Proposed Tax Reform: A Status Update

2021 Land Pro Fall Seminar

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American Rescue Plan

- On March 11, 2021, President Biden signed the **$1.9 trillion American Rescue Plan** into law. Congress passed this legislative package, described as providing COVID-19 relief to businesses and families, through the budget reconciliation process with a vote of 50-49 in the Senate (one Senator did not vote) and 220–211 in the House.
  - This law issued another round of economic impact payments ($1,400 each), called for monthly advance child tax credit payments to families with children, expanded the Affordable Care Act’s premium tax credits, extended unemployment benefits, extended the employee retention credit and family leave/sick leave credits, and much more.

“Build Back Better”

- On March 31, President Biden proposed the $2.4 trillion **American Jobs Plan** (infrastructure).
  - Made in America tax plan would pay for provisions with changes to corporate and international tax structure.

“Build Back Better”

- On April 28, President Biden unveiled the $1.8 trillion **American Families Plan**.
  - The Plan proposes to “grow the middle class, expand the benefits of economic growth to all Americans, and leave the United States more competitive.”
  - States that it will only increase tax on the “wealthiest” Americans.
  - Budget “Green Book” provided additional details.

American Rescue Plan & “Build Back Better”

Senate passed Infrastructure Bill

- Senate passed the scaled down **$1.2 trillion infrastructure package** August 10 by a vote of 69-30.
  - "INVEST in America Act"
    - Replace and repair roads, bridges, modernize ports and waterways, rail, water pipes, power grid, airports, and more.
    - Expand access to internet broadband, including rural broadband.
    - Address some climate change matters
      - Implement charging stations for electric vehicles, transmission lines
    - Say paid for with **repurposed COVID funds and dynamic scoring**.

Shifted the Controversial Provisions to *Reconciliation*

Senate Passed Budget Resolution

- On August 11, Senate Democrats passed a $3.5 trillion *budget resolution* for fiscal year 2022 (50-49).
- This opens door for Senate to later pass (with 50 votes) the provisions within the President's budget, including the **American Families Plan and more** through **budget reconciliation**.
  - Committees are instructed to write legislative language, due September 15.
- **"The Democratic budget will be the most significant legislation for American families since the era of the New Deal and Great Society." Senator Schumer.**

Thune Amendment

- "To protect owners of generationally-owned businesses, farms, and ranches so that they may continue to transfer ownership or operations to family members or others based upon the same tax principles that existed when they began operations and under which they currently operate, including the full benefit of the step-up in basis."

- Passed 99-0.
- Non-Binding

House Divided

- Lots of support in the majority party, but they haven’t agreed on the details.
  - **Tuesday (August 24)**: House passed the $3.5 trillion budget resolution and set a <u>September 27 House vote</u> on **infrastructure**.

  - Moderates wanted to pass infrastructure first. Progressives don’t want infrastructure if they can’t have reconciliation (all or nothing).
    - This may tee up reconciliation earlier than thought.

Budget Reconciliation

Reconciliation Might Try to Include it All

- Including provisions not able to get through the infrastructure bill
  - Corporate tax rate increase (to 28%, maybe 25% as compromise)
  - More climate provisions, although parliamentarian may say not revenue-related.
- Benefits and tax increases proposed by the American Families Plan.

Budget Reconciliation – What Does it Mean?

- The Congressional Budget Act allows ***reconciliation*** for legislation that changes spending, revenues, and the federal debt limit.
  - Allows Congress to enact legislation flowing from a **budget resolution**.
  - Resistant to filibuster (only 51 votes needed in the Senate)
  - Subject to the Byrd rule, provisions that do not change revenue or spending are extraneous and may not be included
    - Legislation may not increase the deficit beyond 10 years.
      - Lots of possibilities: Affordable Care Act, Tax Cuts & Jobs Act, American Rescue Plan Act.

Unclear What Will Happen

Unclear What Will Happen

- Says no increased taxes on those making under $400,000.
- Says won’t impact farms and small businesses.
- Because of potential to overhaul estate and transition planning for rural Americans, farmers, and ranchers, we are taking a serious look.

