Legislative Update: Biden Administration Priorities, Senator Sanders' Proposals, and Deemed Sales upon Gifts and at Death

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1. Insights from President Biden's Campaign

a. In General

President Biden desires to reverse or roll back many of the 2017 changes. Beginning in his campaign, he has spoken of his desire to "Build Back Better" by increasing the corporate income tax rate from 21% to 28% and increasing individual income taxes for annual incomes over $400,000, including an increase in the top rate from 36% to 39.6% and taxation of capital gains at the same rates as ordinary income for individuals with taxable incomes over $1 million.

b. Estate, Gift, and GST Taxes

His campaign website (**https://joebiden.com/plans-to-support-women-duringcovid19/**), under the topic of "Highlights of Joe Biden's Plans to Support Women During the COVID-19 Crisis," stated:

> **Permanently provide family, medical, and safe leave as well as sick and safe days.** As President, Biden will work to provide the type of comprehensive 12 weeks of paid family and medical leave envisioned in the FAMILY Act sponsored by Senator Kristen Gillibrand and Representative Rosa DeLauro. Biden will pay for this proposal by returning the estate tax to 2009 levels.

Similarly, the "Greenbook" revenue proposals of the Obama Administration, beginning in 2013, had proposed to return the estate, gift, and GST taxes to their 2009 levels, which included a top 45 percent rate and non-indexed but portable exemptions of $3.5 million for the estate and GST taxes and $1 million for the gift tax.

c. Treatment of Appreciation at Death

In connection with the taxation of capital gains as ordinary income, President Biden has also referred to the step-up in basis, likely meaning the step-up for appreciated assets that pass from a decedent. Although, again, he has offered few details, insight may be gained from the final two Greenbooks of the Obama Administration, in 2015 (pages 156-57) and 2016 (pages 155-56), which, under the general heading of "Reforms to Capital Gains Taxation, Upper-Income Tax Benefits, and the Taxation of Financial Institutions," include a proposal labeled simply "Reform the Taxation of Capital Income." In addition to increasing the rate of tax on capital gains in general (although not as high as the rate on ordinary income), that proposal would treat the transfer of appreciated property at death (as well as by lifetime gift) as a realization event, subjecting the appreciation to income tax. That proposal was even featured in President Obama's State of the Union Address on January 20, 2015.

Additional details of the Obama Administration's 2015 and 2016 proposals included:

(1) Gifts or bequests to a spouse or charity would not be taxed, but the spouse or charity would take a carryover basis in the asset.

(2) Tangible personal property such as household furnishings and personal effects, but not collectibles, would be exempt.

(3) The gain would be taxable to a donor in the year a gift is made, and to a decedent either on the final individual return or on a separate capital gains return.

(4) Each taxpayer would be allowed an additional exclusion of capital gains at death of up to $100,000 (indexed for inflation), and each person's $250,000 exclusion of capital gain on a principal residence would be extended to all residences. Both of these exclusions would be portable to the decedent's surviving spouse "under the same rules that apply to portability for estate and gift tax purposes."

(5) Taxation of the appreciation in the value of certain small family-owned and operated businesses (no further details given) would be deferred until the business is sold or ceases to be family-owned and operated.

(6) A "15-year fixed-rate payment plan" would be allowed for the tax on appreciated illiquid assets transferred at death.

(7) The Greenbooks clarified that the income tax on capital gains deemed realized at death would be deductible for estate tax purposes.

(8) Showing acknowledgment of the complexities involved, the Greenbooks added the following:

> The proposal also would include other legislative changes designed to facilitate and implement this proposal, including without limitation: the allowance of a deduction for the full cost of appraisals of appreciated assets; the imposition of liens; the waiver of penalty for underpayment of estimated tax if the underpayment is attributable to unrealized gains at death; the grant of a right of recovery of the tax on unrealized gains; rules to determine who has the right to select the return filed; the achievement of consistency in valuation for transfer and income tax purposes; and a broad grant of regulatory authority to provide implementing rules.
>
> To facilitate the transition to taxing gains at death and gift, the Secretary would be granted authority to issue any regulations necessary or appropriate to implement the proposal, including rules and safe harbors for determining the basis of assets in cases where complete records are unavailable.

