 years, and the maximum term would be no longer than the transferor's life expectancy plus 10 years (this eliminates the ability to contribute to a GRAT a note received in a sale to an IDIT for a really long period so that GRAT payments are tied to the note payments and a zeroed-out GRAT can eliminate inclusion of some of the note in the grantor's estate if interest rates increase after the GRAT is funded). In addition, the remainder interest gift must be (1) no less than the greater of 25% of the fair market value of the property in the trust or $500,000, and (2) not greater than the fair market value of the property in the trust.

Heads you win, tails you break even – that's a zeroed-out GRAT. It has been the perfect trust to remove appreciation from an individual's estate above a prescribed rate that has been extremely low for a number of years, as it is tied to the mid-term applicable federal rate, without paying gift tax or using gift tax exemption (other than a nominal and inconsequential amount). And if drafted properly, a zeroed-out GRAT eliminates all risk of gift tax even if the value of the GRAT assets is increased on audit. This would be gone.

And a short-term GRAT practically eliminates the mortality risk with a GRAT because the GRAT assets are included in the grantor's estate if he

or she predeceases the term. With a minimum term of 10 years, the mortality risk is real.

Individuals who have used their entire gift tax exemption and/or who have assets that could appreciate significantly may want to consider doing multiple GRATs at this time to lock them in before they go away. They may also want to consider slightly longer GRATs, as they would no longer be able to "REGRAT" (through "rolling GRATs") an annuity payment into a new short term GRAT. Of course, mortality risk must be carefully evaluated.

LIFE INSURANCE PLUG #2 – FOR ALL INTENTS AND PURPOSES, SHORT-TERM GRATS HAVE ELIMINATED THE ASSOCIATED MORTALITY RISK. WITH A TEN-YEAR MINIMUM TERM, THE MORTALITY RISK IS BACK. A LIFE INSURANCE POLICY WITH A TEN-YEAR TERM (AND, POTENTIALLY CONVERTIBLE INTO PERMANENT INSURANCE) WILL EFFECTIVELY AVOID THE MORTALITY RISK IF DEATH OCCURS WITHIN THE TERM.

6. <u>Elimination of Estate Planning Using Sales to IDITs</u>. The new rules attempt to eliminate the sale to an IDIT (intentionally defective irrevocable trust) technique by including in a grantor's taxable estate any of the assets held in the IDIT. If a distribution is made from the IDIT to a beneficiary, such transfer would be treated as a gift. If the IDIT's grantor status is eliminated during the lifetime of the grantor, the assets would similarly be treated as a gift made by the grantor. The rules would not apply to a trust that is includible in the grantor's estate (e.g., a revocable trust). However, the amount of estate tax inclusion or gift that would otherwise be deemed to occur would be reduced by the "value of any transfer by gift" the owner previously made to the trust. This rule makes it look like sales to grantor trusts are no longer effective, but gifts to grantor trusts should avoid the application of these rules. While the new rules would apply to trusts created after the date of enactment, they would also apply to any portion of a trust created before the date of enactment that is added to the trust after the date of enactment.

   This provision would essentially be the end of grantor trust planning, which has become singlehandedly, in these authors' opinions, the greatest estate tax reduction planning tool in the toolbox. It is no secret that paying income taxes on income earned on assets outside

of an individual's estate is the tax-free gift that keeps on giving, not to mention the ability to sell assets or make loans between a grantor and a grantor trust, or between grantor trusts, to shift appreciation. While a GRAT is a statutorily enacted technique and, thus, minimizes risk, the sale to an IDIT has traditionally worked if done properly and is a superior technique to the GRAT for a few reasons – there is no mortality risk, the interest rate on the note is typically lower than the rate used for the GRAT and is GST efficient.

Because the proposed change to the law includes the value of the IDIT in the grantor's estate reduced only by the "value of any transfer by gift" the grantor made to the IDIT, even the appreciation on an asset gifted to an IDIT does not escape transfer tax. This alone means that, should this proposal become law, the use of grantor trusts for estate planning purposes is surely over.

