Thoughts on the “For the 99.5 Percent Act”

Paul McGloin, an independent trust and estate planning consultant to Alex. Brown advisors

May 12, 2021

ALEX. BROWN
A DIVISION OF RAYMOND JAMES

What is the “For the 99.5 Percent Act”?

- Introduced to Congress by Senators Bernie Sanders of Vermont and Sheldon Whitehouse of Rhode Island on March 25, 2021.
- Policy ideas behind the act go back at least to former President Barack Obama’s administration; many features of the act have been on the “wish list” of Democratic legislators for a long time.
- If the act were to be included in larger infrastructure legislation under the budget reconciliation process, it could become law by passing the House and receiving 50 Democratic votes in the Senate (plus the vote of Vice President Kamala Harris).
- **The act proposes dramatic changes to the estate and gift tax system in the U.S. and would abolish or severely limit a number of estate planning strategies that wealthy families have relied upon for many decades.**

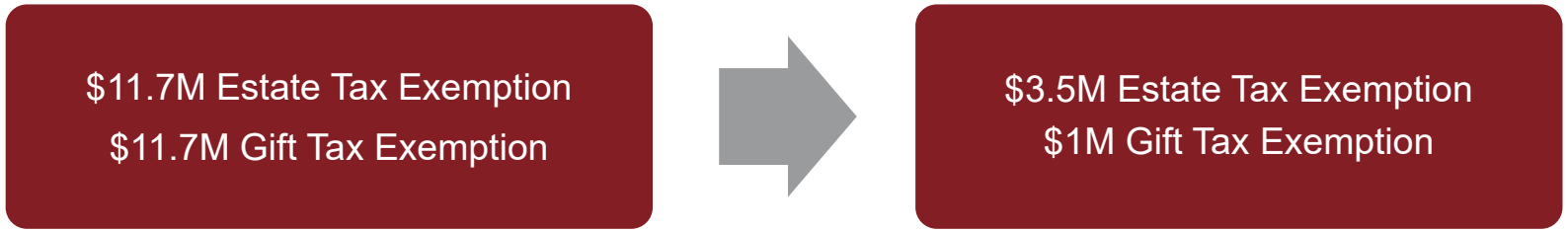
Increases in estate and gift tax rates

- The last two decades have seen a lowering of estate and gift tax rates and huge increases in the amounts that are permitted to pass free of estate and gift taxes.
- Under current law, the maximum rate of federal estate tax and gift tax is **40%**, and the exemption against these taxes is **$11.7 million.**
- The act would change all this, with estates over specific levels being subject to progressively higher levels of tax:

Estate Size	Marginal Estate Tax Rate	Increase from Current Rate
$3.5M to less than $10M	**45%**	12.5% increase
$10M to less than $50M	**50%**	25% increase
$50M to less than $1B	**55%**	37.5% increase
$1B or more	**65%**	62.5% increase

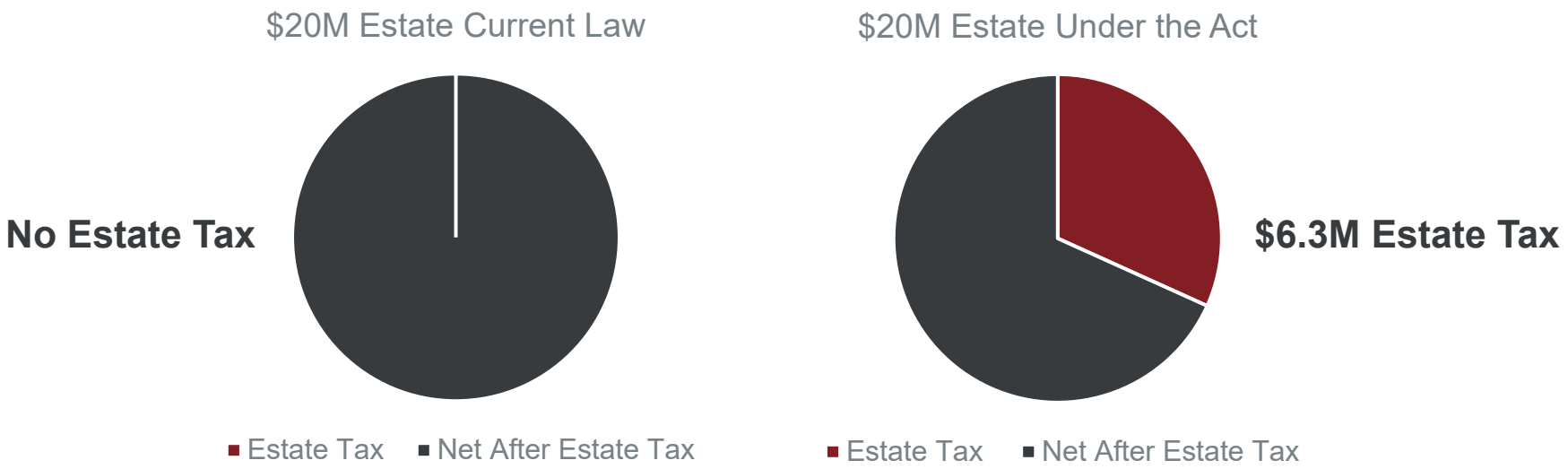
Big cuts in estate and gift tax exemptions

