A Closer Look at Biden's Tax Proposals

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Former Vice President Joseph Biden has proposed a number of fundamental changes to the tax code over the course of his campaign. If he is elected president and if the Democrats keep control of the House of Representatives and take over the Senate, a number of these provisions are likely to be enacted. In addition to significantly increasing taxes on individuals with income over $400,000, corporate tax rates are likely to increase, an already intricate international tax regime is likely to become more complex and a number of other specific industry-focused provisions are expected to have wide sweeping consequences on taxpayer behavior. Below, we provide a brief description of each of Mr. Biden's tax-related proposals along with a few observations.

Corporations

- **Corporate Income Tax Rate Increase**
  - Increase the corporate income tax rate from 21% to 28%, lower than the 35% rate in effect prior to the Tax Cuts and Jobs Act (TCJA) that went into effect in 2018.
- **Alternative Minimum Tax Based on Book Income**
  - Apply a minimum 15% tax rate on income reported on financial statements (so-called "book income") of corporations with at least $100 million of book income. Taxable income can differ significantly from book income and often is much less as a result of special deductions, write-offs and loss carryovers.
- **Fee on Highly Levered Financial Institutions**
  - Apply a fee on certain liabilities of financial firms with over $50 billion in assets. Although there are few details on this plan, it is likely based on Obama-era proposals such as the "Financial Crisis Responsibility Fee" (which would have levied a fee of 15 basis points on the covered liabilities of beneficiaries of the Troubled Asset Relief Program) and similar fees in President Barack Obama's budget proposals (such as a proposed fee of 7 basis points on covered liabilities of large, highly levered financial institutions).

Observations

The potential increase in corporate rates would incentivize taxpayers to identify their most appreciated assets and consider transactions to accelerate gain (including potentially at the end of 2020).[1] These transactions could include simply accelerating sale transactions already in process, contributions to controlled foreign corporations, hedging transactions for publicly traded securities and entering into so-called "disguised sale" transactions to partnerships. In addition, there would be an incentive to defer deductions until later years when they would be more valuable, including deductions for employee compensation expenses.

While the TCJA's reduction of the corporate tax rate from 35% to 21% greatly decreased the incentive to structure tax-deferred transactions, Mr. Biden's proposed rate increase could cause the pendulum to swing back in the other direction, increasing the desirability of tax-deferred reorganizations and other transactions.

Taxpayer incentives are further complicated by Mr. Biden's proposal to introduce an alternative minimum tax on book income, which is a significantly different tax base than the corporate income tax base. Because alternative minimum taxes like Mr. Biden's

[1] Though retroactive tax legislation is rare, in August 1993, a Democratic president and Congress enacted legislation that increased tax rates retroactive to January 1 of that year.

often result in taxpayers not being able to take full advantage of tax preferences purposely enacted by Congress to incentivize specific behaviors (such as an immediate deduction for investment in short-lived property including machinery and equipment), a common criticism of such taxes is that they introduce conflicting policies into the federal tax code, especially when such tax preferences are not taken into account when calculating the alternative minimum tax. Interestingly, 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, which constitute a large part of the difference between book profits and taxable income for many corporations.

International

- **GILTI Changes**
  - Double the tax rate on global intangible low-taxed income (GILTI), from 10.5% to 21%, and eliminate the exemption for qualified business asset investment (QBAI). GILTI was enacted as part of TCJA and applied to taxable income of a controlled foreign corporation to the extent it exceeds 10% of the entity's QBAI, which is the average of the corporation's aggregate adjusted quarterly bases in certain property and is meant to represent "routine" returns.
  - Compute GILTI tax (and related foreign tax credits) on a country-by-country basis, rather than using a worldwide average.
- **Other Anti-Offshoring Policies**
  - Create a "Made in America" tax credit to offset 10% of investments geared toward creating jobs in the U.S., including the reopening, retooling or expansion of U.S. manufacturing facilities, as well as costs related to bringing overseas jobs to the U.S. or increasing manufacturing wages. The credit would be "advanceable," meaning that a taxpayer can claim it immediately upon incurring an expense rather than wait until their annual tax return has been processed to receive a benefit.
  - Introduce a surtax on certain goods produced overseas and consumed in the U.S., bringing the total tax rate on such production to 30.8%. This surtax would also apply to certain U.S.-targeted services performed abroad, such as work provided by call centers in foreign countries. It would likely be implemented as an expansion of the Subpart F regime and so would only apply to U.S.-parented multinationals.
  - Implement "strong anti-inversion regulations and penalties."

