The Tax Implications of the 2020 Presidential Election

The 2020 presidential election is quickly approaching. While the outcome is far from certain, if Democratic candidate Joe Biden wins and the Democrats win the Senate and maintain control of the House of Representatives, the current tax regime is likely to change.

What could this mean for you?

Candidate Biden has proposed extensive legislative changes that include higher income tax rates, higher capital gains rates, fewer deductions and significant limitations on, or the elimination of, many common estate planning techniques currently available. Understanding Biden's plan and its consequences is essential for all taxpayers. In this paper, we will outline key tenets of Biden's tax proposals and strategies to consider before year-end in anticipation of any potential tax law changes.

What Changes Should You Expect with a Biden Presidency?

Under a Biden presidency, wealthy taxpayers will likely see an increase in individual tax rates as well as a repeal of many of the favorable estate and gift tax changes from the Tax Cuts and Jobs Act of 2017 (the "TCJA"). The following page outlines six critical components of Biden's tax platform that could impact you.

1. **Income Tax Rate:** Currently, the highest income tax rate on regular income is 37%. Biden's plan restores the top income tax rate back to 39.6%. While this change could impact economic growth, the effect would most likely be small. As a frame of reference, the highest income tax rate was 39.6% during both President Clinton and President Obama's administrations.

2. **Estate and Gift Tax Exemption:** The estate and gift tax exemption amount is currently $11.58 million per individual ($23.16 million for a married couple). This means individuals can gift $11.58 million ($23.16 million for a married couple) over their lifetime or at death without incurring any transfer taxes. The 2020 exemption is more than twice what it was in 2016 ($5.45 million) and is due to sunset in 2026.[1] If Biden is elected, this exemption would likely be cut in half significantly curtailing the amount individuals can give away tax free during their lifetime or at their death.

3. **Step-up in Basis:** Currently, when an individual dies and passes an asset to his/her beneficiary, the cost basis – the owner's original value of the asset – increases to the asset's market value as of the date of death. The beneficiary then inherits this asset on a "stepped-up basis." If the beneficiary chooses to immediately sell the inherited assets, he or she can do so with minimal to no capital gains tax (any gains would be treated as long-term gains). Biden has proposed repealing this step-up in basis rule and taxing the unrealized appreciation at death. This would subject the beneficiary to taxes at the transfer (owner's death) regardless of whether they sell the asset and create significant negative wealth transfer consequences.

4. **Long-Term Capital Gains and Qualified Dividends:** Currently, the long-term capital gains and qualified dividends tax rate is 23.8% (20% + 3.8% Medicare surtax) for single households with more than $441,451 in taxable income in 2020.[2] Biden has proposed subjecting capital gains and qualified dividends to the same rates as ordinary income for households earning more than $1 million. In this case, individuals could potentially pay a maximum tax rate of 43.4% (39.6% + 3.8% Medicare surtax) on long-term capital gains and qualified dividends. This would materially impact the expected after-tax performance for most long-term investors and would serve as a significant disincentive to make long-term investments.

5. **Corporate Tax Rate:** Biden proposes increasing the corporate tax rate from 21% to 28% with a 15% minimum tax for those corporations with accounting profits of $100 million or more that pay zero or negative federal income taxes. While this reflects a sizable jump, the corporate tax rate was 35% from the early 1990s until the passage of the TCJA. It had not been as low as 21% since the 1930s. If the Democrats take back power and raise the corporate tax rate to 28%, it will still be well below 35%. Increasing the corporate tax rate will negatively impact the profitability of companies which may impact equity market valuations.

6. **Social Security Tax:** Under Biden's proposal, regular earnings above $400,000 would be subject to an additional social security tax of 12.4%. Currently, wages up to $137,700 are subject to the Social Security tax, of which both the employer's and employee's share is 6.2% (12.4% total). Coupled with the income tax increase, the additional social security tax would create a large disincentive for high-income workers.

President Trump's Tax Plan

President Trump has not shared the details of a second-term tax plan, but he has been vocal in his support for payroll-tax reductions, additional tariffs, potential capital-gains tax cut and an extension of the TCJA which is set to expire at the end of 2025.

If Elected, When Could Biden's Plan Go into Effect?

It is anyone's guess who will win the presidential election and what the ultimate composition of the House or the Senate will be. If Biden wins, he would still need the support of the legislative branch to implement his tax plans. And even if that occurs, many of his proposals are likely to be modified, expanded and in some cases eliminated through the negotiating process.

If the democratic party sweeps the 2020 election, Biden's proposed changes could go into effect as early as January 2021 when the new Congress is expected to convene. Even if legislation is passed at a later date, Congress may enact the new tax legislation retroactively to January 2021. However, it is also possible that the new tax legislation would not go into effect until January 2022.

[1] For more information on the lifetime exemption, please see "Election 2020 – Time to Revisit Your Estate Plan."
[2] The minimum threshold for capital gains for married couples that file jointly is $496,601.

Strategies to Consider Before Year-End

Should Biden win, there are many tax and estate planning strategies to consider and then be prepared to execute by the end of the year.

