Published on *The National Law Review* https://www.natlawreview.com

A Summary of Potential Tax Increases That Would Occur Under the Proposed American Families Plan

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On April 28, 2021, the White House issued a fact sheet which set forth some additional details on the tax increase proposals contained in President Biden's "American Families Plan." Many of these tax increases are focused on taxpayers having taxable income in excess of $1 million.

Reinstatement of the 39.6% Tax Bracket

Among the significant proposed tax changes is the reinstatement of the 39.6% tax bracket which was eliminated in the 2017 Tax Cuts and Jobs Act.

Increase to the Capital Gain Rate

A proposed tax increase that will likely significantly affect M&A activity and the real estate market is an increase to the capital gain rate for "households with income in excess of $1 million." Under this proposal, the capital gains rate would be equal to the top rate applicable to individuals, which under the President's proposal would be 39.6%. It is assumed that this 39.6% rate would apply to the portion of capital gain in excess of $1 million with a lower rate imposed for capital gain that is less than $1 million. However, to date, it is unclear if this two rate structure is intended. The 39.6% rate would be in addition to the 3.8% Net Investment Income Tax, for a top marginal rate of 43.4%.

Limitation on the Ability to Defer Gain Under the Like Kind Exchange Rules

A second proposal that will likely significantly affect real estate transactions is the elimination of the tax deferred like-kind exchange rules of Section 1031 of the Internal Revenue Code to gains in excess of $500,000. Under current law, an owner of a real estate project can avoid recognition of taxable gain arising from the sale of real property if it acquires "like-kind" real property under the conditions set forth in Section 1031. Under the current application of Section 1031, if gain is deferred, the tax basis of the replacement property is adjusted so that upon a subsequent taxable sale, the deferred gain could be recognized. Under President Biden’s proposal, a taxpayer that has deferred gain through a series of like-kind exchanges would face significant tax costs on like-kind exchange occurring after the effective date of these proposed rules.

Imposition of Capital Gain Treatment for Certain Assets Owned at Death

The proposal includes the imposition of capital gains taxes on assets held at death that would otherwise benefit from a date of death tax basis step-up. While the details of this specific proposal remain elusive, it appears that certain assets held at death would trigger capital gain (presumably at the 39.6% rate per above) as if they were sold. The President’s proposal mentions an exclusion for family held businesses and farms. However, the scope of these exclusions remains unclear. For example, does the exclusion apply to a business that took on a private equity partner but remains held by family members or apply if a business is held by multiple families?

Changes to the Tax Treatment for Carried Interest

Additional tax changes included in the President’s proposal include the elimination of capital gain treatment on carried interest. It is unclear if this proposal would eliminate the current exclusion from the three year holding period rule that apply to certain real estate funds.

Additional Tax Increase Proposal

Additional tax changes included in the President’s proposal include permanently extending the excess business loss limitation and removing the wage cap for the 3.8% Medicare tax on earnings for taxpayers with taxable income over $400,000.

The American Families Plan also includes a funding increase for the Internal Revenue Service to support additional enforcement activities. As part of this proposal, financial institutions would be required to provide information reporting (e.g., IRS form 1099 reporting) on additional types of transactions. It is the expectation of many that the combination of additional funding to the Internal Revenue Service and expansion of information reporting would trigger additional tax audits.

Business Loss Limitation

The American Families Plan would also permanently extend the current limitation on certain excess business losses.

Child and Dependent Tax Credits

The American Families Plan would extend the enhanced Child Tax Credit (“CTC”) in the American Rescue Plan Act (“ARPA”) through 2025, which provides $3,600 for children under age 6 and $3,000 for children ages 6 to 17 and phases out at a 5 percent rate beginning at $112,500 for head of household filers and $150,000 for joint filers. The credit amounts would not fall below what would be allowed in each year under current law. Further, the American Families Plan would make permanent the ARPA changes that made the CTC fully refundable and expanded the Earned Income Tax Credit and Child and Dependent Care Tax Credit.

Uncertainty Over the Effective Date of Any of These Proposed Changes

The details surrounding these proposals are few and far between. We will continue to monitor the evolution of this proposal from the “fact sheet” stage into a legislative proposal. At this time, it is unclear when the effective date of any of these proposal would be. We anticipate that insight into a proposed effective date will not come out until Congress undertakes consideration of this proposal through the legislative process.

National Law Review, Volumess XI, Number 133