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Robert W. Wood
THE TAX LAWYER

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Biden’s Scary Death & Wealth Tax Plans

President Biden’s budget proposes to repeal step up in basis on death. This is an income tax rule, not an estate tax rule. For generations, decedents and their heirs could avoid income tax on any increase in the value of assets during the decedent’s lifetime. The higher value can be subject to estate tax, but not to income tax. This is among the most hallowed of tax rules, but it is on the chopping block at least for the well-heeled. The proposal says that appreciation would be subject to capital gains tax at death, as if the property had been sold. Under Biden’s proposal, there would be an exemption of $5 million per person, or $10 million for a married couple. But if you exceeded that figure, step in basis for income tax purposes would be a thing of the past.

There are lots of details in this plan. On death, instead of the tax basis going up to market value, an income tax would be triggered on the transfer. When the estate transfers the house to a child, that would be a sale for tax purposes. The estate would file an income tax return and report the tax due. Of course, more than a few observers are noting that this isn’t a real sale, so no cash is generated to pay the tax. It has to come from somewhere, so the house (or other assets) might have to be sold.

The new capital gain tax is supposed to be deductible on the estate tax return, which is at least something. Significantly, transfers to a U.S. spouse or to charity would not trigger a tax—those would receive a carryover of the low basis of the decedent so the income tax would be collected later, on the second spouse to die. There is also an exclusion, so you don't have to pay capital gain tax on all your personal property. There is an exclusion for tangible personal property such as household furnishings and personal effects, but excluding collectibles. The $250,000 per-person exclusion under current law for capital gain on a principal residence would apply to all residences and would be portable to the decedent's surviving spouse. That means the exclusion would be $500,000 per couple.

But repeal of step up in basis on death is not the only fundamental tax rule President Biden wants to change. He also wants to tax plain old appreciation in assets, even if you don't sell them. Let's say you buy and hold crypto, and it goes up stratospherically in value. Up until now, you can't be taxed until you sell it. The same if you buy and hold stock, or buy and hold real estate. It almost seems inconceivable that you could be taxed just for something becoming more valuable, well maybe except for estate tax. But as we all know, there is a step-up in basis for income tax on death. But now, some of these hallowed set-for-generations tax rules could change.

In fact, if President Biden has his way, there would be quite different rules for the wealthy. President Biden has proposed what he calls the "Billionaire Minimum Income Tax" as part of his new budget. The title is a misnomer, as tax legislation so often is. You don't have to be a billionaire to be saddled with it. You start paying it at $100 million, so it's really more like a tenth of a billionaire tax, though that doesn't have the snappy name. It is supposed to "ensure that the very wealthiest Americans pay a tax rate of at least 20 percent on their full income, including unrealized appreciation."

The plan is controversial, but the last part is especially so. The fact that the tax applies to unrealized appreciation means that there's really no "income" to tax in the usual sense. And since you are not selling anything—the tax just applies as your assets increase in value—you have to pay the tax from other sources.

But how would it work if you are in the elite group of people facing this? If you are already paying 20% on your full income, you are not supposed to have to pay an additional tax under the proposal. But if you pay less than 20% in federal tax currently, you will owe a "top-up payment" to meet the new minimum. Under the plan, "this new minimum tax will eliminate the ability for the unrealized income of ultra-high-net-worth households to go untaxed for decades or generations."

This sure looks like a wealth tax, but proponents of the plan say that it isn't a wealth tax at all. They try to distance themselves from a similar tax the Democrats floated last year. Last year's proposal required an annual valuation and assessment that was clearly unworkable. But can the IRS collect taxes if you haven't sold anything? The new plan gives wealthy households five years to come into compliance with the minimum 20 percent tax.

Moreover, the proposed plan gives people nine years from enactment to pay previously unrealized income. Yet even if this unusually ambitious tax passes, it is possible that it might be struck down as unconstitutional. Some features of the new plan are similar to last year's proposed Ultra-Millionaire Tax. The 2021 version would have imposed a tax on the net value of all taxable assets on the last day of each calendar year.

That was clearly a wealth tax, with the tax 2% of the amount of taxpayer's assets exceeding $50 million. Then, it was supposed to go up to 3% or 6% if your taxable assets exceed $1 billion. In the 2021 proposal, the IRS was directed to audit at least 30% of all taxpayers required to pay the tax. Given the annual appraisal requirements (for all assets!) and 30% mandatory audit standard, it hardly seemed realistic and did not pass. The President hopes his wealth tax 2.0 stands a better chance with a five-year compliance window that is supposed to make critics more comfortable. We'll see.

A betting person might say that neither of these ambitious tax proposals are likely to pass in their current form, at least not anytime soon. But this is not the first time that either a wealth tax or step up in basis repeal has been taken on by the current administration. And every time this kind of sea change is proposed, the enormous impact is more normalized and it gets a little easier to discuss.

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