



Washington Policy Research

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As part of his plan to fund key initiatives, President Biden has proposed several tax changes, including taxing unrealized capital gains over \$1 million at time of death and altering how estate taxes are calculated. As is often the case when Congress gets involved, we think actual changes will be more modest than what's been proposed when it's all said and done.

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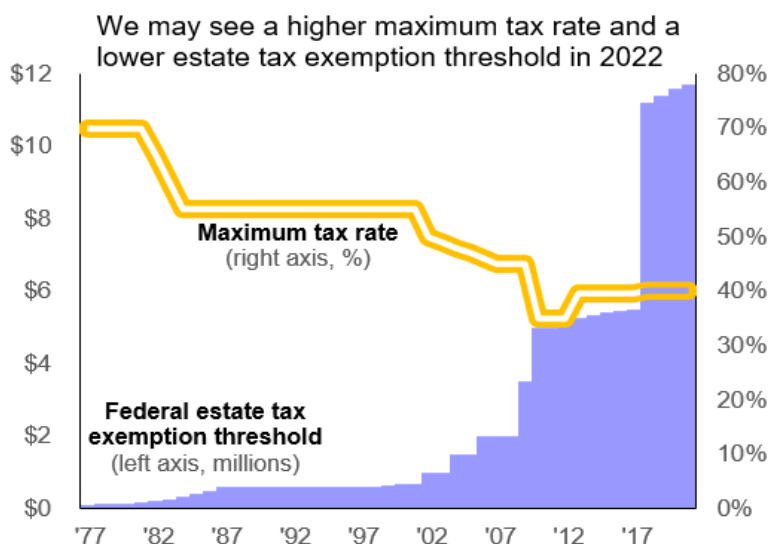
CHANGES TO THE ESTATE TAX NOT EXPECTED TO BE DRASTIC

Changes on the table: President Biden's proposed tax on unrealized capital gains over \$1 million at the time of death is tied to his proposal to tax capital gains and dividends at ordinary income rates, [which we discussed last month](#). These changes would take steps to prevent investors from avoiding the tax by simply not realizing gains. He also wants to change the estate tax from "step up in basis" to "carryover basis," which would mean the person inheriting the assets is responsible for paying taxes for price appreciation from an earlier, and often lower, cost basis. Let's look at the current estate tax, past changes, and what we expect to emerge from the other end of the legislative process.

The rules we have now: The chart below shows historical changes and where we are today. The current maximum estate tax rate is 40% on estates more than \$1 million above the \$11.7 million threshold. As you can see in the chart, Congress doubled the federal estate tax exemption threshold in 2017 and had previously indexed it to inflation (though the higher threshold is slated to expire in 2025). Currently, when an asset transfers due to death, the cost basis is "stepped up" to the market value at the time of death, so that the heir is not taxed on the entire price appreciation of the asset from its original purchase. This could be changed under the new proposal.

Previous (failed) attempt to change to carryover basis: Congress attempted to move the estate tax to a carryover basis in 1976 but measuring the original basis proved to be administratively complicated and after significant pushback, Congress repealed the change retroactively in 1979. Then-Senator Biden was one of just four senators to vote against the repeal.

Present-day opposition to new changes: Members of Congress, particularly from farm states, are expressing opposition to the unrealized capital gains provision (despite proposed exemptions for farms). Moderate Democratic senators have also voted to repeal the estate tax in the past. Therefore, we think moving to a carryover basis *and* establishing an unrealized capital gains tax seems unlikely.



What seems likely, given all the factors: We expect changes to the estate tax to be fairly modest, such as a higher rate and lower exemption threshold. Although estate tax changes have been applied retroactively in the past, we expect the effective date to be near enactment of the legislation (which will be a budget reconciliation bill passed by Democrats). At the same time, the closer the bill's enactment approaches year-end, the more likely the effective date will be 2022.

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