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Biden's FY2024 Budget: Key Real Estate Tax Proposals

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On March 9, 2023, President Biden released his FY2024 budget (the "FY2024 Budget"), and the U.S. Treasury released the so-called "Green Book," which provides details related to the revenue provisions in the FY2024 Budget. Given Republican control of the House of Representatives and the thin Democratic majority in the Senate, it would seem unlikely that any significant tax-related legislation would get passed in the next two years. However, the revenue proposals in the FY2024 Budget might be of interest, as certain of these proposals may be included in future legislation.

Below is a high-level summary of certain revenue proposals included in the FY2024 Budget that may impact the real estate industry and investors in real estate.

Tax Rate Increase. The top marginal tax rate would increase from 37% to 39.6% on taxable income over $450,000 for married individuals filing a joint return ($400,000 for unmarried individuals). The corporate tax rate would be increased from 21% to 28%.

Phase Out of Capital Gains Rates. Long-term capital gains and qualified dividends would be subject to ordinary income rates to the extent taxable income exceeds $1 million ($500,000 for married taxpayers filing separately).

Increase in Medicare Tax and Net Investment Income Tax. For taxpayers with more than $400,000 in earnings, the top rate for the Medicare tax on employment earnings would be increased from 3.8% to 5%. Similarly, the top net investment income tax rate would be increased from 3.8% to 5% for taxpayers with more than $400,000 in income.

G&S Insight: When taken together, the combination of the marginal tax rate increase, capital gains phase out, and increase in net investment income tax, results in a top federal marginal rate on long-term capital gains and qualified dividends of 44.6%.

Expansion of the Net Investment Income Tax. The net investment income tax would be expanded to apply to business income of taxpayers with adjusted gross income over $400,000 ($200,000 for married taxpayers filing separately) to the extent such income is not otherwise subject to the net investment income tax or self-employment tax. This provision would apply to income allocated to a taxpayer from an S corporation or partnership.

Treat Death and Gifts as Taxable Events. The proposal would treat 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 and certain other exceptions (e.g., transfers to a spouse or charity). The proposal would include a deemed transfer for property held by a trust, a partnership, or other non-corporate entity to the extent such property has not been subject to a recognition event in the past 90 years.

Net Wealth Minimum Tax. A 25% 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.

Phase Out of the Carried Interest. For partners with taxable income (from all sources) exceeding $400,000, a partner's allocable share of income from profits interests in investment partnerships (i.e., carried interest) would be subject to tax as ordinary income and self-employment tax regardless of the character of the income at the partnership level.

Excess Business Losses. The proposal would make permanent the excess business loss limitation that was introduced in the Tax Cuts and Jobs Act and is currently set to expire for taxable years beginning after January 1, 2029. In addition, any excess business loss carried forward from a prior year would be treated as an excess business loss in the current year instead of as a net operating loss carryforward.

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, 2023.

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).

Partial Repeal of Section 1031. The proposal would limit gain deferred under section 1031 to $500,000 ($1 million in the case of married individuals filing a joint return) per taxpayer per year.

Prison Facility Rents. The proposal would treat any rents received from a prison or detention facility as excluded from both the 95% and 75% gross income tests for REIT qualification purposes.

Creation of Neighborhood Homes Credit. A new allocated tax credit regime would be introduced to foster new construction and rehabilitation of for sale property as well as rehabilitation by existing homeowners in neighborhoods located within certain census tracts. Among other things, the proposed credit would be limited to projects that are a single-family home (including homes with up to four dwelling units), a condominium or a residence in a housing cooperative.

Expansion of the LIHTC. The proposal would make several changes to the low-income housing tax credit rules, including:

- increasing the housing credit dollar amount allocated to the states from the greater of $2.75 per capita or $3.185M in 2023 to the greater of $4.25 per capita or $4,901,620 in 2024 and the greater of $4.88 per capita or $5,632,880 in 2025;
- modifying the so-called "50% test" for projects financed with tax-exempt bonds (private activity bonds) such that a building would be eligible for the 4% credit based on 25% tax-exempt financing of the building and land;
- repealing the qualified contract rules in section 42 such that the extended use period would no longer terminate upon failure of a state or housing credit agency to respond to an owner's request for a qualified contract following the compliance period; and
- replacing the right of first refusal safe-harbor in section 42(i)(7) for tenants, resident management corporations, qualified nonprofit organizations, or certain governmental agencies, with an option to purchase. In addition, the rules related to the minimum purchase price would be amended to eliminate the component related to federal income taxes attributable to the sale.

New Markets Credit. The new markets tax credit would be made permanent.

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