President Biden’s April 28 Tax Proposal

On April 28, 2021, President Biden outlined the second phase of his infrastructure plan in a Joint Session Address to Congress. As a follow-up to the American Jobs Plan announced last month, the new “American Families Plan” will seek to: (1) extend through 2025 the enhanced child tax credit established for 2021 under the recent COVID-19 relief law, (2) expand access to child care, (3) establish a national paid family leave program, and (4) provide free prekindergarten and community college education. Below are tax changes related to investing and estate planning proposed by the Biden Administration to fund these initiatives:

- Raising the top marginal income tax rate from the current 37% to 39.6%, which was the top rate in effect before 2017’s Tax Cuts and Jobs Act.
- For those with adjusted gross income of $1 million or more, increasing the top capital gains tax rate (currently set at 20% for long-term capital gains) to match the new top marginal income tax rate of 39.6%. Together with the 3.8% surtax implemented under the Affordable Care Act, the effective federal tax on long-term capital gains for high-income individuals would be 43.4%.
- Revising the income tax treatment of “carried interest” (a common form of compensation for hedge fund and private equity managers) from capital gains to ordinary income.
- Capping basis “step-up” on death at $1 million, or $2.5 million per couple when the estate includes a primary residence.
- Limiting tax deferral provided by Section 1031 exchanges when the capital gain is greater than $500,000.
- Expanding the budget and enforcement authority of the Internal Revenue Service to pursue tax compliance. The proposal includes more than $80 billion in additional IRS funding over the next 10 years.
- To increase tax collection from business owners and others who don’t report personal W-2 income as employees, mandating that financial institutions report account inflows and outflows (not only income) as part of annual reports to the IRS.

Notably, President Biden’s new tax proposals do not include any changes to the federal gift, estate, or generation-skipping transfer (“GST”) tax exemptions or rates. This means that clients would still have up to $11.7 million per person to use for current gift, estate, and GST tax planning. We remind clients that these large exemptions are scheduled to end, even without further legislative action, in 2026, at which time the exemptions will revert to the pre-Tax Cuts and Jobs Act level of $5 million adjusted for inflation (estimated to be $6.56 million in 2026).

For those thinking about planning, we note that the proposed change in the basis “step up” rules at death, if passed, would be a significant departure from current rules. This change could fundamentally impact decisions relating to investing and estate planning far into the future for high net worth clients.

As with President Biden’s earlier American Jobs Plan, the tax changes outlined above are merely proposals, the terms of which could change as President Biden negotiates with legislators. These changes to taxes paid by individuals are expected to meet greater resistance than the corporate tax changes unveiled as part of the American Jobs Plan.

Your Choate team will continue to monitor legislative developments. In the meantime, please feel free to reach out to any of your team with questions.

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