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A CLOSER LOOK AT THE PRESIDENT'S PROPOSED BUDGET

On May 28, 2021, President Biden's administration unveiled its proposed budget for fiscal year 2022. The administration's budget recommendations are, of course, only recommendations. Congress can accept, reject or modify them as part of the legislative process, as well as add other proposals. It can also choose to offset all or only a part of any spending programs it approves. As a result, we want you to be aware of the following tax proposals from the President's budget. More information will be released as we gain clarity on these items.

Increase the Top Individual Rate on Ordinary Income

Increase the top ordinary income tax rate from 37% to 39.6%, effective for tax years beginning after 2021. This change would accelerate the return of the top income tax rate of 39.6%, which, under current law, would have occurred automatically for tax years after 2025.

The top bracket threshold would be indexed for inflation — applying to income over $509,300 for married individuals filing jointly and $452,700 for single individuals for 2022. This top rate would apply at lower income thresholds than under current law (for 2021, $628,300 for married individuals filing jointly and $523,600 for single individuals).

Tax Capital Gains and Qualified Dividends at Ordinary Rates for High-Income Taxpayers

Currently, individual taxpayers are taxed at preferential rates on their long-term capital gains and qualified dividends as compared to ordinary income—the current highest rate for long-term capital gains and qualified dividends is 20 percent (23.8 percent, including the net investment income tax, if applicable).

The proposal would tax capital gains and qualified dividends at ordinary income tax rates (highest rate of 43.4% if the ordinary income rate is increased to 39.6%, together with net investment income tax of 3.8%) for taxpayers with income of over $1 million (but only to the extent the taxpayer's income exceeds $1 million).

For example, an individual with $200,000 of long-term capital gains and $900,000 of wages would have $100,000 of long-term capital gains taxed at ordinary income rates (the $100,000 excess over $1 million).

Effective for gains recognized after "the date of announcement" which is May 28, 2021. If the retroactive capital gains increase is approved, it will cause a lot of tax pain without giving taxpayer's the opportunity and time to plan.

Treat Transfers of Appreciated Property by Gift or on Death as Realization Events

Under general tax principles, taxpayers take into account increases and decreases in the value of their assets only at the time of a realization event, such as a sale. Currently, gifts and transfers upon death are not treated as taxable events. This is the case on transfers on death, even though the heir generally takes a "stepped up" fair market value basis in the decedent's assets upon death, with no income tax due at that time.

Under the proposal, donors and decedents would recognize capital gain upon a transfer to a donee or heir, as applicable, based on the asset's fair market value at the time of transfer. A decedent would be permitted to use capital losses and carry-forwards to offset such capital gains.

The proposal would provide several exclusions, including a $1 million per-person exclusion, $250,000 per-person exclusion for all residences (not only principal residences), transfers to a spouse (until the spouse disposes of the property or dies) and transfers of certain small business stock and family businesses. The tax on the capital gains triggered at death would be deductible for estate tax purposes, reducing the impact by 40% at current estate tax rates. If this provision were enacted in this or a similar fashion, it would make charitable transfers of appreciated property even more attractive from a tax perspective.

Limit Deferral of Gain from Like-Kind Exchanges

Limit gain deferral on "like-kind exchanges" of real property to an aggregate amount of $500,000 per year per taxpayer ($1 million for married individuals filing jointly), effective for tax years beginning after 2021. It is unclear how the threshold would be determined for entities (e.g., whether the limit would apply at the partnership or partner level).

These provisions are proposals at this time, but we want you to be aware of their significance. Please contact us with any questions on this information.