American Families Plan

Proposed Benefits

- $1.8 Trillion in proposed benefits, mainly to families with young children.
  - $1 trillion in investments
  - $800 billion in tax cuts
  - Says program will be paid for in 15 years, with no one earning less than $400,000 paying any more taxes.

Proposed Benefits - Education

- "Four years of free education."
  - Universal preschool to three and four-year-olds
  - Two years of "free community college"
  - Increased Pell grants
  - Scholarship program for future teachers

Proposed Benefits – Family Support

- “Direct support for children and families”
  - Ensure families spend no more than seven percent of their income on child care
  - $15 minimum wage for early childhood caregivers
  - National comprehensive paid family and medical leave program
  - Expanded nutrition assistance
    - Expanded summer and school lunch assistance

Proposed Benefits – Medicare Expansion

- Budget reconciliation would reportedly expand Medicare to include dental, hearing, and vision coverage.

Proposed Benefits – Tax Credits

- Extend increase of refundable child tax credit ($3,000, $3,600)
- Expansion of dependent care credit
- Expansion of earned income credit
- Increased tax credits for Affordable Care Act insurance

~~Million Dollar~~ 4.7 Trillion Dollar Question: How would it be paid for?

Increase Top Tax Rate

- **Increase the Top Individual Tax Rate**
  - For tax years **beginning in 2022**, AFP would restore the 39.6 % individual tax rate that was in effect before the TCJA and lower the income thresholds at which it applies.
    - For tax years beginning in 2018 through 2025, the TCJA lowered the top tax rate from 39.6 percent to 37 percent.
      - It also raised the income thresholds at which the highest rate was triggered.

      - Green Book explanation: This change would raise revenue while increasing the progressivity of the tax system.

Increase Top Tax Rate

- Proposals would also lower the income thresholds at which the top rate is triggered.

Top Tax Rate Increase

	2021 (37 percent)	2022 (39.6 percent)
MFJ	$628,301	$509,301
Single	$523,601	$452,701
HOH	$523,601	$481,001
MFS	$314,151	$254,651

Eliminate Preferential Capital Gains Rate

- **Beginning ~April 28, 2021**, eliminate the Preferential Capital Gain Tax Rates for Taxpayers with > $1 million in Income.
  - The Plan proposes to subject long-term capital gain to **ordinary income tax rates** where overall income (including gain) exceeds $1 million.
    - “Reforms to the taxation of capital gains and qualified dividends will reduce economic disparities among Americans and raise needed revenue.” Green Book

Current Rates

Tax Rates - 2021

Ordinary Income Tax Rates					Long-Term Gain		
Single		MFJ			Single	MFJ	
0	9950	0	19,900	**10%**	0	0	
9951	40,525	19,901	81,050	**12%**	40,400	80,800	**0%**
40,526	86,375	81,051	172,750	**22%**	40,401	80,801	
86,376	164,925	172,751	329,850	**24%**			
164,926	209,425	329,851	418,850	**32%**			
209,426	523,600	418,851	628,300	**35%**	445,850	501,600	**15%**
523601+		628,301+		**37%**	445,851	501,601	**20%**

Eliminate Preferential Capital Gains Rate

This gain > $1 million would be taxed at the current rates in 2021 and at the higher rates **in 2022**:

	2022 (39.6 percent)
MFJ	$509,301
Single	$452,701
HOH	$481,001
MFS	$254,651

Taxpayers would also owe the **3.8 percent Net Investment Income Tax** on this gain, increasing the 2022 tax rate to **43.4 percent**.

Extend NIIT and SECA

- Ensure that all trade or business income of high-income taxpayers (>$400K AGI) is subject to the 3.8 percent Medicare tax, **either the NIIT or SECA tax**
- For taxpayers with > $400,000 AGI, the definition of net investment tax would be amended to include “gross income and gain from any trades or businesses that is not otherwise subject to employment taxes.”
- Self-rental, sale of business assets, S corporation distributions?

