

**Biden Administration FY2022 Budget Proposals
Related to Individual Tax Matters
Released May 28, 2021**

Overview

The proposals included in the Treasury’s FY 2022 green book related to individual tax matters are generally consistent with the proposals included in “The American Families Plan” released by the Biden Administration April 28, 2021. In general, the most significant proposals would: (i) make permanent the expansions in the American Rescue Plan (ARP) of the Premium Tax Credits, EITC and the Child and Dependent Care Tax Credit; (ii) generally extend the Child Tax Credit expansions in the ARP to 2025, except full refundability would be made permanent; (iii) increase the top individual marginal rate to 39.6 percent; (iv) increase the tax rate on capital gains (CG) to the top rate applicable to ordinary income; (v) impose a tax on CG at death; (vi) treat certain gains from carried interests as ordinary income; (vii) repeal deferral of gain from like-kind exchanges above a threshold amount; and (viii) make permanent the excess business loss limitation to non-corporate taxpayers under section 461(l).

Summary of proposals

The following is a summary of the green book’s proposals related to individual tax matters (not including tax gap measures), including proposed effective dates and Treasury’s 10-year revenue estimates.

1. **Raise the top individual income tax rate to 39.6 percent.**
 - a. Thresholds. For taxable year 2022 and thereafter, the top marginal tax rate would be raised to 39.6 percent applicable to taxable income over \$509,300 for married individuals filing a joint return; \$452,700 for unmarried individuals (other than surviving spouses); \$481,000 for head of household filers; and \$254,650 for married individuals filing a separate return. These thresholds would be indexed for inflation using the C-CPI-U.
 - b. Effective date. Taxable years beginning after December 31, 2021.
 - c. Revenue estimate. \$131.9 billion over 10 years.
2. **Capital income taxed at ordinary rates for high-income taxpayers.** Long-term capital gains and qualified dividends would be taxed at ordinary income tax rates to the extent the taxpayer’s AGI exceeds \$1 million (\$500,000 for married filing separately).
 - a. Thresholds. Only applies to taxpayers to the extent the taxpayer’s AGI exceeds \$1 million (\$500,000 for married filing separately). The threshold amounts would be indexed for inflation.
 - b. Effective date. Effective for gains required to be recognized after the “date of announcement.” (No effective date is specified with respect to dividends).
 - c. Revenue estimate. Combined with the proposal to treat transfers of appreciated property by gift or on death as realization events, this proposal raises \$322.5 billion over 10 years.
3. **Transfers of appreciated property by gift or at death treated as realization events.** Donors and decedents generally would be required to recognize CG upon a transfer of an

appreciated asset to a donee or heir, based on the fair market value of the asset at the time of transfer. A decedent would be permitted to use capital losses and carry-forwards to offset any capital gains and up to \$3,000 of ordinary income.

- a. Non-corporate entities. Unrealized appreciation in property owned by partnerships, trusts, and other non-corporate entities would be required to be recognized if that property has not been subject to a recognition event in the prior 90 years. The look-back period begins January 1, 1940; consequently, this rule would not become effective until December 31, 2030. Several operational aspects of this proposal are left unaddressed, such as who bears the incidence of tax.
 - b. Contributions and distributions. Contributions to, or distributions from, partnerships, trusts, and other non-corporate entities would be treated as taxable events. Note: as currently described, the proposal would completely overturn nonrecognition of gain under sections 721 and 751. The unfettered breadth of this proposal seemingly cannot be what was intended.
 - c. Revocable grantor trusts. The deemed owner of a revocable grantor trust would recognize gain on the unrealized appreciation in any asset distributed from the trust to any person other than the deemed owner (or his or her U.S. spouse), other than a distribution to discharge an obligation of the deemed owner. All of the unrealized appreciation on assets of such a trust would be triggered upon the death of the deemed owner or when the trust becomes irrevocable.
 - d. Exclusions.
 - i. Assets transferred to U.S. spouses and charities (with carry-over basis).
 - ii. A \$1 million per-person exclusion (portable to the surviving spouse, so effectively \$2 million per married couple). The amount of this exclusion would be indexed for inflation.
 - iii. Tangible personal property, such as furnishings and personal effects (excluding collectibles).
 - iv. The current exclusion of gain on personal residences would remain applicable, as would the exclusion applicable to certain small business stock.
 - e. Farms and family-owned businesses. Payment of tax would not be due in the case of certain family-owned and -operated businesses until the interest in the business is sold or the business ceases to be family-owned and -operated.
 - f. Installment payment. The tax on appreciated assets transferred at death (excluding certain liquid assets and transfers of businesses for which the deferral election is made) could be paid over 15 years. Posting of security could be required by the IRS.
 - g. Effective date. Generally, would be effective for gifts made or decedents dying after December 31, 2021.
 - h. Revenue estimate. Combined with the proposal to tax capital income for high-income earners at ordinary rates, this proposal raises \$322.5 billion over 10 years.
4. **Rationalize net investment income and Self-Employment Contributions Act taxes.** All trade or business income of high-income taxpayers would be subject to the 3.8 percent Medicare tax (either through the net investment income tax or the SECA tax).
- a. Partnerships and LLCs. Limited partners and LLC members who provide services and materially participate in their partnerships and LLCs would be subject to