2. "For the 99.5 Percent Act" Introduced by Senator Sanders

a. **The "For the 99.5 Percent Act."** On March 25, 2021, Senator Bernie Sanders (I-Vermont) introduced S. 994, titled "For the 99.5 Percent Act," an updated compilation of legislative proposals he and Democrats have been offering for many years regarding the estate, gift, and GST taxes and related grantor trust income tax issues. Senator Sanders has introduced a bill like this in every Congress since 2010, when he named it the "Responsible Estate Tax Act" (S. 3533, 111th Cong., June 24, 2010). The bill includes, but is not limited to, adaptations of proposals in the Treasury Department's "General Explanations" (popularly called "Greenbooks") of revenue provisions in the budget proposals of the Obama Administration and even the Clinton Administration. A companion bill (H.R. 2576) was introduced in the House of Representatives on April 15, 2021, by Congressman Jimmy Gomez (D-California).

b. Senator Sanders' proposals will be important to his Democratic colleagues as a source for ideas if comprehensive estate tax reform becomes a priority and political possibility. One reason for that is simply that his proposals have been written – that is, reduced to statutory wording – and they are "out there" or "on the shelf" for lawmakers to incorporate into whatever other legislation happens to be popular at the time. These proposals are distinguished in that respect from some other more fundamental ideas that are offered from time to time, such as a "wealth tax" that would have to be analyzed, modeled, written, and refined and might still face years of uncertainty about its scope, operation, and constitutionality.

c. Senator Sanders' bill is important for another reason. Drafted legislation like this can be the source for fillers in the legislation of the day, for Republicans as well as Democrats, particularly a revenue-raiser that has just the right revenue estimate to "pay for" other legislation. That is exactly what happened when "Consistent Basis Reporting Between Estate and Person Acquiring Property from Decedent" was added to the Surface Transportation and Veterans Health Care Choice Improvement Act (Public Law 114-41) by a Republican-controlled Congress in July 2015. It raised just the right amount of money to fund a desired extension of the Highway Trust Fund that was scheduled to expire on the day President Obama signed the Act into law. Significantly, the first introduced statutory wording for the consistent basis provision had been section 6 of Senator Sanders' "Responsible Estate Tax Act" of 2010.

(1) **Short Title.** The title, "For the 99.5 Percent Act," is changed from "For the 99.8 Percent Act," which Senator Sanders introduced in the last Congress, on January 31, 2019.

(2) **Modifications to Rates and Exemptions.** Section 2 of the "For the 99.5 Percent Act" would raise rates and lower exemptions.

(a) The marginal estate and gift tax rate would be increased to

i. 45 percent (the top rate in 2007 through 2009 under the 2001 Tax Act signed by President George W. Bush), from \$3.5 million to \$10 million,

ii. 50 percent (the top rate in 2002 under the 2001 Tax Act), from \$10 million to \$50 million,

iii. 55 percent (the top rate achieved in 1984 through 2001 under the 1981 Act signed by President Reagan), from $50 million to $1 billion, and

iv. 65 percent (the top estate tax rate in effect in 1982; this is down from 77 percent in Senator Sanders' 2019 bill) over $1 billion.

(b) The basic exclusion amount would be reduced to

i. $3.5 million, not indexed, for estate tax purposes and

ii. $1 million, not indexed, for gift tax purposes.

(c) Portability would be retained for both estate and gift tax purposes.

(d) A detailed set of "anti-clawback" rules that had been included in Senator Sanders' 2019 bill is omitted, perhaps simply in recognition of the fact that the anti-clawback regulations have now been finalized, with an "anti-abuse" refinement (which Senator Sanders would presumably favor) in progress.

(e) The bill says nothing about the GST tax, which apparently would make the GST tax rate 65 percent and the GST exemption $3.5 million.

(f) These proposals would "apply to estates of decedents dying, and generation-skipping transfers and gifts made, after December 31, 2021." This is consistent with the effective dates in Senator Sanders' previous bills and reflects a long-observed drafting principle (or at least drafting preference) for estate and gift tax changes. Presumably, pursuant to that preference, if this legislation were enacted, for example, in 2022, the reference to 2021 would be changed to 2022, making the effective date January 1, 2023.

(3) **Value of Farm, etc. Real Property.** Section 3, like section 4 of the 2010 "Responsible Estate Tax Act," would, effective January 1, 2022, increase the cap on the reduction in value under the special use valuation rules of section 2032A from $750,000 ($1.19 million in 2021, after indexing since 1998) to $3 million, indexed for inflation going forward from 2022.

(4) **Land Subject to Conservation Easements.** Section 4, like section 5 of the 2010 "Responsible Estate Tax Act," would, effective January 1, 2022, increase the maximum exclusion from the gross estate under section 2031(c) by reason of a conservation easement from the lesser of $500,000 or 40 percent of the net value of the land to the lesser of $2 million or 60 percent of the net value of the land.