Example – Lifetime Sale

Worked with ISU ag economist Wendong Zhang to review statistically representative sample of Iowa farmland owners to determine impact of American Families Plan on these owners, based **solely** upon their farmland holdings:

https://www.card.iastate.edu/products/publications/synopsis/?p=1330

Impact

- On average, we estimate that a full-time farmer owning 358 acres of farmland would see tax liability from a lifetime sale increase from $475,248 to $860,572 (**81% increase**) or from 14.5% to 26% of FMV.

Example of *Average* Impact

- In 2002, an unmarried Cerro Gordo County farmer purchased **422 acres** of farmland worth $2,648/acre or **$1,117,550**.
- In 2021, the FMV of the land is $3,250,642 or $7,703/acre. The farmer sells, recognizing **$2,133,092** in gain.

- Under current law, the farmer would owe **$398,265** or 12% of the sales price in tax, assuming no additional income beyond the standard deduction.

Example – Lifetime Sale

- Under the AFP, this farmer would owe $686,208 or 21% of the sales price in tax, a **72% tax increase**.

New Tax at Death or Gift

- **Beginning in 2022**, treat the **transfer of appreciated property at death or by gift as a sale**, meaning that unrealized capital gain would be taxed at the time of death or gift.
- Dying with or gifting appreciated property would trigger taxable income to the decedent on the Federal gift or estate tax return or on a separate capital gains return.
  - Note this is in conjunction with provisions that would **increase the top tax rate**, subject gains to **ordinary income tax rates where income is more than $1 million**, and **apply the NIIT** to gain from the sale of business assets, like farmland, if overall AGI > $400K.

Remember Thune Amendment

- "To protect owners of generationally-owned businesses, farms, and ranches so that they may continue to transfer ownership or operations to family members or others based upon the same tax principles that existed when they began operations and under which they currently operate, including the full benefit of the step-up in basis."

- Passed 99-0.
- Non-Binding

New Tax at Death or Gift

- This is a **controversial provision** that appears to face significant opposition, even amongst some Democrats. But lockout is feared.
- But: **How do you raise money with higher capital gain taxes if no one sells?**

New Tax at Death or Gift

- Each deceased person would be allowed to exclude **up to $1 million (indexed for inflation) in gain from recognition at death or at the time of gift**.
- Married couple would each get their own exemption, which is **portable**, meaning that a couple could exempt $2 million in gain from tax.
  - $250,000 in gain from taxation for the sale of a personal residence ($500,000 for married filing jointly)would also be excluded
    - A married couple could potentially exempt up to $2.5 million in gain from taxation at death.

New Tax at Death - Basis

- If property is transferred at death, the recipient's basis in the property would be the FMV of that property at the decedent's death.
- Still have step up. Just not tax free for > $1 million.
  - **Example**: Transfer $5 million parcel of land with $3 million in appreciation ($2 million basis) at death.
    - Heir receives the land with a $5 million basis. Tax is due on $2 million of gain ($1 million exemption).

New Tax at Gift - Basis

- If property is transferred by gift, the recipient would receive a carryover basis, to the extent that the $1 million exclusion applies.
  - For gifts that trigger a transfer tax, the basis would adjust to FMV for that portion of the property subject to the tax.
    - **Example**: Gift $5 million parcel of land with $3 million in appreciation ($2 million basis).
      - Donee receives the land with a $4 million basis. Tax is due on $2 million of gain.

New Tax at Death / Gift

- This is not an estate and gift tax (taxed upon value of estate).
- Current estate tax would still apply if value of estate exceeds basic exclusion amount (currently $11.7 million).
  - New tax would be deductible from estate value.
- This would be a new transfer tax at death, **never before used in our country**.

Family Business Deferral – Few Details

- Payment of tax on the appreciation of **certain family-owned and -operated businesses** would *not be due* **until** the interest in the business is sold or the business ceases to be **family-owned and operated**.
  - IRS could require **security** at any time when there is a reasonable need for security to continue this deferral. That security could be provided from any person, and in any form, deemed acceptable by the IRS.

