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## The \$1 million question of higher capital gains taxes under Biden, answered

By [Lynnley Browning](#) August 25, 2021, 7:40 p.m. EDT 5 Min Read

When the Treasury Department first explained in late spring how a proposed higher tax on investment profits would work if approved by Congress, it left some financial advisors and tax experts scratching their heads.

A new capital gains rate, nearly double the existing 23.8%, would kick in on profits and qualified dividends banked by earners making at least \$1 million a year, the government agency said.

Just what kind of earners? Confusingly, Treasury only partially answered the question last May in its [Green Book](#), an official document detailing the spending and tax increases outlined in the Biden administration's proposed \$6 trillion federal budget.

The all-important question Treasury didn't directly address or explain: Would the proposed \$1 million threshold for adjusted gross income (AGI) apply to single and married filers equally? Treasury made clear that it applied to married couples, but what about individuals, like unmarried working professionals and divorced small business owners?

Turns out the answer to the high-stakes question is yes. While the highest rate would apply to married couples with more than \$1 million in income, that threshold would be the same for individuals, giving some single filers a juicy tax break. "That's correct," Treasury spokesperson Alexandra LaManna wrote to *Financial Planning* in an emailed response to the query.

While the point is moot for the ultra wealthy, who easily blow past the threshold, it's of interest to advisors with upper middle class clients and emerging millionaires. At stake for a filer was potentially tens of thousands of dollars in tax a year on investment profits.

Under Biden, once a married couple's or individual's taxable income reaches \$1 million, realized gains and qualified dividends [in excess of that mark would be taxed at 43.4%](#), the [highest rate since the early 1920s](#). The 39.6% base of that high rate would also become the new top ordinary income tax rate. While not all advisors wondered if the threshold applied to individuals, many had questions.

### Marriage penalty, confirmed

The seven-figure threshold solidifies what some advisors say is an [exacerbation of the longstanding](#)

["marriage penalty](#)" in the tax code, in which wedded people who each earn high incomes can pay more in federal (and, often, [state](#)) income tax than they would if they filed separate returns.

At the same time, the threshold would give well paid individuals a sizable advantage over high earning couples if President Biden's proposed tax increases are eventually voted into law and signed by him.

That's because a highly paid technology executive, banker or doctor who isn't married would have more wiggle room to take investment profits at the current 23.8% rate before getting hit by the 43.4% rate (both include the Affordable Care Act's 3.8% surcharge).

By contrast, two high earners who are married — say, an advertising executive and a lawyer — and who file jointly would see their combined salaries push them to the higher-tax threshold faster, leaving less room for taking investment gains at the current preferential rate.

"It's another example of IRS rules and regulations not incentivizing the family unit," said Clark Kendall, the president and CEO of fee-only fiduciary firm Kendall Capital Management in Rockville, Maryland. The threshold "really gives you incentive to divorce your spouse. Maybe you're saying, 'I was gonna divorce anyway, might as well now.'"

In its 114-page Green Book, Treasury devoted all of two brief paragraphs, with two short footnotes, to the issue of how a taxpayer's filing status would affect the income level at which their capital gains tax bill would spike.

The language clearly addressed married couples filing jointly, who would face the higher rate at \$1 million in income. Ditto married couples filing separately, who would each hit the rate at a lower \$500,000. But it said nothing about individual filers, referring instead to the generic word "taxpayer."

The explanation was "not entirely clear," says John Gimigliano, accounting firm KPMG's principal-in-charge of federal tax legislative and regulatory services. "You could read it more than one way" — as a \$1 million threshold for individuals, or a \$500,000 one. While "the most simple, straightforward reading suggests \$1 million" for individuals, Gimigliano said, the issue was "debatable" because the Green Book didn't specify that.

"It was not clear," agreed Dean Zerbe, the national managing director of alliantgroup, a tax services firm, in Washington, D.C.

#### **'Re-title' assets; bag the altar?**

Advisors know that [filing separate returns when married](#), in which the IRS treats each spouse as its own taxable entity, can help a couple avoid having their combined income push them into a higher tax bracket. [Only around 5% of married couples file separately](#), according to IRS data. Now doing so could be beneficial on another tax front.

Michael D'Addio, a lawyer specializing in tax at accounting and business advisory firm Marcum in New Haven, Connecticut, said that if a married couple consists of one high earner and one lower

earner, they could adjust their joint ownership of stock and other assets so that profits are in the name of the lower earner. That would preserve the couple's ability to keep their capital gains tax bill low if they file separately.

Kendall said that if the proposed changes become law — and it's not certain that they will — affluent older people who are divorced or have lost a spouse might "think twice about remarrying."

### **More questions**

It's not up to Treasury to answer the question of when a higher capital gains rate would go into effect. While the date [could potentially be retroactive to April 28](#), when the Biden administration first announced its proposed increases, it's up to Congress to decide.

"Everyone's really freaked about the effective date, but nobody thinks it will be April 28," Zerbe said. "I think it will be Jan. 2, 2022."

It's also up to Congress to decide just how high a new capital gains rate might be. Zerbe said that "the expectation is more 25-28%," once the tax-writing House Ways and Means Committee completes its "mark up" of a tax bill.

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