(5) **No Step-up in Basis for Assets in Grantor Trusts.** Section 5 would add a new section 1014(f) (redesignating the current section 1014(f) as 1014(g)), providing that property "held in a trust of which the transferor is considered the owner under subpart E of part I of subchapter J" would not receive a new basis at the deemed owner's death if "such property is not includible in the gross estate of the transferor for purposes of chapter 11." Although subpart E includes section 678, which treats "[a] person other than the grantor" as the owner of part or all of a trust, it seems that the reference in this bill to "the transferor" is intended to exclude section 678 deemed owners.

(a) This amendment would "apply to transfers after the date of the enactment of this Act." That would evidently apply to grantor trusts created and funded after enactment. It is less clear how it would apply to transfers to a trust after its initial funding, including perhaps transfers involving sales or exchanges with an existing trust.

(b) Section 5 of Senator Sanders' 2019 bill would have extended the "consistent basis" rules of section 1014(f) and the accompanying reporting rules of section 6035(a) to property received by gift. That provision is omitted from this year's bill, although it presumably would be moot to the extent other legislation taxes unrealized appreciation upon gift or death.)

(6) **Valuation of Nonbusiness Assets; Limitation on Minority Discounts.** Section 6 is titled "Valuation Rules for Certain Transfers of Nonbusiness Assets; Limitation on Minority Discounts." It is almost identical to section 7 of Senator Sanders' 2010 "Responsible Estate Tax Act."

(a) Section 6 is also similar to section 276 of H.R. 3874, introduced in March 2000 by Rep. Charles Rangel of New York, the Ranking Democrat on the House Ways and Means Committee, to implement a legislative proposal in the 1998 Clinton Administration's "Greenbook." And it is almost identical to section 303 of H.R. 1264, introduced by Rep. Rangel in March 2001 as an alternative to the Republican proposals that became the 2001 Tax Act, and to three bills subsequently introduced by Rep. Earl Pomeroy (D-North Dakota): H.R. 5008 in June 2002, H.R. 1577 in April 2005, and H.R. 4242 in November 2007.

(b) The bill would add a new section 2031(d)(1) to the Code, applicable to transfers after the date of enactment, to read as follows:

> (d) Valuation Rules for Certain Transfers of Nonbusiness Assets—For purposes of this chapter and chapter 12—
>
> (1) In General—In the case of the transfer of any interest in an entity other than an interest which is actively traded (within the meaning of section 1092) [*see* Reg. §1.1092(d)-1(a) & (b)]—
>
> (A) the value of any nonbusiness assets held by the entity with respect to such interest shall be determined as if the transferor had transferred such assets directly to the transferee (and no valuation discount shall be allowed with respect to such nonbusiness assets), and
>
> (B) such nonbusiness assets shall not be taken into account in determining the value of the interest in the entity.

The bill includes detailed rules about "passive assets" that might be used in a business and "look-thru rules" for entities that are at least 10 percent owned by another entity.

(c) The bill would also add a new section 2031(e), to read as follows:

> (e) Limitation on Minority Discounts—For purposes of this chapter and chapter 12, in the case of the transfer of any interest in an entity other than an interest which is actively traded (within the meaning of section 1092), no discount shall be allowed by reason of the fact that the transferee does not have control of such entity, or by reason of the lack of marketability of the interest, if the transferor, the transferee, and members of the family (as defined in section 2032A(e)(2)) of the transferor and transferee—
>
> (1) have control of such entity, or
>
> (2) own the majority of the ownership interests (by value) in such entity.

The words "or by reason of the lack of marketability of the interest" are new in this year's version. Simply stated, the objectives of the proposed new section 2031(e) are to attribute control among family members and to presume control from majority ownership, without exception, apparently not even an exception for an active trade or business. Both objectives will undoubtedly be viewed as unrealistic in many contexts, especially in the context of an active trade or business.

(7) **Grantor Retained Annuity Trusts.** Section 7 mirrors the proposals of the Obama Administration's Greenbooks regarding GRATs, generally in the form in which those proposals solidified in the 2015 and 2016 Greenbooks.

(a) Like the 2015 and 2016 Greenbooks, the bill, applicable to transfers after the date of enactment, would require any GRAT to

i. have a term no shorter than 10 years (the proposal in the original 2009 Obama Administration Greenbook),

ii. prohibit any decrease in the annuity during the GRAT term (a proposal added in the 2010 Greenbook),

iii. have a term no longer than the life expectancy of the grantor plus 10 years (a proposal added in the 2012 Greenbook), and

iv. have a remainder interest with a value for gift tax purposes when the GRAT is created equal to at least 25 percent of the value of the assets contributed to the GRAT or $500,000, whichever is greater (but not greater than the total value of the assets contributed) (a proposal added in the 2015 Greenbook).

