Biden releases budget and Green Book, advocates for increased taxes

This Finseca Policy Deep Dive publication was prepared exclusively for Finseca members by Finseca staff and counsel.

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On Friday, May 28th the Biden Administration released its 6 trillion-dollar budget for the upcoming fiscal year. The budget projects trillion-dollar deficits, 1.9% GDP growth, and assumes no significant changes to inflation – all over the next decade.

Accompanying the release of the budget was the "green book", a more detailed look at the tax proposals in the budget. The Biden administration reinstated the annual release of the green book after it had been discontinued by President Trump.

Contained were a number of proposals that impact Finseca members and their clients.

Corporate rate set to 28%.
Effective date: taxable years beginning after 12/31/2021 (and the 2022 calendar year portion of any taxable year starting after January 1, 2021)

Capital gains and dividend rate: 43.4% [including Net Investment Income Tax] for taxpayers with AGI of more than $1 million.
Effective date: gains required to be recognized after the date of announcement (likely end of April 2021 making it retroactive)

Gift and death treated as realization event by donor or decedent, triggering immediate taxable income.
Effective date: gifts or individuals dying after 12/31/2021

Dynasty Trusts Any unrealized gain inside of a trust, partnership, or other non-corporate entity for 90 years would be deemed taxable.
Effective date: The first possible recognition event for any taxpayer under this provision would thus be 12/31/2030

Repeal 1031 tax-free exchanges.
Effective date: exchanges completed in tax years beginning after 12/31/2021

Individual rate set to 39.6%.
Effective date: taxable years beginning after 12/31/2021

Carried interest rate taxed as ordinary income:
Effective date: tax years beginning after 12/31/2021

Not Included Changes to Inside Build Up, Death Benefit, COLI/BOLI, NQDC, 199A, or Estate Tax Rates & Exemptions.

Both the budget and green book are only proposals, while influential, Congress will ultimately decide what becomes law.

Read on for a detailed analysis of the proposals, their impact to Finseca members and their clients, as well as political analysis from our D.C. experts on their likelihood of becoming law, click below.

A note from Armstrong Robinson

Every year, Presidential administrations release a budget that outlines their policy priorities and encourages Congress to enact those policies. It is up to Congress to decide whether or not to accept, some, all, or none of the President's proposal.

By the very nature of just having taken office, the budget and green book, in the first year of a new administration are often less robust. Many observers have remarked that this green book falls clearly within that description. However, the proposals made would represent profound changes to our system of taxation.

Below Finseca's experts analyze what was included in the proposal, what was left out, and how likely it is to be made into federal law. Finseca Influencer Members get access to this regularly through the Finseca Forecast delivered directly to your inbox every other Thursday at 6 p.m. ET.

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Finseca expert analysis

Corporate rate set to 28%.

Effective date: taxable years beginning after 12/31/2021 (and the 2022 calendar year portion of any taxable year starting after January 1, 2021)

Ken Kies: Not much of a surprise here as the Administration has been arguing for a 28% rate since the Presidential campaign began. Of note, however, is Democrats in the Senate seeming to coalesce around 25% as a ceiling, forecasting that the 28% proposed may be nothing more than a marker.

Ashli Palmer: Of all the revenue raising proposals, an increase in the corporate rate seems the most likely to be included in a final package. Public polling indicates such a change is broadly popular and Democrats believe that corporations would have been happy with a 25% rate back in 2017.

Capital gains and dividend rate 43.4%. [including Net Investment Income Tax] for taxpayers with AGI of more than $1 million.

Effective date: gains required to be recognized after the date of announcement (likely end of April 2021 making it retroactive)

Ken: Again, this proposal has been broadly known for some time. The new detail released here is that effective date, going back to late April and making it retroactive. Tax changes have been made retroactive before, but in general tax increases are done prospectively – this is one to watch as Congress weighs in and I wouldn't be shocked if the effective date were changed. The late April date seems likely to correspond to President Biden's address to Congress – April 28. Of course, Congress will have the final say.

