Biden's Tax Proposals: Considering the Impact on Corporate Taxpayers

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If former Vice President Joe Biden is elected president in November, his inauguration would take place just about three years after the Tax Cuts and Jobs Act (TCJA) went into effect. The TCJA is widely regarded as containing the most significant revisions to the federal tax laws in a generation, enacting changes that affected taxpayers and taxes of almost all types. The Biden campaign has put forth a variety of tax proposals that, while not yet developed in detail, would likely retain the fundamental infrastructure of the TCJA while blunting some of its impacts and potentially enhancing others. Of particular interest to many businesses is how a Biden administration's tax policies could affect corporate taxation. (For details on proposed modifications to the tax treatment of decedents and their estates, see "Biden's Tax Proposals and Estate Planning" on page 2. For more details on the tax proposals overall, see our September 24, 2020, client alert, "A Closer Look at Biden's Tax Proposals.")

Corporate Tax Provisions in the TCJA

The centerpiece of the corporate tax provisions in the TCJA was a reduction of the federal corporate income tax rate from 35% to 21%. That rate reduction, and the TCJA's elimination of the corporate alternative minimum tax, resulted in a broad reduction of corporate taxes. The TCJA also contained provisions intended to spur investment in the U.S. and deter investment offshore. For example, it greatly expanded an "expensing" deduction that now allows taxpayers an upfront write-off for most investments in machinery, real estate improvements and other tangible personal property used in U.S. businesses. Likewise, it created a deduction for foreign-derived intangible income (FDII) that lowered the effective tax rate for businesses selling goods and services from the U.S. to foreign customers. In order to deter U.S. businesses from choosing to locate operations in foreign jurisdictions, the TCJA also enacted a new 10.5% tax on global intangible low-taxed income (GILTI) that taxes most amounts earned offshore by U.S.-parented businesses in excess of an allowed 10% return on investments in certain qualified tangible assets (QBAI). These new deductions and taxes, together with the headline reduction of the federal corporate income tax rate, evidence the TCJA's "carrot-and-stick" approach in incentivizing businesses to operate in the U.S. and disincentivizing U.S. businesses from operating in foreign jurisdictions.

Biden's Proposals

If enacted, Mr. Biden's corporate tax proposals would reduce the impact of some of the TCJA's changes but perhaps increase the impact of others. Most notably, a Biden administration would seek to raise the federal corporate income tax rate from the current 21% to 28%, the same rate proposed by the Obama administration in both 2012 and 2016.

Any corporate income tax rate change has the potential to influence corporate actions in myriad ways. For example, the TCJA's rate reduction resulted in a 40% reduction in the tax cost to corporations undertaking taxable M&A deals, greatly reducing the incentive for them to structure into tax-deferred transactions; the rate increase proposed by the Biden campaign could cause the pendulum to swing back in the other direction, increasing the desirability of tax-deferred deals. Companies could be pushed further toward tax-deferred transactions if a Biden administration successfully reduces or eliminates the capital gains rate preference for shareholders, as proposed by his campaign. The potential elimination of the capital gains rate preference, along with the anticipation of a likely corporate rate increase, could also serve as potential catalysts for taxpayers to close M&A deals this year if they anticipate that these proposals could be enacted in the first year of a Biden presidency, with the possibility of a retroactive effective date of January 1, 2021. While the TCJA did not contain a retroactive effective date, other tax law changes, such as the 1993 corporate rate increase and the 2001 tax cuts under President George W. Bush, were retroactive to the beginning of the year in which they were enacted.

A corporate income tax rate increase also usually bolsters the after-tax value of benefits that reduce taxable income, such as the expensing and FDII deductions included in the TCJA. However, the Biden campaign has also outlined a new 15% alternative minimum tax applicable to corporations with at least $100 million in book profits, which could undercut that effect, at least for larger taxpayers. The exact contours of Mr. Biden's proposal have not yet been specified, but alternative minimum taxes generally are designed to prevent companies from eliminating their tax liability through tax preferences. In particular, the tax proposed by the Biden campaign would focus on profits for book purposes, in lieu of tax-based calculations, meaning that certain tax-specific concepts such as the TCJA's expensing deduction and lower effective tax rate for FDII generally would not be taken into account when calculating such an alternative minimum tax. Because alternative minimum taxes often result in taxpayers not being able to take full advantage of tax preferences purposely enacted by Congress in order to incentivize specific behaviors (such as, in the case of the expensing deduction, investment in short-lived property, including machinery and equipment), a common criticism of those taxes is that they introduce conflicting policies into the federal tax code. Though Mr. Biden's proposed minimum tax is designed to ensure that corporations pay a minimum amount of tax based on book profits, it would allow corporations to take into account foreign tax credits and net operating loss carryovers. For corporate taxpayers for which those two items constitute a large part of the difference between their book profits and their taxable income, the impact of the tax may not be as significant.

