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The Biden American Families Plan and the “For the 99.5% Act” Proposals

On April 28, 2021, President Biden addressed Congress to introduce his American Families Plan. The plan is, self-acknowledged, part of an ambitious agenda to expand social and family programs, including family leave, child and healthcare, and government funded preschool and 2 years of college.

Its stated goal is to position the United States to compete in the 21st century against countries such as China, through direct government support. However, it comes at a steep \$1.8 trillion cost that is primarily intended to be paid through increased taxes and enhanced tax collection. The revenue raised is expected to both offset the costs of the American Families Plan and the recent infrastructure proposals, and the several COVID-19-related relief bills passed over the past 2 years and administrations.

The proposed tax changes are not yet well detailed and will likely evolve as this plan, along with its sister infrastructure program, work their way through Congress. Both proposals are already meeting strong headwinds from members of both parties.

There are a few items worth noting as you work with clients over the next several months. Included in this eNotice are some comments related to a bill recently introduced by Senator Sanders, the For the 99.5 Percent Act. This bill is independent of either of

Biden's proposals, but sections of that bill could affect future estate planning and may influence some of the discussions within Congress during the upcoming months.

Changes in income taxation

Perhaps the most expected portion of the proposal is a resetting of the top income tax rate on upper income earners. This has long been discussed by Biden going back to the 2020 campaign.

As expected, the proposal is to increase the top rate from the current 37% to 39.6%, the rate that was in place before the 2017 Tax Cut and Jobs Act (TCJA).

This would affect those earning more than

\$400k

Although it is not clear how this will be addressed across single and married taxpayers or households, this will be an increase for a wider net of top income earners.

The top band currently starts when an individual earns more than \$523,601 or a couple earns more than \$628,301. The proposed top bracket will be coming in at significantly lower income levels.

This will also come with an increase in the Social Security payroll tax on these same taxpayers of 12.4% on earnings more than \$400,000.

Changes in capital gain taxation

The current top capital gains rate is 20%. Biden has proposed increasing that rate to 39.6% for taxpayers with more than \$1 million of income. At this income level, these individuals and families are additionally subject to the 3.8% Affordable Care Act surcharge, for a total top capital gains rate of 43.4%. Depending on one's location, there may be additional state taxes on top of these federal rates.

This will affect not only taxpayers who consistently earn \$1 million or more, but it will also affect individuals who are selling a business or selling a home. Here, a single one-time bump in one's taxable income may trigger this tax. Homeowners and smaller property owners may have some limited deferral, but this could greatly affect negotiations and prices; this is discussed in more detail below under real estate transactions. There are certain deferrals that can be built in for taxes on the sale of a business, but they are very fact- and circumstances-focused.

The interplay between capital gains and transfer (estate and gift) taxes

There is an interesting new interplay that may develop between estate taxation and the capital gains tax. Biden's proposals do not call for revisions in the estate tax code (see the discussion further in this document on what is not included in Biden's proposals and Sanders' For the 99.5% Act).

Currently, and in most prior years, when an individual died, their assets would receive a "step-up" in tax basis, to reset the taxation of capital gains. In effect this could wipe out years of taxable gains. Heirs could then sell this asset at little or no taxable gain. This would occur regardless if an individual was subject to an estate tax.

Several times in the last 40 years Congress sought to eliminate this step-up at death. Each time it appeared it was going to become law, it was eliminated as the reality of decades of poor book-keeping hit home.

Under the current proposal, heirs would receive assets at their original purchase price, or adjusted tax basis (adjusted for depreciation, etc.). As a result, heirs would need to factor in that selling these assets would be subject to a capital gains tax, potentially as high as 43.4%. This can become an issue for many Americans who would not have anticipated a tax on their parents' deaths, particularly one that might run higher than the current top estate tax rate of 40%.

There is a recommendation of an exemption of \$1 million on capital gains transferred to heirs. However, for many individuals who inherit businesses, stocks or other assets, this could still result in a significant loss on their hands.

Note: This is already on the heels of the SECURE Act from 2020, which accelerated payout from IRAs and other tax-qualified retirement plans received by all but a narrow set of beneficiaries.

