The 99.5% Act – What You Need to Know

The Biden administration's first major legislative accomplishment was the $1.9 trillion COVID-19 relief bill. Now attention is turning to a massive infrastructure and tax package. The White House is describing that effort in two stages. President Biden introduced "Infrastructure 1" on March 31, a $2 trillion package paired with substantial corporate tax increases.

On April 28, during an address to a joint session of Congress, the president introduced the framework for "Infrastructure 2," which the White House is calling the "American Jobs Plan." As expected, the plan called for universal preschool for 3 and 4 year olds, paid family leave, and two years of free community college, among many other provisions. The American Jobs Plan comes with a proposed $1.8T price tag, which is $1T in spending and $800B in tax credits. This will be paid for with proposed tax increases focused on individuals and small businesses, specifically a proposal to increase the maximum tax bracket to 39.6%, an increase of the capital gains tax rate to 39.6% for households making more than $1M, a $500,000 cap on Section 1031 exchanges, and $80B for the IRS to increase tax audits and collection efforts.

The two infrastructure proposals from the White House combined with other recent tax-overhaul bills is a lot for all of us to unpack. Before we get too far into the analysis of all this potential tax law change, it's important to remember that making law in this area will involve compromise between progressive and moderate democrats, and, ideally, Republicans. For example, Senate Republicans recently unveiled a counterproposal to President Biden's first infrastructure bill, offering their own infrastructure bill that had a $568B price tag, rather than the $2.25T price tag for President Biden's bill. As the dramatic swing between the two spending bills illustrates, there is a lot of room for negotiating and the initial salvo is rarely what actually becomes law.

Despite the long road ahead of all of this proposed legislation, it's important to understand the various proposals. Two bills of note were recently introduced that represent potential dramatic change to the transfer tax system we currently know and plan for: the **For the 99.5% Act** (Senator Bernie Sanders) and the **Sensible Taxation and Equity Promotion (STEP) Act** (Senator Chris Van Hollen, co-sponsored by Senator Bernie Sanders).

While these proposals have been introduced in the House and Senate, they have not been brought up for debate in either Chamber and are still a long way from becoming law. But, they do represent how some members of Congress are thinking about tax law changes, and represent the need for clients to start planning for any possible challenges even while they continue to hope for the best. Given the major impact these bills could have if they become law, we're going to break them down separately. The discussion of the STEP Act can be **found here**. As always, NFP will be here with you to keep you up to date on any potential changes to our current tax system.

FOR THE 99.5% ACT

The 99.5% Act makes changes to the estate tax exemption and rates, plus it proposes changes to commonly utilized estate planning techniques — many of which are ideas that we've seen in prior Green Books (i.e. presidential budgetary wish lists) put out by Democratic administrations. We expect the Biden-Harris Administration's first Green Book to be released in early May.

First, the 99.5% Act would "uncouple" the estate and gift tax exemption amounts and lower them to $3,500,000 and $1,000,000 respectively. It also would stop the indexing for inflation that's been a part of the estate tax since 2012. Under the 99.5% Act the estate tax rate would be based on the size of the estate with the following divisions: estates $3.5M to $10M would be taxed at 45%; estates $10M to $50M would be taxed at 50%; estates $50M to $1B would be taxed at 55%; and estates over $1B would be taxed at 65%.

When introducing the 99.5% Act, Senator Sanders noted that the Joint Committee on Taxation expects this bill to raise $430B in revenue through 2031. In order to raise substantial revenue, the 99.5% Act makes changes to some common planning techniques including annual exclusion gifts, dynasty trusts, grantor trusts, valuation discounts and grantor-retained annuity trusts (GRATs).

Under the proposed 99.5% Act, donors would be limited to just two exclusion gifts annually when the gift is made to a trust or is a gift of certain "flow through" assets. This means that instead of being able to give $15,000 per donee per year to a trust, the most that a donor could give to a trust is $30,000 per year regardless of the total number of donees.

In addition to limiting the annual exclusions that can be given to trusts, the 99.5% Act would limit the duration of dynasty trusts to a maximum of 50 years. GRATs would have a mandatory minimum term of 10 years and a mandatory minimum gift amount, which means that the zeroed-out two-year rolling GRAT would become a thing of the past. Grantor trusts would also see significant changes under the 99.5% Act, which states that if a grantor is deemed to be the owner of the trust for income tax purposes, the grantor is also the owner for estate tax purposes.

The For the 99.5% Act also proposes reform of valuation discounts for family assets. Under the 99.5% Act, valuations must be based on a pro-rata percentage of ownership multiplied by the value of the underlying assets. So a 10% ownership interest in an entity must be valued at 10% of the assets owned by that entity.

The For the 99.5% Act attempts to blunt objections from at least one class of Americans: farmers. It increases the amount by which family farms can be discounted inside an estate to $3M and it increases the maximum estate tax exclusion for conservation easements to $2M.

WHAT SHOULD BE DONE NOW?

One key fact of the 99.5% Act is that its effective date is from its date of enactment forward: there aren't retroactive provisions inside the 99.5% Act. So GRATs, grantor trusts and dynasty trusts in existence prior to the 99.5% Act would be able to rely on prior law. In addition, gifts, both annual exclusion gifts and lifetime exemption gifts, made prior to the 99.5% Act can rely on the gift tax rules currently in effect. All of which means that now is the time to "hope for the best, but plan for the worst."

People should be taking steps to employ the current planning techniques that we've been recommending and utilizing for decades. If the proposals in the 99.5% Act demonstrate anything, it's that these planning techniques are highly effective vehicles for transferring wealth out of the taxable estate and down to future generations. For the remainder of 2021, anyone can make gifts of $11.7M to a defective grantor trust for the benefit of their spouse and descendants. People can create dynasty trusts and short-term GRATs until the 99.5% Act gets signed into law.

This proposal is a long way from becoming law and could change significantly or be dropped entirely. However, insight from our partners in Washington suggests that the fastest Congress could get this done would be August 1. It could well slip past that date and the latest it could come together this Congress is probably December 31, 2021.

If it does nothing else, the 99.5% Act should serve as a call to action for families with a net worth in excess of $3.5M. They need to look at their current planning situation and determine whether they need to take immediate steps to avoid negative consequences from the 99.5% Act or any similar bill that might have a significant impact on their ability to plan for their family's future.

For more information, visit NFP.com.