Memo

To: Clients and Friends

From: Capital Enhancement LLC

Date: October 20, 2020

Re: Biden Tax Proposals

The purpose of this memo is to outline some of the formal and informal Biden tax proposals should he be elected President.

OVERVIEW

Mr. Biden has promised that those with incomes of less than $400,000 per year will not have an increase in their income tax. Target groups with income below that level will be the beneficiaries of income tax cuts. Almost all companies and people with incomes over $400,000 will experience tax increases.

INCOME TAX AND SOCIAL SECURITY TAX INCREASES

- If your taxable income (we presume married filing jointly) is more than $400,000, your marginal federal income tax will be 39.6%, which was the top bracket in 2017. Currently, the top rate is 37%.

- If taxable income is above $1 million, long-term gains and qualified dividends are taxed at the same rate as ordinary income (39.6%).

- For partners in hedge funds, private equity, and venture capital, the ability to recharacterize your share of capital gains (carried interest) as long-term gains or qualified dividends is eliminated.

- Instead of receiving a deduction at your marginal tax bracket for contributions to a pension, 401K, or IRA, you will receive a tax credit equal to 26% or 28% of the contribution, limiting the value of the deduction (the percentage has not been clearly stated).

- The 20% pass-through qualified business income deduction is eliminated for those with taxable income in excess of $400,000. This will mainly affect owners of REIT's and owners of operating businesses with substantial profits.

- Itemized deductions will generate a tax credit equal to 28% of the deduction. This again limits the value of a deduction. We believe state income taxes and real estate taxes will no longer be capped at $10,000, but please remember the Alternative Minimum Tax (AMT) still exists. For taxpayers in high tax states with incomes under $1.5 million per year, the AMT may greatly limit the value of the 28% credit on your state and real estate taxes. Additionally, the old 3% "haircut" on itemized deductions reappears, meaning the effective marginal tax on income is 40.788% (39.6% times 1.03), whereas deductions yield a 28% benefit if not limited by AMT.

- For those with wages or self-employment (board and consulting) income of more than $400,000 per year, you will see an increase in your Social Security tax on that income. Social Security tax at 6.2% resumes at that level (it currently stops at $137,700) and presumably, the self-employment tax on income above $400,000 adds another 12.4% For a highly paid employee in New Jersey, your marginal tax bracket would be 57% considering federal, state, Social Security and Medicare taxes. The same person would have a marginal bracket of close to 61.5% as a self-employed person such as a law firm partner or board member.

- 1031 like-kind exchanges of real estate would be eliminated.

MIDDLE CLASS TAX RELIEF

This seems to be targeted more towards certain groups rather than broad rate relief. Proposals include:

- Temporary expansion of the child tax credit

- Tax credits for health insurance payments if your insurance premiums exceed 8.5% of income.

- Expansion of child care tax credits.

- Reintroduction of a $15,000 first-time homeowner credit.

ESTATE AND GIFT TAX PROPOSALS

- The current estate exclusions of $11.58 million per person and $23.16 million per couple would be halved to $5.79 million per person and $11.58 million per couple.

- The “step up in basis” where capital gains for a specific asset are eliminated at death is abolished.

CORPORATE TAX PROPOSALS

- The C Corporation tax rate would be increased from 21% to 28%. In 2017, it was 35%.

- There would be minimum corporate tax rates of 21% of taxable income, or 15% of book income as reported on financial statements.

PLANNING CONSIDERATIONS

- On the income tax side, if you have highly appreciated assets that are not long-term holds, you could consider selling those this year to prepay tax at lower capital gains rates.

- If you are a senior corporate executive, you may wish to determine if your company could prepay bonuses before year end, or you could exercise stock options before year end (remember, the stock price and not taxes is the most important consideration with respect to options.)

- Prepay charitable contributions in 2020 if you are in a 37% tax bracket. Defer paying real estate taxes or state income taxes until January 2021.

- Income for a given year will need to be managed where possible to stay under $1 million going forward (try to avoid large capital gains by spreading income across several years where possible.) Consider tax free municipal bonds for fixed income investing. Passive index funds and low cost deferred annuities could make sense for stock investing for those with incomes above $1 million annually.

- Moving to a lower tax/no tax state still makes sense.

- On the estate tax side, talk to us about gifting before year end. If married and family assets are below $15 million, there may be no great need to gift to take advantage of the current exclusions. If married and family assets are between $15 million and $30 million, consider using one's spouse's $11.58 million exclusion in 2020 while leaving the other's intact (presumably at $5.79 million). If well over $30 million, consider using both exemptions in 2020. Obviously, there is a balance between estate tax savings and your own retirement cash needs.

CONCLUSION

Besides raising taxes, these proposals will make the tax code significantly more complex if enacted. No provisions seem to be taken away, but new ones are added. Please call us to discuss in light of your situation.