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TAXES 09/07/21

Critics Sound The Alarm Ahead Of Possible Retroactive Capital Gains Tax Hike

Are retroactive tax increases constitutional or even fair? Up until now, the tax rate on [capital gain](#) has been zero, 15% or 20%, depending on your income. In some cases, you add the 3.8% Obamacare tax, but at worst, your total tax bill is 23.8%. The long term capital gain tax is graduated, 0% on income up to \$40,000, 15% over \$40,000 up to \$441,450, and 20% on income over \$441,451 (in some cases, add the 3.8% Obamacare tax).

The President's proposed 43.4% capital gain rate is supposed to hit only those earning \$1M or more, but if you bought a house 30 years ago that is now worth over \$1M, you could be impacted. Wages can face federal tax of 40.8% once you include payroll tax, but hiking the top 23.8% capital gain rate to 43.4% would be a staggering 82% increase. If you add state taxes like California's current 13.3% rate the government gets most of your gain.

A natural reaction to a looming tax hike is to sell quickly before the new law takes effect. But as proposed the rate hike *is already in effect* for sales after

April 28, 2021. It might not pass, or it might pass with a different effective date. But it is hard to decide what to do, especially now that additional proposals seem inevitable as part of the pending infrastructure bill.



Do you sell now, figuring you are stuck with higher rates, or do you wait and see? If you wait, might you miss the chance to sell under the old rates? What if you wait until November and the tax hike passes, but with a September or October effective date? There's no easy answer. If the law passes as proposed, there could be a legal fight too. An [analysis](#) by Joe Bishop-Henchman of the National Taxpayers Union Foundation's Taxpayer Defense Center says that [a retroactive capital gains tax increase](#), would be unfair to taxpayers and would undermine public respect for the law. He [wrote](#) that retroactive tax hikes violate the fundamental principles of transparency and stability, and prejudice taxpayers ability to plan their affairs.

There is even a question whether retroactive taxation is constitutional. Justice Sandra Day O'Connor once warned that retroactivity over one year would likely violate the Due Process Clause. Justices Antonin Scalia and Clarence Thomas called retroactive taxation “bait-and-switch taxation.” However, these statements are not legal holdings, and it's not clear how the April 28, 2021 retroactive effective date would stand up if the law passes in its current form with that long reach back in time.

The tax break for long-term [capital gains](#) applies to assets held over a year, and that includes crypto—which also is in Congressional crosshairs in the infrastructure bill. Of course, capital gain tax applies to your *gain* not to your sales proceeds, so your adjusted tax basis can be subtracted. Your basis is your original investment, as adjusted by things like remodeling costs, expenses related to the investment, etc. Keep your receipts, which can be relevant for decades with assets like a house. The [IRS always wants receipts](#), and if you can't establish your basis, you could face tax on it all. At least timing is on your side with when to sell. Traditionally, holding until death was also an attractive tax strategy. Sure, the asset would be in your estate for estate tax purposes, but with an over \$23 million exemption for a married couple, that isn't such a big deal. But for income tax purposes, your assets get a stepped up basis on your death.

Under present law, inherited property receives a full fair market value tax basis on death. This step-up in basis provides tax benefits for everyone passing down appreciated assets, including real estate, stock, family companies and more. If you make repeated section 1031 exchanges of real estate for years and die, the appreciation escapes income tax. For generations, assets held at death have received a stepped-up basis to market value when you die. Small businesses and family farms—everyone really—counts on this. President Biden said he would end step up in basis, subject only to an exemption of \$1 million

plus \$250,000 of gain on a home. Beyond that, everything would be taxed, a massive [tax increase on death](#). After the Democratic National Convention, Mr. [Biden pledged 'no new taxes' on incomes under \\$400,000 and on mom & pop businesses](#). Stay tuned.

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