Although the government anticipates it will receive revenue from estate transfers that might not have previously generated either an estate or income tax, they may find some heirs hesitant to sell low basis stocks or businesses. It is too early to see how this might play out or what form this might ultimately take.

At the same time, very high-net-worth families remain subject to an estate tax. At the moment, those are families whose estates exceed the \$11.7 million dollar exemption (\$23.4 million for married couples who use portability). Those families will see both an estate tax, as well as lose the step-up in basis for their heirs. Although many anticipated the lifetime exemption would drop to \$3.5 million or a similar amount, that was not proposed (this is discussed later in this eNotice).

However, as the law currently stands, the \$11.7 million lifetime exemption is already scheduled to drop after 2025 to an amount equal to the former \$5 million dollar exemption (indexed for inflation). **Even if none of the estate tax proposals (such as the For the 99.5% Act) pass, just the running of the clock will expose even more estates to both estate taxation, as well as capital gains taxation.**

Real estate gain and deferrals under Section 1031

Several longstanding sections of the Tax Code allow sellers to defer their gains if the sales proceeds are “rolled” into similar property. For the real estate industry, this ability to defer gains on the sale of property has existed nearly since the start of the modern Tax Code under Section 1031. Many taxpayers have often deferred their gains multiple times and then relied on the step-up at death to avoid taxation on those gains permanently as property was transferred to their families.

This approach applies to other property; in the case of life insurance, this is covered by Tax Code §1035. Over the years some deferrals have been eliminated; notably a few related to equipment and artwork were eliminated under Trump’s TCJA to help fund other tax cuts.

Under the Biden proposal, real estate gain deferrals under §1031 would be sharply curtailed. In a drive to capture capital gains, the Biden proposal would put real estate transactions on par with the sales of other forms of property. There are limited exceptions. The proposal would tax gains on real estate greater than \$500,000 at current capital gain rates. Homeowners would have a one-time exemption of \$500,000 on the sale of their homes.

This provision in Biden’s proposal has drawn considerable attention from lobbyists who recognize that §1031 helps encourage real estate transactions and development that might not otherwise occur.

An additional \$80 billion to staff IRS audits

In recent weeks there has been considerable press about revenue loss through tax evasion. Much has been discussed about IRS budget erosion over the past decade and the toll it has taken on systems and audit

personnel. It was noted by the Congressional Budget Office that the agency’s annual budget has decreased by 20% over the past decade and its staff decreased a similar 22%. Some figures have discussed revenue losses ranging from \$700 billion to \$1 trillion. According to the New York Times, the \$80 billion would be parceled out over 10 years. The proposals would replace 1960s-era technology and increase audit staff.

These projected revenue increases through tax audits are speculative, but could raise more revenue than any single tax increase. Even though the stated goal is to increase audits on high-income taxpayers, it may be years before these benefits might be received. It will take time to hire and train auditors. Additionally, high-income taxpayers may stretch out large tax audits over many years.

Key items not addressed

There are a few high-profile tax-related items that are notably missing; time will tell if they are raised by the Biden Administration or Congress.

The effective date: This is not addressed in the Biden proposal, although Sanders’ For the 99.5 Percent Act discussed below has an effective date of January 1, 2022. However, at Equitable we are seeing an increase in interest in wealth transfer and tax planning.

State and Local Tax (SALT) deductions: These deductions, which include state and local income taxes as well as real estate taxes, were sharply curtailed under the 2017 TCJA to \$10,000/year. Those cuts were accompanied by increases in the standard deduction and removing certain itemized deduction phase-outs. This offset the loss of these deductions for many. Nevertheless, the loss of these deductions remains a point of contention with taxpayers in high-income and real estate tax states. Biden has repeatedly indicated a lack of interest in removing the SALT limitations, despite the fact that most of the affected states are Democratic strongholds. Perhaps for this reason, there is nothing in this bill that addresses this issue. However, it may come up in debates over the spring and summer.