(b) Section 8 of Senator Sanders' 2010 "Responsible Estate Tax Act" had included only the minimum 10-year term and the prohibition on decreases in the annuity, reflecting only the 2009 and 2010 Greenbooks that had been published before then.

(c) The 2015 Greenbook had also added that "the proposal … would prohibit the grantor from engaging in a tax-free exchange of any asset held in the trust." That would diminish the availability of some techniques for managing long-term GRATs. The "For the 99.5 Percent Act" omits that proposal.

(8) **Grantor Trusts in General.** Similarly, section 8 mirrors the proposals of the Obama Administration's Greenbooks regarding grantor trusts and provides proposed statutory language for those proposals, also generally following the 2015 and 2016 Greenbooks.

(a) The bill would add to the Code a new chapter 16 (titled "Special Rules for Grantor Trusts"), containing a single section 2901 (titled "Application of Transfer Taxes").

(b) Section 2901 would apply to any portion of a trust if

i. the grantor is the deemed owner of that portion under subchapter J, or

ii. a person other than the grantor is the deemed owner of that portion under subchapter J, if that person "engages in a sale, exchange, or comparable transaction with the trust that is disregarded for purposes of subtitle A [the federal income tax subtitle]," to the extent of "the portion of the trust attributable to the property received by the trust in such transaction, including all retained income therefrom, appreciation thereon, and reinvestments thereof, net of the amount of consideration received by the deemed owner in such transaction." (This second category appears to target the techniques known as "BDITs" and perhaps some "BDOTs," whether as a matter of tax policy or simply to crack down on techniques known to be in use.)

(c) Tracking the Obama Administration Greenbooks, section 2901 would

i. include the value of the assets of such portion in the gross estate of the deemed owner for estate tax purposes,

ii. subject to gift tax any distribution from such portion to one or more beneficiaries [presumably beneficiaries other than the deemed owner] during the deemed owner's life, and

iii. treat as a gift by the deemed owner, subject to gift tax, all assets of such portion at any time during the deemed owner's life that the deemed owner ceases to be treated as the owner of such portion for income tax purposes.

(d) Section 2901 would reduce the amount thereby subject to estate or gift tax by "the value of any transfer by gift by the deemed owner to the trust previously taken into account by the deemed owner under chapter 12." This is not an exception for the **portion** of the trust attributable to such a taxable gift; it is a "reduction" by the amount reported as a gift. In other words, section 2901 would "freeze" the amount excluded from its reach at its initial gift tax value (thus targeting "leveraged" transfers).

(e) Section 2901 provides that it "shall not apply to any trust that is includible in the gross estate of the deemed owner (without regard to [section 2901])." (An additional exception in Senator Sanders' 2019 bill for "any other type of trust that the Secretary determines by regulations or other guidance does not have as a significant purpose the avoidance of transfer taxes" is omitted from his 2021 bill.)

(f) Section 2901 would provide that "[a]ny tax imposed by [section 2901] shall be a liability of the trust." It does not specify whether any such tax, especially estate tax, would be calculated at the average or marginal tax rate, or in some other way.

(g) Section 2901 would apply to

i. trusts created on or after the date of enactment,

ii. any portion of a trust attributable to a contribution on or after the date of enactment to a trust created before the date of enactment, and

iii. any portion of a trust created before the date of enactment if a sale, exchange, or comparable transaction referred to in paragraph (b)ii above occurs on or after the date of enactment.

(h) There is considerable overlap in the effects of sections 5 and 8 of this bill. In general, section 5 appears to provide that there is no stepped-up basis at death for assets in a grantor trust if the value of those assets is not included in the decedent's gross estate, while section 8 appears to ensure that there are no such trusts by including the value of the assets of all grantor trusts in the gross estate. There are some differences, such as the application to section 678 deemed owners, the exception for "any trust that is includible in the gross estate of the deemed owner (without regard to [section 2901])," the possible application to foreign trusts, the effect of transactions between the trust and the deemed owner after the effective date, and even a one-day difference in the effective date itself (section 5 would apply "after" the date of enactment while section 8 would apply "**on or** after" the date of enactment). But, in the main, it appears that there is a lot of redundancy between these two sections, which tends to reinforce the narrative that this bill has been put together with a view toward making it easy for one or more, but not all, of the individual provisions of this bill to be "pulled off the shelf" to serve a targeted policy or revenue purpose in the consideration of legislation on almost any subject.

(9) **Elimination of GST Exemption for Certain Long-Term Trusts.** Section 9 would mandate an inclusion ratio of one for any trust that is not a "qualifying trust." A "qualifying trust" is "a trust for which the date of termination of such trust is not greater than 50 years after the date on which such trust is created."