Sales to IDITs should be implemented now in order to optimize the planning while it still exists.

7. Dynasty Trust Planning Curtailed/Welcome the Federal Rule Against Perpetuities. Any transfer from a trust more than 50 years after it is created would be treated as having an inclusion ratio of one for GST tax purposes, effectively eliminating the ability for trusts in states like Delaware, Nevada and Alaska (to name a few) to pass assets, in trust, from generation to generation for an unlimited number of generations without the imposition of transfer tax. The law would apply to trusts created after enactment and, what's worse, it would also apply to trusts created before the date of enactment – the law will cut off the transfer tax benefits 50 years from the date of enactment.

For all intents and purposes, Congress will be imposing its own "rule against perpetuities" of 50 years for tax purposes, and it appears that it will not be possible to decant assets from one trust to another trust to circumvent the new rule, as the 50 year countdown starts on the date of creation of the transferee trust or the transfer to the trust, whichever is earlier. Trusts created before this proposal becomes law could avoid the GST for only 50 years after the date of enactment of this proposal.

This new law would change GST planning in a substantial way. For

example, GST tax exempt trusts that are created for children will effectively need to be distributed out to grandchildren before the end of the 50 year period; if distributions to grandchildren come after that date, they will be subject to transfer tax. Provisions will need to be added to trusts that permit the trustees to make these distributions before the end of the 50 year period. Those trustees will be required to balance the children's need for assets to support their lifestyles with the tax savings if those assets are distributed to grandchildren before the end of the 50 years.

In fact, in many cases it may mean that the GST tax exemption should not be used during life, but rather at death, because there would be a better chance that within 50 years after a transfer, a grantor's children will die and the assets will reach skip persons (and the children won't have to give up the benefit of the assets during their lifetimes). Of course, the corollary argument is that it would be impossible to pass appreciation on gifted assets for GST purposes to skip persons. This will be a difficult balancing act to work through with clients.

This change to the law will also eliminate the transfer tax benefit of creating trusts in states like Alaska, Delaware, Nevada and South Dakota (to name a few), which do not have a rule against perpetuities. If the "federal rule against perpetuities" of 50 years applies, the state law governing the trust will be irrelevant and dynastic transfer tax planning will no longer be available. Of course, the trust laws of these states will continue to be attractive for asset protection and other reasons, but the lure of the ability to avoid transfer tax at every generation will be gone.

8. Annual Gift Tax Exclusions Limited. The "present interest" requirement to get the benefit of the annual gift tax exclusion would be eliminated because there would be a cap on the amount a donor can gift if the transfer is made to a trust, or of an interest in a pass-through entity, or of an interest subject to prohibition on sale, or any other transfer of property which cannot immediately be liquidated. Those are the types of gifts that individuals claimed were present interest gifts, but the IRS thought otherwise. For example, *Crummey* trusts allowed the annual exclusion to be applied to each beneficiary even though beneficiaries practically never withdraw funds using their Crummey powers. And *Cristofani* trusts went one step further by allowing even contingent beneficiaries to be counted. With the new cap, gifts to trusts would be limited. The same would hold true for

gifts of interests in pass-through entities, as the donees generally don't control when distributions from the entity can be made. Similarly, the limitation would apply to gifts of assets that cannot be sold or immediately liquidated. The limit is two times the amount of the annual exclusion for the year of the gift. And that is for all gifts of the types listed in this new code section. The result would be that an individual would be able to gift an unlimited number of outright gifts of cash equal to the amount of the annual exclusion to as many donees as he or she wants, but would be capped at two times the annual exclusion for gifts made to trusts, or the other types of gifts listed above. Note that the inflation adjustment for the annual gift tax exclusion would remain part of the law.

This new law would have a dramatic impact on traditional gifting/life insurance trusts that are "loaded up" with beneficiaries. Crummey trusts would be eliminated. For big premium policies, alternative funding strategies will be necessary and critical. It may even make sense to make large loans to insurance trusts now in order to pay premiums later. Or maybe annual exclusion gifts to fund policies will need to be made to children and grandchildren outright, who could use those gifts to fund an LLC that would purchase and own the policy, which would be payable to the members when the insured dies.

