Uncertainty Remains Regarding Year-End Tax Planning

Even though the election is over, there is still uncertainty regarding future tax policy. President Trump has not conceded the election, and the House has shifted less Democratic. As for the Senate, both Georgia seats will be decided in a runoff election on January 5th. It is possible that the Democratic candidates could win one or both of those seats. If the Democrats win both seats, the Senate would be evenly split 50-50 with an effective Democrat majority with the Vice President as a tiebreaker.

Assuming the Republicans hold onto their slight majority in the Senate, it seems that the potential for some of the sweeping tax changes proposed by Joe Biden has been reduced. We will communicate in more detail other tax planning ideas to you in the coming days, but the items below are relevant in light of a potential shift in the legislative power of the Senate to the Democrats.

- Biden has indicated a preference to increase the top individual income tax rate back to 39.6% for taxpayers with incomes exceeding $400,000. Also proposed for those with incomes exceeding this amount is the capping of itemized deductions at 28%, reinstating the "Pease" limitation (which is the gradual phase-out of itemized deductions based on income), and a phase-out of the Section 199A deduction (the 20% deduction for certain pass-through business income).
  - *Tax planning points:*
    - *Consider accelerating income into 2020 vs. 2021, and/or deferring deductions from 2020 until 2021. (This is counter to traditional year-end tax planning logic).*
    - *Consider a Roth conversion in 2020 while the tax rate is lower.*
    - *Hold off on accelerated depreciation deductions for 2020 to preserve future depreciation expenses in years when the tax rate is higher.*

- Biden proposes to tax capital gains at the top (39.6%) rate for individuals with more than $1 million of income. This would nearly double the tax rate on capital gain income for certain taxpayers.
  - *Tax planning point:*
    - *Consider recognizing capital gains on investments in 2020 while the current capital gains rate is in effect.*

- Biden has proposed, but not in specific detail, to tax capital gain assets at death and to eliminate the step-up in asset value. In addition, he has proposed to decrease the lifetime estate and gifting exemption, currently at $11.58 million ($23.16 million for married taxpayers due to portability). Many experts believe the exemption may be reduced to an amount closer to the prior $5 million level.

- *Tax planning point:*
  - *Because, presumably, such a decrease would be implemented in 2021 at the earliest, higher net worth individuals should consider accelerating gifting and other estate reduction opportunities now, while the estate tax exemption is high. Doing so may result in a significant reduction in a future taxable estate.*

- Biden has proposed imposing Social Security tax on earned income over $400,000. The current cap of $137,700 for 2020 would be retained under his proposal, so wages between the current cap and $400,000 would be free from the Social Security tax. It is not clear at this time whether Biden's proposal includes only the individual 6.2% or if employers would also be required to pay their 6.2% share on this income as well.
  - *Tax planning point:*
    - *Sole proprietorships and flow-through entities taxed as partnerships should consider S corporation status to reduce Social Security taxes.*

- Biden proposes to increase the C corporation tax rate to 28%, which is currently 21% but below the previous rate of 35%. *With this in mind, acceleration of a corporation's taxable income into 2020 may be advisable.*

We have been asked the question, if a tax bill were to be enacted later in 2021 to increase tax rates, when would it be effective? Prior tax legislative history suggests that any tax legislation enacted in 2021, even toward the end of the year, could be retroactive to transactions completed at any time in 2021. For example, a tax law unofficially referred to as the Deficit Restoration Act of 1993 increased tax rates retroactively to the beginning of the year (the top tax rate went from 31% to 39.6%), even though it wasn't signed into law until August 10th of that year. The Senate passed that bill by a vote of 51 to 50, with Vice President Gore as the tiebreaker. In recent history, retroactive long-term capital gains tax rate changes have generally been for rate decreases, which are easier to sell from a political standpoint. However, that does not preclude a retroactive rate increase.

From a tax perspective, the current uncertainty will remain until the January 5 th runoff election, clearly making year-end tax planning more difficult. Taxpayers need to evaluate both short-term and long-term tax planning considerations. The strategies mentioned above can offer benefits if future tax rates increase; however, these strategies need to be balanced against liquidity needs during this period of economic disruption. Please reach out to us to discuss opportunities specific to your situation.