

FAILURE TO STEP-UP: THE UNEXPECTED AMERICAN BURDENS OF REMOVING THE STEP-UP IN BASIS

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I. INTRODUCTION

Political activists and politicians frequently garner support by advocating for programs and drafting proposals to tax the rich. The Biden administration is no exception and has developed the American Families Plan, a proposed tax plan that aims to equalize wealth between the rich and the poor by targeting inherited wealth. In the hopes of taxing the rich at higher rates, these proposed tax changes could have severe implications for American families because they fail to safeguard fundamental principles of estate planning. These changes could also disparately impact middle-class and lower-class families either directly or indirectly through the bill's effects on small businesses and farms. Further, the wealthy targets of the American Families Plan have already begun to take actions to minimize the impact created by these tax changes, potentially thwarting the Biden administration's efforts.

First, this paper seeks to clarify key aspects of the Biden administration's proposed tax plan. Next, it will review the history of estate exemptions and revisit core concepts in estate planning. Finally, it will evaluate the impact of the Biden administration's proposed tax proposal. Although these proposed changes have not been implemented, they are unlikely to disappear anytime soon. While taxing the rich appeals to many, the ramifications of implementing changes to estate planning could be far-reaching and neglects to consider other options for increasing tax revenue.

I. HISTORY OF TAXING ESTATES AND THE BIDEN ADMINISTRATION'S PROPOSED TAX PLANS

In attempting to tax the rich, politicians frequently attack those with inherited wealth because of supposed loopholes that ensure generational wealth passes without being burdened by excessive taxes.¹ Michael J. Graetz² explores the history and relevant historic battles that have occurred from political initiatives to tax estates, in particular.³ Not surprisingly, taxes on inherited wealth trace back to ancient Egypt.⁴ Later, the Roman Empire imposed a five percent tax on inherited property to fund soldiers' pensions.⁵ Over the past two decades,

1. See Lily Batchelder & David Kamin, *Taxing the Rich: Issues and Options*, 1 URBAN-BROOKINGS TAX POL'Y CTR. RSCH. RPT. 3-6, 22 (Sept. 11, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3452274; see also Lily L. Batchelder & David Kamin, *Policy Options for Taxing the Rich*, in MAINTAINING THE STRENGTH OF AMERICAN CAPITALISM 200, 205 (Aspen Institute 2019).

2. See Michael J. Graetz, "Death Tax" Politics, 57 B.C.L. REV. 801, 801 (May 26, 2016).

3. *Id.* at 801-02.

4. *Id.* at 801.

5. Elke Asen, *Estate, Inheritance, and Gift Taxes in Europe*, TAX FOUND. (Apr. 29, 2021), <https://taxfoundation.org/estate-taxes-in-europe/>.

renewed controversy about the purpose and role of estate taxes has given rise to proposed reforms.⁶

A. *Eliminating the Step-up Basis*

In the American Families Plan, the Biden administration proposed eliminating “step-up” in basis as one way to generate capital gains.⁷ Although Congress failed to pass this tax change for this term, politicians are likely to continue to advocate for its removal.⁸ Understanding its implications and history of failure is critical to analyzing future tax policy changes for inherited property because it provides valuable protections for all Americans – not only the wealthy.⁹

B. *What is a Step-up in Basis?*

When an asset is passed through an inheritance, its value has typically increased from when the original owner acquired it.¹⁰ To determine liability for capital gains tax purposes, the IRS relies on the “basis” of an asset, which generally means the asset’s value when it was acquired; this basis is used to determine gains or losses when the asset is sold.¹¹ A step-up in basis allows for beneficiaries to rely on the value of inherited assets to be “stepped up” to fair market value at the decedent’s death, essentially resetting the tax basis.¹² Because inherited property or assets are reset at the time of transfer, a beneficiary’s tax liability is much lower when they sell the inherited assets or property.¹³ Often, this means a beneficiary pays little to no capital gains tax on the asset when they decide to sell it.¹⁴ Families rely on this cornerstone of estate planning to shield their wealth and protect their beneficiaries when assets are passed at death.¹⁵ Repealing the step-up in basis could

6. James R. Hines, *Taxing Inheritances, Taxing Estates*, 63 TAX L. REV. 189-90 (2010).

7. Allyson Versprille, *How Biden Would ‘Step Up’ Taxes on Inheritance: Quick Take*, BLOOMBERG L. NEWS, (Apr. 28, 2021, 4:00 AM), <https://www.bloomberg.com/news/articles/2021-04-28/how-biden-would-step-up-taxes-on-inheritances-quicktake>.

8. Taylor Tepper, *What Investors Should Learn From The Failed Bid To End Stepped-Up Basis*, FORBES ADVISOR, (Sept. 21, 2021, 8:00 AM), <https://www.forbes.com/advisor/investing/stepped-up-basis-lessons/>.

9. *Id.*

10. Will Kenton, *Step-Up in Basis*, INVESTOPEDIA, <https://www.investopedia.com/terms/s/stepupinbasis.asp> (July 9, 2022).

11. Andrew J. Barron, *Biden’s American Families Plan to Partially Eliminate Stepped Up Basis*, JD SUPRA (Aug. 4, 2021), <https://www.jdsupra.com/legalnews/biden-s-american-families-plan-to-1476641/>.

12. Versprille, *supra* note 7.

13. *Id.*

14. Richard Rubin & Rachel Louise Ensign, *Biden’s Capital-Gains Tax Plan Would Upend Estate Planning by the Wealthy*, WALL ST. J. (Apr. 29, 2021, 2:57 PM), <https://www.wsj.com/articles/bidens-capital-gains-tax-plan-would-upend-estate-planning-by-the-wealthy-11619716044>.

