

Tax legislation update

New details from White House budget



While legislation has yet to be proposed for any upcoming tax changes, last Friday the White House gave us more details on what they want, when it released its budget proposal along with the Green Book (which provides explanations and more details on the budget proposal).

Think of this as the beginning of negotiations. The final legislation will no doubt look different. It takes the votes of all 50 democratic and independent senators to pass any legislation using the *Budget Reconciliation Method* (versus the usual 60 votes). This gives individual senators more power to dictate changes.

Here are updates on what we've learned from the recent budget proposal and Green Book. *See the May 2021 BMO Proposed Tax Changes Update Article for reference.*

Effective date — retroactivity for new capital gains tax rate

All of the proposals appear to be effective 1/1/2022 except the new capital gains tax rate. The Administration has proposed taxing capital gains and qualified dividends at 39.6% (plus the existing 3.8% Medicare Net Investment Income tax) for taxpayers with adjusted gross income of more than \$1 million. The Green Book indicates that this one proposal would be retroactive to the "date of announcement." It is unclear exactly what date that is, but it is most likely either the prior release of the American Families Plan fact sheet on April 28, 2021, or the release of the Budget proposal on May 28, 2021. Keep in mind that it is exceedingly rare to have retroactive tax increases. In addition, it is likely there will be pushback, even among some democratic senators, to this retroactivity, as well as to the tax rate itself.

1031 tax deferred real estate changes

The proposals clarified that while they are still pursuing the repeal of Section 1031 tax deferred real estate tax changes, the exception for capital gains on the sale of real estate of \$500,000 or less is per taxpayer. So married couples would have a \$1 million exclusion.

Triggering of capital gains when assets are transferred

A new provision not seen in the current tax code has been proposed. Lifetime gifts and transfers of assets at death would trigger capital gains on the built-in appreciation of the assets. For example, if Amazon stock was originally purchased for \$200,000 (basis) and was gifted to someone when the fair market value was \$500,000, it would trigger \$300,000 of capital gains income to the gift-giver with the corresponding tax due — even though the stock was not sold. This would not apply to transfers to (1) spouse, (2) charity, (3) grantor transfers to a revocable trust or (4) transfer of certain family business & family farms (where a family member continues to run it).

As mentioned in our prior pieces, there would be an allowance of \$1 million per person that could be allocated to these gains; so now capital gains tax would not be due on \$1 million of appreciation (based on the value as of the date of transfer). Considering our prior example, the \$1 million allowance could be applied to that \$300,000 of gain when the gift was made so no capital gains tax would be due.



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However, the person who received the gift would keep the gift-giver's tax basis. The new proposals make it clear that there is portability of this \$1 million allowance for spouses. So, a surviving spouse could claim any of the deceased spouse's unused \$1 million amount. A married couple, therefore, effectively has a \$2 million allowance in total. In addition, there would be a \$250,000 per person allowance for appreciation in any residence; this also would have portability for surviving spouses. A married couple would have a \$500,000 allowance in total, toward any residence.

As part of this expansion of when capital gains are triggered, gain recognition would also be triggered when assets are transferred to, and distributed by, irrevocable trusts and partnerships. If passed, this would have a dramatic effect on some estate tax planning strategies. All the more reason to talk to your advisors and evaluate what gifting you should do in 2021 before this takes effect January 1, 2022.

Lastly, a new "90 year" rule would be added for assets held by a trust, partnership or other non-corporate entity. Gains on unrealized appreciation would be recognized (and capital gains tax would be due) if capital gains had not been paid on the property for 90 years. The initial date for the beginning of the 90-year rule would be 1940, thus the first possible recognition event would be December 31, 2030.

In Closing:

These provisions are only proposals; we are still waiting to see actual legislation drafted. However, it does give us a clue of where the White House is headed for beginning negotiations.

Let's start planning!



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