Jay Heimbach: The path forward for what the administration has proposed will be a rocky one. Many moderate Democrats in both the Senate and House have expressed concern about the political ramifications in the midterms for making this change as well as the potential impact to investment. I think there is path forward for raising the capital gains rate but making death a realization event will be a more uphill battle, as will doing away with Step Up in Basis.

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Gift and death treated as realization event by donor or decedent, triggering immediate taxable income.

Effective date: gifts or individuals dying after 12/31/2021
Payment of tax on the appreciation of certain family-owned and operated businesses or farms would not be due until the interest in the business is sold or the business ceases to be family-owned and operated.

Ken: The Administration is proposing to make a gift or death a realization event for tax purposes. This means the proposal would impose tax (at a rate of 43.4% for those making at least $1 million) upon gift (on the person making the gift) or death (on the decedent) on the difference between the tax basis of property and the fair market value. (Another approach would have been to leave the recipient with carryover basis).

Jeff Ricchetti: Treating gifts, as well as death, as a realization event was one of the more consequential elements of the Administration's budget. While it was foreseeable to prevent tax avoidance strategies in response to treating death as a realization event, it makes the proposal far more disruptive of lifetime wealth transfer planning and heightens the stakes for planners making decisions regarding gifting while the lifetime exemption remains at over $22 million per couple.

Dynasty Trusts Any unrealized gain inside of a trust, partnership, or other non-corporate entity for 90 years would be deemed taxable.

Effective date: The first possible recognition event for any taxpayer under this provision would thus be December 31, 2030

Ken: The Biden administration would make a major change to estate planning by instituting an effective federal rule against perpetuities by making "Gain on unrealized appreciation" recognized by a trust, partnership, or other noncorporate entity that is the owner of property if that property has not been the subject of a recognition event within the prior 90 years, with such testing period beginning on January 1, 1940.

Josh: Notable by their absence were any changes to estate tax rates and exemptions, or other planning techniques and tools in the wealth transfer arena. If other proposals such as capital gains / repeal of step-up fall by the wayside, it is possible that the estate tax is an area Congress could look at for revenue, including making changes to dynasty trusts.

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Repeal 1031 tax-free exchanges.

Effective date: exchanges completed in tax years beginning after 12/31/2021

Ken: The proposal would limit the deferral of gain from like-kind exchanges of real estate property to an aggregate amount of $500,000 per taxpayer (or $1 million for married individuals filing joint returns) each year. It would be effective for exchanges completed in taxable years beginning after December 31, 2021.

Josh: Members of Congress have been hearing much more chatter around this proposal and the Finseca team has been monitoring those conversations closely for any spill over into 1035 exchanges. A proposal like this could find its way into a final package given the relatively few Americans it would impact.

Individual rate set to 39.6%.

Effective date: taxable years beginning after 12/31/2021

Ken: Nothing new here – this proposal was as discussed.

Army: Like the corporate rate, this is a proposal that could stick when a final package is enacted. Most democrats have campaigned on taxing the wealthy, and don't feel obligated to maintain any of the tax cuts Republicans passed in 2017. However, the vote math will control the final result and there is no margin for error.

Carried interest rate taxed as ordinary income.

Effective date: tax years beginning after 12/31/2021

Ken: This was a surprise when the Administration announced it as part of their rollout on the infrastructure package. Prognosticators had speculated that the carried interest rate deduction would be left unchanged. The proposal would repeal section 1061 for taxpayers with taxable income (from all sources) in excess of $400,000 and would be effective for taxable years beginning after December 31, 2021.

Jeff Shapiro: The carried interest rate deduction has been utilized by hedge fund managers for years and has withstood prior attempts to modify it. While this issue polls well, especially given that a relatively small – and wealthy – group takes advantage of it, expect many influential stakeholders to work to maintain the current treatment.

This Finseca Policy Deep Dive is brought to you by the following Finseca staff and counsel.

Additional resources

Click here to view the entire Green Book.

For more insights and analysis, RSVP for one of our member-only tax update calls.

- June 10 @ 11:00 a.m. ET – 11:30 a.m. ET
- June 30 @ 11:00 a.m. ET – 11:30 a.m. ET This call is only for Influencer members and will focus on the Wealth Transfer marketplace.