



Budget and Treasury Green Book for 2022

On May 28, 2021, the Biden Administration released its FY 2022 Budget and Treasury Green Book, providing additional detail surrounding the administration's tax increases previously outlined in the Made in America Tax Plan and the American Families Plan. We hope you find this comparison of current and proposed laws helpful. The buzz around these most recent proposals is loud, so we'll break down the more significant tax proposals below. It's important to remember that the Green Book is the administration's budget *recommendation*, so these initiatives are subject to review by Congress which can then enact, modify, or dismiss them through the legislative process. These congressional conversations are already underway, with talks of bipartisan spending projects seeing approval. The specifics regarding their funding from the tax proposals below will be further cemented in the coming months.

Proposals Relating to Individuals and Investments:

- 1) **Increase the top marginal individual income tax rate from 37% to 39.6%**, accelerating the sunset changes scheduled to take place in 2026 under the TCJA (Tax Cuts and Jobs Act) of 2017.

| | 37% in 2021 | 39.6% in 2022 |
|---------------------------|-------------|---------------|
| Married filing jointly | \$628,300 | \$509,300 |
| Single | \$523,600 | \$452,700 |
| Head of household | \$523,600 | \$481,000 |
| Married filing separately | \$314,150 | \$254,650 |

- 2) **Increase taxation of capital income:**

Current tax law: Most realized long-term capital gains and qualified dividends are taxed at graduated rates under the individual income tax, with 20% generally being the highest rate.

Proposal: Long-term capital gains and qualified dividends of taxpayers with adjusted gross income of more than \$1 million (\$500,000 for married filing separately) would be taxed at ordinary income tax rates. Results in a top rate of 43.4% when the 3.8% net investment income tax is included.

Comment: The Green Book implied an effective date of April 24, 2021. If this change were to be retroactive, it would limit the ability to make any sales ahead of time, prior to enactment.

- 3) **Realize capital gain upon death or by gift of transferred, appreciated assets:**

Current tax law: The transfer of an asset upon the death of the owner is not recognized as a realization event. Rather, the donee is granted a "stepped-up" basis in the asset to fair market value of the asset at the date of the decedent's death. Thus, the appreciated value of the asset is not subject to federal capital gains tax.

Proposal: Treat death as a realization event, meaning recognize the capital gain upon the death of the owner of an appreciated asset. This gain would be taxable income to the decedent. Additionally, every 90 years, a gain on unrealized appreciation of a property will be recognized if that property has not been subject to a realization event within the prior 90 years.¹

Repeal of the stepped-up basis may resurrect the carryover basis administrative burdens of the past. The repeal would only apply to a floor of \$1 million (\$2 million for joint filers) plus the current capital gains exclusion of \$250,000/\$500,000 for primary residences. The 90 year limitation is a direct attempt to limit the long-term effect of Dynasty trusts.

- 4) **Extend application of net investment income (NIIT) and Self-Employed Contributions Act (SECA) taxes:**

Current tax law: Individuals with incomes over \$200,000 (\$250,000 for joint returns) are subject to the 3.8% tax on net investment income (NIIT) enacted as a part of the funding for the Affordable Care Act.

Proposal: Some exemptions and loopholes related to tax on income for S corporation shareholder-employees, limited partners, and LLC members would be closed. NIIT would apply to active pass-through business income for those earning more than \$400,000.

(continued)

5) Place limit on deferral of gain from like-kind property exchanges:

Current tax law: There is no limit on gains that can be deferred from like-kind exchanges of real property. The tax on these gains is deferred until a later recognition event.²

Proposal: Gains in excess of \$500,000 for each taxpayer, or \$1 million for married filing jointly, will be taxed in the year of the like-kind property exchange.³

Comment: This proposal eliminates another avenue to avoid increased capital gains tax and ensures there is funding for American Jobs Act.

6) Tax carried interest as ordinary income:

Current tax law: Partnerships are not subject to Federal income tax. When a partnership recognizes a long-term capital gain, individual partners recognize this gain as a long-term capital gain on their tax returns, which is taxed at reduced rates.

Proposal: For partners with total taxable income exceeding \$400,000, “carried interest” will be taxed as ordinary income, rather than a long-term capital gain. Additionally, such income will be subject to self-employment tax and will not be eligible for the preferable rates that apply to long-term capital gains.

Comment: This proposed change is primarily limited to Private Equity and Hedge Fund Managers who largely use entity structures with vast numbers of partnerships as flow-through entities to both pass tax burdens to individual investors as well as make it very complicated to unravel and determine income liability.

Proposals Relating to Businesses:

1) Increase the corporate tax rate from 21% to 28%:

Current tax law: The Tax Cuts and Jobs Act of 2017 (TCJA) instituted a flat tax of 21% for all C corporations – a replacement of the previous graduated tax schedule, with most corporate income taxed at a marginal and average rate of 35%.

Proposal: Increase the income tax rate for C corporations from 21% to 28%, effective for taxable years beginning after December 31, 2021.

Comment: This tax increase is **only applicable to C corporations**, and likely not to have any impact on small businesses that are taxed as “pass-through” entities.

2) Adding 15% minimum tax to corporations with book value exceeding \$2 billion rather than taxable income:

Current tax law: There exist certain allowances that reduce the income of corporations that is subject to federal income tax.

Proposal: Tighten up regulations surrounding these allowances and ensure all corporations **exceeding \$2 billion in book value** incur at least a 15% federal income tax.⁴

Comment: This tax increase is in response to the practice of many of the largest corporations that pay zero taxes. Setting a floor of 15% ensures that regardless of incentives, deductions or other loopholes, the corporation pays at least a minimum amount.

¹ There are special rules and exclusions for charitable donations, deferral of gain for family-owned and operated businesses, spousal portability, and capital gains attributable to primary residences.

² Such exchanges could be transactions of one business for another, one real estate property for another, livestock for qualifying livestock, and exchanges of other qualifying assets.

³ Applicable to like-kind exchanges in tax years beginning after December 31, 2021.

⁴ Effective in tax years beginning after December 31, 2021.

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