15. *Id.*

have serious consequences for families, and may disincentivize beneficiaries from selling an asset.¹⁶

According to a recent report authored in part by New York University Tax law professor Lily Batchelder,¹⁷ the United States needs to find alternative ways for increasing revenues in order to “reduce [...] disparities, finance much-needed new services and investments, and address the nation’s long-term fiscal needs.”¹⁸ This study points out that accrued and unrealized capital gains account for “nearly 40% of the wealth of the top 1%.”¹⁹ By boosting the capital gains tax rate, coupled with eliminating the step-up in basis, the Biden administration believes it would raise \$113 billion²⁰ to help fund the \$3.5 trillion Build Back Better package.²¹

Instead of the current “step-up” in basis available to American families, Biden’s Administration proposed that inherited assets “carryover” their tax basis.²² A carryover may unduly burden a beneficiary upon receipt or transfer of the inheritance because the beneficiary would be liable for the tax liability from the increase in the asset’s value from the time it was originally acquired.²³ By eliminating the “step-up” in basis, beneficiaries become subject to paying much higher capital gains taxes when they decide to sell the asset.²⁴

Additionally, a beneficiary could also be hit with a secondary tax liability depending on whether their Adjusted Gross Income (AGI) surpasses a certain amount.²⁵ If the beneficiary’s AGI surpasses the one-million-dollar threshold, it would trigger capital gains tax under this

16. Andrew Wilford, *Senators Are Right to Cast Doubt on Stepped-Up Basis Repeal*, REALCLEAR MKTS. (Aug. 2, 2021), https://www.realclearmarkets.com/articles/2021/08/02/senators_are_right_to_cast_doubt_on_stepped-up_basis_repeal_787928.html.

17. *Professor Lily Batchelder nominated to Senior Treasury Department Position*, NYU L. NEWS (Mar. 11, 2021), <https://www.law.nyu.edu/news/lily-batchelder-nomination-treasury-tax-policy>.

18. See *supra* text accompanying note 1 (outlining the rationale for this analysis).

19. Verpsrille, *supra* note 7 (citing Batchelder & Kamin *supra* note 1).

20. John Rico & Mariko Paulson, *Revenue Effects of President Biden’s Capital Gains Tax Increase*, UNIV. PENN. BUDGET MODEL (Apr. 23, 2021), <https://budgetmodel.wharton.upenn.edu/issues/2021/4/23/revenue-effects-of-president-bidens-capital-gains-tax-increase>.

21. Barron, *supra* note 11.

22. Leon LaBrecque, *The New Death Tax Proposal: Major Tax Change*, FORBES (July 15, 2021, 7:00 AM), <https://www.forbes.com/sites/leonlabrecque/2021/07/15/the-new-death-tax-in-the-biden-tax-proposal-major-tax-change/?sh=3ae0b0ed1e35>.

23. *Id.*

24. Robert W. Wood, *Biden’s Tax Increase On Death That No One Is Talking About*, FORBES (Nov. 2, 2020, 9:48 AM), <https://www.forbes.com/sites/robertwood/2020/11/02/bidens-tax-increase-on-death-that-no-one-is-talkingabout/?sh=2ebc083a376f>.

25. See LaBrecque, *supra* note 22; see Wood, *supra* note 24 (“Biden’s proposal would subject capital gain to the same tax rate as ordinary income for incomes over \$1 million.”).

plan.²⁶ To compound the issue even further, some states impose additional state income taxes that could significantly affect and increase the amount of taxes imposed on a beneficiary.²⁷

C. Exemptions From Estate Taxes That May Change Under The Biden Administration

In addition to the elimination of the step-up in basis, the Biden administration has also discussed possible changes to the Tax Cuts and Jobs Act (TCJA) of 2017, in which the federal estate exemption was increased to \$11.7 million.²⁸ For 2022, the federal estate exemption has been raised from \$11.7 million to \$12.06 million for individuals.²⁹ For transfers that exceed this amount, a 40 percent tax rate is applied.³⁰ While these provisions are not yet specified in the Green Book,³¹ lowering this exemption to \$3.5 million and raising the tax rate to 45% were proposed during Biden's campaign and potentially could be added at a later time.³²

As a result, estate planners for high-net-worth individuals with estate tax concerns anticipate these potential changes and recommend techniques and strategies to get ahead of them and curtail future impact.³³ Exploring past failed attempts to implement similar tax plans provides insight into potential issues facing the Biden administration's proposals.

II. PAST ATTEMPTS TO REMOVE THE "STEP-UP" IN BASIS AND PROPOSED ALTERNATIVES

Academics and politicians have advocated for and investigated alternative methods to tax individuals with generational wealth for decades; however, no adopted plan has successfully been implemented.³⁴ In fact, most attempts by Congress have been repealed

26. See LaBrecque, *supra* note 22.

27. See *id.*

28. Daniel R. Donovan et al., *The 2020 Election and the Effect on Current Gift, Estate and Generation-Skipping Transfer Taxes*, NAT'L L. REV. (Feb. 22, 2021), <https://www.natlawreview.com/article/2020-election-and-effect-current-gift-estate-and-generation-skipping-transfer-taxes>.

29. Jim Probasco, *Estate Tax Exemption 2022: How Much It Is and How To Calculate It*, INVESTOPEDIA, <https://www.investopedia.com/estate-tax-exemption-2021-definition-5114715> (Sept. 3, 2022).

30. Donovan et al., *supra* note 28.

31. Jeffrey M. Glogower et al., *Impact of President Biden's Tax Plan on Estate Planning*, NAT'L L. REV. (July 26, 2021), <https://www.natlawreview.com/article/impact-president-biden-s-tax-plan-estate-planning>.

