Stepped-Up Basis

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 are subject to the estate tax, which is currently 40% on amounts over $11.7 million for couples.

President Biden's American Families Plan has proposed 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 under current law. Worse, this tax is due before an asset is actually sold by the heir.

The President has proposed increasing the capital gains rate to 43.4%. The combined effect of the estate and higher capital gains tax would be a marginal tax rate over 60%.

If stepped-up basis is repealed few family-owned businesses would have the cash to pay the tax.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. In the case of an inherited partnership interest representing a property interest, such a sale may not even be possible without the consent of other partners. Even if the funds to pay the tax are available, little might be left over 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. Property owners should decide when it is the right time to sell, not the government.

While the American Families Plan contemplates enabling family-owned businesses to defer this tax until an inherited asset is sold, this approach is still problematic. If a fully depreciated property was passed to the next generation the heir would face significant depreciation recapture and capital gains taxes. This would discourage additional capital investments into the property. Moreover, such a proposal does not cover situations where the family-owned business may wish to diversify into other business assets or when multiple heirs wish to go separate ways.

ICSC believes that stepped-up basis must continue to apply to family-owned businesses, particularly when the gains relate to highly illiquid assets like real estate, where the burden of the tax otherwise could force the dismantling of a family's livelihood.

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

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