Observations

U.S.-parented businesses that currently have offshore operations would need to 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 foreign-derived intangible income (potentially subject, however, to the 15% alternative minimum tax discussed above) and the 10% advanceable tax credits. The application of specific provisions to any such domestication (such as base erosion and anti-abuse tax, the deduction for GILTI, and the proposed surtax) remains uncertain. Taxpayers planning in advance for a potential Biden presidency could weigh the benefit of achieving domestication 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 if and when Mr. Biden's proposals are enacted. In addition, the increase in the corporate tax rate would reduce the benefit of the GILTI high-tax exception, which excludes income subject to a tax rate equal to at least 90% of the corporate tax rate from GILTI. The increase in the corporate rate therefore broadens the GILTI tax base, potentially increasing the effective tax rate on such income for some taxpayers even more than the GILTI rate increase.

Individuals

- **Individual Income Tax Rate Increase**
  - Increase the tax rate on incomes over $400,000 from 37% to 39.6%, a return to the pre-TCJA rate while generally retaining current rates for incomes below that level.
- **Subject Capital Gains to Ordinary Income Tax Rates**
  - Equalize the tax treatment of ordinary income and capital gains by subjecting capital gains and qualified dividends of taxpayers with income over $1 million to a 39.6% rate.
- **Subject Income Over $400,000 to Social Security Tax**
  - Apply the Old-Age, Survivors and Disability Insurance (OASDI) tax of 12.4% to income over $400,000. OASDI currently only applies on wage income up to $137,700.
- **Eliminate Like-Kind Exchanges and Other Real Estate-Related Provisions**
  - Eliminate a number of tax provisions currently enjoyed by real estate investors, including tax deferral of like-kind exchanges of real property (so-called "Section 1031 exchanges") as well as the ability to offset real estate losses against other unrelated income under the so-called "passive activity loss" rules.

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Observations

Similar to corporate taxpayers, individuals would be incentivized by a Biden victory to accelerate income and gain, and defer deductions. Eliminating the capital gain preference would effectively eliminate certain tax benefits of so-called "promote" or "carried interests" currently available to private equity managers that benefit from long-term capital gain allocations. However, a promote may still be beneficial in that it (i) can be granted and vested on a tax-free basis, (ii) may be used to avoid the 12.4% Social Security tax component of Self-Employed Contributions Act (so-called "SECA") tax for limited partners, and (iii) is exempt from Sections 409A and 457A governing the deferral of compensation.

Although individual taxpayers may want to accelerate income and gain to mitigate the risk of higher rates under the Biden plan, in the context of employee compensation, this will often conflict with the employer's desire to defer the deduction of the corresponding employee compensation expense until later years when the deduction would be more valuable. For example, paying annual bonuses for 2020 performance in December 2020 will enable employees to take such bonuses into income in 2020 at lower tax rates but will also accelerate the employer's corresponding deduction into 2020.

Estates and Decedents

- **Estate Tax Increase**
  - Increase the estate tax. Mr. Biden has provided limited information about his plans to modify the tax treatment of decedents and their estates; however, his campaign has signaled that he supports raising estate taxes.
- **Tax on Accrued Capital Gains**
  - Modify the tax treatment of accrued capital gains at death. Under current law, the income tax basis of assets owned by a decedent at the time of death generally is "stepped up" to fair market value as of the date of death. The Biden campaign has signaled a willingness to change this treatment. It is not clear, however, whether this change is to be effected by the imposition of a mark-to-market tax on appreciated capital assets at death or by the elimination of the basis step-up.

Observations

High-net-worth individuals should consider using their remaining gift tax exemption amounts prior to the end of 2020. 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. The 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 chambers of Congress.

In the event of such a victory, taxpayers may also wish to consider triggering capital gains prior to the end of the year, both because capital gains tax rates are likely to rise and because death may no longer be an event that eliminates built-in gain in capital assets.

