The Legislative Stage is Set: Overview of Biden Administration Tax Priorities and Other 2021 Legislative Proposals Impacting High Income and Wealth Individual Taxpayers

One May 28, 2021 the Treasury Department released its General Explanations of Tax and Revenue Proposals (known as the "Green Book") as part of President Biden's fiscal year 2022 Budget. As anticipated, the Budget proposes numerous ambitious and aspirational tax reforms that generally echo President Biden's 2020 campaign platform, including targeting high-income individuals with tax hikes; extending certain tax benefits to low and middle-income taxpayers; promoting housing, infrastructure, and clean energy; and reforming the corporate and international tax systems.

While 2021 has already seen the introduction of several legislative proposals targeting the wealthy, the much-anticipated Budget more formally blueprints the Administration's focus and priorities and sets the stage for the remainder of the 2021 Legislative session. Given the historically thin Democrat majority and sharp ideological divides between and within both parties, it is highly unlikely that the President's agenda will receive wholesale support. However, the Budget does have political significance in that it telegraphs to lawmakers the thematic tax initiatives that the White House will ultimately support.

Summarized below are the Budget provisions and three other 2021 legislative tax proposals that could adversely impact higher income and higher wealth individual taxpayers.

Biden Budget & Green Book (Individual Provisions)

- Increase the current top individual income tax rate from 37% to 39.6% and reduces the income levels at which the top rate would apply.
  - From current $628,300 to $509,300 (married filing jointly)
  - From current $523,600 to $452,700 (single filers)
- Tax capital gain and qualified dividend income at ordinary rates for individuals to the extent their income exceeds $1M.
  - If enacted, purports to apply retroactively to date of announcement on 4/28/21.
- Limit the current step-up in basis rule by triggering gain realization upon gift or death.
  - Gifts, bequests, and transfers of appreciated property into, or distributed in kind from, trusts (other than revocable, wholly owned grantor trusts) and partnerships will be treated as recognition events for the donor/donor's estate.
  - Limited exclusions apply including a general $1M exclusion (per spouse) and special rules are provided for tangibles, residences, family operating businesses, certain Qualified Small Business Stock (QSBS).
  - Transfers between spouses and to charity would also be exempt.
- Subject trusts and other non-corporate entities to mark-to-market capital gain realization where appreciated assets have not otherwise been taxed in the previous 90 years.
- Broaden application of self-employment taxes and the 3.8% net investment tax to widely capture pass-thru entity income.

- End "carried interest" capital gains treatment of certain partnership investment income.
- Make permanent the current limitation on certain excess business losses.
- Eliminate like-kind exchange tax deferral for real estate gains >$500k ($1M for joint returns)
- Provide additional funding for tax administration, audit and compliance initiatives.
- Require additional financial institution reporting on investment fund flows and cryptocurrencies.
- All proposals other than capital gains, would be effective 2022.

Note: absent from the Budget are proposed reforms related to lifting State and Local Tax deduction limits, capping other itemized deduction benefits at 28%, limiting the section 199A Qualified Business Income deduction for higher income taxpayers, and altering the Estate, Gift or Generation Skipping Transfer tax exemptions, rates and common transfer tax planning structures like grantor trusts, grantor retained annuity trusts (GRATs), dynasty trusts, etc.

Sen. Sanders (S.994) – For the 99.5% Act

- Primarily focused on reforming the transfer tax system.
- Reduces lifetime gift exemption to $1M and estate exemption to $3.5M.
- Increases rate from current 40% to graduated structure ranging from 45% to 65%.
- Eliminates or substantially limits common transfer tax planning structures including:
    - Grantor Retained Annuity Trusts – imposes minimum term (10 year) and gift amount (greater of 25% or $500,000).
    - Valuation Discount Planning – eliminates discounts on non-business assets where related parties retain ownership/control.
    - Dynasty Trusts – would limit transfer tax benefits to 50-year duration.
    - Grantor Trusts – eliminates certain tax and basis planning strategies.
    - Crummey Trusts – limits gifts in trust to 2X donor's annual exclusion.
- If enacted, the transfer tax rate and exemption provisions would be effective in 2022. All other provisions would be effective date of enactment.

Sen. Van Hollen & Rep. Pascrell (H.R. 2286) – Sensible Taxation and Equity Protection Act

- Primarily focused on eliminating stepped up basis and minimizing long-term capital gain deferral.
- Limits the current step-up in basis rule by triggering gain realization upon gift or death.
- Subjects non-grantor trusts to deemed capital gain realization every 21 years (30 years in House version).