SECA tax on their distributive shares of partnership or LLC income to the extent that this income exceeds certain threshold amounts. The exemptions from SECA tax provided under current law for certain types of partnership income (e.g., rents, dividends, capital gains, and certain retired partner income) would continue to apply to these types of income. Similar rules would apply to S corporations.

- b. Thresholds. Changes to the net investment income tax would apply to taxpayers with AGI exceeding \$400,000. Under the proposal, the additional income that would be subject to SECA tax would be the lesser of: (i) the potential SECA income, and (ii) the excess over \$400,000 of the sum of the potential SECA income, wage income subject to FICA under current law, and 92.35 percent of self-employment income subject to SECA tax under current law. The \$400,000 threshold amount would not be indexed for inflation.
- c. Effective date. Taxable years beginning after December 31, 2021.
- d. Revenue estimate. Raises \$236.5 billion over 10 years.

Proposals Related to Workers, Families, and Economic Security

1. **Make permanent the American Rescue Plan expansion of premium tax credits.** The green book would make permanent all three changes to the premium tax credits made in ARP (decreases in the applicable contribution percentages, expanded eligibility to taxpayers with household income over 400 percent of Federal poverty line, and elimination of indexation of the applicable contribution percentages).
 - a. Effective date. After December 31, 2022 (when the ARP provisions would otherwise expire).
 - b. Revenue estimate. -\$163 billion over 10 years.
2. **Make permanent the expansion of the Earned Income Tax Credit for childless adults.** The proposal would make permanent changes in the ARP that increased the EITC parameters for childless workers and expanded the age eligibility for certain younger and older workers. In addition, the end of the phase-in and end of the plateau income ranges would be indexed for inflation using the CPI-U.
 - a. Effective date. Taxable years beginning after December 31, 2021 (when the ARP provisions would otherwise expire).
 - b. Revenue estimate. -\$105.2 billion over 10 years.
3. **Make permanent the American Rescue Plan changes to the Child and Dependent Care Tax Credit.** In addition to making permanent the changes to the CDCTC included in ARP, the proposal would establish new reporting requirements to ensure compliance, suggesting as options: (i) applying existing paid preparer due diligence requirements; (ii) requiring taxpayers to provide certain information about the care provider to claim the credit (with math error authority to deny credits to taxpayers who fail to provide such information); and (iii) information return requirements for agencies that provide child care subsidies.
 - a. Effective date. Taxable years beginning after December 31, 2021 (when the ARP provisions would otherwise expire).