1. **Now is a great time to transfer wealth.** The TCJA doubled the amount individuals can transfer to beneficiaries without being subject to a 40% estate and gift tax rate. Additionally, the estate and gift exemption amount is currently at an all-time high of $11.58 million per individual ($23.16 million for a married couple). This increased exemption amount is due to sunset in 2026. Given the evolving political landscape, this provision could be altered sooner. Individuals should consider maximizing their currently available lifetime exemption by year end.
2. **Evaluate estate planning strategies.** Biden and other Democratic leaders have proposed limiting and/or eliminating several common estate planning strategies, such as irrevocable grantor trusts, Grantor Retained Annuity Trusts (GRATs) and minority and non-marketability discounts for transfers of interests in family-controlled entities. How will this impact your current estate plans? Should you consider implementing a GRAT to pass on wealth to the next generation before year end? It is important to ask yourself these questions and be prepared to execute by the end of the year. Waiting until the eleventh hour is not advisable.
3. **Accelerate income and long-term capital gains in 2020.** Given Biden's intention to increase the top income and capital gains tax rate to 39.6% and institute an additional social security tax, individuals should think about recognizing additional income in 2020 to avoid the potentially higher tax rates in 2021 and beyond. This includes accelerating bonuses, harvesting unrealized gains, finalizing the sale of a privately held business, exercising options, making anticipated C-corp dividends to shareholders and converting traditional IRAs or 401ks to a Roth account, among others.

Conclusion

While there is still a great deal of uncertainty about the fate of the presidential election, it is important to be prepared. You should begin talking with your advisors now to be in a position to take advantage of current income and transfer tax planning opportunities before they possibly disappear.

THE TIME TO ACT IS NOW!

As your Chief Investment Officer, we are here to talk with you and your other advisors about the challenges and opportunities that lay ahead. For more information, please reach out to your Investment Officer or Portfolio Manager.

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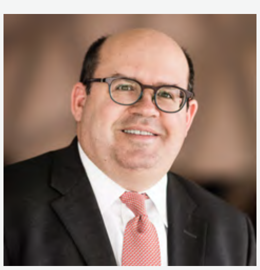

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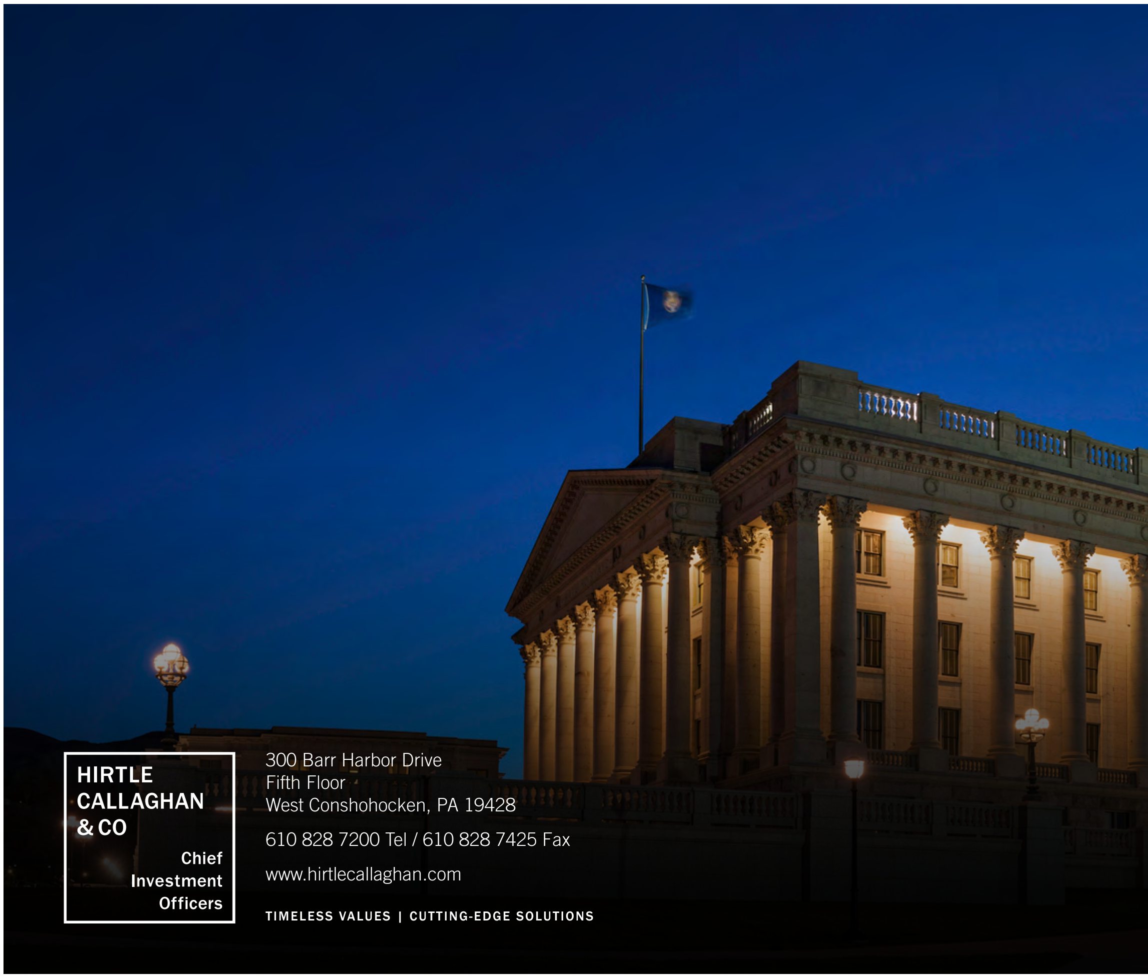

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