Other/Miscellaneous

- **Mr. Biden has proposed several new tax credits, including:**
  - A child care tax credit, which would create a refundable tax credit for up to 50% of child care costs for children under 13. The credit would provide a maximum of $8,000 for one child and $16,000 for two or more children, and phase out for families earning between $125,000 and $400,000;
  - A $5,000 tax credit for informal caregivers to offset qualified expenses over $2,000;
  - A flat-rate, refundable credit that would directly offset each dollar put into a retirement plan and replace the current deduction for contributions to retirement accounts;
  - A refundable, advanceable credit of up to $15,000 for purchasers of a new principal residence;
  - A credit to offset rent and utility bills so that they don't exceed 30% of income; and
  - A Manufacturing Communities Tax Credit, which would offset costs from "revitalizing, renovating, and modernizing existing — or recently closed down — facilities."
- **Mr. Biden would also restore or expand other tax credits, such as:**
  - The Earned Income Tax Credit, which he would make available to childless workers over the age of 65;
  - The Child Tax Credit, increasing the credit (through at least 2021) from $2,000 per child under the age of 17 to $3,600 per child under 6 and $3,000 per child ages 6-17. Would also make the credit fully refundable — currently, families can only receive a refund of up to $1,400 per child — and allow families to claim it in monthly installments rather than make them wait for their annual tax return to be processed;
  - The New Markets Tax Credit, which Mr. Biden would increase to $5 billion per year from $1.9 billion in 2019;

- The Low-Income Housing Tax Credit, which gives credits for the acquisition, rehabilitation or new construction of rental housing targeted toward lower-income households;
- The Plug-In Electric Drive Vehicle Credit, which gave between $2,500 and $7,500 of tax credits to purchasers of certain electric vehicles and began phasing out in 2010;
- Tax credits for energy efficiency and solar investment for both businesses and residences;
- Credit to offset the costs of health care premiums. Mr. Biden would remove the cap on this credit to make them available to families making more than 400% of the federal poverty level and increase the amount of the credit so that no family buying insurance through the Affordable Care Act marketplace pays more than 8.5% (down from 9.6%) of their income for certain plans; and
- Credits for small businesses to offset the costs of workplace savings plans, modeled after the discontinued myRA program.

- **Mr. Biden would also implement the following taxpayer-favorable policies that would benefit individuals:**
  - Allow caregivers who don't earn a wage to make "catch-up" contributions to retirement accounts;
  - Allow people to withdraw from their retirement accounts to buy long-term care insurance without incurring early withdrawal penalties or realizing income; and
  - Protect taxpayers whose student loans are forgiven from realizing income as a result of that forgiveness.
- **Several of Mr. Biden's plans for businesses are much less taxpayer-favorable, including to:**
  - Prohibit pharmaceutical companies from deducting expenses related to "direct-to-consumer advertising";
  - Impose a tax penalty on pharmaceutical manufacturers that increase the costs of brand-name, biotech or "abusively priced" generic drugs over the general inflation rate;
  - Increase taxes on the fossil fuel industry;
  - Reinstate the limitation on the use of excess business losses in Section 461(l), thereby retroactively limiting the amount of nonbusiness income that can be offset by business-related losses to $250,000 per year;
  - Penalize employers who intentionally misclassify their employees as independent contractors; and
  - Require recipients of benefits of the Opportunity Zone program to provide detailed reporting and public disclosure on their investments and impact on local residents. Such participants face limitation of Opportunity Zone benefits if their projects don't demonstrate "clear economic, social, and environmental benefits to a community."
- **Mr. Biden would also increase the tax bills of households earning more than $400,000 by:**
  - Capping the value of itemized deductions so that such deductions can only fully offset income subject to marginal rates up to 28%;
  - Restoring the Pease limitation and reducing the value of itemized deductions by 3% of the amount by which a taxpayer's adjusted gross income exceeds $400,000; and
  - Phasing out the qualified business income deduction in Section 199A.

Conclusion

The Biden proposals create significant incentives for proactive tax planning, especially toward the end of the current tax year. Taxpayers should pay close attention to the outcome of the election and be prepared to act quickly to optimize their tax treatment.

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