

How Biden Would ‘Step Up’ Taxes on Inheritances

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Taxing wealth as it passes from generation to generation is an issue that stokes passions on both sides of the U.S. political divide. President Joe Biden is reinvigorating the debate with a plan to target a tax break that benefits recipients of inherited property.

1. What does Biden want to do?

He proposes to repeal a currently allowed tax adjustment known as step up in basis. Currently, when people die with stocks, real estate and other assets that grew in value during their lifetimes, heirs who inherit those assets don't have to pay capital gains tax on any of the appreciation that occurred under the previous owner. The purchase price of the assets, which is used to determine capital gains tax liability, is adjusted -- "stepped up" -- to the current market value. No taxes are paid at death, and the eventual tax bill is much lower when the heirs finally sell the assets.

2. What would repealing step up in basis mean?

It would mean that heirs would have to pay tax on unrealized gains passed on by the prior owner at death on all sorts of assets, which would amount to a massive increase in their liability. Under Biden's plan, step up in basis would still exist but only for gains less than \$1 million (or \$2.5 million per couple when combined with real estate exemptions).

3. Why repeal it?

The Biden administration and Democratic lawmakers say it primarily benefits wealthy households. Lily Batchelder, Biden's nominee for the top tax job at the Treasury Department, and David Kamin, deputy director of the White House's National Economic Council, published a paper in 2019 that said nearly 40% of the wealth of the top 1% comes from accrued and unrealized capital gains, citing data from the Federal Reserve Board. They also said the top 1% holds about half of all such unrealized gains. The Joint Committee on Taxation estimated that the tax break for capital gains at death will allow taxpayers to save almost \$42 billion this year.

4. Who supports the change?

Democratic senators led by Chris Van Hollen of Maryland introduced a proposal in March to eliminate the step up in basis with a \$1 million exemption, similar to the Biden plan. The senators said the exemption was needed to protect small family farms and businesses -- a nod to arguments often raised by opponents of taxes on estates and inheritances. Biden's plan adds to this by proposing family-owned businesses and farms wouldn't have to pay taxes when given to heirs who continue to run the business.

5. Where does this fit into Biden's larger tax plan?

According to an estimate by the Penn Wharton Budget Model, other aspects of the Biden plan won't work as intended if step up in basis isn't eliminated. Here's the logic behind that thinking: On its own, Biden's plan to almost double the capital gains tax rate on top earners would actually decrease, rather than increase, federal revenue by \$33 billion over 10 years, because investors would exploit every possible loophole to avoid paying the tax. But if the boost in the capital gains rate is paired with the elimination of step up in basis, it would raise \$113 billion over the same time period.

6. Will Biden's changes get enacted?

Not without a fight. Groups that generally oppose the estate tax are expected to come out in full force against the plan. One such group, the Family Business Estate Tax Coalition, has already commissioned a report by EY that concluded eliminating the step up in basis adjustment would reduce jobs and U.S. gross domestic product.

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