(a) This recalls a similar proposal in the Obama Administration's Greenbooks, but would be significantly more aggressive. It would use a period of 50 years (rather than 90 years as in the Greenbooks) and would mandate an inclusion ratio of one from the beginning of a trust (rather than resetting the inclusion ratio to one on the 90th anniversary), thus apparently without any "wait and see" relief.

(b) A trust created before the date of enactment with an inclusion ratio less than one would be allowed to keep that inclusion ratio for 50 years after enactment, and then the inclusion ratio would be reset to one.

(c) Special rules would be provided for portions of trusts treated as separate trusts (see section 2654(b)(1) and Reg. §26.2654-1) and for transfers between trusts.

(10) **"Simplifying" Gift Tax Exclusion for Annual Gifts.** Section 10 would significantly limit the availability of the gift tax annual exclusion, effective January 1, 2022. It would implement a similar proposal in the Obama Administration Greenbooks, from which it borrows the characterization of "simplifying."

(a) Like the Greenbooks, the bill would introduce a **per-donor** limit on the annual exclusion, as a further limitation on the $10,000 (indexed for inflation since 1998) **per-donee** exclusion of current law.

(b) While the per-donor limit in the Greenbooks would have been $50,000 (indexed for inflation), the "For the 99.5 Percent Act" would set the annual per-donor limit at twice the per-donee limit, currently $30,000 (also indexed for inflation).

(c) Like the Greenbooks, the bill would impose this new limitation on transfers in trust (without an exception for trusts described in section 2642(c)(2)), transfers of interests in passthrough entities, transfers of interests subject to a prohibition on sale, and other transfers of property that, without regard to withdrawal, put, or other such rights in the donee, cannot immediately be liquidated by the donee.

(d) Like the Greenbooks, the bill would leave in place the per-donee annual exclusion (currently $15,000), for example for outright gifts of cash or marketable securities.

(e) The bill would repeal section 2503(c), which now provides a special way that a trust for a minor can qualify as a present interest.

(f) As in the Greenbook proposals, the new $30,000 per-donor limit would apply to all transfers in trust, but apparently would not include a present-interest requirement at all, although it apparently would still require identification of donees to apply the $15,000 per-donee limit.

(g) The bill would not change the unlimited exclusion in section 2503(e) for tuition and medical expenses paid directly to the provider.

(h) The bill would not change the gift-splitting rules in section 2513.

3. Deemed Realization Proposals

a. **Legislation Introduced and Under Discussion.** On March 29, 2021, Ways and Means Committee Member Bill Pascrell, Jr. (D-New Jersey) introduced H.R. 2286, described as a bill "to amend the Internal Revenue Code of 1986 to treat property transferred by gift or at death as sold for fair market value, and for other purposes." On the same day, Senator Chris Van Hollen (D-Maryland), joined by Senators Cory Booker (D-New Jersey), Bernie Sanders (I-Vermont), Sheldon Whitehouse (D-Rhode Island), and Elizabeth Warren (D-Massachusetts), issued a statement calling "the Stepped-Up Basis Loophole" "one of the biggest loopholes in the U.S. tax code, which subsidizes America's wealthiest heirs," citing a Joint Committee on Taxation estimate that it will cause a loss of $41.9 billion of tax revenue in 2021 alone. The statement was accompanied by 32 pages of statutory language titled the "Sensible Taxation and Equity Promotion ("STEP") Act of 2021," with the acronym of "STEP" evidently designed to recall the "step-up" in basis that it attacks.

b. **Effective Dates.** A conspicuous and significant difference between Congressman Pascrell's H.R. 2286 and Senator Van Hollen's "discussion draft" of the "STEP Act" is their effective dates.

H.R. 2286 would apply to gifts and transfers made, including transfers from decedents dying, after December 31, 2021. As discussed in the context of section 2 of Senator Sanders' "For the 99.5 Percent Act" in Part 2.c(2)(f) above, that is the typical effective date for broad changes in the taxation of transfers by gift and at death, although other provisions of the Sanders bill itself show how the date of enactment can be a typical effective date for changes to the tax treatment of particular transactions or structures.

For the Senate discussion draft, the corresponding date would be December 31, 2020. In other words, it would be uncharacteristically retroactive to the beginning of 2021. This could be a portent of less deference to conventional effective-date norms in the political climate of the current Congress. Or it could mean only that Congressman Pascrell, as a member of the Ways and Means Committee, has received more technical assistance from staff members who understand the historical and practical preferences for avoiding retroactivity. Or it could mean that a "discussion draft" is only that.