- The **estate tax exemption** – currently $11.7 million – would be reduced to **$3.5 million**. This is a 70% decrease from the current estate tax exemption.
- The **gift tax exemption** – currently the same $11.7 million – would be reduced to just **$1 million**. This is a 91% decrease from the current gift tax exemption.
- Generation-skipping transfer (GST) tax rates would be increased, and exemption would be decreased in the same amount as the estate tax.
- **Effective date: These rate and exemption changes would be effective beginning Jan. 1, 2022.**



A married couple with a $20 million estate

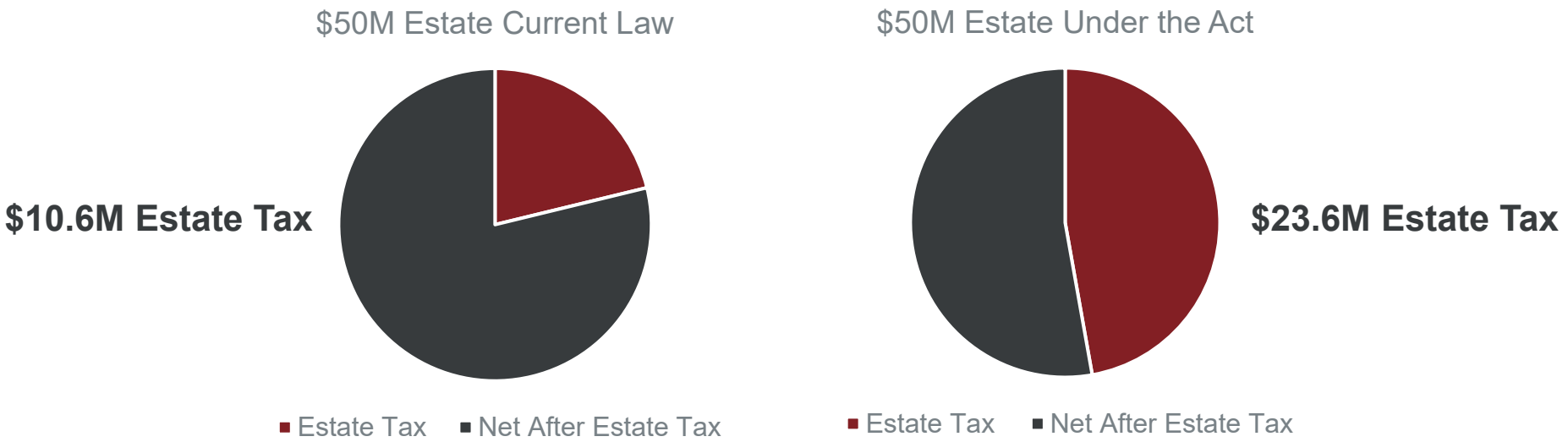
- A married couple with a net worth of $20 million face **no** federal estate tax liability at all under current law on the death of the survivor, given current levels of the estate tax exemption.
- The same couple would pay **$6.35 million** in federal estate tax upon the death of the second to die under the act.



This is a hypothetical example for illustration purposes only. Actual investor results will vary.

A married couple with a $50 million estate

- A married couple with a net worth of $50 million would pay $10.6 million in federal estate tax under current law on the death of the survivor, given current levels of the estate tax exemption.
- The same couple would pay **$23.6 million** in federal estate tax upon the death of the second to die under the act.



This is a hypothetical example for illustration purposes only. Actual investor results will vary.

Grantor trusts: key planning tool lost

- For decades, **irrevocable grantor trusts** have been one of the most important tools in sheltering family wealth from estate taxes.
- Using the elevated gift tax exemptions of recent years, individuals and families have moved vast amounts of wealth into trusts that are “outside” the grantor’s taxable estate at death but are still considered to be “owned” by the grantor of the trust for income tax purposes. This strategy enables a patriarch or matriarch to move wealth for estate planning purposes but continue to pay the trust’s income taxes during their lifetime, thus shifting more wealth to the next generation.
- But no more. The act would include any grantor trust in the estate of the deceased grantor (making them subject to estate tax) and would treat distributions from the grantor trust to beneficiaries as gifts (making them subject to gift tax).
- These provisions would apply to any grantor trust created, or receiving a contribution, on or after the date of the enactment of the act. **Thus, grantor trusts created and funded prior to the date of enactment will continue to enjoy the benefits of the current law, but grantor trusts created or funded after that date will not.**

Generation-skipping trusts: capped at 50 years

- Under current law, every individual can transfer up to $11.7 million during their lifetime or at death to a long-term trust that benefits successive generations of a family. If these trusts, which are sometimes called “generation-skipping trusts” or “dynasty trusts,” are created under the laws of a state that permits a trust to continue for many centuries, or forever, the trust can go from generation to generation without ever being subject to estate or gift taxes.

