The Impact of Biden Administration Tax Proposals on Real Estate

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In March 2022, the Treasury Department issued General Explanations of the Biden Administration's Fiscal Year 2023 Revenue Proposals, commonly referred to as the "Green Book."

There are several provisions that would affect the real estate industry as well as those who work in it. The following discusses the most applicable provisions.

Tax Rates
Currently, the top marginal tax rate through the end of 2025 is 37% on taxable income over $647,850 for married individuals filing jointly and surviving spouses, $539,900 for unmarried individuals and heads of household and $323,925 for married individuals filing separately. The tax bracket thresholds are indexed for inflation.

The proposal would increase the top marginal rate to 39.6% and lower the taxable income thresholds to $450,000 for married individuals filing jointly, $400,000 for unmarried individuals, $425,000 for head-of-household filers and $225,000 for married individuals filing separately. The increases would be effective for tax years starting after December 31, 2022 and then be indexed for inflation.

Capital Gain Rates
Currently, most long-term capital gains and qualified dividends are taxed at a maximum rate of 20% plus a net investment income tax of 3.8% (where applicable, depending on modified adjusted gross income).

The proposal would tax long-term capital gains and qualified dividends for taxpayers with taxable incomes greater than $1 million at ordinary income tax rates, with 37% being the highest rate, or 40.8% including the net investment income tax. The threshold for married individuals filing separately would be greater than $500,000. This could have a dramatic effect on taxpayers with a large liquidation event of their real estate holdings.

Transfers of Appreciated Property
Under current law, making a gift of a partnership interest (including those that hold real estate) to a family member or trust is not taxable upon transfer. In addition, real estate that is inherited receives a step up in basis to fair market value, eliminating gain on a subsequent sale.

The proposal would treat transfers of appreciated assets either by gift or upon death as a current taxable event. The amount of the gain realized upon transfer would be the excess of the asset's fair market value on the date of gift or date of death over the holder's basis in the asset. The gain would be taxable on either the gift tax return or the estate tax return, or some other type of capital gains tax return. The tax paid would be a deduction on the estate tax return.

Unrealized appreciation on property held by a trust, partnership or non-corporate entity will be subject to tax if the property has not been the subject of a recognition event in the prior 90 years.

The initial measuring date is December 31, 1939, which would make the date of the first recognition event deemed to occur December 31, 2030.

(There are various exclusions and exemptions to above rules which are beyond the scope of this article.)

Limitation on Like-Kind Exchanges
This is probably one of the most impactful proposals for the real estate industry. Individual taxpayers would only be able to defer capital gains of $500,000 per year ($1 million for married filing jointly). Any gains from like-kind exchanges in excess of those amounts would be recognized as a sale of real estate.

Recapture of Depreciation as Ordinary Income
Under current law, when real estate is sold, the depreciation taken on real property is referred to as "unrecaptured section 1250 depreciation." Any long-term gain on the sale of the real property in excess of the unrecaptured section 1250 depreciation is taxed at long-term capital gain rates. The portion of the gain up to the section 1250 depreciation is taxed at 25%.

The proposal is to tax long-term capital gain from the sale of real property up to the section 1250 depreciation taken as ordinary income. This is only on the depreciation taken after enactment. The prior depreciation is still subject to the lower 25% rate. It also only applies to non-corporate taxpayers with adjusted gross incomes greater than $400,000 ($200,000 for married filing separately).

The above does not include all of the proposals under the Biden Administration plan, but the ones with the greatest impact on the real estate industry. Consult with your tax advisor so you can plan ahead.

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