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Research Paper

Tax Reform: On Hold for Now?

by Nicholas Breit, CFA, CFP®, Principal, Director of Financial Planning November 2020

During his presidential campaign, Joe Biden outlined his tax policy proposals[1], which included rolling back key provisions from the Tax Cuts and Jobs Act (TCJA). An analysis by the Tax Foundation estimated the Biden plan would raise tax revenue by $3.3 trillion over the next decade.

	Current	Biden Tax Plan
Top Individual Federal Income Tax Rate	Currently 37%	Restore the top rate to the pre-TCJA level of 39.6% for taxable incomes above $400,000
Social Security Payroll Tax	Social Security's Old-Age, Survivors, and Disability Insurance (OASDI) tax (6.2%) is not collected on earnings above $137,700 (2020 earnings limit)	Collect additional OASDI tax on earnings above $400,000; this would effectively create a "donut hole" for the OASDI tax
Long-Term Capital Gains & Qualified Dividends	Top federal tax rate of 20%, plus 3.8% Net Investment Income Tax (NIIT)	Tax at the top (proposed) ordinary income rate of 39.6% for taxpayers with incomes above $1 million
Itemized Deductions	Itemized deductions generally provide a tax benefit equivalent to a taxpayer's income tax bracket	Limit the tax benefit of itemized deductions to 28% for taxpayers earning more than $400,000 Restore the Pease limitation on itemized deductions for taxpayers earning more than $400,000
Estate & Gift Tax Exemption	$11.58 million per person for 2020 $11.70million per person for 2021 *(subject to change)*	Return estate tax to 2009 levels: reduce the estate exemption to $3.5 million per person, with a top federal estate tax rate of 45%
Cost Basis at Death	Heirs receive property with a step-up in cost basis equal to fair market value	Eliminate the step-up in cost basis, though possibly with a base exemption
Corporate Income Tax Rate	21%	Raise to 28%
Section 199A Deduction	The Tax Cuts & Jobs Act created a 20% deduction for pass-through business income for certain eligible taxpayers	No explicit details, but presumed that taxpayers earning more than $400,000 may see the deduction phased out

In order to achieve these tax policy proposals, Democrats would likely need to have control of both the House and the Senate. While Democrats ended up retaining control of the House, the path to gaining control of the Senate appears

[1] The Tax Foundation – "Details and Analysis of President-elect Joe Biden's Tax Plan" (October 22, 2020)

challenging. As it currently stands, Republicans have a narrow lead (50-48) in the Senate, with special run-off elections slated for January 5, 2021 for Georgia's two Senate seats. If Republicans win at least one of the run-off elections, Republicans would maintain control of the Senate.

So where does this ultimately leave taxpayers? The safest bet is to execute certain tax and estate planning strategies prior to year-end 2020 to avoid risks associated with potential tax reform. For those that would prefer a 'wait-and-see' approach to see if tax reform legislation gains traction in 2021, we would offer the following insights:

- **The Senate Matters, A Lot** – The prospects for tax reform largely hinge on which party has control of the Senate. Republicans appear well-positioned to maintain a majority, needing to win only one of the two Georgia run-off elections. Should that occur, the chances for near-term tax reform are substantially diminished.

- **Moderates Matter Too** – Even if Democrats were to win both Senate run-off elections to get to 50 seats (with Vice President-elect Kamala Harris acting as a decisive tie-breaking vote), it is not guaranteed that all Democratic senators would fall in line with broader party proposals. This may particularly be the case for moderate Democrats as well as Democratic senators who hail from states that otherwise lean Republican.

- **Proposals May Only be a Starting Point** – Certain elements of the proposed Biden tax plan could be modified or even scrapped altogether. For example, there is already speculation that eliminating the step-up in cost basis (which could meaningfully impact inherited family businesses or family farms) could fail to gain broad support.

- **Time Still on the Clock? –** The current general consensus is that taxpayers may still have additional time to plan in 2021 due to a perceived reluctance by Congress to implement tax increases on a retroactive basis.
  - Mark Luscombe, a CPA, attorney and principal analyst for Wolters Kluwer Tax & Accounting commented that newly elected presidents "have a pretty good record of getting things through during their first year in office," though even if Biden were to get his tax plan enacted, "assuming it's passed in 2021, any legislation probably won't be effective until 2022. Congress seems to be hesitant to make tax hikes retroactive."
  - An analysis by Grant Thornton[2] noted "retroactive tax rate increases are relatively rare, but not unprecedented. There have been six major rate increases since 1980 and… only the 1993 increases in

[2] Grant Thornton – "Biden Win Changes Tax Policy and Planning Outlook" (November 9, 2020)

the corporate and individual rates were retroactive" [enacted August 1993, but effective as of January 1, 1993].

- **Legislative Priorities & Economic Health** – Given the ongoing COVID-19 pandemic, additional coronavirus-related stimulus and relief packages may take priority over tax reform legislation, which might further delay the implementation of any tax changes. Senator Richard Blumenthal (D-Connecticut) said Democrats will need to balance raising tax revenue with the health of the U.S. economy, noting, "I think a tax bill can be made effective at a time when we think the economy will be sufficiently robust that some increase in taxes will have no detrimental effect."

High net worth individuals are strongly encouraged to coordinate with their accountant and estate planning attorney to review whether potential planning opportunities should be pursued prior to December 31, 2020.

For more information, please contact any of the professionals at Fiducient Advisors.

About the Author

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Nick provides investment consulting services to nonprofit organizations, corporate executives, family trusts and other high net worth investors. He services clients by providing advice and expertise on asset allocation, portfolio design, investment policy statements, manager search process and overall investment management. Nick heads the firm's Financial Planning Committee. Prior to joining the firm in 2007, Nick was a Senior Financial Planner with The Ayco Company where he provided comprehensive advice to affluent clientele. Nick earned a BA in Finance and Economics from the University of Illinois at Urbana-Champaign. He obtained the designation of Certified Financial Planner (CFP®) from the College of Financial Planning and is a CFA® charterholder and member of the CFA Society of Chicago. Nick enjoys long distance running (having completed four marathons and multiple half-marathons) and spending time with his family.