

Biden's American Families Plan to Partially Eliminate Stepped Up Basis

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In late April 2021, President Biden announced The American Families Plan as part of his Build Back Better economic agenda. The plan proposes to overhaul the longstanding rule that estate beneficiaries receive assets with a "stepped up" tax basis based on the asset's fair market value at the time of death.

To understand the tax implications of the proposal, you first need to understand the concept of tax basis. Basis is the value of an asset used to determine gain or loss when the asset is sold. Generally, when you purchase a capital asset like stock or investment real estate, your tax basis in that asset is the purchase price. Certain events can alter your basis in the asset. For instance, if you make capital improvements on the asset or claim a depreciation deduction, your tax basis in the asset increases or decreases, respectively. If an asset's fair market value is greater than your tax basis in that asset, you have an unrealized gain.

When you sell the asset for an amount greater than your tax basis, the difference is taxed as a capital gain. If the purchase price is lower than your tax basis, you have a capital loss that can be used to offset certain other capital gains. The buyer's new tax basis in the asset is the purchase price.

If you give away (gift) the asset during your lifetime, the recipient receives the asset with a "carryover basis" equivalent to your basis in the asset. If you die owning the asset, it passes to a beneficiary according to your will (or through state intestacy laws if you don't have one) and the beneficiary inherits the asset with a "stepped up" basis equal to the asset's fair market value at the time of your death.

Because of the stepped up basis rule, it is often advantageous to inherit property from someone who died instead of receiving it as a gift during the donor's life. To illustrate, if you purchase stock for \$100,000, your basis in that stock is \$100,000. Over time, the fair market value of the stock appreciates to \$500,000. If you were to sell the stock for that amount, you would recognize a \$400,000 capital gain and pay up to 20% in tax on the gain. If you gift the stock to someone during your lifetime and the recipient sells the stock for \$500,000, the recipient also incurs a \$400,000 capital gain. On the other hand, if you die leaving the stock to a beneficiary in your will, the recipient takes the stock with a new basis of \$500,000. If the recipient sells the stock for that amount, there is no gain recognized and no tax owed.

As a way to combat wealth inequality and raise revenue, President Biden's plan proposes raising the top capital gains rate to from 20% to 39.6% and partially eliminating the stepped up basis rule. The proposal includes an exemption of \$1 million for individuals. That amount can be "ported" over to a surviving spouse, increasing the survivor's exemption to \$2 million. Beneficiaries would still receive property with a stepped up basis if the decedent's total unrealized capital gains at death were under his or her exemption. Assets received by estate beneficiaries in excess of the exemption come with a carryover basis.

To revisit the earlier example, assume you bought stock for \$100,000 and die when it is worth \$500,000. If you bequeath that stock to someone in your will, on your death that person would inherit it with a \$500,000 basis. Under the American Families Plan, the beneficiary would still inherit it with a \$500,000 basis if your estate has less than \$1 million in unrealized capital gains (or up to \$2 million if you were predeceased by a spouse). If your estate has unrealized gains in excess of that exemption amount (e.g. if you die owning significant appreciated assets), the beneficiary inherits the stock with your original \$100,000 basis and would be liable for capital gains tax upon its sale.

Of course, all of this is just a proposal. Very few, if any, Republican senators would vote for this plan and there is no guarantee all Democrats will be on board. The Tax and Estates lawyers at White and Williams are following this matter closely and will publish updates as this proposal and others are deliberated in Congress.

If you have questions or would like more information, please contact Andrew J. Barron (barrona@whiteandwilliams.com; 215.864.7167) or another member of the Tax and Estates Group.

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