



TTAA Legislative Update

December 14, 2020



Joe Biden's Death Tax Plans

During the presidential campaign, President-elect Biden proposed a number of changes to how family businesses are taxed, including hiking the death tax. Here is a “quick” look at some of the potential policy changes we’ll be up against.

Joe Biden’s Death Tax Plan:

Biden would return to 2009 law for the death tax (\$3.5 million exemption and 45% rate vs. \$11.7 exemption for individuals/\$23.4 million for couples in 2021 and 40% rate). According to the JCT, this change would more than triple the number of taxpayers currently subject to the death tax. Joe Biden’s other proposed tax increases would compound the financial and compliance burden on next generation family business owners.

Step up in basis repeal

Joe Biden has proposed repealing the step up in basis provision of the law. ATR has catalogued the President-elect advocating for eliminating step up on the stump several times. As an example, consider a family distribution business started with no basis that has grown to a \$50 million business with locations and jobs across several regions. If step up in basis were repealed, upon the sale of the business, the next generation of ownership would owe capital gains taxes on the full \$50 million in appreciation throughout the lifetime of the business, instead of, as current law calls for, having the basis “stepped-up” to its current fair market value on the date of the previous owner’s passing. Stepping up the basis of property protects next generation business owners from the potential double whammy of paying a 40% death tax and then another large capital gains tax upon the sale or future passing on of the business.

Capital Gains Due at Death

Death is not predictable in the same way a planned sale is which makes the estate tax hard to plan for and pay. When a business owner passes away, under the Biden plan, inheritors would now owe capital gains taxes as if a profitable sale of the family business had occurred upon the owner’s death in addition to death taxes. This would add yet another layer of complexity to the tax code for family businesses at the worst possible time.

Taxing Capital Gains as Ordinary Income

The potential tax increase on family businesses will be compounded by the Biden plan to tax capital gains as ordinary income. A part owner of a large family business making over

\$1 million in income would potentially have to pay the ordinary income tax rate on a small business they inherited at death versus the capital gains tax rate. Let's step back and consider an example with all of the above factors worked in.

Example, Current Law vs. Biden tax plans:

John is second generation part-owner of a family distribution company valued at \$50 million, started by his father with no basis. The company makes an annual profit of \$1 million per year with taxes paid by John and his father.

Let's consider a scenario where John's father, the majority owner of this company, dies in 2021 under current law vs. under the Biden tax plan. John who has been running the family business for his father is set to inherit the company, with the goal of keeping it running, protecting jobs, and staving off a fire-sale to a publicly traded multi-national company.

John's tax obligations under current law, post Trump tax cuts:

If John's father used the full 2021 estate tax exemption with spousal portability of \$23.4 million, about half of the business would be protected from death taxes. John while attempting to keep workers employed and the business running would still need to come up with \$10 million for death taxes (40% estate tax rate on roughly \$25 million over current exemption). Upon paying this huge tax bill to Uncle Sam, John would inherit the company and have the basis of the company "stepped up" upon inheritance to its fair market value of \$50 million. No additional capital gains or income taxes would be due by the estate or heir. In some states an additional state estate/inheritance tax may be due.

Assets left after taxes: Roughly \$40 million

John's tax obligations after the potential Biden tax increases:

Under Joe Biden's death tax plan, (\$3.5 million exemption and 45% rate, with no spousal portability), John's goal of preserving jobs in the family business becomes much more difficult. Before paying the death tax, John must first pay capital gains taxes due at death on the \$50 million business. Capital gains for taxpayers making more than \$1 million would be taxed at ordinary income rates, a proposed 39.6% under the Biden tax plan. Additionally, the 3.8% net investment income tax created by the Affordable Care Act would likely still apply, increasing the tax rate to 43.4%. Since our hypothetical next generation business owner John now makes \$1 million as the sole owner of the family business according to pass-through rules, his inheritance of the business is now taxed at the maximum income tax rate.

Business value: \$50 million

Capital gains tax rate: 43.4%

Capital gains tax owed: \$21.7 million

After paying the capital gains due at death, John must also pay the death tax on the remaining assets in the estate. Instead of coming up with \$10 million under current law, John must now pay Uncle Sam an additional \$11.2 million in death taxes under the Biden tax plan in addition to \$21.7 million for capital gains taxes.

Value of remaining estate: \$28.3 million
Estate tax exemption: \$3.5 million
Taxable estate: \$24.8 million
Estate tax rate: 45%
Death tax owed: \$11.2 million

Taken altogether the Biden tax hikes would shrink the \$50 million business all the way down to \$17.1 million versus \$40 million under current law. That's not factoring in state transfer taxes.

Under a fully implemented Biden tax plan, John is having to at a minimum shut down branches, sell assets, and lay off employees to keep the business running. For many family businesses operating on tight margins, coming up with any spare cash is a struggle and that extreme level of taxation would be nearly impossible to overcome. That's a look at what's at stake for the treatment of family businesses under a possible Biden administration tax plan.

We expect 2021 to be an active year for the death tax, step up in basis, and protecting other technical changes relating to estate planning so please stay tuned for more frequent updates as we gear up to protect family businesses from these policies.



We wish you and your family a Happy Holidays! We will resume the Legislative Update on January 4th, 2021.

