Worth®

BEYOND WEALTH

Financial Planning Considerations Under Joe Biden's Proposed Tax Plan

Financial Planning Considerations Under Joe Biden's Proposed Tax Plan

Justin Charise, CFP, Founding Partner

WEALTH MANAGEMENT ADVISOR,
SAUGATUCK FINANCIAL

With the U.S. presidential election only a few weeks away, it's timely to evaluate the details of Joe Biden's tax plan, the potential implications and some strategies that might be worth considering.

Before we begin, it's worth noting that even if Biden is elected, his tax plan becoming a reality would likely hinge on Democrats also gaining control of the Senate this November. And, even if that occurs, it could prove difficult to increase taxes if the 2021 economy is still fragile due to COVID-19. With that said, it is prudent to understand what the tax implications might be so we can evaluate which planning strategies could be beneficial in advance.

INCOME TAX IMPACTS

If you earn more than $400,000 per year, Biden's income tax plan would negatively impact you in several ways:

- Under Biden's plan, the top tax bracket, which is currently $622,051 for married couples filing jointly and $518,401 for single filers, would drop to $400,000, and the top tax bracket would increase from 37 percent to 39.6 percent.
- Additionally, the Social Security payroll tax of 12.4 percent, which is split evenly between employers and employees and currently only applies to the first $137,700 of income, would also apply to all income above $400,000.

PHOTO COURTESY OF GETTY IMAGES

- As an example of how the above could impact high income earners, for a taxpayer earning $500,000, their $100,000 of income above the $400,000 threshold would be taxed at 52 percent (39.6 percent + 12.4 percent) vs. the current 35 percent tax (based on being in the second highest tax bracket currently). That's before factoring in any city or state income tax.

STRATEGIES TO CONSIDER

Business owners who think there's a good chance that Biden's tax plan will become a reality might want to consider accelerating income into 2020 and pushing business expenses into 2021, which would increase their taxable income in 2020 (subject to the lower current tax rates) and reduce their taxable income in 2021 (subject to the higher potential tax rates).

INVESTING IMPACTS

- All investors should be aware that the proposed increase of the corporate tax rate from 21 percent to 28 percent could negatively impact equity markets, broadly speaking.
- For taxpayers earning more than $1 million per year, Biden's tax plan also calls for long-term capital gains and dividends to be taxed as ordinary income, roughly doubling the current long-term capital gains tax rate for those taxpayers.
- Biden's tax plan also involves eliminating the deductibility of retirement plan contributions—instead, providing a flat retirement plan contribution credit, which could be 26 percent, although the exact credit has not yet been outlined.

STRATEGIES TO CONSIDER

Taxpayers earning more than $1 million per year who think their long-term capital gains tax rate could increase dramatically might want to consider a couple of strategies:

- First, they might want to reduce their exposure to high dividend paying stocks, as well as to funds that tend to have large capital gains distributions, in their taxable accounts. One way to do this could be to shift more of that exposure to their tax-sheltered retirement accounts (i.e., 401(k)s, IRAs, SEP IRAs, 403(b)s, etc.).
- Additionally, those investors who plan on selling positions in the near- to mid-term might want to accelerate those sales to occur before YE 2020 to pay the current long-term capital gains tax rate on the gain. If they want to stay invested, they could certainly reinvest in the same positions and would essentially be paying the current long-term capital gains tax rate to buy a step-up in their basis, which will reduce the amount of future realized gains that could be taxed at a higher rate.
- Having a flat 26 percent tax credit on retirement plan contributions would make retirement plan contributions more attractive for taxpayers in tax brackets below 26 percent and less attractive for taxpayers in tax brackets above 26 percent. To illustrate this, the value of a $10,000 401(k) contribution for taxpayers in two different marginal tax brackets is illustrated below.

12 percent marginal tax bracket taxpayer:
▹ $2,600 tax credit (26 percent x $10,000) - $1,200 tax paid (12 percent x $10,000) = $1,400 after-tax BENEFIT

39.6 percent marginal tax bracket taxpayer:
▹ $2,600 tax credit (26 percent x $10,000) - $3,960 tax paid (39.6 percent x $10,000) = $1,360 after-tax COST

This doesn't factor in Biden's proposed 12.4 percent Social Security payroll tax on income above $400,000, which would further increase the $1,360 after-tax cost noted above. Additionally, since retirement plan contributions would be treated as tax-credits vs. tax-deductions, they would no longer decrease taxpayers' AGI on their federal tax returns, which flows into their state tax returns. Consequently, contributions would be taxable at the state level.

It is unclear if the treatment of distributions would be altered to avoid this double taxation, but, as you can imagine, that could get very muddy.

- For taxpayers in the higher tax brackets, Roth 401(k)s and cash value life insurance are likely to become even more popular strategies since, although those vehicles are funded with after-tax dollars, the benefits include tax-deferred growth and the potential for tax-free distributions.

CHARITABLE GIVING IMPACTS

While Biden tax plan includes the repeal of the $10,000 cap on the ability to itemize deductions for SALT (state and local tax, including income tax and property tax), it includes a 28 percent cap on the value of itemized deductions, as well as a return of the Pease limitation which would result in a phase out of itemized deductions calculated as 3 percent of a taxpayer's income above $400,000.