- The act caps the duration of trusts that would otherwise be GST-exempt at **50 years**.
- This rule would apply both to newly created trusts and pre-existing trusts – no grandfathering
- After the 50-year grace period expires, distributions from the trust to a “skip person” (i.e., someone more than one generation removed from the grantor of the trust) would presumably be subject to the dreaded GST tax.

GRATs and BDITs

- **Grantor retained annuity trusts** (GRATs) are an estate planning technique that is sometimes used to transfer future appreciation in the value of an asset with little or no gift tax cost. They are often used by clients who own assets (e.g., pre-IPO stock) that are expected to appreciate dramatically in value over a relatively short period of time.
- Under the act, future GRATs will be required to have a minimum term of **10 years**, and the gift made on inception will be required to be at least 25% of the value of the trust or **$500,000** (whichever is greater).
- **Beneficiary defective inheritor trusts** (BDITs), sometimes referred to as 678 trusts, are another GRAT-like estate planning technique that seemed to draw the special ire of the authors of the act. BDITs, whether newly created or existing, are all pulled back into the estate of the “deemed owner” at death.

Valuation discounts

- Current law allows the value of assets to be discounted for estate and gift tax purposes due to factors like lack of marketability (i.e., illiquidity) and minority interests. Proper structuring could enhance discounts – indeed, create discounts – even if the underlying assets consisted of marketable securities or other highly liquid assets.
- Under the act, assets must be used in the active conduct of a trade or business to qualify for a valuation discount, and transfers of interests in entities that hold “non-business assets” receive no discount.
- Discounts for transfers of minority interests are also limited by the act. If the person making a transfer and the person receiving the transfer, together with other family members, have either (i) control or (ii) majority ownership of what is being transferred, no minority discount is allowed.
- These new valuation rules are effective for transfers made after the date of enactment of the act.

Annual exclusion gifts

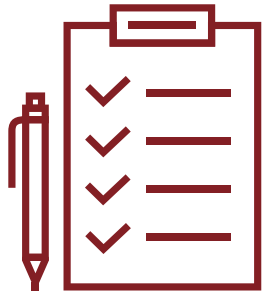
- Currently, anyone can make as many gifts of $15,000 per year as they choose, with no limit on the number of gifts a single donor can make, or the number of gifts a single recipient can receive from different donors.
- Under the act, the annual exclusion is reduced to just **$10,000** per annum.
- A donor would be limited to giving away just **$20,000** in annual exclusion gifts each year.
- No recipient would be able to receive more than **$10,000** in total in a year.
- If enacted (the provision would apply to tax years after the year of enactment), this radical restriction on annual giving would certainly have many unintended consequences. Life insurance trusts, for example, are often funded with annual exclusion gifts to avoid using up the donor's lifetime gift tax credit. It may be difficult to maintain policies that require annual premiums in excess of $20,000 per year under this proposal.

Where do we go from here?

- Some provisions of the act, such as those on tax rates, exemptions and annual exclusions, would only apply in 2022 and thereafter.
- Other provisions, such as those on grantor trusts and valuation discounts, would apply as soon as the act is enacted in Congress.
- Some commentators have projected that the earliest date the act could become law would be in **October of this year as part of the budget reconciliation process**. Reconciliation permits legislation to be enacted in the Senate without a 60-vote majority – the 50 Democratic senators and the added vote of the vice president would be sufficient to achieve passage.

Key planning point

- Whether the “For the 99.5 Percent Act” ultimately goes nowhere or is enacted into law in its current form, the current gift tax exemption is $11.7 million.
- Under the provisions of the act, a gift to an irrevocable grantor trust made before enactment of the act is effectively “grandfathered” and is not included in the estate of the grantor.
- **Clients who have the means to do so should consider getting their trusts created and funded as soon as possible.**



Other legislative proposals to watch

- **Capital gains tax at death** (“STEP Act”): Senator Chris Van Hollen (D-MD)
- **Mark-to-market tax**: Senator Ron Wyden (D-OR)
- **Carryover basis** (President Biden proposal)

Legal disclaimer

The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. Raymond James is not affiliated with Paul McGloin. Expressions of opinion are as of this date and are subject to change without notice. There is no guarantee that these statements, opinions or forecasts provided herein will prove to be correct. This material is being provided for information purposes only. Any information is not a complete summary or statement of all available data necessary for making an investment decision and does not constitute a recommendation. Please note, changes in tax laws may occur at any time and could have a substantial impact upon each person's situation. Raymond James does not provide tax or legal services. Please discuss these matters with the appropriate professional.

INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER

880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716

DIVISION HEADQUARTERS: ALEX. BROWN, A DIVISION OF RAYMOND JAMES

350 PARK AVENUE // NEW YORK, NY 10022 // ALEXBROWN.COM