- Transfers, sales, modifications, terminations, or certain distributions from grantor trusts not includible in the grantor's taxable estate would be deemed capital gain realization events.
- Tax on deemed sale of illiquid assets could qualify to be paid over a 15-year period.
- Limited exceptions and exclusions would apply:
    - $1M at death and $100k for lifetime gifts
    - Personal residence up to $250k single / $500k married
    - Tangible personal property (other than collectibles)
    - Transfers to spouse, charity and certain special needs or burial trusts
- If enacted, the Van Hollen discussion draft Bill would be effective retroactive to 01/01/2021. The Pascrell version in the House would apply from date of enactment.

Sen. Warren (S.510) – Ultra-Millionaire Tax Act of 2021

- Solely focused on perceived inequity of accumulation and perpetuation of substantial wealth.
- Annual confiscatory tax assessed on fair market value of broadly define taxpayer assets.
    - 2% tax on wealth in excess of $50M
    - 6% tax on wealth in excess of $1B
    - 40% one-time tax on 'covered expatriations' with wealth in excess of $50M
- Tax could be deferred up to 5 years with interest if illiquid or other undue hardship.
- Calls for the development of new valuation rules in determination of Fair Market Value.
- Provides for increased IRS funding, minimum audit rates and hefty understatement penalties.
- If enacted, would be effective beginning calendar year 2023.

So where does Washington go from here? The publication of the Budget would appear to set the stage for the Democrat majority to begin to consolidate and refocus their efforts on key areas of common ground. If party lines hold, President Biden's tax increase proposals will need the support of all 50 Democratic Senators and nearly all House Democrats to be enacted over the expected objections of Congressional Republicans. Moderate Democrats in the House and Senate will likely seek to scale back some of President Biden's proposals and even seek to block others. While impossible to predict the ultimate legislative path forward, watching for either conciliatory developments among moderate Democrats and/or signs of bi-partisan compromise with Republican leadership on the current infrastructure proposals should serve as a leading indicator on the tone of individual tax reform debates to come.

2021 Planning Considerations

- Reassess your wealth transfer planning goals and review existing planning.
- Utilize current elevated $11.7M per person transfer tax exemption, as potential to dwindle to $1M next year.
- Gift appreciated, multi-generational family assets such as business, residential or collectible assets ahead of possible deemed gain realization legislation.
- Accelerate annual exclusion gifts to multi-beneficiary trusts (Crummey Trusts).
- Form new or further fund/transact with existing Grantor Trusts.
- Utilize Zero Out GRATs for high appreciation potential assets.
- Gift/sell minority interests in existing non-operating business entities to potentially capture valuation discounts.
- Expedite any necessary or desired trust modifications or decanting.
- Expedite any Section 1031 real estate exchange transactions.
- Apply enhanced caution, but proceed with (or even accelerate) large, planned near-term capital gains transactions (business sales, real estate sales, prudent diversification, etc.).
    - Accelerating sales otherwise planned to occur over the next 6-18 months currently bears little tax risk or financial downside. Acceleration can deliver a better tax result if late year legislation is prospective or has 2022 effective date. If retroactive, no worse off than if sale occurred post enactment or later in 2022.

Note: many of the structures above may have limited windows of opportunity or could be impacted by retroactive or future law changes, so any planning should be closely coordinated with tax and legal counsel to help mitigate the potential for unintended planning outcomes.

While the summaries above are not intended to be comprehensive, they do capture most of the themes and provisions relevant to individual wealth planning. Given the breadth, complexity, and fluidity of this legislation, we want to assure you that your Pathstone Team is closely monitoring these developments and assessing their implications on your family's investment, financial, tax and estate planning. Please remember that at this point, everything discussed above are merely proposals that will most certainly undergo substantial revision, redaction and compromise over the coming months of Congressional debate.

In the meantime, please contact your Pathstone client service team if you have questions or wish to discuss. We look forward to further collaborating on your planning goals and seizing any planning opportunities these tax law changes may present.

***Sources**: FY2022 Treasury Green Book; Senate Bills S.994 and S.510; House Bill H.R 2286; Bloomberg Tax & Accounting – BTAX OnPoint Green Book Summaries; Wolters Kluwer – CCH 2021 Legislation: Law, Explanation and Analysis; and multiple publications by EY, PWC, KPMG and Leimberg Information Services, Inc.*

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