Taxes in the Biden Era: An Early Look

By Kristi Mathisen

KRISTI MATHISEN,
JD, CPA, PFS

Kristi is LNWM's managing director of tax and financial planning. An attorney and CPA, she has more than 25 years of experience providing analysis and guidance on tax and wealth planning issues.

With the Biden administration in the White House and Democrats in control of Congress (just barely), tax policy could change significantly in the next several years. Athough it's too early to know specifics, we can get an idea of what might lie ahead from the tax proposals that Biden put out as the Democratic nominee.

Based on what we know so far, it seems that tax policy under President Biden would increase taxes for certain upper-income households but certainly not for everyone. And the annual wealth tax, which was a big focus during the Democratic primary debates, is no longer on the table.

The overview so far: Under Biden, two of the biggest beneficiaries of the 2017 tax cuts – US households with annual income of $400,000 or more and US corporations – would likely see 2017 benefits ratcheted back. And there is something new: how the Biden administration would tax capital gains, affecting mostly inherited assets and high-income investors. Below is our assessment of whom would be impacted most by type of tax, based on what we know so far.

INCOME TAXES

You're in the top tax bracket. Biden has proposed increasing the top income tax rate to 39.6% – where it was in 2017 – from 37% currently. This would apply to ALL filers with income over $400,000 annually – both married filing jointly and single. Currently, the highest rate of 37% applies to singles with income over $518,400 and joint filers with income over $622,050.

CAPITAL GAINS TAXES

For a long time, US tax policy has given beneficial treatment to long-term capital gains (profits on the sale of an investment held for more than 12 months). Consider that long-term capital gains and qualified dividends are taxed at a maximum 20%. Meanwhile, regular income from sources like wages and retirement accounts is taxed at a maximum 37%. Because of this disparity, how the Biden capital gain proposals would affect you greatly depends on the amount and sources of your income.

You're an investor with more than $1 million in annual income. Biden has proposed ending the preferential tax rate on long-term capital gains but only for households with $1 million or more in income from all sources. For them, capital gains would be taxed as income at their highest rate, which would revert back to 39.6%. For everyone else, long-term capital gains would continue to be taxed at beneficial rates of 0%, 15% and 20%, depending on income level.

You intend to leave greatly appreciated assets to your heirs. Currently, assets owned at death transfer to heirs at the prevailing market price, referred to as "stepped-up tax basis." This means heirs can inherit, sell immediately, and not pay any capital gains tax. Biden proposals would do away with "stepped-up basis." This means a capital gains tax would be due, although it is not clear when: at the time the estate settles and transfer to heirs, or when the heirs sell. Most likely it would be at the time of transfer (with transfers to spouses and charities exempt). This tax change could present a logistical challenge in that the original cost of certain assets – such as a family business or vacation home – can be very difficult to determine.

Example: Martin paid $200,000 for an apartment building in 1984; his daughter eventually inherits that building at a market value of $2 million after he passes away. Under the Biden capital gains proposal, the estate would then owe $454,000 in taxes (39.6% rate on $1.8 million in capital gains).
Biden may also call for changing the relatively high exclusion from federal gift and estate taxes. This currently allows each person to pass on $11.7 million to beneficiaries (double the level in 2017), although this higher level is set to expire at the end of 2025. And since many of Biden's other

BIDEN TAX PROPOSALS: IMPACT BY INCOME LEVEL

Potentially Higher Taxes

Tax Type	Less than $400,000 Household Income#	More than $400,000 Household Income#	More than $1 million Household Income#
Highest income tax bracket	37%	39.6%	39.6%
Long-term capital gains	0% - 20%	0% - 20%	0% - 39.6%
Capital gains taxes on inheritance and gifts	✔	✔	✔
New Social Security payroll tax	X	✔	✔
Limit on 20% qualified business income	X	✔	✔
Limits on itemized deductions	✔	✔	✔

#Annual adjusted gross income (AGI) for both married filing jointly and single filers.

proposals do increase taxes on the wealthy, halving the exclusion to 2017 levels (or even lower) would not be all that surprising.

SOCIAL SECURITY TAXES

You work and your salary is $400,000 or higher. The Biden plan would impose a new 12.4% Social Security payroll tax on earned income above $400,000 – 6.2% to be paid by you and 6.2% by your employer. Workers with salaries between $137,700 and $400,000 would see no increase, creating what some are referring to as a "donut hole." Over time, the donut hole would close, as the $137,700 cutoff is adjusted annually for inflation.

TAX DEDUCTIONS

You have $400,000 or more in income and you claim the 20% business income deduction. Many who own a business with pass-through income – such as a sole proprietorship, LLC, or partnership -- now qualify for a 20% deduction on their business income (thanks to the 2017 Tax Act). Biden proposes a phase-out of this deduction for those with annual income of $400,000 or more.

You have $400,000 or more in income and you itemize deductions. Biden would bring back the "Pease" limitation (suspended by the 2017 Tax Act), reducing allowable itemized deductions by 3% for every dollar of taxable income above a certain threshold (in 2017, $254,200 single; $305,050 for joint filers).

Your top tax bracket is higher than 24%. Biden proposals would cap the tax benefit of allowed itemized deductions to 28% of value, meaning that if your tax bracket is 28% or higher, the benefit of itemizing deductions would be greatly reduced. Currently, there is no 28% income tax rate; the 24% bracket tops out at $163,300 for single and $326,600 for joint filers.

Example: Sam and Suzie have income of $600,000 and donate $100,000 to a charity. Under current law, they're in the 32% tax bracket and the tax-deductible $100,000 donation saves them $32,000 in taxes. Under the Biden proposal, the most they would save from the $100,000 donation would be capped at $28,000.

