

Observations on the Administration's 2023 Tax Agenda

April 5, 2022



On March 28, 2022, the current Administration released its proposed fiscal year 2023 budget blueprint which contains many notable tax changes, some of which are highlighted below.

Notable Proposed Tax Changes:

1. Increase of the preferred long-term capital gains and qualified dividends rates to the ordinary income rates for taxpayers with taxable income of more than \$1 million.
 - **Observation:** *The \$1 million threshold would be indexed for inflation. Additionally, it appears that ordinary tax rate would only apply to the long-term capital gains and qualified dividends that exceed the income threshold.*
2. Creation of a so-called “billionaire’s income tax” beginning with the 2023 tax year which would impose a 20% minimum tax rate on those individuals with assets exceeding \$100 million inclusive of unrealized capital gains. Payments of this minimum tax would be treated as a prepayment to be credited against future taxes on realized capital gains, thus avoiding taxing the same amount of gain more than once. Uncredited prepayments may be refunded if unrealized capital gains are significantly reduced in a given year.

- **Observation:** Similar taxes have been proposed over the years, most recently under the Build Back Better plan. The taxing of appreciation of unrealized gains differs substantially from the current income tax framework of taxing realized gains only. Valuations of non-tradable assets, such as real estate and artwork, would use the greater of the original or adjusted cost basis. However, there is an “illiquid” election that would apply to those whose tradeable assets make up less than 20% of their wealth in which case the tax would only be imposed on the unrealized gain of the tradeable assets and defer the minimum tax on the remaining assets.
3. Returning the top individual marginal tax rate to 39.6%.
 - **Observation:** Many of the individual tax brackets were lowered beginning in 2018 including the top rate which was cut from 39.6% to 37%.
 4. Raising the corporate tax rate to 28% up from 21%.
 - **Observation:** The Tax Cuts and Jobs Act substantially cut the corporate tax rate from 35% to 21%. This was done in an effort to make the U.S. corporate tax rate more competitive with other low-taxing countries thereby curbing corporations from establishing their operations outside the U.S.
 5. Addition of certain tax incentives for companies that keep jobs in the U.S., such as a 10% credit with regard to eligible expenses incurred in connection with the on-shoring of a US business, and the removal of certain deductions when domestic jobs are moved abroad.
 6. Creation of a new “undertaxed profits rule” targeting multinational organizations which would replace the current base erosion anti-abuse tax (BEAT) regime.
 7. Modifications to estate and gift taxes, including limiting the exemption for generation-skipping transfer (GST) taxes and changing the rules for certain grantor trusts.
 - **Observation:** The proposal contains many changes targeting this area of taxation. Specifically, a deceased owner of an appreciated asset would realize “a capital gain” at the time of an asset transfer. A GST exemption would apply to direct skips and taxable distributions

to beneficiaries no more than two generations below the transferor. Also, remainder interests in a grantor remainder annuity trust (GRAT) would be required to have a minimum value for gift tax purposes of the greater of 25% of the value of the assets transferred to the trust or \$500,000 (but not more than the value of the assets transferred).

8. Taxing carried interest fees earned by hedge fund managers for providing services to a partnership would be taxed as ordinary income rather than capital gains.

- **Observation:** *This is another area that has long been the subject of many proposed tax changes and is a known talking point on the campaign trail, but has never come to fruition. Will this be the year that what some call a tax loophole will be closed?*

9. Imposition of a limit on the deferral of gains from like-kind exchanges of real property to \$500,000 for each taxpayer (\$1 million for married individuals filing a joint) per tax year.

- **Observation:** *The Build Back Better plan contained similar provisions which would have a drastic impact on many within the real estate industry who use 1031 exchanges to build sizeable real estate portfolios.*

10. Provide the IRS with \$14.1 billion in funding of which \$798 million will be directed toward improving taxpayer service and \$310 million for digital modernization of systems.

- **Observation:** *The COVID-19 pandemic only added to the difficulties of the IRS. Millions of tax returns remain unprocessed, including many for carryback refund claims which were to provide much-needed pandemic relief funds for struggling businesses. Furthermore, the Service was inundated with unprecedented call volume in response to erroneous notices issued as a result of the processing backup. Antiquated computer systems and the lack of automated phone answering technology also added to the frustration of dealing with the IRS.*

As we saw last year, there will undoubtedly be a lot more discussion on Capitol Hill regarding this proposal. The Build Back Better proposal reminded us that no tax

change is certain even if one party holds both the White House and Congress. We will continue to monitor this and the many other anticipated proposals from Washington to inform you how such changes will impact your tax position and what you may be able to do about it. For now, stay tuned...