Biden's FY2023 Budget: Key Real Estate & Corporate Tax Proposals

April 2022

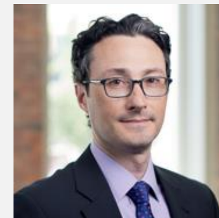
On March 28, 2022, President Biden released his FY2023 budget (the "FY2023 Budget"), and the U.S. Treasury released the so-called "Green Book," which provides details related to the revenue provisions in the FY2023 Budget. The revenue proposals in the FY2023 Budget rely on a baseline that generally presumes the enactment of the revenue provisions in the Build Back Better Act (the "BBBA") as passed by the House of Representatives on November 19, 2021. As a result, the revenue proposals described in the Green Book are intended to be in addition to the provisions included in the BBBA. It should be noted that the BBBA has been stalled in the Senate since late 2021. The current status of the BBBA is not entirely clear, but it would appear that the most likely path forward might be narrower tax legislation. In this regard, the revenue proposals in the FY2023 Budget might be of interest, as certain of those proposals may be included in future legislation.

The FY2023 Budget includes several proposals that were first proposed in the Administration's FY2022 budget, but that were not included in the BBBA. Notably, the FY2023 Budget once again proposes:

- an increase in the tax rate for C corporations from 21% to 28%;
- an increase in the top marginal tax rate from 37% to 39.6% for taxable income over $450,000 for married individuals filing a joint return ($400,000 for unmarried individuals);
- a limitation on gain deferred under section 1031 to $500,000 ($1 million in the case of married individuals filing a joint return) per taxpayer per year;
- subjecting long-term capital gains and qualified dividends to ordinary income rates for taxpayers with taxable income exceeding $1 million;
- for partners with taxable income (from all sources) exceeding $400,000, subjecting a partner's allocable share of income from profits interests in investment partnerships (i.e., carried interest) to tax as ordinary income and self-employment tax regardless of the character of the income at the partnership level;
- a permanent extension of the new markets tax credit; and
- treating transfers of appreciated assets by gift or death as realization events subject to capital gains tax, subject to a $5 million per donor lifetime exclusion.

Below is a high-level summary of certain revenue proposals included in the FY2023 Budget that were neither proposed in the FY2022 budget nor included in the BBBA.

Net Wealth Minimum Tax. A 20% minimum tax that includes a mark-to-market regime with respect to unrealized capital gains for taxpayers with a net worth exceeding $100 million. The proposal would include installment payment options as well as an election for "illiquid taxpayers" to only include unrealized gains from tradable assets in the calculation of their tax liability; however, such illiquid taxpayers would be subject to a deferral charge (of no greater than 10 percent) upon recognizing gain on non-tradable assets subject to the election. For this purpose, a taxpayer is illiquid if tradable assets make up less than 20% of their wealth. The proposal would be effective for taxable years beginning after December 31, 2022.



Gerret Baur
Director
gbaur@goulstonstorrs.com
+1 617 574 3857

Gerret is a tax attorney handling U.S. and international tax issues associated with real estate matters, closely-held business operations, joint ventures, mergers and acquisitions, financing transactions, and investment funds.

Martha Frahm
Director & Co-Chair
mfrahm@goulstonstorrs.com
+1 617 574 4063

Martha is a tax lawyer who advises on federal and state tax planning for businesses and individuals relating to business formations, mergers & acquisitions, divestitures, and partnership formations including venture capital and real estate joint ventures.

Abraham Leitner
Director & Co-Chair
aleitner@goulstonstorrs.com
+1 212 878 5158

Abe is an internationally recognized tax lawyer who handles complex domestic and cross-border transactions in the U.S. and internationally.

goulston&storrs

© 2022 Goulston & Storrs PC. All Rights Reserved. Attorney Advertising. Prior results do not guarantee a similar outcome.

