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Revenue Vanishing into the Heir: Closing the Stepped-Up Basis Loophole

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Since the beginning of the pandemic, the wealth of America's 700+ billionaires rose by 60% while millions of working Americans suffered. For too long, the wealthy few have rigged the rules so they don't have to pay their fair share at the expense of funding our communities.

The current U.S. tax code incentivizes billionaires to hoard their wealth through various tricks and loopholes that keeps their assets in the hands of their own family and out of the pockets of the rest of us. However, Congress has the opportunity to reform some of the most egregious tax avoidance practices of billionaires in the Build Back Better Act, including by closing the "Stepped-Up Basis" loophole.

Stepped-Up Basis Loophole

One way that billionaires and millionaires avoid taxes is by concentrating their wealth in the hands of their own family members, usually their children or other heirs, before they die. When a billionaire dies but does not sell off investments that have increased in value over time (such as real estate or stocks), the federal government cannot collect revenue from the capital gains.

To avoid selling assets and to get liquidity, billionaires will use a tax avoidance tactic known as "Buy-Borrow-Die." A billionaire will leverage their assets to receive a loan from a bank at a much lower cost than if they sold their assets outright, which would be liable to tax. If a billionaire then leaves their assets to an heir after they pass, that heir is able to then sell the inherited assets without additional taxation on those capital gains for a huge profit.

This is known as the stepped-up basis loophole, and it is estimated that this loophole costs taxpayers between $44-$54 billion per year—funding that could be used for essential services such as healthcare, childcare, housing, and/or education, amongst others.

Build Back Better Act

To partially pay for the social programs included in the Build Back Better Act, President Biden proposed closing the stepped-up basis loophole. Specifically, the Administration's plan calls for closing the stepped-up basis loophole for inherited wealth over $1 million for single filers and $2 million per couple. This change would raise nearly an estimated $325 billion over 10 years.[1] The $1 million exemption plus an

[1] When coupled with raising capital gains taxes on the wealthy and closing the carried-interest loophole. More on proposals to tax the ultra-rich can be found here.

exclusion for home sales would ensure that the wealthiest heirs (less than 0.5% of households) would be subject to the closure of the loophole.

The Build Back Better agenda also calls for a 90-year "deemed realization" rule. ("Realization" is an event in which a tax is levied.) This means that if property in a trust goes untaxed for 90 years (starting January 1, 1940), then after 90 years, the property would be taxed as if it were sold. The richest families would be liable to taxation under this provision beginning on December 31, 2030.

On September 13, the House Ways and Means Committee released a summary of proposed tax reforms to be included in the Build Back Better Act. The legislative text did not include language that would close the stepped-up basis loophole. As Congressional leadership has noted that the Build Back Better Act would be fully paid for, not closing the stepped-up basis loophole removes critical revenue needed to sustain new funding in the Build Back Better Act.

Sensible Taxation and Equity Promotion (STEP) Act

Similar to the Biden Administration's proposal, Sen. Chris Van Hollen (D-MD) and Rep. Bill Pascrell (D-NJ) introduced the Sensible Taxation and Equity Promotion (STEP) Act. The bill would close the stepped-up gains loophole and ensure that wealthy families are not able to abuse trusts to avoid the tax.

For more information on tax policy, visit the Progressive Caucus Action Fund's Tax the Rich page: progressivecaucusactionfund.org/issues/tax-the-rich