LIFE INSURANCE PLUG #3 – A GOOD INSURANCE PROFESSIONAL WILL COMPARE THE PROS AND CONS OF ANNUAL PREMIUMS VERSUS A FULLY PAID-UP POLICY. NOW MAY BE THE TIME TO PURCHASE A PAID-UP POLICY, PARTICULARY IF THE USE OF CRUMMEY BENEFICIARIES WILL BE ELIMINATED UNDER THIS NEW RULE AND OTHER FUNDING OPTIONS ARE NOT AVAILABLE. INDEED, THIS MAY BE A GOOD WAY TO USE THE BALANCE OF AN INDIVIDUAL'S GIFT TAX EXEMPTION BEFORE IT IS REDUCED.

The "STEP" Act

On March 29, 2021, Senator Chris Van Hollen (MD), Senator Cory Booker (NJ), Senator Bernie Sanders (VT) and Senator Sheldon Whitehouse (RI) introduced the "Sensible Taxation and Equity Promotion (STEP) Act" (also referred to as the "STEP Act"). The provisions are discussed below.

1. <u>Elimination of step-up in basis at death.</u> In general, the bill proposes that property should be treated as sold for its fair market value when transferred by gift, bequest or to a non-grantor trust.

This is essentially the Canadian system, which treats death as a recognition event for income tax purposes. This rule, combined with a higher capital gains rate, as proposed by President Biden during his campaign, could be a significant revenue raiser. Moreover, it is problematic from the perspective of liquidity, as death would be a "deemed" sale, meaning there may not be a sufficient amount of cash to pay the tax, which could cause a sale of assets that would otherwise not be made. Finally, some view this rule as an administrative burden because basis information for certain assets may not be available. Indeed, Congress has gone down this path twice before in a modified way. First, in 1976, Congress instituted a carryover basis regime, but after sharp criticism from financial institutions, Congress deferred its effective date and ultimately repealed the law. Second, the carryover basis regime did become law in 2010 when the estate tax was repealed (temporarily). From a planning perspective, perhaps when death will occur in the short term, it may make sense to accelerate gain at lower tax rates and, perhaps even consider the state taxes that could be avoided based on domicile.

2. <u>Special Rules for Trusts:</u>

    a. <u>Grantor Trusts</u>: Property will be not treated as sold when assets are transferred between grantors and grantor trusts. Instead, grantor trust property will be deemed to be sold when the assets are transferred to another person, when the grantor dies or when the grantor is no longer treated as the owner of the trust. Additionally, property transferred to or held by a grantor trust will be treated as sold if such property would no longer be included in the owner's estate for estate tax purposes.

This new law would limit the effectiveness of intentionally defective grantor trusts for the purpose of deferring realization on gifts.

    b. <u>Non-Grantor Trusts:</u> Property held by a non-grantor trust will be treated as sold for its fair market value every 21 years after the establishment of the trust. As a transition rule, trusts

established earlier than December 31, 2005 will have their first deemed realization in 2026.

3. Exceptions and Other Special Rules: Exceptions to the general rules under the bill are included for tangible personal property, transfers to spouses, transfers to charities, charitable trusts, qualified disability trusts and cemetery perpetual care funds.

   a. Tangible Property: Tangible personal property other than a collectible (as defined in IRC Section 408(m)), which is not held in connection with a trade or business, or for any purpose described in IRC Section 212, is excepted from deemed realization of gain at the time of gift or death of the transferor.

   b. Spousal Exception: If a transfer is made to the spouse or surviving spouse of the transferor, or if a transfer consists of qualified terminal interest property or of property to which IRC Section 2056(b)(5) or 2523(e) applies, such transfers are excepted from deemed realization of gains at the time of gift or death of the transferor. Instead, the realization of gain for qualified terminal interest property or of property to which IRC Section 2056(b)(5) or 2523(e) applies is recognized on the earlier of the date of the disposition of such property by such spouse or surviving spouse or the date of death of such spouse or surviving spouse. Importantly, the spousal exemption does not apply if the spouse or surviving spouse of the decedent is not a citizen or long-term resident of the U.S. In order for the exception to apply, the spouse must be a U.S. citizen and long-term resident, who would be subject to the existing deemed realization rules under IRC Section 877A if they subsequently expatriated.

