A Guide to Potential Tax Law Changes

A look into changes the Biden Administration might propose and what you can do now to prepare

Prior to the Presidential election, we created the content piece, [Presidential Candidate's Tax Policy Review] that outlined the differences in tax policies between the then President Donald Trump and Joe Biden. Since then we have had an election and our office of the President is in Democratic hands, with that comes changes, some definite and others potential. Many legal and tax professionals are predicting sweeping changes and repeals to tax laws under President Biden's administration. We outline here some potential changes that may occur and ones we feel are important for you to consider acting on.

Personal Income Tax

President Biden has proposed a number of initiatives during his presidential campaign surrounding tax increases for individuals with high income. More specifically, for individuals with income over $400,000 will be greatly affected. Below are some key items from the President's income tax proposals:

- Increase top marginal tax rate from 37% to 39.6%
- Long-term capital gains/qualified dividend income for individuals with income over $1 million will be taxed at the ordinary income rate instead of the lower capital gain tax rate, which will result in an additional 19.6% tax
- Social security payroll tax will be imposed on wages above $400,000
- Itemized deductions will be capped at 28% for individuals earning more than $400,000

While the actual timing and extent of the tax legislation is uncertain, it is still prudent to take advantage of tax planning opportunities that are available now to hedge against potential future tax hikes. If you are a high-income earner, consider accelerating income and harvest capital gains in 2021 and defer expenses and losses to 2022. For those who may be subject to a higher tax rate on their capital gains, consider gifting stocks instead of cash to avoid the capital gain tax while still being able to take a deduction on the charitable donation. Also, to capitalize on the current low tax rate environment, consider doing a Roth conversion to fill

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up your current tax bracket. For those who inherited an IRA from a non-spousal decedent who passed away in 2020, don't forget that new distribution rules from the SECURE Act enacted end of 2019 may now apply. The ability to stretch an inherited IRA over a non-spouse beneficiary's lifetime has been eliminated and instead it must be withdrawn within 10 years. For sizable inherited accounts, this accelerated depletion will certainly increase an heirs' income taxes significantly in the near future years.

What's raising even more eyebrows is the proposed elimination of the "Step Up In Basis" so that all capital gains taxes will be paid at death. Currently, assets held until death receive a "Step Up In Basis" (heir's cost basis becomes the market value of the asset at death avoiding capital gains tax). This portion of the tax reform would create significant taxation to your heirs, especially on assets above the lifetime exemption. In this scenario, inherited low basis assets that are over the lifetime estate tax exemption could be taxed at a 40% (or higher) Estate Tax Rate. In addition, a capital gains tax rate may be imposed at the highest income tax bracket which will likely increase to 39.6% with an additional 3.8% surtax for individuals with an income over $1,000,000. For example, a decedent's asset with $1,000,000 in basis and a fair market value of $10,000,000 at death will be subject to capital gain tax of $3,906,000 at the combined 43.4% rate. This capital tax would then reduce the overall market value of the asset which is included in the estate and the remaining portion of $6,094,000 in this example would then be subject to estate tax. With an estate tax payable of $2,437,600, this leaves $3,656,400 for the heirs and $6,343,600 is paid to our favorite uncle…Uncle Sam!

Proposed capital gains tax changes are not the only federal tax changes that may affect your heirs. A reduction in the lifetime gift and estate tax exemption amount and an increased estate tax rate are also on the horizon.

It is difficult to know what the comprehensive tax package will include, but it is important to be prepared by understanding the potential changes and proactively discussing planning ideas with your financial consultant. Rockland Trust Investment Management Group's team includes several experts who are very knowledgeable on these topics and who can work closely with you and your other professional advisors to help you make the best decisions for your current and future situations.

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