THE BIDEN TAX PROPOSALS – PART II

WILL THEY BECOME LAW, AND SHOULD ONE PLAN TO REDUCE THEIR IMPACT?

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As of the date of this writing, we have gained a high-level insight to President Biden's proposed tax changes in his recently announced American Jobs Plan and the American Families Plan, although no legislation has been formally presented. As a result, it is important for United States ("US") taxpayers and practitioners to understand the proposals that have been put forward. While administration officials believe that tax legislation now has a fair chance of passing both the House of Representatives and Senate, it remains to be seen whether the Biden proposals will become legislation in their current form. Although President Biden pledged during his campaign not to raise taxes (at least not on taxpayers earning less than $400,000 a year), the American Jobs Plan and the American Families Plan paints a slightly different picture.

NOTABLE INCOME TAX PROPOSALS

The main income tax proposals for individuals include the following:

- The top income tax rate will be increased from 37% to 39.6% and will affect taxpayers having more than $400,000 of income. Before the Tax Cuts and Jobs Act of 2017, 39.6% was the top tax rate for single taxpayers having taxable income above $400,000 (as adjusted for inflation). It is not clear whether the proposed $400,000 threshold refers to all individual taxpayers or only single taxpayers with married couples having a slightly higher threshold. It is likely that trusts will maintain their $12,950 threshold for the top tax rate or adjust slightly for inflation.
- The top tax rate for long-term capital gains and qualified dividends earned by taxpayers having more than $1 million of income will be increased from the preferential rate of 20% to 39.6%, the same rate as ordinary income. Combined with a 3.8% "Medicare Investment Income Tax" (described below), this means that individuals with income of more than $1 million could potentially pay a 43.4% top rate on capital gains.
- The basis step-up of capital assets at death will be eliminated for gains in excess of $1 million per taxpayer (or $2.5 million per couple), with certain protections for family-owned businesses and farms. At this time, it is unclear if death itself will trigger a realization event for taxpayers or if heirs will be given a carryover basis until the asset is actually disposed.
- The like-kind or "1031 exchange" rules that allow taxpayers to defer capital gains tax on real estate exchanges will be eliminated for gains in excess of $500,000.
- A number of other credits, deductions and related items are proposed to ease the burden on low-income taxpayers and students and also enhance the ability of low-income taxpayers to save for retirement.
- A 3.8% "Medicare Investment Income Tax" will be imposed on active income from partnerships and S-corporations for owners making more than $400,000 per year.
- The corporate tax rate will be increased from 21% to between 25% and 28%. In addition, the effective tax rate on global low-taxed intangible income (or "GILTI") will be raised to 21%, the exemption for qualified business asset investments will be repealed, and the tax will be applied on a county-by-country basis to make it akin to a true global minimum tax. This is part of a larger plan by the Biden administration to increase tax revenue and collections from corporations.

Pre-2021 year-end tax planning techniques to mitigate the impact of these items include:

- Accelerating transactions that generate income and capital gains; and
- Accelerating transactions that will generate deductions.

An accurate picture of a taxpayer's ultimate tax liability needs to take into account a number of related factors that can only be modeled with certainty once all tax legislation for a particular year is finalized. For this and the other reasons already stated, such techniques should be considered carefully.

TRANSFER TAXATION (GIFT, ESTATE, AND GENERATION-SKIPPING TRANSFER TAX) OF INDIVIDUALS

Although there have been no written proposals in regard to transfer taxes, the main elements of transfer tax changes for individuals that the Biden campaign made include the following:

- The top estate tax exemption will be reduced to $3.5 million per person. The estate tax exemption is presently an inflation-adjusted amount of $11,700,000 for 2021, but is currently slated to be reduced by half after December 31, 2025, even if Congress does not otherwise reduce the exemption.
- The gift tax exemption would be reduced to $1 million and be decoupled from the estate tax exemption. Currently, the estate and gift tax is a unified credit, meaning whatever exemption a taxpayer uses for gifting will reduce the amount the taxpayer can use for the estate tax at death.
- As stated above, the basis step-up of capital assets at death will be eliminated for gains in excess of $1 million per taxpayer (or $2.5 million per couple). While this is an income tax item, the basis step-up is considered a part of comprehensive estate planning.

Pre-2021 year-end tax planning techniques to mitigate the impact of these items include:

- Accelerating large gifts to family members or trusts for their benefit; and
- Selling appreciating assets to family members and trusts in exchange for low interest rate notes.

As is the case with the income tax proposals, the legislative picture is far from certain, and such techniques should be considered carefully and with expert advice.

In addition, it is worth noting that the American Families Plan also includes a series of proposals that overhaul tax administration and provide the Internal Revenue Service ("IRS") additional resources to address tax evasion. These tax administration reforms will provide the IRS the resources it needs to stop sophisticated tax evasion, provide the IRS with more complete information from third parties, overhaul outdated technology, and regulate paid tax return preparers. Most interestingly, the US Treasury Department has also announced plans to require US financial institutions to file annual reports of the aggregated inflow and outflow of funds from every individual and business taxpayer's financial accounts. This proposal is also part of the Biden administration's strategy to collect more taxes from high earners and high-net-worth individuals.

CONCLUSION

While this Announcement focuses mostly on US taxpayers, the proposals will have consequences for taxpayers and investors with cross-border families and structures. Taxpayers and their advisors should always remain aware of potential tax legislation. However, as the old saying goes, "don't let the tax tail wag the dog." In this uncertain political climate, that saying carries more than a grain of truth. We are always available to discuss these issues with you.

FOR MORE INFORMATION

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