32. *Id.*

33. See *id.*

34. Richard Schmalbeck et al., *Advocating a Carryover Tax Basis Regime*, 93 NOTRE DAME L. REV. 109, 111-12 (2017).

before going into effect or were in effect for an extremely limited time.³⁵ Twice, once in 1976 and 2001, Congress attempted to implement tax carryover plans to replace the step-up in basis.³⁶ Both failed.³⁷

A. *1976 Tax Reform Act*

In 1976, Congress passed a carryover in basis tax plan in The Tax Reform Act of 1976.³⁸ This plan imposed a tax based on the carryover basis rather than the stepped-up basis, meaning a person inheriting an asset would also inherit the asset's original basis, thus inheriting tax responsibility for the asset's appreciation or depreciation at the time of an eventual disposition.³⁹ Although the Act passed, it never took effect.⁴⁰ Unpopular with banks, trust departments, and other institutions, Congress was forced to defer the Act's effective date, and then eventually repealed it in 1980.⁴¹ Congress replaced this Act with today's tax rules, which include the step-up in basis.⁴²

B. *2001 Economic Growth and Tax Relief and Reconciliation Act*

In the early 2000s, Congress again toyed with the idea of implementing a carryover basis to replace the step-up in basis in the Economic Growth and Tax Relief and Reconciliation Act of 2001.⁴³ This time, Congress made slightly more progress than the 1976 Tax Reform Act and passed the Act. The 2001 Act was to be implemented during the 2010 tax year.⁴⁴ The 2001 Act incorporated two major changes, which differed from the 1976 Tax Reform Act: it repealed an estate tax and implemented a carryover in basis.⁴⁵ Advocates for implementing a permanent carryover basis argue that the 2010 tax year suggests that a carryover basis would be successful, but they too, acknowledge that the success that year is owed to its temporary and limited application.⁴⁶ What advocates fail to acknowledge is that for the 2010 tax year, Congress "retroactively restored the estate tax and step-up in basis for

35. Garrett Watson, *History of Attempted Changes to Step-Up in Basis Shows Perilous Road Ahead*, TAX FOUND. (Sept. 28, 2021), <https://taxfoundation.org/biden-estate-tax-unrealized-capital-gains-at-death/>.

36. See Schmalbeck et al., *supra* note 34, at 111–12; see also Watson, *supra* note 35.

37. See Watson, *supra* note 35.

38. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2005, 90 Stat. 1520, 1872 (codified as amended in scattered sections of 26 U.S.C.).

39. See Watson, *supra* note 35.

40. See Schmalbeck et al., *supra* note 34, at 112.

41. *Id.*

42. See Watson, *supra* note 35.

43. *Id.*

44. *Id.*

45. *Id.*

46. See Schmalbeck et al., *supra* note 34, at 112–13.

2010 decedents” and allowed 2010 estate executors to “opt out of the estate tax and into a carryover basis tax regime.”⁴⁷ This allowed executors for decedents dying in 2010 to make strategic decisions regarding tax liability:

Executors for decedents dying in 2010 were therefore accorded the unprecedented luxury of selecting whichever tax regime—estate tax or carryover tax basis regime—produced the lesser tax burden. From the vantage point of estates that were just barely large enough to face a positive estate tax, the opportunity to elect a step-up in basis instead was attractive. For estates that would have faced a substantial estate tax, forfeiting a step-up in basis may have been the small price to pay.⁴⁸

Some say George Steinbrenner⁴⁹ “hit a home run” when he died because his estate did not have to pay estate tax as a result of the 2001 Tax Plan.⁵⁰ His estate opted for the latter, and less costly, carryover basis.⁵¹ Subsequent to the 2010 tax anomaly, the step-up in basis was reinstated.⁵²

C. *Treating Death as a Realization Event and the Taxation of Capital Gains*

An alternative to a carryover in basis approach that Congress has proposed is to treat death as a realization event in which death would be treated as if the decedent sold the asset in the last year of his or her life.⁵³ Although the idea of treating death as a realization event has taken a backseat to the carryover in basis plan under the Biden administration’s proposal, advocates suggest that realization at death has become a “hot button issue” and is likely to reemerge in the coming election years.⁵⁴

47. Lincoln Fleming, *Repeal of Basis Step-Up: Third Time’s the Charm?*, APERIO (June 29, 2021), <https://www.aperiogroup.com/blogs/repeal-of-basis-step-up-third-times-the-charm> (citing Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (2010)).

48. Schmalbeck et al., *supra* note 34, at 125.

49. Danielle B. Mayoras & Andrew W. Mayoras, *Steinbrenner Goes Out a Real Winner*, FORBES (July 20, 2021, 7:00 PM), <https://www.forbes.com/2010/07/20/yankees-estate-tax-intelligent-investing-steinbrenner.html> (“Baseball pioneer George Steinbrenner, owner of the famed New York Yankees franchise, died from a heart attack on July 13, 2010, at age 80.”).

50. *See id.*

51. *See id.*; see also Justin P. Ransome & Frances Schafer, *Estate Tax or Carryover Basis?*, J. OF ACCT. (July 1, 2011), <https://www.journalofaccountancy.com/issues/2011/jul/20113784.html>.

52. Fleming, *supra* note 47.

53. Jane G. Gravelle, CONG. RSCH. SERV., IF11812, TAX TREATMENT OF CAPITAL GAINS AT DEATH (2021).

54. Benjamin Willis, *Is Repealing The Tax-Free Basis Step Up Really Dead?*, FORBES (Sept. 29, 2021, 12:36 PM), <https://www.forbes.com/sites/taxnotes/2021/09/29/is-repealing-the-tax-free-basis-step-up-really-dead/?sh=be6080c34da0>.

III. FAILURE TO IMPLEMENT ALTERNATIVE PLANS

Frequent criticism of Congress' attempts to eradicate the step-up in basis includes several issues: (1) liquidity, (2) documentation problems, and (3) difficulty in ascertaining value.⁵⁵ These reasons were all prevalent in the 1976 and 2001 failed attempts to remove the step-up in basis.⁵⁶

A. *Liquidity Concerns*

First, one main criticism of eliminating a step-up in basis and implementing death as a realization event arises from liquidity issues.⁵⁷ One consequence of this type of taxation structure would be the forced sale of assets, like family businesses, to accommodate and pay the impending taxes upon the death of a decedent.⁵⁸ The Biden administration accounts for this problem by including a provision that allows the tax for illiquid assets to be paid over a fifteen-year period.⁵⁹ However, tax professionals are concerned that it is unclear which types of assets qualify for protection, which "could potentially create unique issues for the IRS and for taxpayers" according to former IRS Chief Counsel Michael Desmond.⁶⁰ Currently, the IRS only has three years to perform audits of tax returns.⁶¹ Extending payment deadlines for fifteen years for illiquid assets could complicate auditing matters.⁶²

Removing the step-up in basis would compound the issue for cash poor farming families whose value is "tied up in land and equipment."⁶³ Without a step-up in basis, passing the family farm to the next generation would become exceedingly difficult because the taxes would surpass the farm's net income.⁶⁴

55. See Schmalbeck et al., *supra* note 34, at 151; see also Miranda Perry Fleischer, *Not So Fast: The Hidden Difficulties of Taxing Wealth*, 58 NOMOS 261, 275 (2017) ("The main problem with an annual wealth tax is the necessity of annual valuations.").