The Individual Alternative Minimum Tax (AMT):

This tax, a parallel calculation to standard income taxes, was originally intended to capture high-income taxpayers who used certain tax loopholes to minimize

their taxes. The AMT was introduced decades ago as an alternative calculation to assure certain minimal tax levels were paid by these taxpayers. Over the years the indexing of the AMT exemption caused this tax to creep to increasingly lower income taxpayers, including many below the \$400,000 mark, which has usually been Biden's stated threshold.

The AMT was temporarily changed with a sharply higher exemption under the 2017 TCJA. That change is already scheduled to lapse after 2025, unless extended by Congress. As this goes to press, nothing in the proposals appears to address extending this exemption or changing the scope of the AMT.

Estate tax changes: During the campaign, Biden's platform indicated a plan to revisit estate taxation. This was to counter a sharp increase in the lifetime estate and gift tax exemption that was enacted with the 2017 TCJA; that exemption currently stands at \$11.7 million, up sharply from a \$5 million exemption introduced under the Obama Administration in 2012.

Notably, nothing in the April 28 proposals discussed changes to estate or gift tax rates or exemptions.

There could be any number of reasons ranging from:

- The proposed changes in capital gains tax and loss of step-up in basis could be viewed as a substitute for traditional estate taxation; additionally, the proposed capital gains rate approaches the current estate tax rate.
- There may be plans to introduce estate tax changes at a later point in time.
- Introducing changes to the lifetime gift exemption could be a "bargaining chip" in negotiations with Congress around the capital gain proposals.

Still, as it stands, the current high estate and gift exemption will lapse after 2025. Without further legislation, the scheduled drop in the exemption will trigger estate tax exposure for more Americans than

are currently affected. It could also be possible these individuals will have both capital gain exposure as well as estate tax exposure.

Read [Wealth planning after the Tax Cut and Jobs Act](#) to see options to planning around that should be considered in 2021.

What might be on the horizon

Although not proposed by Biden, the progressive arm of the Democratic Party has rallied around Senator Bernie Sanders' For the 99.5 Percent Act. This bill was formally introduced on March 25, 2021, and as proposed, would become effective after December 31, 2021. This proposed legislation could also color the conversations around these tax proposals. Some brief highlights of this potential act:

- A sharp reduction in the estate tax exemption to \$3.5 million for individual estate tax exemptions (\$7 million for married couples). However, unlike other recent changes, there is no plan for cost-of-living adjustments. This has not been the case since the 1990s.
- At the same time there would be a reintroduction of a graduated estate tax ranging from 45% for estates over the \$3.5 million dollar exemption up to 65% on estates over \$1 billion.
- A sharp reduction in lifetime gifting – a reduction to \$1 million for individuals and \$2 million for married couples.
- This would be coupled with a sharp reduction in the annual gift tax exclusion, currently \$15,000 per person and replaced with an annual total gift amount for each donor.
- Some popular estate tax-planning techniques such as grantor retained annuity trusts, irrevocable grantor trusts (defective grantor trusts) and certain valuation discounts would be curtailed. Some existing trusts might either need to limit new funds or face a prorating calculation on assets included in a grantor's estate.
- There would also be limitations in dynasty or generation-skipping trusts.

Conclusion

These proposals are expected to receive considerable resistance in Congress from Republicans. It's also apparent that some moderate Democrats are averse to some of the capital gains provisions.

As with the parallel infrastructure bill, the provisions and sources of revenue will be sorted through committees and on the Congressional floor over upcoming months. It's likely these will change during that time. It is entirely possible that both this bill and the infrastructure bill would pass under a process known as budget reconciliation that allows for expedited and faster passage of certain legislation. It was used to fast-track the 2017 TCJA under Trump and the recent COVID-19 stimulus under Biden.

Equitable Advanced Markets wanted to make this summary available to you early in the process, but we may not revisit this until the final version(s) of the bill become clearer.

However, please work with Equitable Advanced Markets regarding any questions you may have about this legislation. In particular, we should note we have seen an escalation in discussions around estate transfers, and this conversation is likely to dominate throughout 2021.

**If you have any questions, contact
Advanced Markets.**

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