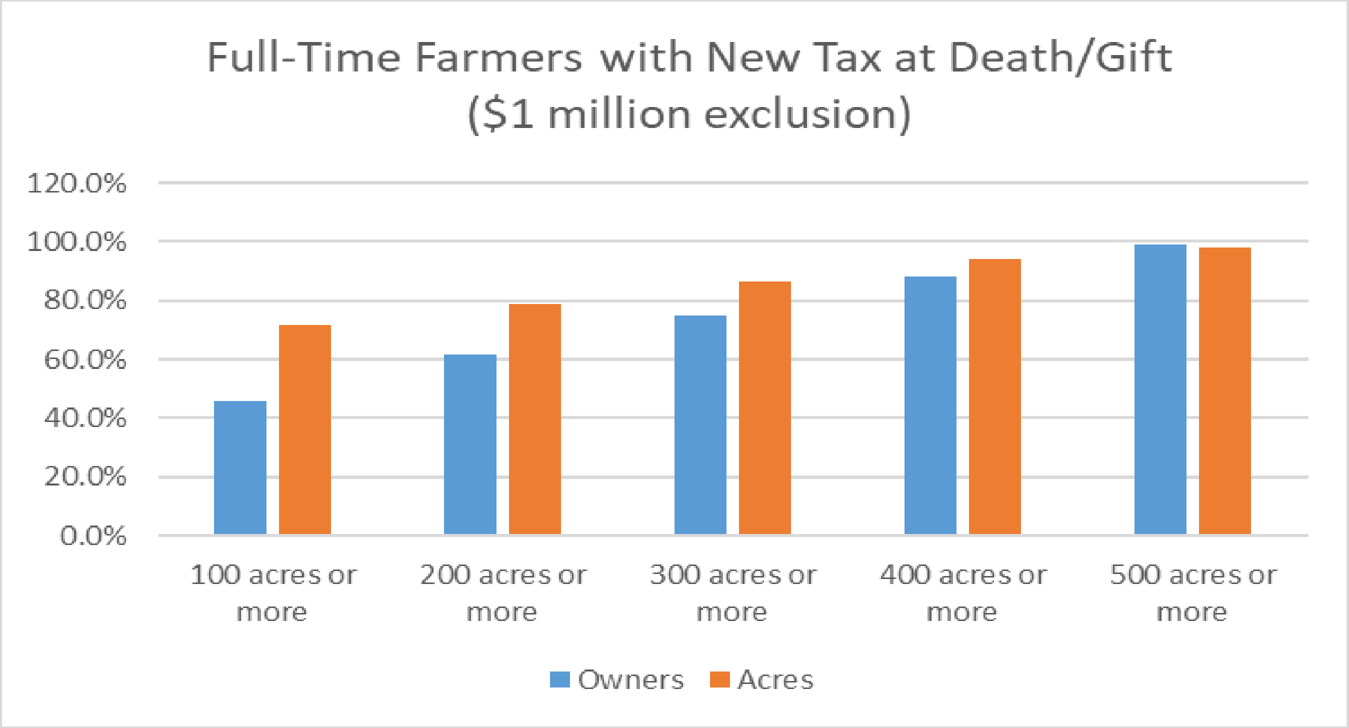
American Families Plan – Exemption for Farms

- Although the plan appears to **defer any tax liability on family farms as long as the farm remains *family-owned and operated, not clear what that means***.
  - The tax would presumably become due at any point where the land was no longer actively farmed by a family member, perhaps with interest?
  - Basis would step up by $1 million, but remainder would have carryover basis.
  - A lien would likely remain on the land and perhaps other farm assets, impacting ongoing operation and credit acquisition, etc.

American Families Plan – Exemption for Farms

- Difficult to define “family farm” or “farming”?
  - Crop share, custom farming, retired, widowed, etc.? Special use valuation definition is *very* restrictive.
- Who are family members?
  - Descendants or siblings or cousins?