Both proposals would tax past appreciation, not just appreciation following enactment. This contrasts with the 1969 proposed "Taxation of Appreciation of Assets Transferred at Death or by Gift," which stated that "[o]nly appreciation occurring after the date of enactment would be subject to tax." "Tax Reform Studies and Proposals, U.S. Treasury Department," Joint Publication of the House Committee on Ways and Means and Senate Committee on Finance, at 335 (91st Cong., 1st Sess., Feb. 5, 1969). It also contrasts with the 1976 enactment (which proved to be temporary) of carryover basis, which provided a "fresh start" valuation on December 31, 1976, and a proration of appreciation over the entire holding period of nonmarketable assets acquired before that date. Section 1023(h), added by section 2005(a)(2) of the Tax Reform Act of 1976, Public Law 94-455 (94th Cong., 2d Sess., Oct. 4, 1976). Interestingly, it does not contrast as sharply with the "aggregate basis increase" and "spousal property basis increase" provided by the second (also temporary) enactment of carryover basis in 2001, taking effect in 2010, which was not as clearly tailored to sheltering pre-enactment appreciation. Section 1022(b) and (c), added by section 542(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16 (107th Cong., 1st Sess., June 7, 2001).

c. **Deemed Sale Rule of New Section 1261.** The proposals would add a new section 1261 to the Code, generally treating any property transferred by gift or at death as sold for its fair market value on the date of the gift or death. Both proposals appear to contemplate that the gain on deemed sales at death would be reported on the decedent's final income tax return (Form 1040), or a supplement to it, but they do not say that.

d. **Exception for Tangible Personal Property.** The deemed sale rules would not apply to transfers of tangible personal property other than collectibles (including coins and bullion) and property held in connection with a trade or business. H.R. 2286 adds property held for investment, and the STEP Act adds property related to the production of income under section 212, to the coverage of the deemed sale rules.

e. **Exception for Transfers to Spouses.** A transfer to the spouse of a transferor or surviving spouse of a decedent would be exempt from this deemed sale treatment if the spouse is a U.S. citizen (or long-term resident under the STEP Act), essentially deferring sale treatment until the spouse disposes of the asset.

Under H.R. 2286, this exemption is extended to a "qualifying spousal trust," which is defined as a qualified domestic trust ("QDOT") of which the transferor's spouse or surviving spouse is the sole current income beneficiary and has the power to appoint the entire trust. Under the STEP Act, this exemption is extended to a QTIP trust. Awkwardly, the STEP Act describes a QTIP trust as "qualified terminal [*sic*, not "terminable"] interest property." Also awkwardly, H.R. 2286 incorporates the QDOT definition of section 2056A, even though the spouse must be a U.S. citizen to qualify for the deemed sale exception in H.R. 2286 in the first place. That could conceivably even require any ordinary QTIP trust for a U.S. citizen spouse to mandate the withholding under section 2056A(a)(1)(B) of estate tax payable with respect to distributions, for example (or, channeling it into the deemed sale context, withholding the income tax on unrealized appreciation avoided by the transfer to the trust), although there is no indication that such an odd result is intended or would serve any purpose of this proposed legislation. And a strict application of the "qualifying spousal trust" rules in H.R. 2286 would also require the spouse to have the power to appoint the entire trust, which is not normal in an ordinary QTIP trust.

Property transferred in such an exempt transfer to an eligible trust for the benefit of the transferor's spouse or surviving spouse would be subject to the deemed sale rules (1) upon a distribution from the trust to someone other than the spouse, (2) upon the cessation of the trust's status as an eligible trust, or (3) upon the spouse's death.

f. **Exception for Transfers to Charity.** A transfer to a charity or another organization described in section 170(c) would not be a deemed sale. The STEP Act adds explicit exemptions for (1) a trust in which property is set aside for such an organization (subject to annuity, unitrust, and other valuation rules of section 2702), (2) a qualified disability trust defined in section 642(b)(2)(C)(ii), and (3) a cemetery perpetual care fund described in section 642(i).

g. **Other Estate-Includible Grantor Trusts.** In the case of a transfer to a trust is that is **both** deemed owned by the transferor under subpart E of part 1 of subchapter J (commonly called generically the "grantor trust rules") **and** includible in the transferor's gross estate, **the deemed sale would occur**, not when the property is transferred to the trust, but when:

(1) a distribution is made to a person other than the deemed owner,

(2) the transferor ceases to be the deemed owner of the trust (including, apparently, upon the transferor's death), or

(3) the trust ceases to be includible in the gross estate of the transferor (oddly, in H.R. 2286, explicitly including upon the transferor's death).

h. **Other, Non-Includible, Grantor Trusts. Under the STEP Act,** in the case of other deemed-owned trusts (except the spousal, charitable, disability, and cemetery care trusts discussed above) – that is, a deemed-owned trust that is not includible in the transferor's gross estate – **the deemed sale would apparently occur**:

(1) when a transfer is made to the trust,

(2) when a distribution is made to a person other than the deemed owner,

(3) when the transferor ceases to be the deemed owner of the trust, or

(4) upon the death of the transferor.