56. Schmalbeck et al., *supra* note 34, at 111-12.

57. Gravelle, *supra* note 53.

58. *Id.*

59. Allyson Versprille, *Tax Pros Perplexed by Scope of Biden's Capital Gains Overhaul*, BLOOMBERG L. NEWS: DAILY TAX REP. (June 9, 2021, 1:00 PM), <https://news.bloomberglaw.com/daily-tax-report/tax-pros-perplexed-by-scope-of-bidens-capital-gains-overhaul>.

60. *Id.*

61. Robert W. Wood, *IRS Audit Period is 3 Years, 6 Years or Forever: How to Cut Your Risk*, FORBES (Oct. 8, 2019, 9:04 AM), <https://www.forbes.com/sites/robertwood/2019/10/08/irs-audit-period-is-3-years-6-years-or-forever-how-to-cut-your-risk/?sh=11e063827ba6>.

62. Versprille, *supra* note 61.

63. *Stepping on Stepped-up Basis Has Big Consequences*, AM. FARM BUREAU FED'N (Apr. 7, 2021), <https://www.fb.org/newsroom/stepping-on-stepped-up-basis-has-big-consequences>.

64. *Id.*

B. Documentation Problems

Second, because both alternative plans use the initial basis to determine capital gains tax liability, it could be difficult in some cases to gather documentation, especially for decades-old assets.⁶⁵ One of the many benefits a step-up in basis provides is the efficiency in determining an asset's basis—because it is the fair market value at the decedent's death.⁶⁶ The prospect of determining the original value of the asset can be daunting for many families and can lead to inaccuracies in the asset's value.⁶⁷ Proponents of a carryover basis argue that documentation is no longer a concern because most documents have been digitized.⁶⁸ However, they fail to consider that while taxpayers are responsible to keep records during their life, upon death, the executor of the estate, who is responsible for paying the taxes, may not actually hold the assets until the decedent's death.⁶⁹ When people intend to utilize the step-up in basis in their estate planning, they may not have maintained adequate records of an asset's basis.⁷⁰

Despite the ease of digital documentation, even in 2021, a carryover basis “poses a potential documentation nightmare” because many assets may have been acquired decades ago.⁷¹ A step-up in basis provides the benefit of not needing to determine or figure out the original basis because it is automatically stepped-up.⁷² Without information about how an asset increased in value during its lifetime, accurately determining a carryover basis imposes unforeseen difficulties.⁷³ Partner and national tax leader Brad Strong at KPMG⁷⁴ argues that a carryover basis would burden individuals invested in flow-through entities, for example, because records are not easily accessible and it is difficult to obtain IRS transcripts.⁷⁵ He estimates he would need to review forty-five years' worth of his clients' tax returns to determine the basis for a flow-through entity.⁷⁶ Real estate transactions also

65. See Darla Mercado, *Biden's Bid to Tax Inherited Assets Could be a Documentation Nightmare for Wealthy Heirs*, CNBC (May 27, 2021, 3:42 PM), <https://www.cnbc.com/2021/05/27/bidens-bid-to-overhaul-taxes-on-inheritances-could-bring-new-problems.html>.

66. Casey Dorman Lawson, *Asset Basis and the Future of the Federal Estate Tax*, JD SUPRA (Aug. 18, 2021), <https://www.jdsupra.com/legalnews/asset-basis-and-the-future-of-the-7758506/>.

67. *Id.*

68. Schmalbeck et al., *supra* note 34, at 129.

69. Gravelle, *supra* note 53.

70. *Id.*

71. Lawson, *supra* note 66.

72. *Id.*

73. *Id.*

74. KPMG is a global network of professional firms providing audit, tax, and advisory services.

75. Mercado, *supra* note 65.

76. *Id.*

impose added difficulties in determining the basis.⁷⁷ Making improvements to or renovating a property imposes the additional task of obtaining this information to be able to better determine the exact basis for tax purposes, which can be cumbersome or even impossible for many families.⁷⁸ Moreover, the IRS retains the right to question estimates and methodology used to determine the basis for carryover purposes.⁷⁹

C. Difficulty in Determining Value

Estate tax experts frequently argue the proper determination of tax basis because asset valuation is not always forthcoming or easily discernible.⁸⁰ In an open letter to the United States Senate, the American Institute of Certified Public Accountants (AICPA) voiced concerns for the practical implications of the Biden administration's proposed tax changes surrounding basis.⁸¹

Among the many concerns, the AICPA raised the issue that some provisions of the Biden administration's proposal are "inconsistent with well-established valuation principles and could result in valuations that do not reflect the true economic value of transferred assets."⁸² One example that drafters of the AICPA relied on concerns issues relating to limited access when there are multiple owners of a shared interest.⁸³ The AICPA emphasized that this proposal will impose additional burdens on taxpayers who could potentially have an asset with two different values to track.

The letter also highlighted that this proposal for many assets, such as a C Corp, could potentially be the third time the gain is taxed.⁸⁴

IV. IMPACT OF ELIMINATION OF STEP-UP IN BASIS

Proponents of eliminating the step-up in basis argue that the implementation of an alternative plan would only affect a very small percentage of the population.⁸⁵ Other interest groups advocate the

77. *Id.*

78. *See* Lawson, *supra* note 66.