Impact



Full-Time Farmers with New Tax at Death/Gift
($1 million exclusion)
120.0%
100.0%
80.0%
60.0%
40.0%
20.0%
0.0%
100 acres or more
200 acres or more
300 acres or more
400 acres or more
500 acres or more
Owners
Acres

Example

- Married farmers in Buena Vista County own 722 acres of farmland as joint tenants with right of survivorship. In 2004, they purchased the land for **$3,093/acre** or $2,233,146. In 2021, the land is worth **$9,972/acre**, for a total FMV of $7,199,784. Thus, in 2021, they have **$4,966,638** in unrealized gain in their farmland.
  - The farmers are killed together in a tragic accident in 2021. Under current law, their land would pass to their heirs with **no tax liability**, and the basis of the property would step up to $7,199,784.

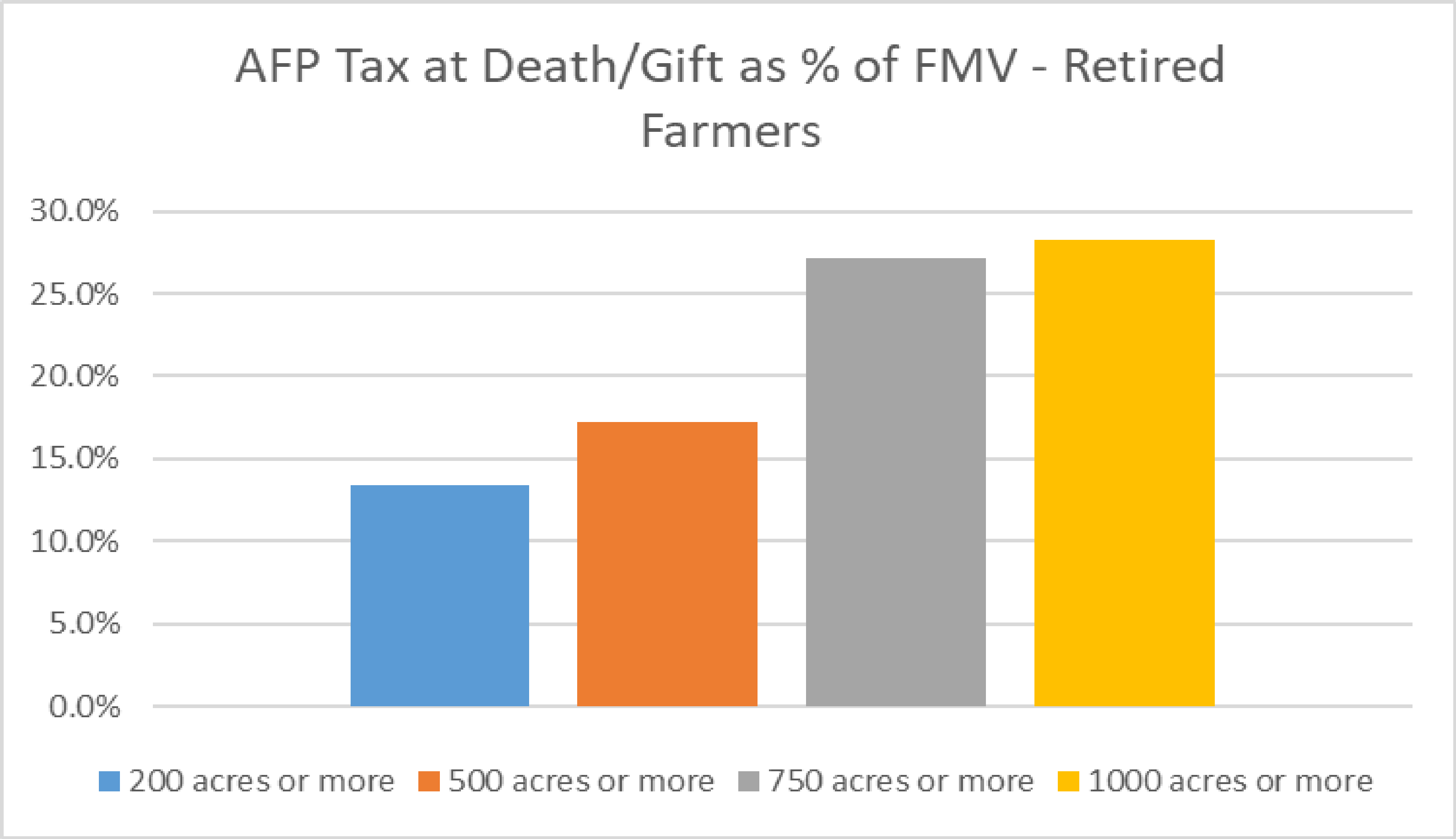
Example

- Under the AFP, after applying a **$2 million exclusion**, the death of these owners would trigger the realization of **$2,966,638** in gain from their farmland. This would generate **$1,039,122 in net tax liability** at death ($519,561 per spouse), assuming no other assets or income.

Estimated Impact

- Our data show that the **average new tax liability** for retired farmers with an interest in 200 acres or more or 500 acres or more would be **$582,659 and $1,002,543**, respectively.

Estimated Impact



Example

- A retired farmer from Buena Vista County dies in 2021 owning 700 acres of farmland.
- In 1975, he purchased the land for $1,450/acre or $1,015,000. In 2021, it is worth $9,800/acre or $6,860,000. He dies with $5,845,000 in unrealized gain.
- Under the AFP, the retired farmer's death creates new tax liability of $1,863,178. This is **27% of the FMV of the land**.

American Families Plan – Like-Kind Exchange

- Proposes to limit Section 1031 Exchange Deferral to $500,000 in Gain ($1 million for a married couple) **per year**