This type of trust is commonly called a "defective grantor trust." The treatment of a transfer to the trust, a distribution from the trust, the termination of grantor trust status, and the death of the transferor as deemed realization events, in effect overturning Rev. Rul. 85-13, 1985-1 C.B. 184, would likely be viewed as quite harsh.

i. **Non-Grantor Trusts.** In the case of other trusts – that is, a trust that is not deemed owned by the transferor for income tax purposes – the transfer to the trust would be treated as a sale, and property held in a long-term trust would be deemed sold at specified intervals. In H.R. 2286, property that has been held in trust for **30 years** without being subject to section 1261 would be deemed sold, or, if it has been continuously held in trust for more than 30 years on the effective date (January 1, 2022), it is treated as sold on that date. In the STEP Act, **all** property held by such a trust would be treated as sold every **21 years**, with property in a trust created before January 1, 2006, first treated as sold on December 31, 2026. Thus, H.R. 2286 would apparently require tracking the holding period of each individual asset, while the STEP Act would apparently subject all trust assets to tax every 21 years regardless of the asset's holding period.

In addition, H.R. 2286 would treat a modification of the direct or indirect beneficiaries of a trust (or the beneficiaries' rights to trust assets) or the transfer or distribution of trust assets (including to another trust) as a deemed sale, unless Treasury and the IRS determine "that any such transfer or modification is of a type which does not have the potential for tax avoidance." This apparently is intended to include some decantings.

j. **Other Exclusions.** H.R. 2286 would exclude annual exclusion gifts and up to $1 million of net capital gain at death. The $1 million amount would be indexed for inflation after 2022. Thus, lifetime exclusions would be measured by the total value transferred (and the number of donees), while the exclusion at death would be measured by the net gain. Among other complications, the exclusion of gifts to the extent of the dollar amount of the annual exclusion would present the challenge of allocating that exclusion when gifts to any individual of assets with different bases exceed the annual exclusion amount in any year, as well as the challenge of applying that allocation in the case of gift-splitting by spouses.

The STEP Act would provide what amounts to a "lifetime exclusion" of $100,000 of gain, expressed as "the excess of … $100,000, over … the aggregate amount excluded under this subsection for all preceding taxable years." For transfers at death, the exclusion would be $1 million, less the amount of the $100,000 exclusion applied to lifetime gifts. Both the $100,000 and $1 million amounts would be indexed for inflation.

The proposals would not change the exclusion for sales of a principal residence.

k. **Netting of Gains and Losses.** In the case of deemed sales occurring upon death, the proposals would exempt the sales from the disallowance of related-party losses under section 267, which would allow losses on deemed sales to offset gains.

l. **Coordination with Basis Rules.** The basis rules for property acquired from a decedent (section 1014) or upon gift or transfer to a trust (section 1015) would be amended to more or less coordinate with the new deemed sale rules, generally providing a stepped-up (or stepped-down) basis if there is a deemed sale. Apparently, under H.R. 2286, that would mean that even annual exclusion gifts excluded from deemed sale treatment would receive a new basis equal to the fair market value at the time of the gift. Spouses and surviving spouses would receive a carryover basis in all cases.

m. **Extension of Time for Payment of Tax.** The proposals would add a new section 6168, providing an election to pay the income tax on deemed sales in installments, similar to the rules in section 6166 for estate taxes. Like section 6166, section 6168 would apply only with respect to transfers at death, not during life. In contrast to section 6166, however, section 6168 would apply not only to closely held business interests that exceed 35 percent of the gross estate, but to all assets other than "actively traded" personal property (such as securities traded on an exchange).

The STEP Act would mirror section 6166 by allowing payment of the additional income tax in up to 10 equal annual installments beginning no later than five years after the prescribed due date. H.R. 2286 would allow up to seven equal annual installments, with no deferral of the first installment.

Both proposals would provide for payment of interest (at 45 percent of the normal rate as in section 6601(j)(1)(B) for estate tax extended under section 6166, but with no "2-percent portion" as in section 6601(j)(1)(A)), and the STEP Act would make that interest nondeductible for estate tax purposes. Both proposals, like section 6166, would also include provisions for a special lien (which the STEP Act would allow to be partially replaced by a bond), extensions of the period of limitations on assessment, and proration of deficiencies to installments.