79. Mercado, *supra* note 65.

80. Fleischer, *supra* note 55.

81. Letter from Jan F. Lewis, Chair, AICPA Tax Exec. Comm. & Bethany M. Hearn, Chair, AICPA Forensic and Valuation Serv. Exec. Comm., to Hon. Ron Wyden, Chairman, U.S. S. Comm. on Fin., Hon. Richard Neal, Chairman, U.S. H.R. Comm. on Ways and Means, Hon. Mike Crapo, Ranking Member, U.S. S. Comm. on Fin. and Hon. Kevin Brady, Ranking Member, U.S. H.R. on Ways and Means (Aug. 24, 2021)(on file with AICPA).

82. *Id.*

83. *Id.*

84. *Id.* (explaining that the asset is first taxed at the Corporate Income Tax level at 28%, then the Capital Gain tax upon death of shareholder decedent at 40%, finally an estate tax at 40%).

85. *See* Rubin & Ensign, *supra* note 14.

disastrous impact repealing the step-up in basis would have on (a) small business, (b) farmers, (c) estate-planning, and (d) middle-class families.

A. Impact on Small Businesses

Those in favor of implementing the American Families Plan's proposed tax changes defend eliminating the step-up in basis because it "allows huge fortunes to permanently escape income tax."⁸⁶ They argue that removing the step-up in basis would only impact passive business owners.⁸⁷ The National Federation of Independent Business (NFIB) reviewed the impact of estate taxes, like the proposed tax plans under the AFP, and concluded that "estate tax provides no incentive for small and family-owned businesses to expand their business or create new jobs" and stated its far-reaching impact could "tax [a] family right out of business."⁸⁸

Advocates against the repeal of the step-up in basis argue that if the step-up in basis were removed, it would leave little money for beneficiaries to invest in and maintain a property, for example.⁸⁹ An Ernst & Young study revealed that repealing the step-up in basis would result in 80,000 fewer jobs in each of the first ten years, large reductions in wages, and a reduction of Gross Domestic Product.⁹⁰ Due to these outcomes, some argue the elimination of the step-up in basis is a tax on the middle class, which contradicts the asserted purpose of the American Families Plan.⁹¹

Using patent data, one study demonstrates that tax policy could negatively impact business innovations.⁹² Researchers in this study reviewed state-level patent data and found that personal and corporate taxes have significant effects on not only the quantity of innovation but also the quality of innovation.⁹³ The study concluded that "if a high tax burden reduces [inventors'] ability to experiment and innovate, it could have broadly negative implications for long-term economic growth" and

86. Nick Buffie & Bob Lord, *The American Families Plan Taxes Billionaires and Protects Family Farms and Businesses*, CTR. AM. PROGRESS (Aug. 30, 2021), <https://www.americanprogress.org/article/american-families-plan-taxes-billionaires-protecting-family-farms-businesses/>.

87. *Id.*

88. *Relief From the Estate Tax*, NFIB (Jan. 30, 2017), <https://www.nfib.com/content/issues/tax-help/relief-from-the-estate-tax-254/>.

89. Mike Tomko & Bailey Corwine, *Study Shows Repealing Stepped-up Basis Would Damage the Economy*, AM. FARM BUREAU FED'N (Apr. 20, 2021), <https://www.fb.org/newsroom/study-shows-repealing-stepped-up-basis-would-damage-the-economy>.

90. *Id.*

91. *Id.*

92. Alex Durante, *New Study Shows Tax Policy Has Strong Effects on Innovation*, TAX FOUND. (Oct. 27, 2021), <https://taxfoundation.org/reconciliation-bill-tax-innovation/>.

93. *Id.*

advises lawmakers to consider these implications when they decide to raise taxes on both individuals and corporations.⁹⁴

The Biden administration frequently emphasizes that it will not raise taxes on those earning less than \$400,000 per year.⁹⁵ However, the Small Business & Entrepreneurship Council (SBE) does not share this view.⁹⁶ Instead, the SBE Council posits that through the American Families Plan, raising taxes on small businesses results in restraining economic, income and employment growth.⁹⁷ Weighing the economic benefits of allowing businesses to invest and expand against the goal of seeking capital gains tax at death, the SBE views the Biden tax plan as potentially functioning as a death sentence for small businesses and enterprises.⁹⁸

B. Impact on American Farmers

In addition to business concerns about the AFP's impact, data suggests that farmers fall subject to substantial tax impact if the step-up in basis were made unavailable.⁹⁹ While farm owners are currently relieved that the House Ways and Means Committee omitted changes to the step-up in basis, they still believe that the changes may be resurrected in some form in the future.¹⁰⁰

While the American Families Plan proposed exemptions for farmers, such as keeping the farm within the family after the asset is passed, farmers raise concerns that this is not as straightforward as it appears.¹⁰¹ First, the proposal does not clarify certain key terms that could impact those inheriting the family farm.¹⁰² For example, it lacks clarity in how "family" is defined. Under the tax code, family does not include nephews, nieces, and cousins.¹⁰³ Second, the plan does not clarify the length of time that the farm would have to remain within a family to retain this exemption.¹⁰⁴ Finally, the lack of clarity in the

94. *Id.*

95. Raymond J. Keating, *Death and Higher Taxes: Biden's Massive Blow to Small Business, Investment and Wealth Creation*, SMALL BUS. & ENTREPRENEURSHIP COUNCIL (May 12, 2021), <https://sbecouncil.org/2021/05/12/death-and-higher-taxes-bidens-massive-blow-to-small-business-investment-and-wealth-creation/>.

96. *Id.*

97. *Id.*

98. *Id.*

99. Sara Schafer, *All in the Family? How the American Families Plan Could Impact Your Succession Plan*, FARM J. AGWEB (May 14, 2021), <https://www.agweb.com/news/business/succession-planning/all-family-how-american-families-plan-could-impact-your>.

100. Jacqui Fatka, *ERS: Stepped-up basis tax proposal impacts 20% of farms*, NAT'L HOG FARMER (Sept. 30, 2021), <https://www.nationalhogfarmer.com/farm-policy/ers-stepped-basis-tax-proposal-impacts-20-farms>.

101. Schafer, *supra* note 99.

102. *Id.*

103. *Id.*

104. *Id.*

exemption concerns farm owners who plan to pass their assets to non-farming beneficiaries. For example, when there are multiple children, some of whom do not participate in the farm business, would the nonparticipants be subject to capital gains taxes at the time of transfer?¹⁰⁵ These answers remain unclear.

