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AHEAD OF THE CURVE: A BIDEN TAX LANDSCAPE OUTLOOK

HOW A BIDEN ADMINISTRATION WILL AFFECT THE TAX LIABILITIES OF HIGH-INCOME INDIVIDUALS AND THEIR BUSINESSES

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INTRODUCTION

With the Presidential and Congressional elections looming, democratic presidential candidate Joe Biden ("Biden") proposed new tax legislation (the "*Biden Plan*") that significantly changes key areas of the *Tax Cuts and Jobs Act of 2017* ("TCJA"). However, any specific details regarding his strategy towards the implementation of the proposed changes are not yet clear. Below is a summary of the key proposals within the *Biden Plan* for individuals and businesses to consider in connection with the upcoming election.

The potential for any part of the Biden Plan to make it into the Internal Revenue Code will depend in large part on the balance of power in Congress. However, if everything goes according to his "plan," new legislation could kick-in as early as January 2021 when the new Congress is expected to convene. Even if legislation is not passed during January 2021, and it's passed at a later date, Congress may enact the new tax legislation retroactively to January 2021. A&M Taxand does not express any opinion or predictions on the election results, nor is it certain in any way that the Biden Plan, or other legislative tax measures, may be introduced in 2021 or later. Nevertheless, knowing the proposals on the table and understanding their consequences, may be critical to all taxpayers considering year-end planning.

THE *BIDEN PLAN* FOR INDIVIDUALS:

Raises the top individual income tax rate from 37% to 39.6%.

> ***A&M Planning Tip:*** *If possible, consider accelerating income to capture the lower ordinary rate.*

Subjects capital gains and certain qualified dividends to ordinary income tax rates for taxpayers reporting $1 million or more of income. Applicable individuals could potentially pay a maximum tax rate of 43.4% (39.6% + 3.8%) on capital gains under the *Biden Plan* (up from the current maximum of 23.8%).

> ***A&M Planning Tip:*** *Consider accelerating built-in capital gains before the rates increase. Use or harvest existing capital losses to offset some or all of the accelerated capital gain. Taxpayers that recognize significant capital gains before a change in the current tax regime would reap the benefit of approximately 19.6% (i.e., the difference between 43.4% and 23.8%) on such gains.*

Raises payroll and self-employment taxes by subjecting income above $400,000 to the 12.4% Social Security tax. Under current law, the Social Security tax applies on income up to $137,000. Under the *Biden Plan*, income between $137,000 and $400,000 would not be subject to the Social Security tax, but it applies again above the $400,000.

> ***A&M Planning Tip:*** *Consider planning to convert income otherwise subject to employment tax to non-employment earnings, such as S Corporation's earnings.*

Imposes a 28% cap on the value of itemized deductions for taxpayers that earn more than $400,000.

> ***A&M Planning Tip:*** *Consider prospective strategies to align deductions with income from business activities.*

THE *BIDEN PLAN* FOR ESTATE AND GIFT TAXES:

Lowers the lifetime unified estate and gift tax exemption amount to $5 million per individual (adjusted annually for inflation), and $10 million for married couples. The current lifetime estate and gift tax exemption amounts are $11.58 million per individual and $23.16 million for married couples, which is set to expire in 2025. The potential to lower the exemption may create situations where the taxpayer makes lifetime gifts using the higher current lifetime exemption amount of $11.58 million but dies in a year after a change to the lifetime exemption amount (i.e., reduced to $5 million or less). The Internal Revenue Service finalized regulations that would not "claw-back" the exemption amount to a deceased taxpayer's estate, even if it is more than the date-of-death exemption amount. It is unclear whether Biden intends to maintain this protection.

> ***A&M Planning Tip:*** *Taxpayers should consider using the current exemption amount of $11.58 million before changes of the Biden Plan take effect.*

Repeals the tax-free stepped-up basis on inherited assets. The proposal may subject the unrealized built-in value on assets upon death to tax at ordinary income tax rates. Under current law, heirs receive a stepped-up basis on assets that they receive through inheritance without any accompanying income taxation on the built-in gain.

THE *BIDEN PLAN* FOR BUSINESSES:

Raises the corporate income tax rate from 21% to 28%. Additionally, the *Biden Plan* imposes a minimum tax on corporations with "book" profits greater than $100 million. A&M TAX anticipates that the new "minimum tax" may be reduced by foreign tax credits or the carryover of prior year losses.

> ***A&M Planning Tip:*** *Corporations may also consider accelerating the timing of income and potential transactions to take advantage of the 21% tax rate before a possible increase next year.*

Phases out the deduction of 20% against income from a qualified trade or business for high-income earners.

> ***A&M Planning Tip:*** *Taxpayers with passthrough entities that are currently taking the deduction should consider their choice of entity structure in light of the proposed removal, and increased individual income tax rates.*

Raises the Global Intangible Low-Taxed Income ("GILTI") tax to 21%.

