

The Potential Impact of Green Book Provisions on Capital Gain Income



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Are your high-net-worth clients aware that they could face up to an 82% increase in capital gain taxes under the new tax proposals?

On May 28, 2021, the Biden administration released the Fiscal Year 2022 Budget, and the “General Explanations of the Administration’s Fiscal Year 2022 Revenue Proposals,” which is commonly referred to as the “Green Book”. The Green Book summarized the Administration’s tax proposals contained in the budget. While the Green Book is not proposed legislation, it is a starting point for Congress and many of these concepts are being considered for inclusion in the latest legislative budget talks.

Two of the more significant provisions included in the Green Book focus on the following two items:

- Taxation of capital gain income for high-income earners at ordinary rates.
- The transfer of certain appreciated assets which pass by gift or death would now be treated as a realization event for income tax purposes.

Both provisions could significantly impact tax planning in the near term.

Taxation of Capital Gain Income

Long term capital gains and qualified dividends have been taxed as high as 23.8% beginning in 2013 when President Obama signed the Affordable Care Act, which added the 3.8% net investment income tax to this type of income. President Biden’s proposal focuses on taxing this type of income at ordinary rates for those with adjusted gross income exceeding \$1 million. This would result in capital gain income being taxed at 37%, which is currently the highest individual tax rate, or 40.8% if you include the net investment income tax. Also, taxpayers must be mindful that President Biden is also proposing to increase the top tax bracket from 37% to 39.6%, which would further compound the issue. If both proposals are successful, long term capital gains and qualified dividends would jump from a tax rate of 23.8% to 43.4% for high net wealth individuals, which would be an 82% increase.

Even more concerning is the effective date of this provision. The proposal states that the change would be effective for gains after the date of announcement, April 28, 2021, which would make it retroactive. In any event, these proposed changes would have profound ramifications for individual taxpayers, creating incentives to defer realization events for appreciated investments, increasing the economic value of capital losses and capital

loss carryforwards, and bringing dividend bearing investments closer to tax parity with interest-bearing debt investments. It also potentially means that planning needs to be done with much longer timelines, years in advance of possible large transactions.

Tax Recognition of Appreciation at Gift or Death:

Under current law, when a taxpayer passes away, he does not recognize any income tax consequences on unrealized gains of capital assets at the date of death. President Biden’s proposal would force recognition of unrealized gains for certain taxpayers forcing the decedent’s estate to pay the tax. In addition, gains on unrealized appreciation would be recognized by a trust, partnership or other noncorporate entity if that property has not been the subject of a recognition event within the prior 90 years. The testing period for this provision would begin on January 1, 1940, with the first possible recognition event occurring on December 31, 2030.

Certain exclusions would apply:

- Transfers by a decedent to a U.S. spouse or charity.
- Gain on tangible personal property, such as household furnishings and personal effects (excluding collectibles).
- Certain small business stock.

In addition to the above, the proposal allows a \$1 million per-person exclusion on the recognition of unrealized gains for transfers at death or by gift. Also, the payment of tax on certain family-owned and operated businesses could be deferred until the interest in the business is sold. Finally, a taxpayer may be allowed a 15-year payment plan for tax on the unrealized gains from the appreciated assets transferred at death, other than liquid assets such as publicly traded securities.

These proposed changes are a fundamental shift to more than a century of tax law. The change will layer an increased capital gains tax on top of any gift, estate, or generation-skipping transfer tax and will effectively eliminate the step-up in basis in estates. However, the Green Book notes that unrealized gains subject to tax at death would be deductible on the estate tax return. Look for a shift in planning away from gift and estate tax, towards income tax planning. Holding appreciated assets until death in order to achieve a stepped-up basis will no longer be a viable strategy. Stay tuned to see how these provisions are ultimately either included, amended, or excluded from the legislative process.