While the U.S. Department of Agriculture assured farmers that the removal of the step-up in basis would impact only two percent of family farmers, it neglected to mention hidden tax increases that would result in new tax liability for sixty-five percent of agricultural production.¹⁰⁶ According to the chief economist for the Senate Agriculture Committee, John Newton, under the United States Department of Agriculture's own study "combining the deferred tax and the immediate tax for the total new tax liability, 17% of small farms, 66% of mid-sized farms, 80% of large farms and 96% of very large farm operations would have a new tax burden with the elimination of stepped-up basis."¹⁰⁷

The concern about the impact of these proposed tax changes does not reflect partisan leanings. Rather, both Republicans and Democrats share concerns about the impact on American families, especially regarding the proposed elimination of the step-up in basis.¹⁰⁸ The Democratic chairman of the House Agriculture Committee, David Scott, expressed his concerns openly in a letter to President Biden warning that the burden of paying for the American Families Plan "cannot be borne by the next generation of farmers taking over the land" and that "any increase in inheritance tax for those taking over farmland is untenable and will further strain a farm economy" as it begins recovering from the COVID-19 pandemic.¹⁰⁹ The Texas Farm Bureau President echoes this concern, stating that farm owners cannot afford additional burdens as they "suffer from inflation, supply chain issues, volatile markets and other obstacles."¹¹⁰

C. Impact on Estate-Planning

While the removal of the step-up in basis proposal has not been enacted, estate planners and wealth advisors have already been

105. *Id.*

106. Fatka, *supra* note 100.

107. *Id.* (citing Tia M. McDonald, Ron Durst, & Christine Whitt, *The Effect on Family Farms of Changing Capital Gains Taxation at Death*, U.S. DEP'T AGRIC., ECON. RSCH. SERV., EB-31 (Sept. 2021)).

108. *Republican, Democratic Lawmakers Unite with Farmers on Stepped-Up Basis*, AM. FARM BUREAU FED'N (Sept. 2, 2021), <https://www.fb.org/news/republican-democratic-lawmakers-unite-with-farmers-on-stepped-up-basis>.

109. *Id.* (citing Press Release, Chairman David Scott, House Agriculture Committee (June 2, 2021), <https://agriculture.house.gov/news/documentsingle.aspx?DocumentID=2213>).

110. Jennifer Whitlock, *Texas Farm Bureau Opposes Build Back Better Act*, TEX. FARM BUREAU: TEX. AGRIC. DAILY (Nov. 18, 2021), <https://texasfarmbureau.org/texas-farm-bureau-opposes-build-back-better-act/>; *see also* Tepper, *supra* note 8.

exploring ways to lessen the impact on their clients.¹¹¹ While the intentions of the Biden administration are to ease “inequalities by raising money from the most affluent people in the U.S.,”¹¹² wealthy Americans are already making plans to brace for the effects of the new changes.¹¹³ One strategy includes private placement life insurance (PPLI), which allows heirs to inherit the PPLI policy tax-free.¹¹⁴ Other strategies include increasing charitable donations to minimize “a tax bite,” “bypass[ing] capital-gains taxes” or simply holding onto the appreciated asset for as long as possible while awaiting a “future Congress [to] change the rules.”¹¹⁵ These types of strategies thwart the Biden administration’s goal of making affluent Americans pay their share of taxes, who have otherwise avoided paying taxes while continuing to accumulate wealth, such as Jeff Bezos and other billionaires.¹¹⁶

Because removing the step-up in basis would apply to many people, not only billionaires, many families are taking steps to protect their wealth. Non-billionaire families have raised concerns with their wealth advisors that their children will bear the burden when they inherit a home, for example.¹¹⁷ Advisors and wealth planners are now rethinking strategies and investments to help their clients whose estates face an unexpected tax increase if a carryover in basis was applied instead of the planned for step-up in basis.¹¹⁸ Removing the step-up in basis would impact families who do not use “sophisticated

111. Ben Steverman, *Rich Americans Who Were Warned on Taxes Hunt for Ways Around Them*, BLOOMBERG (Apr. 24, 2021, 8:00 AM), <https://www.bloomberg.com/news/articles/2021-04-24/rich-americans-hunt-for-ways-around-tax-hikes-they-were-warned-about#xj4y7vzkg>.

112. Mirit Eyal-Cohen, *Weekly SSRN Tax Article Review And Roundup: Eyal-Cohen Reviews Batchelder’s Leveling The Playing Field Between Inherited Income And Work Income*, TAXPROFBLOG (Feb. 28, 2020), https://taxprof.typepad.com/taxprof_blog/2020/02/weekly-ssrn-tax-article-review-and-roundup-eyal-cohen-reviews-batchelders-.html.

113. Ben Steverman, *Rich Americans Already Have a Plan to Escape Biden’s Tax Hikes*, BLOOMBERG L. (Sept. 2, 2021, 7:00 AM), <https://news.bloomberglaw.com/mergers-and-acquisitions/rich-americans-already-have-a-plan-to-escape-bidens-tax-hikes>.

114. Brady C. Knight & Chelsea Maeda, *Modernized Estate Planning With Private Placement Life Insurance*, WEALTH MGMT. (May 20, 2021), [https://www.wealthmanagement.com/insurance/modernized-estate-planning-private-placement-life-insurance\(explaining-that-a-PPLI-differs-from-a-traditional-life-insurance-policy-in-that-it-allows-for-the-allocation-of-alternative-and-more-robust-investments\);-see-also-Steverman,-supra-note-111-\(“...\[H\]eirs-inherit-the-PPLI’s-contents-tax-free.”\)](https://www.wealthmanagement.com/insurance/modernized-estate-planning-private-placement-life-insurance(explaining-that-a-PPLI-differs-from-a-traditional-life-insurance-policy-in-that-it-allows-for-the-allocation-of-alternative-and-more-robust-investments);-see-also-Steverman,-supra-note-111-(“...[H]eirs-inherit-the-PPLI’s-contents-tax-free.”)).