> ***A&M Planning Tip:*** *Taxpayers taking advantage of current GILTI-planning (e.g., blocker planning) may wish to revisit and consider in light of the tax increase on GILTI.*

Eliminates the deferral of real estate gains on "like-kind" exchanges for high-income earners. Under these types of transactions, a taxpayer may defer taxable gain on the sale of real property if such property is exchanged for property of a "like-kind." Like-kind transactions have long been an effective strategy for deferring the taxable gain on the sale of real property in the real estate sector.

> ***A&M Planning Tip:*** *While this tax planning strategy is still in effect, it would be advisable for taxpayers to identify replacement property opportunities, and accelerate their like-kind transactions before a possible change to this tax benefit under a Biden administration.*

CONCLUSION

The *Biden Plan* proposals may change or die during the legislative process, even if Biden is elected. Moreover, there is also the question of how quickly he is likely to get his proposals enacted into law. Consider that while current President Trump's 2016 Tax Plan proposed top rates of 33% and 15% for individuals and corporations, respectively, the 2017 Tax Cuts and Jobs Act concluded on rates of 37% and 21%. Thus, recent history suggests that a campaigning presidential candidate tends to err on the extreme side of their party's "tax spectrum." Nonetheless, it is important for taxpayers to keep these potential changes in mind, as careful planning will need to be undertaken, as early as November of this year, to mitigate the tax impact before the changes may come into effect.

EXECUTIVE SUMMARY OF KEY CHANGES

Individuals		
TCJA Section	**Current Law**	***Biden Plan***
Ordinary Income	U.S. individuals are subject to U.S. federal income tax at graduated rates, culminating at 37%.	Increases the ceiling on U.S. individual tax rates to 39.6% for U.S. individuals with taxable income above $400,000.
Capital Gains and Investment Income	Under current law, capital gains and certain dividends are taxed at a preferential rate of 20%, plus a 3.8% net investment income tax.	U.S. taxpayers with over $1 million of income will be subject to ordinary income tax rates on capital gains and certain dividends, plus the net investment income tax. Under the proposed maximum income tax rate, this could result in an effective tax rate of 43.4% (39.6% + 3.8%) on capital gains.
Itemized Deductions	Repealed limitation on itemized deductions for taxable income above $400,000.	Restores the limitation on itemized deductions for taxable income over $400,000 and caps the tax benefit of such deductions to 28% of the value.
Payroll and Self-Employment	A 12.4% Social Security tax is split evenly between employers and employees up to $137,700 of employee's wages. A Medicare tax of 2.9% is similarly split evenly between employer and employee, without an income limitation.	An additional 12.4% social security tax would apply to individuals with income over $400,000.
Income from Pass-Through Entities	Passthrough entities, such as partnerships, S-corporations, and real estate investment trusts, are currently eligible for a 20% deduction on qualified business income.	Phase-out the 20% deduction on qualified business income for high-income earners.
Estate and Gift Taxes	As of 2020, the estate and gift exemption amount is $11.58 million per individual and $23.6 million for married couples. Amounts above the exemption are subject to a 40% estate or gift tax. Heirs receive a stepped-up basis (i.e., FMV as of the date of death) on inherited assets.	Taxes unrealized appreciation on inherited assets at death. Such appreciation will likely be taxed as ordinary income. Heirs would obtain a stepped-up basis at death. Lower the exemption amount to its pre-2018 amount (i.e., $5.49 million per individuals, and $10.98 million for married couples)

EXECUTIVE SUMMARY OF KEY CHANGES (CONT.)

Businesses		
TCJA Section	**Current Law**	***Biden Plan***
Corporations	Corporations are subject to tax at a standard rate of 21%. Corporate taxpayers are entitled to a deduction equal to 50% of their global intangible low-taxed income ("GILTI") until 2026, or 10.5% (21% * GILTI 50% deduction) from foreign subsidiaries.	Increases the standard tax rate of 21% to 28%. Imposes a minimum tax of 15% on corporations with more than $100 million in "book" net income. Reduces the amount of the GILTI deduction to 25%. In conjunction with the increased tax rate on corporations to 28%, this would result in an effective tax rate of 21% on GILTI inclusions. Makes the New Markets Tax Credit permanent, which provides equity investors in low-income communities with a tax credit.
Like-Kind Exchanges	Gain from sale of real property can be deferred if such property is exchanged for a "like-kind" property (i.e., another real property).	Biden has indicated his intent to eliminate "like-kind" transactions to limit deferment on the gain from the sale of real property.
Pass-Through Entity Income	Pass-through entities (i.e., partnerships, S corporations, sole proprietorships) are generally able to deduct 20% of qualified business income.	Phases out the 20% deduction on qualified business income.

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