GOVERNMENT SPENDING ON THE RISE

The US federal budget deficit has grown dramatically due to the 2017 tax cuts and 2020-2021 spending to counter the health and economic impact of Covid-19. Reversing this trend will eventually require higher tax revenue and lower spending. For now, the focus is on economic recovery.

The Biden administration is likely to propose more government spending to upgrade US infrastructure (which would be part of Biden's clean energy and climate change initiative). Other initiatives could include making Medicare available at age 60 instead of 65 (hugely relevant for people planning for retirement), and forgiving some student loans for low- and middle-income students at public colleges and universities.

COROPORATE TAXES

Biden has proposed the following:

- Raise the top US corporate tax rate to 28%; that's up from 21% now but less than the 35% it was in 2017.
- Double the tax rate on the income of foreign subsidiaries to 21% from 10.5% currently;
- Bring back a corporate minimum tax of 15% on worldwide income over $100 million;
- Do away with real estate industry tax loopholes;
- Provide tax credits to induce companies to manufacture in the US, offer retirement plans to their workers, and use renewable energy;
- Expand the "new markets credit" for investments in low-income communities.

WHAT LIES AHEAD

As noted earlier, we don't really know. Great uncertainty remains about the details of the Biden tax platform. So it's premature to act on any of their pronouncements. We will be keeping a close watch, as more specifics are likely to be released in the coming months, not just about taxes but also economic policy. And we will continue to review client tax strategies for 2021 and beyond.

ABOUT THE AUTHOR

Kristi Mathisen, JD, CPA, PFS is managing director, tax and financial planning at Laird Norton Wealth Management. She also provides guidance and advice on philanthropic strategies and estate planning to the firm's client services team and to clients directly. An attorney, CPA and Personal Financial Specialist with more than 25 years of finance-related experience, Kristi has a bachelor's degree in business administration from the University of Washington and a Juris Doctor from the University of Washington School of Law. She is a member of the Washington State and King County Bar Associations, the Washington State Society of CPAs and the American Institute of CPAs.

ABOUT LAIRD NORTON WEALTH MANAGEMENT

With $6 billion in assets under management, Laird Norton Wealth Management is the Northwest's premier wealth management company. Founded in 1967 to serve the financial management needs of the Laird and Norton families, the firm now provides integrated wealth management solutions to approximately 700 individuals, families, business leaders, private foundations and nonprofit organizations.

801 Second Avenue, Suite 1600, Seattle WA 98104 206.464.5100 800.426.5105 lairdnortonwm.com

DISCLOSURE

All investments involve a level of risk, and past performance is not a guarantee of future investment results. The value of investments and the income derived from them can go down as well as up. Future returns are not guaranteed and a loss of principal may occur. All investment performance can be affected by general economic conditions and the extent and timing of investor participation in both the equity and fixed income markets. Fees charged by LNWM will reduce the net performance of the investment portfolio.

The information presented herein does not constitute and should not be construed as legal advice or as an offer to buy or sell any investment product or service. Any opinions or investment planning solutions herein described may not be suitable for all investors nor apply to all situations. All opinions expressed are those of Laird Norton Wealth Management and are current only as of the date appearing on this material.

Any accounting, business or tax advice contained in this presentation (or communication, including attachments and enclosures) is not intended as a thorough, in-depth analysis of specific issues, nor a substitute for a formal opinion, nor is it sufficient to avoid tax-related penalties.

Some investments may not be publicly traded and they may only allow redemptions at certain times conditioned on various notice provisions and other factors as more fully described in the related offering and subscription documents provided at the time of the investment. Due to the nature of these types of investment funds, hedge funds, fund of funds, and similar partnership-like investment vehicles, they should be considered illiquid. In addition to restrictions on redemption, they often include holdback provisions that may delay a full redemption for several months or longer. There is no guarantee that the amount of the initial investment can be received upon redemption. Due to the nature of the tax reporting that may be available from these types of investments, clients should expect to extend the filing of their tax returns.

A benchmark is an unmanaged index, and its performance does not include any advisory fees, transaction costs or other charges that may be incurred in connection with your investments. Indices are statistical composites and are shown for informational purposes only. It is not possible to invest directly in an index. Indices are unmanaged and are not subject to management fees. Any benchmark whose return is shown for comparison purposes may include different holdings, a different number of holdings, and a different degree of investment in individual securities, industries or economic sectors than the investments and/or investment accounts to which it is compared. Comparisons of individual account or portfolio performance to an index or benchmark composed of indices are unreliable as indicators of future performance of an actual account or portfolio. Actual performance presented represents past performance net of investment management fees unless otherwise noted. Other fees, such as custodial fees or transaction related fees may not be reflected in the actual performance results shown.

Certain information herein has been obtained from public third party data sources, outside funds and investment managers. Although we believe this information to be reliable, no representation or warranty, expressed or implied, is made, and no liability is accepted by Laird Norton Wealth Management or any of its officers, agents or affiliates as to the accuracy, completeness or correctness of the information herein contained. In addition, due to the nature of an investment or the date of the creation of the attached presentation, some values shown or used in the calculation of performance may be based on estimates that are subject to change.

All data presented is current only as of the date thereon shown. Laird Norton Wealth Management is comprised of two distinct entities that may offer similar services to clients. Laird Norton Trust Company is a State of Washington chartered trust company. Its wholly owned subsidiary, Laird Norton Tyee Asset Strategies, LLC, is an Investment Advisor registered with the Securities and Exchange Commission. Such registration does not imply any level of skill or expertise.