The apartment industry supports the retention of current-law stepped-up basis rules. Changes to current law could either diminish or discourage the ability of heirs to make improvements to inherited property. Affordable housing inventory could be lost as a result.

EY estimates that repealing stepped-up basis and imposing tax on transferred assets at death would cost 80,000 jobs in each of the first 10 years and 100,000 jobs each year thereafter. Workers’ wages would decline by $32 for every $100 collected in tax.

**STEPPED-UP BASIS & UNREALIZED CAPITAL GAINS**

Given that many apartment firms are small businesses, often family owned, the transfer of assets to heirs is a major consideration for company principals. While the estate tax may apply to decedents if exemption amounts are exceeded, current law appropriately enables those inheriting property to step-up the basis of that property to fair market value at the time of transfer. This is particularly important for the apartment industry because many industry executives’ estates include significant amounts of depreciable real property.

To illustrate how stepped-up basis works, consider the following example: Two married taxpayers purchased an apartment building in 1995 for $5 million before passing away in 2022 and transferring the property to an heir. At the time of transfer, the property is worth $15 million and, due to depreciation of $6 million and improvements of $2 million, has a tax basis of $1 million. The property has an operating income of $1.05 million.

Under current law, the $1 million in tax basis would be stepped-up to $15 million. Tax would only be imposed when the heir sells the asset and would be based on the difference between the value of the property at time of sale and the $15 million in tax basis (and any changes thereto).

Unfortunately, policymakers are now considering changes to step-up in basis rules: Under one option, tax would be imposed on gain exceeding a threshold amount (e.g., $2.5 million) at the time of transfer. In the example, above, a capital gain of $11.5 million would be realized when the property is passed to an heir. (This is calculated as $15 million in fair market value, less $1 million in basis, and less a $2.5 million exclusion.) Assuming the married taxpayers actively managed the asset prior to their deaths, the $11.5 million capital gain would generate a $2.6 million tax liability under current-law rates. This would be more than double the annual operating income.

If enacted, this proposal would have extremely unfortunate consequences. Not only would death become a taxable event at $2.5 million, a level far below today’s estate tax exclusion, but funds available to pay the tax could be in short supply.

Under one option, taxpayers would have 15 years to pay the tax. However, this would mean that a substantial portion of a property’s operating income (16.5 percent in the example above) would go just toward paying this tax, leaving little to improve and upgrade the property (in addition to paying current-year income and property taxes attributable to the asset). This could negatively impact the amount of affordable housing in the marketplace.

Under a second option, policymakers could allow family-owned businesses to defer tax until a property is sold. While tax may not be immediately due, an heir could well inherit an apartment property with little or no basis and sizeable debt. If it is sold, the heir will face significant depreciation recapture taxes and capital gains taxes. This discourages heirs from investing further capital to maintain it and could also remove valuable affordable housing from inventory.