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Biden's Green Book Includes Retroactive Capital Gains Tax Increase

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On Friday, May 28, 2021, the Biden Administration released its Green Book setting out the President's revenue and policy proposals. Of particular interest to investors is the administration's proposal to raise the tax on long-term capital gains from its current maximum rate of 23.8 percent (including the 3.8 percent net investment income tax) to a new rate of 40.8 percent for certain higher-income taxpayers: those with adjusted gross income exceeding $1 million if married filing jointly and exceeding $500,000 if married filing separately or individuals. Though no effective date is specified, the Green Book provides that the proposal would be effective for gains recognized "after the date of announcement," which could refer to the date at which the proposal was first publicized in April 2021.

The Green Book also proposes that the transfer of appreciated property, whether gifted during life or inherited at death, would be a taxable event to the transferor.

Accompanying this proposed transfer tax would be a $1 million lifetime exclusion per married couple, indexed to inflation. If adopted, this proposal would likely be effective December 31, 2021.

Taxpayers should consult with their income tax and estate planning advisors to determine the appropriate response to these potential changes.

Details of the tax rate changes

The Green Book's proposed long-term capital gains increase would be the first retroactive capital gains increase in U.S. federal tax history and would have potentially far-reaching consequences. For example, for owners of pass-through entities, who receive "phantom income," as a result of the undistributed earnings of the pass-through entity, such a rate hike would create a substantial tax burden should the pass-through entity dispose of appreciated capital assets. Furthermore, in the context of selling a business, parties would have to determine who should bear the brunt of the increased cost (i.e., should the seller expect a higher purchase price from the buyer to account for the additional income tax expense).

The Green Book's proposed tax on the transfer of appreciated property would effectively magnify the effects of the long-term capital gains rate hike by imposing an additional income tax burden on top of the estate tax for many high-net-worth taxpayers. For example, under current law, a gift of a long-term capital asset with a value $10 million and a basis of $5 million would not result in the imposition of any income or transfer taxes, provided that the transferor had sufficient remaining lifetime exemption. As of 2021, the lifetime gift tax exclusion is $11.7 million per individual and $23.4 million per married couple.

Whereas, under the Green Book proposal, that same $10 million gift would trigger $1,632,000 in capital gains tax, assuming that none of the $1 million exclusion had previously been used ($5 million of gain minus $1 million of exclusion, times the proposed rate of 40.8 percent). This does not include state tax.

Figure 1. Comparison of making a gift, current v. future (if proposal is adopted)

	Current Law	January 1, 2022	
Fair Market Value of Gift	$10 million	$10 million	A
Donor's Basis	$5 million	$5 million	B
Realized Gain	0	$5 million	C
Exclusion	0	-$1 million	D
Rate	0%	40.8%	E
Tax on Gift	**$0**	**$1,632,000**	**G = (C - D) *E**

What this means to you

Taxpayers should consult with their income tax and estate planning advisors to determine the appropriate response to these potential changes. While the Green Book is merely a proposal and not law, it does suggest that investors should prepare for changes to the taxation of capital gains.

Contact us

For questions on your income tax and estate planning future contact Jacque Albus, Robert Romashko, Jessica Quintero or your Husch Blackwell attorney.