10 Things Every Client Should Know About Biden's Tax Proposal

The current tax rates are among the lowest U.S. citizens have ever experienced since the inception of the federal tax code in 1913. Unfortunately, good times can't last forever. Since the election, President Biden was noticeably mum about raising taxes, but now that he unveiled his $2.3T Infrastructure Plan, the focus has now shifted back to taxes as the way to pay for all (or at least some of) this largesse. Because taxes are now once again front and center, it is time to revisit key components of his proposed plan and start discussing these items with clients who could be affected. And to be clear, the outlines of the plan are still hazy, and much is subject to change. But, forewarned is forearmed.

I. Corporate Tax Increases Are on the Front Burner

Under the Biden tax plan, the corporate tax rate could increase from 21% to 28% and there could be an increase in taxation of international corporate income earned by US-based companies. The proposal would increase the minimum tax on global profits of US corporations to 21%. These increases could take effect as early as January 2022.

The President plans to levy a 15% minimum tax on the income that the largest corporations report to investors, known as book income, as opposed to the income reported to the Internal Revenue Service. Finally, Biden would make it harder for US companies to acquire or merge with a foreign business to avoid paying US taxes by claiming to be a foreign company. And he wants to encourage other countries to adopt strong minimum taxes on corporations, including by denying certain deductions to foreign companies based in countries without such a tax. Janet Yellen, in the meantime, has recently called for a uniform taxation of international corporations to try to even the playing field and discourage using a corporation's location as the basis of their taxation.

According to Forbes, analysts from Goldman Sachs have predicted that Biden's entire tax plan would reduce 2022 earnings-per-share on the S&P 500 by 9%. They say it's more likely that Congress will end up passing a smaller rate increase to 25%, which would only depress earnings by 3%. But, most of your work is not counseling multinational corporations, so we focus instead on changes that are being proposed for individual taxpayers and how you should be thinking about it.

II. Individual Tax Increases are not Far Behind

As for individual taxes, Biden would seek to reverse some of the 2017 Tax Cuts & Jobs Act (TCJA) changes and also return the estate tax to 2009 levels thus increasing the number of estates that are subject to taxes.

Below we discuss the 10 major tax changes that could come to fruition soon under the Biden Administration and how to address planning if your clients are concerned about their taxes.

1. Increase the top ordinary income tax rate for income over $400,000 to 39.6% (unclear whether for families or on individuals). It is currently 37% as enacted by the Tax Cuts and Jobs Act (TCJA).

Planning Tip: Consider all strategies to bring down income, including funding traditional retirement plans, opening profit sharing/defined benefit plans, bunching deductions and so on, Consider charitable giving to decrease taxes: QCD's (if 70 ½), CGA's, CLT's, DAF's, and donating appreciated stock to charity. Increase municipal bond holdings – they become more valuable when taxes increase as the tax-equivalent yield also increases. Consider barebones investment-only variable annuities to defer income. Consider decreasing dividend or other income-producing investments or placing them in retirement accounts.

2. Eliminate step-up in basis at death and potentially create a taxable event at that time. This could be the most challenging of all to pass.

Planning Tip: Consider "Basis Management" as an ongoing strategy to bring down gains in portfolios, particularly if the step-up in basis is done away with. This may include paying more attention to annual rebalancing, placing stocks that are anticipated to appreciate into retirement accounts, transferring low-basis stocks to lower-income family members (up or down), gifting, charitable giving and CLT's, and so on.

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

Planning Tip: If enacted, this would make Roth accounts more attractive for High Net Worth clients as those clients would not be receiving their full deduction for their retirement account contributions. It would also make funding retirement accounts more attractive for lower-income investors, which is the point of this provision.

4. Increase long-term capital gains rates on income $1,000,000 and over from 20% to 39.6%. And don't forget the Medicare Tax of 3.8% on top of those amounts, regardless if the tax increase goes through or not.

Planning Tip: Reduce the size of annual capital gains budget – keep to 23.8% vs. potential 43.4% top rate. That may mean accelerating gains into this year, gifting highly appreciated stock to charity, more attention paid to tax-loss harvesting, and deathbed planning (depending on whether the step-up in basis is still available). Also, consider installment sales, funding retirement plans, accelerating deductions, increasing business expenses and otherwise leveling income so as not to be in the highest tax bracket next year and not to exceed the $1 million capital gains threshold.

5. **Unified gift and estate tax exemption amounts would decrease from $11.58M to $3.5M for individuals and $23.16M to $7M for married couples.** Portability would remain and those amounts would be indexed to inflation. There is also talk of doing away with GRAT's (or

requiring a ten-year minimum term and a minimum of 25% gift of the market value of the property). There is also discussion of getting rid of FLP discounts, and limiting dynasty trusts and defective trusts, all very effective tools for the UHNW.

Planning Tip: If your client falls in this category, consider aggressive gifting NOW, as there are no clawbacks so USE IT OR LOSE IT!

Review all trusts and estate plans in light of the SECURE Act and potential estate tax changes and consider setting up Trusts now and aggressive gifting.

Segment your book to those whose net worth is under $5 million and perform reviews looking for large appreciated positions and engage in tax basis management, which can include looking for the step up in basis, gifting up to parents, and deathbed planning. For those clients worth between $5 million to $11 million, consider implementing gifting techniques now to drive down their estate, including low interest notes to children, SLAT's (but look out for death or divorce) and GRAT's (look out for death). And for those clients worth over $11 million, engage in more aggressive planning to try to get as close to the $11 million number as possible, using up as much of the lifetime exemptions as possible. Consider setting up GRATs, forgivable loans, SLAT's, QPRT's and so on. Work closely with the estate planning attorney as there are risks connected with all these strategies, but your options may be limited and there is also a lot at risk if planning is not addressed.

Consider life insurance if illiquid assets exist in your estate and taxes (whether through federal or state estate taxes or SECURE Act) remain a concern.

6. **The maximum amount of itemized deductions would be no more than 28% for those earning over $400,000** (again unclear whether that is individual or joint).

7. The earned income tax credit would be expanded to include workers age 65 and older, **without children living at home**, who are considered "childless" for tax purposes.

8. The Child and Dependent Care Tax Credit would increase from $3,000 to $8,000 for one child and from $6,000 to $16,000 for two or more children. The maximum reimbursement rate would increase from 35% to 50%. **The Child Tax Credit would increase from $2,000 to $3,000 per child ($3,600 for children 5 years old and younger).** As it stands right now, these changes only apply to the 2021 tax year, but there could be an effort to extend the enhancements beyond this year.

Planning Tip: Married Filing Separately may be the best course of action for your client. Encourage your clients with children to work with their tax preparer to consider whether this filing status can make sense for the lower income spouse who would then claim the children.

9. 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.

10. Tax-deferred exchanges for real estate performed under IRC 1031 would no longer be available. 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.

Planning Tip: Consider performing like kind exchanges this year in order to defer the gains, but make sure that any transaction qualifies under any tax law changes.

Some or all of these provisions may never pass, but if nothing else, your clients will appreciate your passion and your diligence on their behalf.