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The Biden tax proposal

President Biden's proposed tax platform could lead to major changes to existing federal tax rules applicable to many individuals and businesses. The proposed plan would place more federal taxes on high-income individuals and businesses. There could be sweeping changes aimed at many federal tax categories. These changes may impact Social Security tax, individual income tax, business and investment tax, capital gain tax, and federal and gift tax exemptions.

Although these revisions are proposed and not yet enacted, it is possible they could be effective much sooner than expected. It may benefit you to know the existing tax rules and what is proposed in order to better plan, prepare and act on strategies that are based on income, retirement, estate and gift tax.

Key proposed points:

Increase the top ordinary income tax rate for income over $400,000.

Increase the long-term capital gains rate for earners over $1,000,000.

Eliminate step-up in basis for capital gains taxation.

Replace deductions for contributions to IRAs, 401(k)s, and similar retirement accounts **with a flat 26% credit.**

Personal income tax changes

The proposal increases long-term capital gains rates back to ordinary income above $1,000,000.

Total taxable income (single)	Current long-term capital gains rate	Long-term capital gains rate under President Biden's proposal
Up to $40,400	0%	0%
$40,401-$445,850	15%	15%
$445,851-$999,999	20%	20%
$1,000,000 and over	20%	**39.6%**

The top individual income tax rate for taxable income above $400,000 would revert to 39.6%. It is currently 37% as enacted by the Tax Cuts and Jobs Act (TCJA).

Income over $200,000 (single) and $250,000 (married, filing jointly) will continue to pay the net investment income surtax of 3.8% to fund Medicare, instituted by the Affordable Care Act of 2006.

Estate and transfer taxes

Federal estate and gift tax changes

Under the proposed plan, the step-up in basis for capital gain assets would be eliminated. This applies to assets subject to capital gain treatment.

Low basis assets passed to heirs upon death could be subject to substantial capital gains taxation. Under the current rules, there is a step-up in basis on certain capital assets passing to heirs on death.

The current and proposed individual and married unified gift and estate tax exemption amounts are:

	2020	Under President Biden's proposal
Individual exemption	$11.58 million	**$3.5 million**
Married exemption	$23.16 million	**$7 million**

The proposed federal estate and gift tax rules would have a substantial impact on estate and gift planning. The plan calls for a return to the pre-2009 TCJA levels on federal estate and gift tax exclusion. The proposed plan would make the exemption at death equal to $3.5 million and the lifetime gift exemption would be $1 million. The current annual exclusion for 2020 is $15,000. It is scheduled to be the same for 2021.

Deductions for IRAs and 401(k)s

As proposed, a flat 26% tax credit would replace deductions on IRA contributions. Currently, IRAs are deductible depending on income, and whether or not the individual is a participant in a qualified plan through an employer. This also applies to 401(k)s and other qualified plans.

Additional proposed personal income tax changes

There are numerous proposed changes to the current income tax rates, deductions and credits at the individual taxpayer level, including:

- The maximum amount of itemized deductions would be no more than 28% for those earning over $400,000.
- The earned income tax credit would be expanded for certain workers 65 or older.
- The Child and Dependent Care Tax Credit would be increased to $8,000 ($16,000 for multiple dependents) and increase maximum reimbursement rate from 35% to 50%.
- There would be renewable energy-related tax credits for individuals.
- The first-time homebuyer credit would be restored with a maximum of $15,000. Under the current rules, there is no first-time homebuyer credit.
- Tax-deferred exchanges performed under IRC 1031 would no longer be available with the proposal. Similar to IRC 1035 where there can be an exchange of one annuity for another annuity without recognition of gain, IRC 1031 applies to like-kind real estate when one property is exchanged for another held for business or investment. TCJA limited 1031 to real estate.

Due to many factors affecting proposed tax legislation and resulting legislation, it is not easy to predict exactly what tax change provisions will be enacted, who will be impacted and when newly enacted legislation will be effective. However, business, individual tax, estate and gift, and retirement planning strategies are always in need of review, whether legislation is enacted or not.

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