

## **The STEP Act**

### **Senators Propose New Wealth Transfer Tax**

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On March 29, a group of five Democratic Senators introduced the Sensible Taxation and Equity Promotion (STEP) Act (the “Act”). The Act is the first formal proposal introduced to implement some of President Biden’s plans to modify the federal transfer tax system. It is simply a proposal at this point (and not likely to pass in its current form) but is an important indicator of changes that may be coming.

If passed in its current form, the Act would tax transfers of appreciated property at death or by lifetime gift. In essence, the transfer would be treated as a sale and capital gains tax would be due on the difference between the fair market value of the transferred property and its income tax basis. A few exclusions would apply. Lifetime transfers to an individual other than a spouse would be taxable after the first \$100,000 of cumulative gain involved in transfers made by the donor. Transfers upon death to a person other than a spouse would be taxable after the first \$1,000,000 of cumulative gain, taking into account the portion of the \$100,000 exclusion used during lifetime. The balance of the gain would be taxable.

For example, if an individual dies holding stock worth \$4 million that was originally purchased for \$2 million, there would be \$2 million of built-in gain. The first \$1 million of gain would be excluded, but the remaining \$1 million of gain would be taxed as capital gain. Currently, capital gains are subject to a federal tax rate of 15% to 20%, but President Biden has proposed increasing those rates for certain taxpayers.

Under the Act, there would be exemptions for transfers to spouses and for transfers to charities, charitable trusts, qualified disability trusts, and cemetery trusts. In addition, for a personal residence, there would be a separate gain exclusion of up to \$250,000 (\$500,000 for a married couple). Transfers from qualified retirement accounts would not be subject to the transfer tax. For certain transfers of business assets (including farms and certain farm assets) the Act would allow tax payments over a 15-year period. The first 5 years would be interest only followed by 10 equal payments for the remaining 10 years.

The Act would also impose new reporting requirements for all non-grantor trusts on all their appreciated assets every 21 years. All trusts created before 2005 would automatically report this built-in gain in 2026. Additionally, trusts with more than \$1 million of assets or more than \$20,000 of gross income would be required to provide a balance sheet, income statement, and a list of all trustees, grantors, and beneficiaries to the IRS.

As proposed, the Act would apply to transfers occurring after December 31, 2020. As noted above, this is the first proposal and is likely to be significantly modified if and when it moves forward in the legislative process.

The attorneys at Rembolt Ludtke will be closely monitoring developments in this area. Please contact us if you have questions—we look forward to serving you!