TAX POLICY PROPOSALS PRESENT STARK DIFFERENCES

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With election day fast approaching, one of the topics of greatest contrast between the presumptive Democratic nominee Joe Biden and President Trump is the differences in tax policy perspectives. Economic turmoil created by the COVID-19 pandemic and the enactment of the Republican-only Tax Cuts and Jobs Act of 2017 ("TCJA") has created an environment where tax policy will be a critical point of differentiation in the 2020 presidential race.

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With Biden currently holding a significant lead in the polls, and many reasons to doubt polling numbers, it's never a waste of time to think about what tax policy would look like with a different administration in office and how that might impact the economy and client portfolios. The stated goal of the Democratic tax agenda is to use taxes as a tool to reduce inequality and concentrations of wealth as well as to pay for investments in U.S. productivity and fund the ongoing needs of the government. This is in sharp contrast to President Trump, who's campaigning on making the expiring provisions of the TCJA permanent.

Below is a summary of the key tax law changes each candidate is suggesting.

Raising Income Tax Rates on the Highly Compensated

Under the TCJA, individual income tax rates range from 10% to 37%. With a Biden win and if the Democrats win the Senate, it is likely they would be successful in returning the top rate to the pre-TCJA 39.6% and presumably would restore the state and local tax deduction for amounts above the $10,000 cap. Top earners in high-tax states may see a net income tax reduction. However, the payroll tax proposals would result in a significant tax increase for high earners and their employers. This is where the rate was under Clinton and in President Obama's second term and no recession happened in either time frame. Now is a good time to do some proactive tax planning.

Investment Income & Capital Gains

More troublesome from an economic growth point of view would be treating Capital gains as ordinary income for those making $1 million or more. Currently capital gains are subject to a tax rate ranging from 0% to 20% depending on the taxpayer's income. Under the Biden plan, capital gains would be taxed at ordinary income rates for taxpayers with income over $1 million, thereby eliminating the preferential rate for these taxpayers. Gains for these investors would also be subject to the 3.8% net investment income tax as it was enacted as part of the Affordable Care Act. The impact of this would be significant for high-income investors as well as founders and entrepreneurs who may experience a liquidity event after building value over several years.

Estate and Gift Taxes

The TCJA increased the estate tax exemption threshold to its current level of $11.58 million per individual (indexed for inflation). A Biden victory could seek a return to a more “historical norm”. Some have floated the idea of restoring the exemption threshold to the 2009 level of $3.5 million per individual, and an estate tax rate increase back to the 45% rate in effect in 2009.

Under present law, heirs receive an increased basis or “stepped-up basis” in inherited assets equal to the current fair market value (FMV). As a result, capital gains tax is based on the value of the asset at the time it’s inherited. While Biden’s plan eliminates the step-up in basis for inherited assets, it seems as though it would be an administrative nightmare for some heirs who inherit assets with no records of when assets were originally purchased, or at what price. The easier path would be to simply reduce the exemption amounts for the estate tax. Regardless, this is a good time to revisit your estate planning goals.

Corporate Tax Rates

The TCJA lowered the corporate tax rate to a flat 21%, down from a top tax rate of 35%. Biden’s plan would increase the corporate tax rate to 28%. Biden also wants a minimum profits tax of 15% on larger companies’ GAAP earnings. For companies operating in the United States and abroad, Biden has proposed doubling the tax rate on global intangible low-taxed income to 21% (currently 10.5%).

While the increases in corporate taxation sound significant, Biden’s plan is talking about 28%, and not 35%. Before long, if the increased tax structure isn’t working, the American people would have another presidential election in 2024 where they can vote in change, and adjustments. Either way, investors should be mindful of the impact these changes would have on the value of their investments and start to plan today.

The Bottom Line

In these tumultuous times it’s difficult to predict what policy initiatives the winner of the 2020 presidential election is likely to pursue. Given the backdrop of the economic dislocation sparked by the COVID-19 global pandemic and the enactment of a highly partisan tax reform measure in 2017, it seems certain that tax policy will take center stage. A Biden win coupled with Democrats winning the Senate would mean taxes go up. The tax changes being discussed are sweeping in nature, and it’s never a waste of time for clients to prepare.

Item	Present Law	Biden	Trump
Business	•21% corporate rate •20% passthrough-deduction for QBI •Territorial style regime with BEAT, 10.5% GILTI rate	•28% corporate rate •Repeal 20% pass-through deduction for QBI for taxpayers >$400k in income and for REIT dividends •Double GILTI rate •15% minimum global book income tax •Repeal like-kind exchange deferral for real estate •6.2% payroll tax increase on employee wages over $400k (see below)	•Make 20% pass-through deduction permanent
Payroll/Self-employment	•6.2% on wages up to $137,700 & 1.5%	•Impose 6.2% tax on wages >$400K (both employer and employee), wages between $137,700 and $400,000 not taxed	•Supports temporary payroll tax holiday as pandemic relief
Individual Income Tax	•37% maximum rate through 2025, reverts to 39.6%	•39.6% maximum rate	•Make 37% rate and other TCJA changes permanent
Investment Income	•20% maximum capital gains rate •3.8% net investment income tax	•No preferential rate for capital gains for taxpayers over a $1 million income threshold •No financial transactions tax	•Supports indexing capital gains for inflation, further reducing the rate from the current 20% maximum
Estate & Gift Tax	•Top rate of 40% with exemption of $11.58 million through 2025, reverts to $5 million (indexed from 2011)	•Return to “historical norm”, perhaps this means restoring $3.5 million exemption •Eliminate the step-up in basis for inherited assets	•Make TCJA changes permanent
Wealth tax	•None	•No proposal yet	•No proposal

Key:

QBI – Qualified Business Income
BEAT – Base Erosion and Anti-Abuse Tax
GILTI – Global Intangible Low-Taxed Income
TCJA – Tax Cuts and Jobs Act (2017)

Important Disclosures:

Source: Tax Cuts and Jobs Act (TCJA), Biden-Sanders Unity Task Force Recommendations, Joebiden.com

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