

## **Section by Section Explanation of the *Sensible Taxation and Equity Promotion (STEP) Act***

DISCUSSION DRAFT

Senators Chris Van Hollen, Cory Booker, Bernie Sanders, Sheldon Whitehouse, and Elizabeth Warren

### **Section 1. Short Title.**

### **Section 2. Realization of Gains at Time of Gift or Death**

- In general, property is treated as sold for its fair market value when transferred by gift, bequest, or to a non-grantor trust.
  - **REQUEST FOR FEEDBACK: With the exception of Intentionally Defective Grantor Trusts, as described below, the legislation uses income tax rules to define transfers subject to deemed realization. As an alternative, should the rules for estate and gift taxes be used to define when a transfer has taken place?**
- The bill includes special rules for trusts:
  - Property is not treated as sold when assets are transferred between grantors and their grantor trusts, which are trusts in which current tax law treats the assets as belonging to the owner for income tax purposes.
  - Property in grantor trusts is treated as sold when transferred to another person, the grantor dies, or the grantor is no longer treated as the owner.
  - Property transferred to or held by grantor trusts is also treated as sold if it would no longer be included in the owner's estate for estate tax purposes. This prevents the use of Intentionally Defective Grantor Trusts to defer realization on gifts under this bill.
  - To prevent permanent avoidance of capital gains taxes using trusts, property held by a non-grantor trust is treated as sold for its fair market value every 21 years after establishment of the trust. As a transition rule, trusts established in 2005 or earlier will have their first deemed realization in 2026.
    - **REQUEST FOR FEEDBACK: As an alternative to the 21-year rule, should deemed realization instead occur when a trust makes a distribution to a skip person or when there are no longer any non-skip persons who are trust beneficiaries, based on the rules for the Generation Skipping Transfer Tax (regardless of whether the trust is exempt from the GST)?**
- Exceptions are included for tangible personal property (other than collectibles); for transfers to spouses and charities; and for charitable trusts, qualified disability trusts, and cemetery trusts.
  - The spousal exemption applies only to transfers to spouses who are U.S. citizens and long-term residents, who are subject to the existing deemed realization rules in Sec. 877A of the Internal Revenue Code if they subsequently expatriate.
  - **REQUEST FOR FEEDBACK: Should the exception for transfers to spouses be elective in the case of a decedent?**
- Sec. 267 of the Internal Revenue Code disallows losses with respect to transfers to related parties. The legislation applies this rule when assets are transferred by gift, but not at death.
- Eliminates carryover basis for gifts, except for spouses and charities.
- Since built-in gains would be taxed at the time of gift or bequest, the transferee's basis in the property is stepped-up to match the value that was taxed at the time of transfer.

- **REQUEST FOR FEEDBACK: What estate tax valuation rules, if any, should apply to the income tax imposed on the transferor under this bill and the basis of the property in the hands of the recipient?**
- Requires large trusts to report their balance sheet, income statement, trustees, grantors, and beneficiaries to the IRS. Foreign trusts with U.S. owners already have to report this information.
- Retirement accounts are not subject to capital gains taxes, and therefore would not be affected by the bill.
- The exclusion for sales of a principal residence of \$250,000 (\$500,000 if married) would apply to property treated as sold under the bill.
- Like other income taxes, capital gains tax liability incurred as a result of the bill would be deductible from the decedent's gross estate for estate tax purposes.

### **Section 3. Exclusion of Certain Amounts of Realized Gain**

- Provides individuals with a \$1,000,000 exclusion from taxation under this bill for unrealized gains at death.
- Individuals may draw down up to \$100,000 of their \$1,000,000 exclusion for gifts made during their lifetime, with any remaining amount available at death.
- This exclusion is adjusted for inflation.
  - **REQUEST FOR FEEDBACK: Should this exclusion be set at a different level, or structured in a different manner?**

### **Section 4. Deduction for Costs of Appraisal of Appreciated Assets**

- Provides itemized deduction for appraisal costs on any asset that is deemed to be sold due to gift or death.

### **Section 5. Extension of Time for Payment of Tax**

- The tax on gains for assets, other than actively traded assets, that are deemed to be sold under this bill may be paid over a 15-year period. This option is only available for realizations at death or under the 21-year rule for non-grantor trusts.
- Under this option, the decedent's estate or the non-grantor trust could pay only interest for up to 5 years, and then pay the tax and the interest in up to 10 annual installments. The interest rate reduced to be 45% of the usual rate in the tax code.
- The person filing the decedent's final tax return, or the trustee in the case of a non-grantor trust, would make this election.
- If the asset is liquidated, the full unpaid tax attributable to that asset is due immediately.
- Sec. 6165 of the Internal Revenue Code allows the IRS to require taxpayers to furnish a bond when an extension is granted to pay a tax, including the extension provided in this Section. Section 5(b) of this bill allows the IRS, the person filing the decedent's final tax return, and the heirs to agree to an IRS lien on assets as an alternative to furnishing a bond. A trustee could reach a similar agreement with the IRS in the case of a non-grantor trust.
- The parameters are similar to those in Sec. 6166 of the Internal Revenue Code for installment payment of estate taxes.

### **Section 6. Waiver of Penalty for Underpayment of Estimated Tax**

- Since taxation of unrealized gains at death is not a predictable event, underpayment penalties are not assessed for taxes due for this reason.

**Section 7. Effective Date**

- The bill applies to transfers occurring after December 31, 2020; and in taxable years beginning after that date. This means the bill takes effect in 2021 for calendar year taxpayers.

**Section 8. Severability.**

- If any part of the bill is held to be unconstitutional, the remaining parts of the bill shall not be affected by that ruling.

**Please submit comments to: [step\\_act@vanhollen.senate.gov](mailto:step_act@vanhollen.senate.gov).**