For taxpayers in the higher tax brackets, Roth 401(k)s and cash value life insurance are likely to become even more popular strategies since, although those vehicles are funded with after-tax dollars, the benefits include tax-deferred growth and the potential for tax-free distributions."

JUSTIN CHARISE

A taxpayer who makes a $100,000 charitable donation today would itemize their deduction and end up not paying income tax on $100,000 of their income as the result of the charitable donation. However, under Biden's tax plan, if that taxpayer earns $600,000 ($200,000 above the $400,000 threshold) and, for simplicities sake, assuming they have no other itemized deductions, they would still pay an income tax of 11.6 percent (39.6 percent - 28 percent) on the amount of their charitable donation. Additionally, this taxpayer would have $6,000 of their itemized deductions phased out ($200,000 x 3 percent) and would only receive $22,000 of tax savings from the $100,000 charitable donation ($100,000 x 28 percent - $6,000 = $22,000). This does not factor in Biden's proposed 12.4 percent Social Security payroll tax on income above $400,000, which would further increase the amount of tax paid on this charitable donation and reduce the tax savings from the charitable donation.

STRATEGIES TO CONSIDER

- For higher income earning taxpayers who think Biden's tax plan might come to fruition, you may want to consider contributing to a Donor Advised Fund (DAF) before YE 2020 to maximize the benefit of charitable donations. Your 2020 DAF contribution could be treated as an itemized deduction and, assuming you would already be itemizing your deductions (vs. taking the standard deduction), you would stand to benefit from the full tax deductibility of your DAF contribution.

In short, the proposed tax changes under Biden are both broad and complex. As we navigate the political outcome in November, it will be prudent to have a financial advisor who understands the implications and who can think critically about the strategic response that will be best for your specific financial situation.

This article is not intended as, and financial representatives do not give, legal or tax advice. Taxpayers should seek advice based on their particular circumstances from an independent tax advisor.

Saugatuck Financial is a marketing name for Justin Charise and is not a broker-dealer, registered investment advisor, federal savings bank, subsidiary or other corporate affiliate of The Northwestern Mutual Life Insurance Company, Milwaukee, Wis., including its subsidiaries, nor is it a legal partnership or entity.

WWW.YOUTUBE.COM/WATCH?V=CPTJN6SOTII

Biden vs. Trump:

WHAT EACH CANDIDATE'S TAX POLICY WOULD MEAN FOR YOU

Featuring

Justin Charise, CFP
Founding Partner
Saugatuck Financial

Robert Finkel
Partner-in-Charge & Co-Chair,
New York City
Moritt Hock & Hamroff

Juliet Scott-Croxford
CEO
Worth

"For higher income earning taxpayers who think Biden's tax plan might come to fruition, you may want to consider contributing to a Donor Advised Fund (DAF) before YE 2020 to maximize the benefit of charitable donations."

Northwestern Mutual is the marketing name for The Northwestern Mutual Life Insurance Company, Milwaukee, Wis., (NM) (life and disability insurance, annuities and life insurance with long-term care benefits) and its subsidiaries. Justin Charise is a Representative of Northwestern Mutual Wealth Management Company®, (NMWMC) Milwaukee, Wis. (investment management, trust services and fee-based financial planning), a subsidiary of NM and limited-purpose federal savings bank. All NMWMC products and services are offered only by properly credentialed Representatives who operate from agency offices of NMWMC. Charise and Schor are Insurance Agents of NM and Northwestern Long Term Care Insurance Company, Milwaukee, Wis., a subsidiary of NM, and are Registered Representatives of Northwestern Mutual Investment Services, LLC, (NMIS) (securities), a subsidiary of NM, registered investment advisor, broker-dealer and member FINRA and SIPC.

Justin Charise, CFP®
Founding Partner, Wealth Management Advisor

Saugatuck Financial
274 Riverside Avenue., 4th Floor
Westport, CT 06880
Tel. 203-221-5275

justin.charise@nm.com
saugatuck-financial.com

REPRINTED FROM
Worth®

Saugatuck Financial is featured in Worth® 2020 Leading Advisors™, a special section in every edition of Worth® magazine. All firms appearing in this section have completed questionnaires, have been vetted by an advisory group following submission by Worth®, and thereafter paid the standard fees to Worth® to be featured in this section. The information contained herein is for informational purposes, and although the list of advisors presented in this section is drawn from sources believed to be reliable and independently reviewed, the accuracy or completeness of this information is not guaranteed. No person or firm listed in this section should be construed as an endorsement by Worth®, and Worth® will not be responsible for the performance, acts or omissions of any such advisor. It should not be assumed that the past performance of any advisors featured in this special section will equal or be an indicator of future performance. Worth®, a publication owned by Clarim Holdings, is a financial publisher and does not recommend or endorse investment, legal or tax advisors, investment strategies or particular investments. Those seeking specific investment advice should consider a qualified and licensed investment professional. Worth® is a registered trademark of Worth.