50:50 – What It Means for President Biden's Tax Proposals

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As presumptive winners of both Georgia Senate seats, the Democrats will have a majority of the Senate whenever there is an opportunity for Vice President Kamala Harris to vote. But that is a far cry from a clear, decisive majority required to pass all parts of President Biden's tax agenda. Over time, negotiations may lead to some tax increases but probably not the significant increases proposed during the campaign. Independent of this week's elections, tax law change is a persistent concern. If changes do not come now, they will come either as a result of future elections or the sunset of portions of the current law on December 31, 2025. Planning ahead remains essential.

Key takeaways

- **Timing:** The Biden administration may prioritize the COVID-19 vaccination program and a recovering economy ahead of pursing its tax policy. Congress will likely not take up any tax matters until the summer of 2021 and will do so as part of the budget process. Without a strong majority, it seems likely income tax increases, if any, would be prospective, not retroactive to January 1, 2021. Timing for estate and gift tax rate increases and an exemption reduction may differ.
- **It takes a vote:** Vice President-elect Harris votes with the Senate only when a tie-break is required. Most legislation can be filibustered, requiring 60 votes to invoke cloture; many filibustered matters will never make it to an actual vote. However, budget and tax legislation can be passed subject to a complex "reconciliation process" eventually requiring only a simple majority for passage.
- **Income tax rates:** While it is possible personal income tax rates could revert to 2016 levels sooner than January 1, 2026, proposed increases outside those bounds seem unlikely to receive broad support.
- **Extended corporate tax benefits:** Late 2020 pandemic relief legislation extended or made permanent most of the corporate tax benefits set to expire December 31, 2020.
- **Estate tax exemption:** The individual estate and gift tax exemption for 2021 is $11,700,000. President-elect Biden would reduce the exemption to $3,500,000 and increase the tax rate. Where both possible and practical, implementation of estate planning techniques which fully use the available exemption are of paramount importance.
- **Regulatory action:** Regardless of the state of legislation, the Biden administration may still look to use the regulatory process to address perceived "loopholes" in the tax law such as short-term Grantor Retained Annuity Trusts.

Tax legislation

- Tax legislation can be taken up on its own but historically is addressed as part of the budget process. With a 50:50 Congress, it would be impossible to have tax legislation passed without designating it as subject to the "reconciliation process". Each year, Congress can designate only one reconciliation bill on the topic of revenue (tax). It can designate another on spending (the budget); most often the two are combined.
- Any tax legislation passed as part of a "reconciliation bill" may well be a compromise, giving due consideration to Democratic members of Congress who face mid-term 2022 elections and may not want to defend large tax increases. Therefore, it seems possible any near-term individual tax increases will be moderate in nature, perhaps positioned as merely accelerating the tax increases that are to come in 2026 absent further action. It is harder to predict whether corporate tax increases would be palatable to Congress, as the 21% rate was made permanent by the 2017 Tax Cuts and Jobs Act and does not similarly sunset.
- There are a variety of views on when any tax changes might be effective. Tax increases could be part of the 2021 or 2022 fiscal year federal budget. Tax legislation most often has an effective date as of the date the legislation is first introduced in Congress. This is intended to avoid any gaming of the system based on the gap between the time we can parse the first draft of the legislation and the effective date. Importantly, however, both in 2010 when the estate tax was re-imposed and again in 2017 when the Trump tax cuts were passed, the tax changes were retroactive to January 1 of the year passed. Additionally, President-elect Biden made "day one" a rallying cry during his campaign. Therefore, there is some reason to anticipate that any tax increases on the wealthy, particularly estate tax, could be effective January 1, 2021.

Income tax

- The individual tax rate tops out at 37%.Capital gains tax is paid at the rate of 15% (or 20% if income is greater than $445,850). The corporate tax rate is 21%. A schedule of the Biden administration's tax proposals is attached.
- Trusts pay the highest tax rate (37%) on income greater than $13,050. For this reason, it is often advantageous to pass out income from a trust to a beneficiary in a lower tax bracket if the income distribution is in harmony with a family's larger estate plan and the terms of the trust.
- The $10,000 limitation on deductions for state and local taxes remains in place unless or until tax law reverts to the 2016 schema. In some jurisdictions, taxpayers willing to give up control over and access to some assets may be able to put assets in trust in a low- or no-tax state but some taxpayers in high tax states likely will consider changing their state of residence. Doing so requires careful consideration and a full understanding of the steps required to permanently and effectively change tax residence.

Retirement plans

- The CARES Act eliminated the obligation to take a Required Minimum Distribution in 2020. This was not extended to 2021.
- A Required Minimum Distribution is mandatory for any Traditional IRA owner age 72 or older in 2021.
- The SECURE Act, enacted in early 2020, changes many of the distribution rules for inheritors of IRAs. IRA owners should seek legal counsel to determine whether their beneficiary designations are still sound planning.

Estate and gift planning

- The 2021 federal exemption amount is $11,700,000 per person but it will revert to 2016 levels (about $6,000,000) without any legislative action on January 1, 2026. Planning to fully use this exemption, where possible, remains especially important if Biden tax legislation to reduce the exemption to $3,500,000 moves forward.
- Interest rates remain low and markets variable but generally upward trending. While these are in alignment, planning techniques such as intra-family loans, loans to trusts, and Grantor Retained Annuity Trusts remain favored estate planning techniques.
- Absent the ability to raise the estate tax rate and lower the exemption amount, the Biden administration may pursue some regulatory changes proposed by the Obama administration to close some perceived loopholes. For example, we would not be surprised to see short-term GRATs limited by requiring a minimum 10-year term and a 10% (or similar) taxable gift element. Such a change would likely not be retroactive affecting existing GRATs but could prevent creation of short-term GRATs in the future.

	Current/TCJA*	Biden Administration
Top marginal tax bracket	37% top rate	39.6% top rate
Long-term capital gains and dividend rate	20% top rate	20%, but increases to 39.6% for income > $1million
Social Security Payroll Tax (paid ½ by employer)	12.4% on earned income up to $137,000	Adds 12.4% on earned income > $400,000
Itemized deductions	SALT deduction capped at $10,000, limited itemized deductions	Repeal TCJA, revert to 2016; permit SALT and other pre-TCJA deductions but impose Pease limitations
199A real estate deductions	Deduction for up to 20% of qualified business income	Phase-out for taxpayers with income > $400,000
IRA & 401(k) deductions	Contributions deductible to individual limits	Replace with 26% credit; credit would be paid to IRA
Estate and gift tax	40% tax on estates over $11,580,000	45% tax on estates over $3,500,000; $1,000,000 gift tax exemption
Cost basis step-up at death	Yes, on all assets included in estate	Eliminated
Corporate Tax Rate	21%	28%

*Most elements of the 2017 Tax Cuts and Jobs Act (other than the corporate tax rate) are slated to expire December 31, 2026, when tax rates and deductions revert to 2016 law.

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