   c. Gifts and Bequests to Charity: An exception is permitted for transfers made to or for the use of an organization described in IRC Section 170(c).

   d. Qualified Disability Trusts and Cemetery Perpetual Care Funds: An exception is granted for any qualified disability trust (as defined in IRC Section 642(b)(2)(C)(ii)) or any cemetery perpetual care fund described in IRC Section 642(i).

4. Treatment of Basis for Gifts and Bequests to Which Tax Applies: IRC Section 267 disallows losses for transfers to related parties. This bill proposes to apply this rule when assets are transferred by gift, but not at death. Carryover basis is eliminated, except for spouses and charities. Since built-in gains would be taxed at the time of gift or bequest under the bill, the transferee's basis in the property receives a step-up in basis equal to the value that was taxes at the time of transfer.

5. Reporting Requirements: Any Trust with (1) an aggregate value of assets on the last day of the taxable year in excess of $1,000,000, or (2) gross income for the taxable year in excess of $20,000, must report a full and complete accounting of all trust activities and operation for the year and the name, address and TIN of the trustee, the grantor and each beneficiary of the trust.

Essentially, the bill imposes a reporting requirement on domestic trusts similar to existing reporting requirements for existing foreign trusts with U.S. owners.

6. Exclusions and Deductions: Retirement accounts are not subject to capital gains tax (taxed as ordinary income), and, therefore, are not impacted by the bill. The exclusion for the sale of a principal residence of $250,000 ($500,000 if married) still applies to property treated as sold under the bill. Capital gains tax liability incurred as a result of the bill would be deductible from a decedent's estate for estate tax purposes.

7. Exclusion of Gain From Transfers of Certain Appreciated Assets. Individuals are provided with a $1,000,000 exclusion from tax under the bill for unrealized gains at death. In any taxable year ending before the date of the taxpayer's death, an individual may draw down $100,000 of their $1,000,000 exclusion for lifetime gifts, with any remaining amount available at death. The exclusion is adjusted for inflation.

8. Deduction for Costs of Appraisal of Appreciated Assets. The bill proposes to permit an itemized deduction for costs paid or incurred

with respect to the appraisal of any property which is treated as sold during the year by reason of IRC Section 1261 (gift or death).

9. Extension of Time for Payment of Tax. The tax on gains of assets, other than personal property of a type which is actively traded (within the meaning of IRC Section 1092(d)(1)), that are deemed to be sold under this bill may be paid over a 15-year period. The 15-year option is only available for realizations at death or under the 21-year rule for non-grantor trusts. A decedent's estate or a non-grantor trust could pay only interest for up to 5 years, and then pay the tax and interest for a maximum of 10 annual installments.

LIFE INSURANCE PLUG #4 – IF THIS RULE IS IMPLEMENTED, IT SHOULD BE A BONANZA FOR THE LIFE INSURANCE INDUSTRY. LIFE INSURANCE PROCEEDS ARE GENERALLY NOT SUBJECT TO INCOME TAX UPON DEATH OF THE INSURED AND THERE ARE NO STEP-UP RULES (OR LACK THEREOF) TO WORRY ABOUT.

The Mechanics of Getting a Tax Bill Passed

The legislative process can be complicated and, while the Democrats control the Congress, passing tax legislation is easier said than done. Thus, given the probability that there will be tax legislation this year, as is usually the case with a new administration, we thought it would be helpful to summarize the process.

Like all legislative proposals, the "For the 99.5% Act" and the "STEP Act" would first need to be passed through the U.S. House of Representatives and then through the U.S. Senate before being signed into law by the President. With Democrats holding a majority of seats in both the House and the Senate for the first time since 2010, this path to enactment will have less friction than in years past. However, there are still some limitations to what they can enact without bipartisan support and when they can enact it.