If the TCJA's corporate income tax rate reduction was intended to incentivize businesses to operate in the U.S., then raising the tax rate to 28% could reverse that incentive. Perhaps in recognition of that, Mr. Biden's tax proposals also seek to double the rate on GILTI to 21% and to eliminate the exemption from GILTI for a 10% return on QBAI, thereby more than doubling the tax burden on offshore operations of U.S.-parented businesses. Additional measures proposed by the Biden campaign to incentivize U.S. operations include a new 10% penalty surtax on profits earned by foreign subsidiaries of a U.S. company attributable to sales of products to the United States — making the overall tax rate on those profits 30.8% — and a 10% advanceable tax credit for expenses or investments incurred to create U.S. jobs, including

Biden's Tax Proposals and Estate Planning

Democratic presidential nominee Joe Biden has provided limited information about his plans to modify the tax treatment of decedents and their estates. However, he has signaled that he supports raising estate taxes and changing the taxation of capital assets upon death.

Currently, the gift and estate tax exemption amount is at an all-time high: $11.58 million per person and $23.16 million per married couple in 2020. The Tax Cuts and Jobs Act of 2017 (TCJA) doubled the exemption from prior levels and provided for the enhanced exemption amount to automatically sunset at the end of 2025. If Mr. Biden wins the presidency, the sunset of the enhanced TCJA exemption amount may be accelerated or reduced even further, particularly if Democrats also win control of both the Senate and the House.

Mr. Biden also has indicated that he wishes to change the treatment of capital gains at death. Under current law, the income tax basis of assets owned by a decedent at the time of death generally is increased to fair market value. The basis step-up enables heirs to sell inherited assets free of capital gains taxes on appreciation that occurred prior to the decedent's death. The Biden campaign has signaled that Mr. Biden would reintroduce an Obama administration proposal to impose a mark-to-market tax appreciated capital assets upon the death of the owner. Statements Mr. Biden has made also could be read to suggest that he plans to eliminate the basis step-up, without necessarily imposing a mark-to-market tax on death.

Particularly if the Democratic Party sweeps the White House, Senate and House, individual taxpayers may wish to consider triggering capital gains prior to the end of the year — both because death may no longer be an event that eliminates built-in gain in capital assets and because Mr. Biden has proposed to increase the capital gains tax rate for high-net-worth individuals to 39.6% (his proposed top ordinary income tax rate).

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expenses of bringing back production from overseas to the United States and investments in revitalizing closed facilities in manufacturing areas. If the Biden campaign's tax proposals appear likely to be enacted, U.S.-parented businesses that currently have offshore operations should consider whether it is more economical to retain those operations offshore at the cost of the increased GILTI tax or domesticate them to the U.S. and take advantage of the lower effective tax rate of FDII (potentially subject to the 15% alternative minimum tax discussed above) and the 10% advanceable tax credits. Such a domestication is likely to be taxable, but taxpayers planning in advance for a potential Biden presidency could weigh the benefit of achieving it at the current lower rates against taking a "wait and see" approach and potentially benefiting from the 10% advanceable tax credit if they domesticate operations when and if Mr. Biden's proposals are enacted.

Industry-Specific Measures

In addition to the general tax rate increases, the Biden campaign has also released several industry-specific measures. A Biden administration would incentivize investment in renewable energy, energy efficiency and electric vehicles, including by reinvigorating the energy investment tax credit and the electric vehicle tax credit, and enhancing tax incentives for carbon capture. Meanwhile, Mr. Biden proposes to eliminate certain tax preferences for fossil fuels and the real estate industry (including the deferral of capital gain on like-kind exchanges). His campaign has also described a potential "financial risk fee" imposed on banks, bank holding companies and other financial institutions with over $50 billion in assets. Based on a similar proposal by the Obama administration, such a fee presumably would be intended to reduce the incentive for financial institutions to be excessively leveraged. A Biden administration would also seek to eliminate tax deductions for pharmaceutical companies' advertising costs, a proposal floated by Democrats in 2009, 2015 and 2016 as a means of reducing these companies' incentives for direct-to-consumer drug advertising.

A number of uncertainties remain, including the outcome of the election, that make it difficult to predict whether, when and in what form Mr. Biden's tax proposals would be enacted into law. In particular, given the stark partisanship surrounding most legislation nowadays, it is unlikely that any significant tax law will be enacted without a single party controlling both the House and Senate in addition to the presidency. The TCJA, for example, was signed into law by President Donald Trump after the Republican-controlled Congress passed the bill without a single Democrat voting in favor. Additionally, the economic downturn resulting from the COVID-19 pandemic also could impact Democrats' political appetite for enacting widescale tax rate increases. Ultimately, the current tax code may endure for the foreseeable future if Mr. Biden is not elected president, the Republicans retain their majority in the Senate or the state of the U.S. economy in the near-term is such that enacting revenue-raising tax law changes is politically unpalatable.