- b. Revenue estimate. -\$104.2 billion over 10 years.
4. **Extend the Child Tax Credit increase through 2025 and make permanent full refundability.** The proposal would extend most of the ARP expansions of the Child Tax Credit through 2025 (when the TCJA changes to the CTC expire), including: (i) an increase in eligibility for the credit to include children who are 17 years old; (ii) an increase in the amount of the credit to \$3,600 for children under age six and \$3,000 for other children (retaining the ARP phaseout for the amount of the credit that exceeds \$2,000); and (iii) an allowance of 50 percent of the credit to be advanced based on the previous year's tax return. The credit would be made fully refundable on a permanent basis.
- a. Effective date. Taxable years beginning after December 31, 2021 (when the ARP provisions would otherwise expire).
 - b. Revenue estimate. -\$449.1 billion over 10 years.
5. **Increase the employer-provided childcare tax credit for businesses.** The proposal would increase the existing tax credit to 50 percent of the first \$1 million of qualified care expenses for a maximum total credit of \$500,000 per year. The portion of the tax credit related to referral expenses would remain at 10 percent with a maximum amount of \$150,000.
- a. Effective date. Taxable years beginning after December 31, 2021.
 - b. Revenue estimate. -\$302 million over 10 years.

Proposals Related to "Closing Loopholes"

5. **Tax gains from carried interest as ordinary income.** (Similar to a proposal in the Obama Administration FY 2017 green book). Net capital gain from an "investment services partnership interest" (ISPI) is treated as ordinary income and is taken into account in determining the partner's net earnings from self-employment, if the partner's taxable income (from all sources) exceeds \$400,000.
- a. ISPI. An ISPI generally is any partnership interest held by a person who provides services to an investment partnership. A partnership is an investment partnership if substantially all of its assets are investment-type assets (certain securities, real estate, interests in partnerships, commodities, cash or cash equivalents, or derivative contracts with respect to those assets), but only if over half of the partnership's contributed capital is from partners in whose hands the interests constitute property not held in connection with a trade or business (i.e., investment property).
 - b. Invested capital. Rules are provided that allow amounts attributable to invested capital of the services partner to still receive CG treatment.
 - c. Treatment of goodwill (enterprise value). The Administration supports the development of mechanisms to assure the proper amount of income recharacterization where the business has goodwill or other assets unrelated to the services of the ISPI holder.
 - d. Change in character. In addition to the rate change and subjecting income to SECA, converting long-term CG to ordinary income may present various problems. Some of the problems that may be created are: determining whether

the income is from a U.S. or foreign source; determining how the income is characterized for purposes of the foreign tax credit limitation rules; determining whether income is ECI or UBTI, and other similar issues.

- e. Section 1061. The increased three-year holding period would no longer apply to taxpayers subject to the proposal.
 - f. Disqualified interests. Similar recharacterization rules apply to income or gain derived from other “disqualified interests” (e.g., convertible debt, options, or derivatives) held by a person who performs substantial investment management services for any investment entity.
 - g. Effective date. Effective for in taxable years beginning after December 31, 2021.
 - h. Revenue estimate. Raises \$1.47 billion over 10 years.
6. **Repeal deferral of gain from certain like-kind exchanges**. Any gains from like-kind exchanges in excess of \$500,000 (or \$1 million in the case of a joint return) during a taxable year would be recognized by the taxpayer in that year. The threshold amounts would not be indexed for inflation.
- a. Additional details. Gains at or below the above threshold amounts would continue to be deferred.
 - b. Effective date. Exchanges completed in taxable years beginning after December 31, 2021.
 - c. Revenue estimate. Raises \$19.6 billion over 10 years.
7. **Make permanent excess business loss limitation applicable to noncorporate taxpayers under section 461(I)**. Section 461(I) limits the extent to which non-corporate business losses may be used to offset other income. In particular, for taxable years beginning after December 31, 2020, and before January 1, 2027, noncorporate taxpayers may not deduct “excess business losses” from taxable income but may carry them forward to a subsequent taxable year as net operating losses. In 2021, an “excess business loss” is \$524,000 for married couples filing jointly and \$262,000 for all other taxpayers; these amounts are indexed for inflation thereafter. The proposal would remove the sunset and make the limitation under section 461(I) permanent.
- a. Effective date. Taxable years beginning after December 31, 2026.
 - b. Revenue estimate. \$42.9 billion over 10 years.