Certified Public Accountants

Gatto McFerson

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Dear Friends and Colleagues,

$400,000 seems to be the central number inside the proposed Joe Biden tax plan. The candidate has stated repeatedly that those with taxable incomes of under $400,000 will not see a tax increase, while those with incomes above that threshold could see higher taxes of varying degrees.

So, what does this mean? For those with taxable incomes above $400,000, expect higher ordinary income tax rates, additional payroll taxes, capped itemized deductions, and a phase out of Qualified Business Income deduction.

Keep in mind, what is initially proposed and what finally becomes law can be radically different. There is also the timing of getting a new tax law passed (2021? 2022?), what the effective date might be, and whether the Republicans hold onto the Senate.

Regardless, we thought it would be helpful to share what candidate Joe Biden has proposed, and items to consider when tax planning for the future.

Top Income Tax Rate

As of now, the plan is to increase the top income tax rate from 37% to 39.6% for those with taxable incomes above $400,000. It is unclear on whether this $400,000 threshold is across the board, or whether it will vary depending on your filing status. (Single, Married-Filing-Joint, Head-of-Household).

Observation #1: The taxable income threshold/rate increase isn't all or nothing. You only pay tax at the higher rate on the income that exceeds the corresponding threshold.

Observation #2: Depending on your expected income levels in 2020 and 2021, consider shifting income and/or expenses to take advantage of these changing rates.

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Social Security Tax

Currently, a 12.4% social security tax is imposed on employees earning $137,700 or less. This “payroll” tax is split evenly between the employee and employer. For those who are self-employed, the entire 12.4% is paid by the sole-proprietor. Under the Biden Proposal, the 12.4% tax would kick back in for those earning above $400,000. The changes would look something like this:

Wages/Self-Employed Earnings: $0 - $137,700 – SS Tax of 12.4%
Wages/Self-Employed Earnings: $137,701- $399,999 – No SS Tax
Wages/Self-Employed Earnings: $400,000 and above – Resumption of SS Tax of 12.4%

Observation #1: For shareholders in S Corporations, attempt to keep W2 wages under that $400,000 threshold.

Observation #2: It is unclear whether the Obamacare Medicare surtax of 0.9% on wages or self-employment income would continue to apply.

Long-Term Capital Gains/Qualified Dividends

Currently, Long-Term Capital Gains and Qualified Dividends are taxed at 15% or 20%. Under the Biden Proposal, for those with income of over $1 million, these items would be taxed at the increased ordinary income tax rate of 39.6%.

Observation #1: It is unclear whether Long-Term Capital Gains generated from the sale of a business would be included in this. It is possible that gains from the sale of a business, because it is typically a once-in-a-lifetime event for the taxpayer, would be excluded.

Observation #2: Consider timing your gains and losses to best deal with these increased rates.

Observation #3 - It is unclear whether the Obamacare Net Investment Income surtax of 3.8% would continue to apply.

Deductions on State and Local Taxes/Property Taxes

Currently, a total deduction of $10,000 is the maximum permitted for personal state income and home property taxes. This is a very low number for most taxpayers, but especially those who live in states with high tax rates and/or high property values (like California). Under the Biden Proposal, these deductions would be restored.

Observation #1: If your state income and property taxes will exceed $10,000 in 2020, push any additional payments into 2021…but only if you can do so without getting penalized.

Observation #2: The current limitation on property taxes only relates to your personal residence(s). It does not apply to any rental property you might own.

Caps on Itemized Deductions

For those with taxable incomes above $400,000, the taxable benefit of your itemized deductions will be limited to 28 percent (even if you're in a higher tax bracket), with additional phase-outs also possible.

Observation #1: Consider the timing of certain itemized deductions, such as charity, if you think this cap could come into play.

Qualified Business Income Deduction

Currently, individuals are allowed to deduct 20% of "qualified business income" (Section 199A) from a partnership, S corporation, or sole proprietorship. The deduction is disallowed for specified service trades or businesses with income above a certain threshold. Under the Biden Proposal, those with taxable incomes over $400,000 would see a phase out of this qualified business income deduction.

Observation #1: A pass-through entity is considered to be a sole proprietorship, an S-Corporation, or a partnership (LLC/LLP). Employees are not eligible.

Observation #2: Depending on how your income looks for 2020 and 2021, consider shifting income and/or expenses to avoid this phase out.

New Equipment

Small businesses can currently write-off the cost of qualifying new equipment (digital x-ray or computers, for example) placed in service, up to a total of $500,000 in a given year. There is no mention of altering this in the Biden Proposal.

Observation #1: As long as the equipment is signed for and in service by the end of the year, this deduction can be taken. Equipment acquired through a capital lease also qualifies.

Other Potential Changes

- Eliminate 1031 Exchanges (Real Estate) for those with higher taxable incomes;
- Reestablish First-Time Homebuyers' Tax Credit of up to $15,000;
- Expand Dependent Care Tax Credit and Child Tax Credit;
- Restore estate and gift tax rates and exemption to 2009 levels;
- Restore full Electric Vehicle Tax Credit;
- Increase corporate income tax rate from 21 percent to 28 percent;

Should you have any questions about the above, please feel free to contact our office at any time.

Sincerely,

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