Biden Budget Released with Few Surprises for Individuals

June 2021

Last week, President Joe Biden released the proposed budget for fiscal 2022 — with no real surprises. Nonetheless, we believe it's important to keep an open dialogue surrounding any developments so clients have a clear understanding of proposed tax law changes.

The Treasury Department's explanation of the revenue provisions, colloquially known as the "Green Book," gives us better insight into how some of the provisions will be implemented and their proposed effective dates. Negotiations, expected over the summer and through the third quarter, bear close watching for their impact on individuals, especially with respect to capital gains tax and taxes taking effect at death. Following are provisions of interest to clients and their proposed effective dates.

Provisions proposed to take effect on January 1, 2022

- Raise tax rate on ordinary income from 37% to 39.6% for individuals with adjusted gross income greater than $452,700/$509,300 (single/joint).
- Eliminate step-up of cost basis for assets owned at death. Impose capital gains tax at death on unrealized appreciation of assets in excess of $1 million, with an exception for assets transferred to a spouse or charity.
- Impose capital gains tax on unrealized appreciation of any property transferred by the owner to other individuals or entities (e.g., gift transfers and transfers to trusts); transfers to a spouse or charity are exempt.
- Subject all pass-through trade and business income (e.g., ordinary income from partnerships) to the 3.8% net investment income tax or, if the owner participates in the activity, to self-employment tax.
- Tax partnership carried interest as ordinary income rather than capital gains.
- Eliminate tax-deferral benefits for Section 1031 like-kind exchanges for gains greater than $500,000.
- Make permanent excess business loss limitations for non-corporate taxpayers.

Your 2021 Call to Action

Expected income and estate tax changes require careful attention to your planning this year. Your Relationship Manager can help you analyze decisions such as whether to accelerate or defer income or recognize capital gains in 2021. Our Goals-based Wealth Review process will also aid in your decision whether to fully utilize all or part of your $11.7 million estate tax exemption now and what types of gifts and trusts might be used for a successful long-term outcome.

Provision proposed to take effect on April 28, 2021

- Raise tax rate on capital gains and dividends from 20% to 39.6% for individuals with adjusted gross income greater than $1 million.

This is the only provision proposed to take effect retroactively. We expect this date will be the subject of heated negotiation and may be changed to a later date, perhaps to the date a Budget Reconciliation Bill is introduced in August or September.

Provision proposed to take effect on January 1, 2023

- Annual information return reporting by financial institutions and cryptocurrency exchanges and custodians of gross inflows and outflows of cash, transactions with foreign accounts and transactions between accounts of the same owner for each client account greater than $600.

Provision proposed to take effect on January 1, 2031

- Impose a capital gains tax on any appreciated asset held in a trust or partnership for more than 90 years. Assets purchased prior to 1940 will become taxable in 2031.

Provisions not addressed in the budget

There have been bills introduced in Congress already this year that would dramatically change estate tax provisions and many other aspects of estate planning as we know it today. These provisions have no likelihood of being passed unless they are introduced during the negotiation of the Budget Reconciliation Bill. For example, it could be that a decrease in the estate tax exemption is a trade-off for a carryover basis at death rather than the proposed taxable deemed sale of appreciated assets at death. Similarly, a relaxation of the cap on the deduction for state and local taxes as well as property taxes may be demanded by some senators in exchange for their agreement to a budget package.

- Decrease of estate tax exemption amount to $3.5 million and increase of estate tax rate to 45%.
- Relax cap restricting the deduction of state, local and property taxes to $10,000.
- Restrict Grantor Retained Annuity Trusts, requiring a term of not less than 10 years and a gift element of not less than 25% of the trust assets.
- Eliminate valuation discounts on passive interests.
- Limit annual exclusion gifts in size and number.
- Limit Generation Skipping Transfer Tax exemption to 50 years.
- Require trusts that are grantor trusts for income tax purposes to be included as taxable assets owned by the grantor at death.

Conclusion

Our expectations and suggestions will remain fluid through the third quarter as Congress winds its way through the budget process and the road to a Budget Reconciliation Bill that can be adopted by the Democrats in the Senate without any cooperation from the Republicans. We recommend staying in close touch with your Relationship Manager, and look for continuing coverage and communications from Glenmede.