  - Although the Tax Cuts and Jobs Act eliminated like-kind deferral treatment for the exchange of personal property (farmers, for example, must now recognize gain on the trade-in value of a tractor), section 1031 for **real property** survived.
  - *Green Book*: The change would raise revenue while increasing the progressivity of the tax system.

  - This proposal seems to be losing momentum.

What about the estate tax?

- The President's Budget did not reference the estate or gift tax (or the GST), but there has been much chatter about reducing that exemption.

Recent History of Estate Tax Exemption

- 2005 $1.5 million
- 2005 $1.5 million
- 2006 $2 million
- 2007 $2 million
- 2008 $2 million
- 2009 $3.5 million
- 2010 $5 million (or no estate tax with carryover basis)
- 2011 $5 million
- 2012 $5.12 million
- 2013 $5.25 million
- 2014 $5.34 million
- 2015 $5.43 million
- 2016 $5.45 million
- 2017 $5.49 million
- 2018 $11.18 million
- 2019 $11.4 million
- 2020 $11.58 million
- 2021 $11.7 million

Without intervention, scheduled to reset to $5 million, indexed for inflation in 2026.

Above this amount, tax is 40 percent.

0.16 percent of farm operators would owe estate tax today.

The 99.5 Percent Act Proposal

- On March 25, 2021, Senators Sanders and Whitehouse (D-RI) introduced the “FOR THE 99.5 PERCENT ACT.”
- Reduce the estate tax exemption from $11.7 million to $3.5 million for estate tax and to $1 million for lifetime gifts.
  - Effective beginning in 2022.
- Would increase maximum estate tax rates from 40 percent to:
  - Estates over $3,500,000 but under $10,000,000 - 45%;
  - Estates over $10,000,000 up to $50,000,000 - 50%;
  - Estates over $50,000,000 but under $1,000,000,000 - 55%; and
  - Estates over $1,000,000,000 - 65%.

What to do?

- It’s too early to take specific planning steps without more detail or a clearer understanding of what provisions might actually pass (if any).
  - Stay up to date on proposals and work closely with tax advisors if it looks like proposals get traction.

September/October May Get Interesting…

Discussion