Stepped-Up Basis (Taxing Capital Gains at Death)

Background

Under current law, capital gains are generally taxed when an asset is sold and the seller has cash to pay the tax liability. For inherited assets, the basis is "stepped up" to the current fair market value (FMV). Large transfers of wealth remain subject to the estate tax, which is currently 40% on amounts over $13.61 million.

Biden/Harris Proposals

The Biden/Harris Administration's budgets have consistently included plans to end stepped-up basis and impose capital gains tax on the unrealized gain in excess of $1 million and impose income tax on the gain at death.

Under this proposal, death would be a taxable event at far lower asset levels than the current estate tax threshold. This tax is due before the asset is actually sold by the heir. Large estates would still be subject to the estate tax. The combined effect would be a top marginal tax rate of near 60% on inherited assets.

Adverse Effects

If stepped-up basis is repealed, relatively few family-owned businesses would have the cash to pay the tax. This could force the business to sell the property that the decedent intended to leave to his or her family and introduce myriad other issues for the future of the firm. The impact would be widespread in the real estate industry; a survey of ICSC members revealed that 72% of respondents either plan to pass their business on to their heirs or work for a business owner who intends to do so. In the case of an inherited partnership interest such a sale may not even be possible without the consent of other partners.

Even in cases where the funds to pay the tax are available, the tax liability will significantly diminish the new owners' capital, making it harder to improve and upgrade the property. This could have negative consequences for many commercial real estate assets, including apartments and affordable rental housing, office buildings and shopping centers, and have a broader chilling effect on economic activity across the country.

We recognize that the Biden proposal generally contemplates allowing family-owned businesses to defer this tax until an inherited asset is sold. This approach is still problematic. A fully depreciated property would face significant depreciation recapture and capital gains taxes. Few properties could pay the tax liability from their rental income and would be forced to sell their assets in order to pay the tax bill.

Position

ICSC believes that current law reflects sound public policy and supports property owners' ability to determine when the right time is to sell, not the government.

An EY study found that the repeal of stepped-up basis would eliminate 80,000 jobs and reduce wages by $32 for every $100 in new taxes collected.

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