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Biden proposes tax increases, but status quo also unlikely under Trump

Planning for tax changes is prudent, regardless of who is president

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Regardless of who wins the presidency, the status quo for the American tax landscape seems unlikely to continue, given the state of the economy, federal relief spending, state budget shortfalls, and the unknowns surrounding the pandemic. With that in mind, it is crucial to start thinking about and planning for the post-election environment.

Former Vice President Joe Biden, the presumptive Democratic nominee, has proposed tax law changes that are so significant some might argue they are akin to tax reform. Given the potential for changes of such magnitude, you should consider evaluating the known details of Biden's tax plan for areas of risk and opportunity, even if the full impact is unknown.

It is important to ask: Would decisions I made after the passage of the Tax Cuts and Jobs Act (TCJA) still achieve the desired outcomes? Does my business entity choice still serve as the best vehicle to achieve my goals? Are there strategies I can develop today that could position me to quickly respond to a changing tax landscape?

No matter who wins the election, what is certain is that very few things are certain—other than the country's debt is already exerting pressure on tax policy, making the status quo seem unlikely.

Listen to our latest Tax Policy Now ***audiocast for RSM's perspective on Biden's proposed tax plan.***

Broad overview of the Biden tax plan

Item	Present Law	Biden's Proposal
Corporate income tax rate	21%	Increase to 28%
Alternative minimum tax (AMT)	TCJA repealed alternative minimum tax	15% minimum tax on book income for corporations earning greater than $100 million
Section 199A deduction	20% pass-through deduction for qualified business income (QBI)	Repeal of the section 199A deduction for those making more than $400,000
Individuals and owners of pass-through entities	37% individual top rate	Reinstitute the top individual income tax rate to 39.6%
	Capital gains rate of up to 20%	Tax capital gains as ordinary income for taxpayers with over $1 million in income
	Social Security tax for employer and employee applied to first $137,700 of wages or self-employment income	Imposes additional social security taxes on wages or self-employment income over $400,000
	Deduction limited through 2025 to medical and dental, limited state taxes, limited real estate taxes, limited home mortgage interest, mortgage insurance premiums, gifts to charity and casualty or theft losses	Reduce the benefit of itemized deductions to a tax benefit of no more than 28%

	Estate tax exemption for the first $11.58 million per individual and decedents have a FMV basis in the assets	The Biden proposal states that estate taxes should be raised back to the historical norm and would eliminate step-up in basis for property transferred at death
	Exchange of real property held for productive use in a trade or business or for investment for real property of like kind to be held for productive use in a trade or business or for investment without recognition of gain or loss	Retain the current like-kind exchange rules for taxpayers earning less than $400,000. Taxpayers with income greater than $400,000 will be ineligible for capital gains deferral
Global intangible low-taxed income (GILTI)	10.5% tax on un-repatriated amounts	Increase to 21%

Increase corporate tax rates

Biden proposes to increase the corporate income tax rate from 21%, as enacted through the passage of TCJA, to 28%. Biden has expressed that he would push to increase the tax rate shortly after taking office.

Biden's proposal also includes a 15% minimum tax on corporations with book income of $100 million or more. In essence, this would reinstate AMT repealed with the passage of TCJA for those qualifying businesses. Under the proposal, corporations may claim deductions for net operating loss carryforwards and foreign taxes paid. When determining corporate tax liability, corporations would pay the greater of their regular corporate income tax liability or the 15% minimum tax.

Section 199A deduction

TCJA introduced the section 199A deduction, which is a below-the-line deduction available to owners of sole proprietorships, partnerships, S corporations, and some trusts and estates engaged in qualified trades or businesses. Under the current guidance, the deduction is limited to the lesser of 20% of qualified business income plus 20% of the combined real estate investment trust dividends and qualified publicly traded partnership income, or 20% of the taxpayer's taxable income minus net capital gains.

While the section 199A deduction is set to expire at the end of 2025, the Biden proposal would maintain the current deduction for those making under $400,000 per year and phase out the deduction completely for those making $400,000 or more. That is on top of Biden's proposed tax plan to restore the top marginal tax rate for non-corporate taxpayers to the pre-TCJA rate of 39.6%.