Expansion of Recapture Under Section 1250. With respect to depreciation deductions taken on section 1250 property (e.g., depreciable real estate) after the effective date of the proposal, gain on the disposition of such property would be treated as ordinary income. Depreciation deductions taken on section 1250 property prior to the effective date of the proposal would be subject to the current rule and recaptured as ordinary income (subject to a maximum rate of 25% with respect to noncorporate taxpayers) to the extent such depreciation exceeds cumulative straight-line depreciation. The proposal would not apply to noncorporate taxpayers with adjusted gross income of less than $400,000 and would be effective for depreciation taken on, and dispositions of, section 1250 property in taxable years beginning after December 31, 2022.

G&S Insight: The recapture proposal could have a significant impact on real estate investors. Individual taxpayers would see more gain on disposition recharacterized as ordinary income and subject to full ordinary income rates. Corporate taxpayers may also be impacted to the extent they have capital losses. Assuming section 1031 remains in its current form, this change may increase the gain recognized on otherwise tax-free section 1031 exchanges involving the swap of section 1250 property (e.g., a building) for non-section 1250 property (e.g., land).

Undertaxed Profits Rule. Repeal the Base Erosion Anti-Abuse Tax ("BEAT") and replace it with an Undertaxed Profits Rule ("UTPR") that is based on the OECD Pillar Two Model Rules. The Pillar Two Model Rules includes a global minimum tax that would impose (i) a top-up tax on group parent companies with respect to the low-taxed income of members of its financial reporting group and (ii) a UTPR, which denies deductions to the extent that the low-taxed income of a member of the group is not subject to a top-up tax. It would appear that the proposed UTPR would diverge from the Pillar Two Model Rules by including an adjustment to ensure that U.S. taxpayers continue to benefit from certain U.S. tax credits and other incentives that promote U.S. jobs and investment. In addition, the proposal would include a domestic minimum top-up tax to protect U.S. revenues from the imposition of UTPR regimes by other countries. Given the application of the existing global intangible low-taxed income, or GILTI, regime to U.S. parented multinational groups, Treasury anticipates that the proposed UTPR would primarily apply to non-U.S. parented multinationals operating in low-tax jurisdictions.

Under the proposed UTPR, U.S. corporations and branches that are members of a financial reporting group would be disallowed U.S. tax deductions to the extent necessary to collect the hypothetical top-up tax required for the financial reporting group to pay an effective tax rate of at least 15% in each jurisdiction in which the group has profits. For this purpose, the group's income and effective tax rate would be computed on a jurisdiction-by-jurisdiction basis subject to certain adjustments. Only financial reporting groups with at least $850 million of annual revenue in at least two of the prior four years would be subject to the tax. In addition, the proposal includes a de minimis exception that would exclude certain jurisdictions from the computation to the extent that the reporting group has less than $11.5 million of revenue and $1.15 million of profit in that jurisdiction based, in both cases, on a 3-year rolling average. The proposal also includes an exception for groups that are in the early stages of international expansion to the extent such groups operate in no more than five jurisdictions (other than the group's primary jurisdiction) and the book value of the group's tangible assets in those jurisdictions is less than $57 million. The proposal would be effective for taxable years beginning after December 31, 2023.

Change in "Control" Test Under Section 368(c). The current control test under section 368(c), which is relevant to tax-free contributions under section 351 and certain tax-free reorganizations, requires at least 80% of voting power of all classes of voting stock and at least 80% of the total number of shares of each class of nonvoting stock. The proposed change would conform the section 368 control test with the affiliation test under section 1504(a)(2), which is a vote and value test. Among other things, this change would eliminate the use of certain high-vote/low-value arrangements that are permitted under the current section 368(c) control test. The proposal would be effective for transactions occurring after December 31, 2022.

LIHTC Basis Boost. The proposal would enable state housing credit agencies to give nongeographic basis boosts to certain low-income housing tax credit projects financed with passive activity bonds. The proposal would only be effective for buildings that receive more than de minimum financing from passive activity bonds that are part of a bond issue with an issue date following the date of enactment.

© 2022 Goulston & Storrs PC. All Rights Reserved. Attorney Advertising. Prior results do not guarantee a similar outcome.