

MAY 2021

Federal Tax Proposal Update

THE AMERICAN FAMILIES PLAN

On April 28, in advance of his first address delivered before a Joint Session of Congress, President Biden unveiled his \$1.8 trillion proposal titled the *American Families Plan*, which sets forth a myriad of social programs, including tuition-free community college, subsidized child care, universal preschool, expanded child tax credit and paid family leave. The proposal would largely be financed through federal tax increases on high-net-worth individuals.

Key Tax Provisions Included in the *American Families Plan*:

PERSONAL INCOME TAX

Ordinary Income:

- The top federal income tax rate would increase from 37% to 39.6% for individuals with taxable income greater than \$452,700 and for married couples filing jointly with taxable income greater than \$509,300. Currently for 2021, the 37% tax rate applies to individuals with taxable income greater than \$523,600 and for married couples filing jointly with taxable income greater than \$628,300.

Capital Gains:

- Capital gains would be taxed as ordinary income at the proposed top tax rate of 39.6% for taxpayers with taxable income greater than \$1 million, and would include the 3.8% Medicare surtax under the Affordable Care Act – resulting in an increase of the federal capital gains rate to 43.4% from the current top rate of 23.8%.
- The 3.8% Medicare surtax would apply to all net investment income – both passive and active – if the taxpayer has adjusted gross income (AGI) greater than \$400,000 rather than only applying to passive net investment income for individuals with AGI greater than \$200,000 and married couples filing jointly with AGI greater than \$250,000.

Taxation of Carried Interest:

- Carried interest would be taxed as ordinary income at the proposed top rate of 39.6% rather than the preferential tax rate of 20% for capital gains.

Tax Treatment of 1031 Like-Kind Exchanges:

- The tax-deferred treatment of Section 1031 like-kind exchanges for real estate would only be permitted for capital gains not exceeding \$500,000. During the 2020 presidential campaign, then-candidate Biden had proposed the elimination of 1031 like-kind exchanges for real estate.

TRANSFER TAX

Estate and Gift Tax:

- **Step-Up in Basis at Death:** The step-up in basis to fair market value (FMV), for unrealized appreciation of assets transferred at death, would be repealed for the most part. Individuals would receive a \$1 million step-up in basis exemption and married couples would receive a \$2 million exemption.
- **Step-Up in Basis at Death for Family-Owned Businesses and Farms:** The full step-up in basis for unrealized appreciation of interests in family-owned businesses and farms transferred at death would remain if the business or farm is left to family members who continue to run such business or farm.
- **Capital Gains Exemption for Sale of Personal Residence:** The \$500,000 capital gains exemption for married couples and \$250,000 exemption for individuals for the sale of a personal residence would remain.

Key Tax Provisions Not Included in the *American Families Plan*:

PERSONAL INCOME TAX

- The reinstatement of the uncapped state and local tax (SALT) deduction and real property tax deduction.
- The elimination of the 20% pass-through income tax deduction for small businesses.
- The reinstatement of the Pease Limitation on itemized deductions.
- The return of the Alternative Minimum Tax (AMT) exemption phase-out at its pre-2018 income levels.

TRANSFER TAX

- A reduction of the estate and gift tax exemption amounts (currently set at \$11,700,000 for 2021) to pre-2018 levels (\$5,490,000 indexed for inflation).
- An increase of the estate and gift tax rate from 40% to 45%.

Bottom Line:

Please note that this is a fluid situation that will continue to unfold. Negotiations have only just begun to take shape, and more proposals will be forthcoming over the next few months. Therefore, it is important to be cognizant of what is happening and to act within your own timeframe and with your own goals and priorities in mind – in consultation with your estate planning and tax advisors. We will keep you updated as additional tax proposals emerge and laws change.

Source: American Families Plan, CNR Research.

Important Disclosures

Certain information has been provided by third-party sources, and, although believed to be reliable, it has not been independently verified, and its accuracy or completeness cannot be guaranteed.

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