115. Rubin & Ensign, *supra* note 14; *see also* Caleb Melby & David Kocieniewski, *Biden Tax Rule Would Rip Billions from Big Fortunes at Death*, BLOOMBERG (May 4, 2021, 5:11 PM), <https://www.bloomberg.com/news/articles/2021-05-04/biden-tax-rule-would-rip-billions-from-biggest-fortunes-at-death#xj4y7vzkg> (“[E]ven if Biden’s plan is adopted, tax lawyers and accountants will likely find ways to increase flexibility by using charitable donations and novel estate planning strategies.”).

116. Seth Hanlon & Galen Hendricks, *Addressing Tax System Failings That Favor Billionaires and Corporations*, CTR. AM. PROGRESS (Sept. 3, 2021), <https://www.americanprogress.org/article/addressing-tax-system-failings-favor-billionaires-corporations/>.

117. Rubin & Ensign, *supra* note 14.

118. *Id.*

tax-planning vehicles” much harder.¹¹⁹ They also may not be able to financially hold on to an asset for as long as a billionaire can, which again would thwart the Biden administration’s efforts.¹²⁰

D. Impact on Middle Class Families

While the Biden administration claims to target billionaires and the uber-wealthy in its tax proposals, including the removal of the step-up in basis, there could be implications for middle-class Americans. Practically speaking, an estate could be forced to sell off an inheritance if it cannot pay the taxes owed upon the decedent’s death.¹²¹ This could potentially turn into a middle-class tax hike and impair a decedent’s freedom of disposition.¹²² For example, if a person inherits a property that is now valued at 1.8 million dollars with a step-up in basis, that person could choose to keep the property or sell it and be alleviated of paying federal capital gains taxes.¹²³ Without the protections that a step-up in basis provides, because the value of the home is over the one million dollar exemption, under a carryover basis the estate would be forced to pay the difference in capital gains taxes from when that property was acquired many years ago.¹²⁴ A smaller estate could have trouble coming up with the money to pay the tax bill and be forced to sell the asset, which could ultimately drain a smaller estate and deprive a person of their inheritance.¹²⁵

The removal of the step-up in basis has a farther-reaching impact when it is actually applied, and could cause problems for the middle class, which is something the Biden administration supposedly seeks to prevent.¹²⁶ This directly affects a decedent’s freedom of disposition especially when the decedent may not have been wealthy enough during his or her lifetime to pay a tax lawyer or wealth manager to help avoid this pitfall.¹²⁷ Many parents wish to treat all their children equally upon

119. *Id.*

120. *See id.* (discussing a California woman who borrowed against her mother’s home to pay for her mother’s care and is concerned that if her mother lives past the effective date of the Biden plan, it would be impossible for her to pay the taxes and keep the house).

121. *See* Taylor Tepper, *Stepped Up Basis Reform: Biden’s Middle-Class Tax Hike?*, FORBES (May 7, 2021, 10:10 AM),

<https://www.forbes.com/advisor/investing/stepped-up-basis-biden-tax-plan/> (explaining that an estate that could not come up with the funds to pay the bill might be forced to sell the home).

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.*

126. *Fact Sheet: The American Families Plan*, THE WHITE HOUSE: BRIEFING ROOM, (Apr. 28, 2021), <https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/>.

127. *See* Robert H. Sitcoff & Jesse Dukeminier, *WILLS, TRUSTS & ESTATES* 3 (10th ed. 2017).

their death and take this into account in their estate planning.¹²⁸ However, for farm families, removing the step-up in basis could disparately impact children if one or more of the children do not wish to continue in the family farming business and opt to sell their share of their inheritance.¹²⁹ This undermines families' carefully laid estate plans that seek to provide equally for their children upon death.¹³⁰

V. LIKELIHOOD OF AFP'S SUCCESS

The Biden administration failed to pass the removal of the step-up in basis in favor of a carryover basis in 2021. However, this fight is far from over.¹³¹ Despite its recent defeat, politicians continue to seek out other ways to tax the rich, including implementing a carryover basis, which would undo the step-up in basis.¹³² Senator Elizabeth Warren called removing the step-up in basis the "low hanging fruit" and advocates implementing a carryover basis in its place.¹³³ The Biden administration seeks to close loopholes claiming that these loopholes only protect the very rich.¹³⁴ Billionaires have the resources to protect their wealth much more stealthily than most. As mentioned above, targeted wealthy Americans, including billionaires, have already been utilizing their resources to explore ways to get ahead of the proposed tax changes and to protect their wealth.¹³⁵

VI. RECOMMENDATIONS

If the Biden administration's goal is to tax billionaires who escape paying taxes more consistently, then it should focus on that goal, which likely includes other kinds of tax changes. Applying the same tax plan to these dramatically different types of estates does not effectively reach billionaires who notoriously avoid paying taxes. To address this problem, Senator Warren suggests an annual tax on the net worth of

128. Sara Schafer, *All in the Family? How the American Families Plan Could Impact Your Succession Plan*, AG WEB (May 14, 2021), <https://www.agweb.com/news/business/succession-planning/all-family-how-american-families-plan-could-impact-your>.

129. *Id.*

130. *See id.*

131. Tepper, *supra* note 8.

132. Andrew Duehren, *Democrats Seek Backup Plan on Taxing Capital Gains*, WALL ST. J. (Sept. 17, 2021, 11:47 AM), <https://www.wsj.com/articles/democrats-seek-backup-plan-on-taxing-capital-gains-11631893650>.

133. Tepper, *supra* note 8.

134. *See* Nick Buffie & Bob Lord, *American Families Plan Taxes Billionaires and protects businesses and farms*, CTR. AM. PROGRESS, (Aug. 30, 2021), <https://www.americanprogress.org/article/american-families-plan-taxes-billionaires-protecting-family-farms-businesses/>.

135. Steverman, *supra* note 111.

households above \$50 million.¹³⁶ However, her plan draws criticism because it could be an unconstitutional form of taxation.¹³⁷

Finding an equitable solution to the issue of taxing billionaires raises questions about many other types of taxes. Removing the step-up in basis impacts many Americans, undermines estate planning, and offers no reliable way to ensure billionaires pay their share of the tax burden. Possible recommendations include raising awareness through education and safeguarding smaller estates with additional exemptions and raising the federal estate exemption threshold.