1. Number of Votes Required to Pass. The U.S. House of Representatives requires a simple majority to pass legislation. The majority of bills proposed in the U.S. Senate, however, require a 60-vote super-majority in order to pass due to the legislative filibuster. The filibuster permits a senator, or senators, to openly debate

proposals for as long as they wish before being brought to a vote. Under current U.S. Senate rules, 60 votes are required in order to end debate on a bill and overcome a filibuster. Once the debate is ended by the 60-vote super-majority, only a simple majority is required to pass legislation in the U.S. Senate.

With Democrats holding a simple majority in the U.S. Senate (by virtue of party lines and the tie-breaker going to Vice-President Harris), there has been some speculation as to whether or not they can and will reform or eliminate the filibuster. If the legislative filibuster is eliminated, all measures could pass with a simple majority, without the need to overcome the initial 60-vote hurdle. This would, of course, increase the likelihood of all Democratic legislation being passed, including the 99.5% Act and the STEP Act.

While support for filibuster reform is growing among Democratic Senators, it looks unlikely that it has much of a chance at succeeding. In order to reform or eliminate the filibuster, Democrats would need to have all members of their party in favor of creating a new Senate precedent. Three Democratic Senators have vocally opposed these changes—Joe Manchin[iv] *(D-W.Va.), Kyrsten Sinema (D-Ariz.) and Pat Leahy (D-Vt.). Without unanimous Democratic support, the 60-vote filibuster hurdle will remain in place for most, but not all, proposals.*

2. Budget Reconciliation. There is, however, a notable exception to the 60-vote filibuster hurdle in the Senate: budget reconciliation is not subject to the filibuster and can pass with a simple majority of 51 votes. With Democrats holding 50 seats of the U.S. Senate, budget reconciliation has already proven to be a powerful measure of passing fiscal legislation quickly (as seen with the passage of The American Rescue Plan Act of 2021 after a 51-50 vote in the U.S. Senate and a party-line simple majority in the U.S. House).

   As it stood, Democrats had two options to pass legislation through budget reconciliation in 2021: first, to determine the budget for fiscal year 2021 and, second, to determine the budget for fiscal year 2022 (which begins on October 1, 2021). Recently, however, the parliamentarian, Elizabeth MacDonough, announced that Democrats could have a chance at a third budget reconciliation bill this year. Her decision is based on her interpretation of Section 304 of the

Congressional Budget Act of 1974, which allows lawmakers to revise budget resolutions in the same fiscal year that the budget covers.

While previously Democrats would have had to wait until October at the earliest to attempt passing legislation through budget reconciliation, the parliamentarian's decision now opens the door for Democrats to introduce the "For the 99.5% Act" and/or the "STEP Act" as part of a revised 2021 budget prior to their passage of the fiscal year 2022 budget resolution, without the need for bipartisan support.

Conclusion:

The bottom line for estate planning professionals is that if these pieces of legislation pass in current form or modified form, the planning landscape will change dramatically. Assuming that change in the exemptions and rates would have an effective date on January 1, 2022, and that the other changes in the law would be effective on the date of enactment, planners should be proactive with their clients to seize on the favorable exemptions, rates and laws that are still available.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Andy Katzenstein
David Pratt
Brett Rosecan
Brittany Newell

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CITATIONS:

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[i] Indeed, on January 26, 2021, Mark Mazur, the Treasury Department's deputy assistant secretary for tax policy, indicated that the Biden administration was not actively considering retroactive tax increases.

[ii] See https://joebiden.com/plans-to-support-women-duringcovid19.

[iii] See Joy Matak, Sandra D. Glazier & Martin M. Shenkman: An Estate Planning Six-Part Series for Late 2020, Estate Planning Newsletter #s 2840, 2841, 2842 and 2848; A Client Letter from Barry Nelson: Time Running Out on Year End Planning, LISI Estate Planning Newsletter #2824.

[iv] See https://www.washingtonpost.com/opinions/joe-manchin-filibuster-vote/2021/04/07/cdbd53c6-97da-11eb-a6d0-13d207aadb78_story.html