Tax proposals affecting individuals' returns for flow-through entity consideration

Under Biden's proposal, the top individual income tax rate of 39.6% would be restored. The current top individual income tax rate is 37%. The Biden proposal would also tax capital gains as ordinary income for taxpayers with over $1 million in income.

The Biden proposal increases individuals' share of social security taxes by imposing social security taxes on income over $400,000. Currently, social security taxes of 12.4% are imposed on wages or self-employment income up to $137,700 for 2020 (this is indexed for inflation). The proposal would create a donut where the 12.4% tax would stop on income over the normal threshold (i.e., $137,700 for 2020) and then apply to amounts above $400,000. This donut would shrink over time as inflation increases the bottom threshold.

The Biden proposal would reintroduce the Pease limitation on income that exceeds $400,000. That limitation would reduce the benefit of itemized deductions to a tax benefit of no more than 28%. So if a taxpayer was in the 39.6% bracket, a dollar deducted would only reduce taxes owed by 28%, instead of 39.6%. In 2019, Biden indicated that he would eliminate the $10,000 cap on the deduction for state and local tax. This item has not been officially included in his proposals.

The Biden proposal would eliminate the tax-free transfer of property on death. Under current law, the first $11.58 million of an estate is not taxed, and estate beneficiaries or heirs receive the property with a basis equal to the fair market value of the property. That means an estate's beneficiary could immediately sell the property with appreciation never being taxed. The Biden proposal would eliminate this so called "step-up in basis." This, combined with the proposal to tax capital gain at ordinary rates at certain income thresholds, could lead to a substantial increase in taxes on estate beneficiaries, complicating business transfers on death.

Under section 1031, taxpayers may exchange real property held for productive use in a trade or business or for investment for real property of like kind to be held for productive use in a trade or business or for investment without recognition of gain or loss. The TCJA amended section 1031 to exclude exchanges of personal or intangible property from like-kind treatment. Biden's proposal allows for taxpayers with income under $400,000 to make a tax-free exchange of real property held for productive use in a trade or business or for investment for property of like kind. However, taxpayers with income greater than $400,000 must recognize in taxable income the capital gains from the sales of real property.

Global intangible low-taxed income (GILTI)

Companies headquartered in the United States currently pay a 10.5% minimum tax on the un-repatriated low-tax profits earned by their foreign subsidiaries from intangible assets such as patents, trademarks, and copyrights. The TCJA introduced the GILTI tax in an attempt to discourage corporations from shifting intangible assets and related profits to low-tax jurisdictions. Biden's proposal doubles the GILTI tax rate to 21%.

Additional Biden proposals

Much of Biden's proposal focuses on moving the United States towards more reliance on renewable energy, as well as encouraging investment in the United States. In order to achieve these objectives, Biden released limited details regarding the establishment or expansion of certain tax incentives including, but not limited to, The Manufacturing Communities Tax Credit, New Markets Tax Credit, and Solar Investment Tax Credit.

The Manufacturing Communities Tax Credit, originally proposed during the Obama administration, targets communities that have suffered economic disruption due to manufacturing plant closures or government office closures that provided the community with significant employment opportunities.

The New Markets Tax Credit currently provides investors with a federal tax credit in exchange for investment in low-income communities.

The Solar Investment Tax Credit rewards businesses that invest in solar facility construction. Congress extended the credit in 2015; however, the deduction in 2019 was 30% and will be further reduced in 2020, 2021 and 2022, without additional action.

In addition to the like-kind exchange limitations, Biden has also proposed to eliminate certain tax incentives for the real estate industry, including eliminating the passive loss rules for $25,000 of rental losses and accelerated depreciation on rental housing.

Takeaways

Given the current state of the economy and the unknowns surrounding the pandemic, tax reductions or even the status quo seem unlikely, regardless of who wins the presidency. The extent of any tax increases is largely what remains unknown. Adding to the uncertainty is how the states may react to these potential changes as they begin responding to their enormous fiscal challenges.

Businesses, irrespective of size or entity type, should evaluate how their current and future operations and cash flow might be affected not only by Biden's proposed tax changes, but also the likelihood of tax increases in a second term for President Trump. Taking time to assess potential tax law changes now will allow businesses to identify areas of risk and opportunity and better plan for the future.

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