The STEP Act, but apparently not H.R. 2286, would provide for acceleration of the payment of deferred tax if the subject property is disposed of or is used in whole or in part to secure nonrecourse indebtedness.

n. **Information Reporting.** H.R. 2286 would add a new section 6050Z requiring that, except in the case of securities transactions reported by brokers under section 6045(g), the donor or executor must report to the IRS the name and taxpayer identification number of the recipient of each transfer and information describing the property and stating its fair market value and basis. The donor or executor must also report that fair market value and basis to the recipient of the property. These requirements are similar to the rules currently in section 6035 regarding the consistent basis of property transferred at death, except that section 6050Z would require this information reported to the IRS to be shared only with "the person to whom such transfer was made" (not, for example, to all beneficiaries who might receive an asset, as with Schedule A of Form 8971) and only "at such time and in such form and manner as the Secretary shall by regulations prescribe."

The STEP Act omits such a reporting requirement, but, seeming to step off-topic somewhat, it would add a new section 6048A requiring any trust (not already reporting under section 6034(b) or 6048(b)) with assets of more than $1 million or gross income for the year of more than $20,000 to report annually to the IRS "(1) a full and complete accounting of all trust activities and operations for the year, (2) the name, address, and TIN of the trustee, (3) the name, address, and TIN of the grantor, (4) the name, address, and TIN of each beneficiary of the trust, and (5) such other information as the Secretary may prescribe."

o. **Miscellaneous Matters.** In addition, the STEP Act would provide that the costs of appraising property deemed sold under new section 1261 would be deductible for income tax purposes and would not be a "miscellaneous itemized deduction" subject to section 67.

The STEP Act also would waive penalties for underpayment of estimated tax related to income tax on deemed realized gains at death (which, of course, would not have been foreseeable).

4. Estate Tax Repeal Bills

a. On March 9, 2021, joined by several of his Republican colleagues, Senator John Thune (R-South Dakota) introduced the "Death Tax Repeal Act of 2021" (S. 617). The bill resembles repeal bills that have been introduced over the last two or three decades.

(1) S. 617 would permanently repeal the estate and GST taxes, effective for estates of decedents dying, and generation-skipping transfers, after the date of enactment. As in past bills, it would retain the estate tax under section 2056A(b)(1)(A) on distributions from qualified domestic trusts for spouses of decedents who died before the date of enactment, but only for ten years after the date of enactment. It would immediately eliminate the estate tax under section 2056A(b)(1)(B) on the value of property remaining in QDOTs at the deaths of surviving spouses after the date of enactment.

(2) S. 617 would retain the gift tax with a 35% rate for cumulative gifts over $500,000 and would make permanent the current gift tax exclusion amount of $10 million indexed for inflation since 2011 (that is, $11.7 million for 2021), effective for gifts made on or after the date of enactment.

   (a) S. 617 would deal with the issue currently posed by the phrase "as of the end of the calendar year" in section 2505(a)(1) by treating the year in which the bill is enacted as two separate calendar years, one ending on the day before the date of enactment and the other beginning on the date of enactment.

   (b) It would also restore the 2001 Tax Act's enigmatic section 2511(c), providing that "[n]otwithstanding any other provision of this section and except as provided in regulations, a transfer in trust shall be treated as a taxable gift under section 2503, unless the trust is treated as wholly owned by the donor or the donor's spouse under subpart E of part I of subchapter J of chapter 1." (It ignores the 2002 amendment, which changed "taxable gift under section 2503" to "transfer of property by gift.")

      i. This provision appears to perpetuate the 2001 lore that the retention of the gift tax is needed to back-stop the income tax by subjecting to gift tax any transfer that would be "income-shifting," but, as in 2001, it is hard to be sure or to fully understand such a policy.

      ii. In any event, such a provision would presumably shut down the advantages of so-called incomplete-gift non-grantor trusts (or "ING trusts").

      iii. More perplexing, as in 2001, the use of the word "unless" in this provision could create the impression that a taxable gift is **avoided** by simply making the transfer to a trust that **is** a wholly-owned grantor trust as to the grantor or the grantor's spouse. That would certainly be different from the treatment of "intentionally defective" grantor trusts for which current funding is a completed gift but which normally include no features that would subject the trust to estate tax upon the grantor's death.

b. A companion bill, H.R. 1712, was introduced in the House of Representatives on the same day by Congressman Jason Smith (R-Missouri).