A. Education

If the goal is to even the playing field by shrinking the wealth disparity between the rich and the poor, education could potentially play a role.¹³⁸ A lack of estate planning could contribute “to the continued wealth disparities that negatively impact low- to middle-income and minority communities.”¹³⁹ Many people often falsely believe that estate planning is only for the wealthy and find themselves unprepared when someone dies.¹⁴⁰

Estate planning is often associated with only the ultra-wealthy because it helps navigate many tax issues that are raised upon the death of a person with assets, so many people overlook proper planning.¹⁴¹ Proper planning helps anyone with assets plan for potential tax burdens, and ensures a smoother process of passing assets to beneficiaries upon death.¹⁴²

B. Safeguarding Smaller Estates

Although the Biden administration’s plan to remove the step-up in basis failed to come to fruition this year,¹⁴³ the administration’s plan at

136. Duehren, *supra* note 132.

137. Beverly Moran, *Elizabeth Warren’s Wealth tax Would Reduce Inequality – the Problem is it’s Probably Unconstitutional*, THE CONVERSATION (Mar. 2, 2021, 3:05 PM), <https://theconversation.com/elizabeth-warrens-wealth-tax-would-reduce-inequality-the-problem-is-its-probably-unconstitutional-156349> (arguing that “wealth taxes violate Article I, Section 2, Clause 3 of the U.S. Constitution, which forbids the federal government from laying “direct taxes” that aren’t apportioned equally among the states” and that the government cannot tax real estate or any other form of wealth absent a transaction).

138. Astrid Andre, *Can Estate Planning be Used to Help Preserve Economic Assets in Low-Income Communities?*, SHELTERFORCE (Mar. 1, 2019), <https://shelterforce.org/2019/03/01/can-estate-planning-preserve-economic-assets-in-low-income-communities/>.

139. *Id.*

140. *Id.*

141. See Janet Berry-Johnson, *Estate planning is an Important Strategy for Arranging Financial Affairs and Protecting Heirs – Here are 5 Reasons why Everyone Needs an Estate Plan*, BUS. INSIDER, <https://www.businessinsider.com/why-is-estate-planning-important#:~:text=Estate%20planning%20is%20important%20for,you%20if%20you're%20incapitated> (Aug. 12, 2022, 11:46 AM).

142. See *id.*

143. Tepper, *supra* note 8.

least considered the impact on less wealthy estates by including provisions to help protect smaller estates.¹⁴⁴ While this is a good start, it does not go far enough to protect smaller estates that could be inequitably deprived of its wealth.

As argued above, because the step-up in basis is critical for many Americans, it should not be changed. However, if the Biden administration successfully removes the step-up in basis in the future, two suggestions include: First, carving out more exemptions, and second, keeping the federal estate tax exemption at \$12.06 million or even increasing it.

First, if the removal of the step-up in basis is successful in the future, the Biden administration (or other future administrations) must safeguard smaller estates by not equating a one-million-dollar estate with a mega-million- or billion-dollar estate. The Biden administration's proposed plan carved out a \$1 million exemption, requiring a taxpayer to pay a capital gains tax on any gains above that threshold.¹⁴⁵ Raising the threshold amount could help protect smaller estates who breach the one-million-dollar threshold as a result of their inheritance from the risk of being unfairly impacted by capital gains tax if they were unable to hold on to the asset and were forced to sell it.

Second, the current federal estate tax exemption for 2022 is now \$12.06 million.¹⁴⁶ According to the NFIB, "[a] majority (69.7%) of small business owners see this increased exemption as important."¹⁴⁷ However, in 2026, the government plans to lower the current federal estate tax exemption to \$5 million.¹⁴⁸ House Representative Jason Smith of Missouri advocated for a sharp exemption increase in 2017, arguing that this reform helped farmers and small businesses reinvest and grow instead of worrying about an impending and uncertain tax burden while mourning their loved ones.¹⁴⁹ While this increase is temporary, Representative Smith argues that "it is bad policy to require grieving families to pay an unreasonable tax on their loved one's nest egg" and that "[d]eath should not be a taxable event and no one should be punished for pursuing the American dream."¹⁵⁰ To alleviate tax strain on

144. See LaBrecque, *supra* note 22.

145. See LaBrecque, *supra* note 22.

146. Probasco, *supra* note 29.

147. NFIB, *Tax Relief for Small Businesses*, TAXES: TAX ISSUES & SMALL BUS., <https://www.nfib.com/advocacy/taxes/> [<https://web.archive.org/web/20220511232324/https://www.nfib.com/advocacy/taxes/>].

148. Rosemary Durkin et al., *Gift and Estate Tax Changes*, JD SUPRA (Jan. 5, 2022), <https://www.jdsupra.com/legalnews/gift-and-estate-tax-changes-5414221/> (stating that while the reset amount will be \$5 million as it was in 2016, "it will be indexed for inflation, resulting in an amount of roughly \$6.6 million in 2026.").

149. Jason Smith, *Death Should not be a Taxable Event – it's Time to end the Estate tax*, THE HILL (May 4, 2021, 1:00 PM), <https://thehill.com/blogs/congress-blog/politics/551592-death-should-not-be-a-taxable-event-its-time-to-end-the-estate>.

150. *Id.*

smaller estates, Congress should keep the federal estate exemption at \$12.06 million or even increase it.

VII. CONCLUSION

Taxing billionaires is a topic for another day. If the Biden administration's true intent is to tax billionaires who legally avoid tax liabilities, it should focus on those interests – not on unraveling established estate planning principles on which many non-billionaire Americans rely. Americans should be able to plan for their death without fear that Congress will change the rules. Removing the step-up in basis undermines fundamental estate planning and creates uncertainty for anyone with assets that they wish to pass on to their families upon death. Our leaders should safeguard, not discard, this bedrock principle that lies at the heart of the American dream.