APRIL 1, 2022

Proposed Minimum Income Tax on Super High Net Worth Individuals

BERDON TAX TEAM

PREMISE: Beginning in 2023, individuals with a net worth in excess of $100 million would pay a minimum annual income tax of 20% of their regular taxable income PLUS unrealized gains.

OVERVIEW:
What follows is based on the recently released "Green Book," which is a general explanation of the tax provisions in the 2023 budget recently proposed by the Biden Administration. It is not statutory language and is scant on details, so much is left to inference as to how the broad enunciated concepts may work in practice.

- Under current rules, taxable income includes amounts actually earned from businesses and investments but does not include mere appreciation of assets that have not been sold. So appreciated real estate and securities, for example, are not subject to tax until they are actually sold. Moreover, they can be borrowed against without being subject to sale treatment.
- The proposal would apply to individuals, and likely trusts, with assets the value of which, after subtracting liabilities, exceed $100 million (as of December 31st of the taxable year).
- The proposal would impose, on subject taxpayers, a minimum annual income tax of 20% times the sum of (i) their regular taxable, computed under normal rules, and (ii) the unrealized gains (excess of fair market value over tax basis) in the assets they own, minus their regular tax liability.
  Example: Individual X has a net worth in excess of $100 million. For 2023, X has ordinary income from earnings and other sources of $10 million and long-term capital gains of $5 million, and overall regular taxable income of $15 million. X has a regular tax liability of $4.5 million, an effective tax rate of 30%. X's securities portfolio has appreciated substantially, so at the end of 2023, if X sold the securities at their fair market value X would have an additional gain of $20 million. Under the proposal, X's minimum taxable income for 2023 would be the regular taxable income of $15 million PLUS the unrealized gain on the securities of $20 million, for a minimum taxable income of $35 million. At a 20% tax rate, the tax liability would be $7 million. So, X has a regular tax liability of $4.5 million PLUS the minimum tax of $2.5 million, for a total tax liability of $7 million.
- For the initial year, 2023, the minimum tax liability would be payable in nine equal annual installments. For subsequent years, a subject taxpayer can elect to pay any additional annual minimum tax on further asset appreciation equally over five years.
- The minimum tax is essentially a prepayment of tax on appreciated assets. Prepaid minimum taxes are credited against any taxes later due on realized capital gains (when the asset is actually sold), so the appreciation does not get taxed twice and could result in refunds if assets later depreciate in value and/or are sold.

- Taxpayers will be required to report asset values and unrealized gains to the IRS annually, with valuation conventions available for illiquid assets (i.e., non-publicly traded).
- Illiquid taxpayers (greater than 80% or more of whose net worth consists of non-tradeable assets, such as real estate or a closely held business) can elect to defer the minimum tax on their non-tradeable assets until sold. However, a deferral charge of up to 10% of the deferred gain would apply.
- The proposal states that minimum tax prepayments remaining at death will be refunded to the extent they exceed "tax liability from gains at death." Inasmuch as the Green Book proposes the taxation of unrealized gains at death, it appears that any remaining prepayments at that time will be absorbed by income tax at death.
- Critical questions remain unanswered such as, will family wealth be aggregated (e.g., family members and trusts) for determining the $100 million threshold? How will this integrate with the existing tax systems (e.g., capital loss carryovers, passive loss carryovers, net operating loss carryovers, etc.)? Are unrealized gains net of unrealized losses? What happens if net worth later drops below the $100 million threshold?

IN CLOSING…

There are significantly more questions than answers on how this proposal would work in practice. While we have begun to think through the mechanics of a construct like this, it will take time to flush out the full implications. Proposed statutory language will be illuminating. But much is often left to the regulation writers by Congress in modern practice. At this juncture, the likelihood of passage is entirely up in the air. Questions as to its constitutionality remain as well. But as they say, once proposed, they never die.

Note: There are many other tax provisions in the Build Back Better bill passed by the House, in the recent Green Book, and other earlier Biden proposals that are intended to narrow the income/wealth gap by targeting wealthy taxpayers. For additional information on these proposals, please refer to the following articles previously distributed by the Berdon Tax Team:

- "Preparing for President Biden's Tax Increases"
- "How Will President Biden's Tax Plan Impact Income Taxes on Businesses and Their Principals"
- "How Will President Biden's Tax Plan Impact Income Taxes for High Net Worth Individuals And Their Families?"
- "How Will President Biden's Tax Plan Impact Estate and Gift Taxes for Business Owners and High Net Worth Families?"

Questions: Contact your **Berdon advisor**.

Berdon LLP is a full-service accounting and advisory firm which also offers specialized services such as state and local tax, trust and estate planning, family office services and business valuations. For more than 100 years, Berdon has served a variety of clients, including some of the nation's premier family-owned real estate companies, international law firms, advertising, architecture, and engineering/construction firms and noted figures in the arts and entertainment industry.

BERDON LLP | 360 Madison Avenue, New York, NY 10017 | 100 Jericho Quadrangle, Jericho, NY 11753 |