

# SEPTEMBER 2020 NEWSLETTER

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## DETAILS AND ANALYSIS OF FORMER VICE-PRESIDENT BIDEN'S TAX PLANS AND PROPOSALS

### FIRM ANNOUNCEMENTS

#### 1. AWARDS:

Pozzuolo Rodden, P.C. is pleased to announce that Martindale-Hubbell, the information service company to the legal profession since 1868, announced that Joseph R. Pozzuolo's 2020 Peer Review Rating for ethical standards and professional ability is excellent.

Pozzuolo Rodden, P.C. is pleased to announce that The New York Times and The American Lawyer Roster Announced Joseph R. Pozzuolo's selection for the Lawyers of Distinction Selection Committee for Fall 2020.

Pozzuolo Rodden, P.C. is pleased to announce that The American Registry have selected Joseph R. Pozzuolo as an America's Most Honored Lawyer.

#### 2. BLOGS:

1. The following are a few of the business, tax, employment, estate planning and business litigation blogs posted on our main website [www.pozzuolo.com](http://www.pozzuolo.com) during the past month:

- a. 37 Year Old Son Was Not A Dependent Child To Cause A Forfeiture Of Father's Share Of Son's Estate;
- b. Can I Disinherit My Spouse and/or My Child(ren)? and,
- c. Injunctive Relief Enforcing Non-Compete Covenant Granted Binding Family Members For Acting In Concert To Circumvent Restrictive Covenant.

**Please visit our website [www.pozzuolo.com](http://www.pozzuolo.com) for more information on these and other relevant business, tax, estate, business litigation and employment topics.**

2. The following are a few of the family law blogs posted on our family law website [www.pozzuolofamilylaw.com](http://www.pozzuolofamilylaw.com) during the past month:

- a. How To Uncouple Insurance Policies In Divorce;
- b. The Benefits of Divorce Mediation; and,
- c. Facing Divorce? 8 Ways To Protect Your Assets.

**Please visit our website [www.pozzuolofamilylaw.com](http://www.pozzuolofamilylaw.com) for more information on these and other relevant family law topics.**

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## DETAILS AND ANALYSIS OF FORMER VICE-PRESIDENT BIDEN'S TAX PLANS AND PROPOSALS

The \$11.58 million per person federal estate tax exemption is scheduled to sunset to the pre-2018 exemption of \$5 million in 2025. My reasoning for starting this newsletter with this statement is every tax practitioner knows that when giving federal tax planning advice the "current" law could change at any time depending on who is in power. United States is a country with two ever diverging halves, thus, it is important to realize and understand that in this type of political climate the tax rules may flip back and forth depending on the political regime in power.

With any financial/investment/tax planning, it sometimes requires you to take a wait and see approach, and other times it requires you to take immediate action to secure the benefit of the current tax scheme. While we are pretty certain that most of the current tax laws will continue if President Trump remains in power, this newsletter will review certain tax changes we can expect if former Vice-President Joe Biden wins the Presidential election in November and what their effects would be. To be clear, the following tax proposals are not in effect. They depend on former Vice-President Biden winning the election, and even if he did, his tax plan would need to go through the political process which may ultimately change any final bill.

Most importantly, this newsletter is not intended to endorse President Trump for reelection or former Vice-President Biden for President but to alert and educate our clients and friends to Vice President Joe Biden's tax plan, if elected. Whether you laud these tax proposals for providing fairness or loathe them for their possible effect on the economy is

your personal decision and choice.

1. **End of the Current 401(k) Scheme:** Biden plans on overhauling the current traditional 401(k) tax benefits. Currently, an employer will contribute money to a 401(k) plan for its employees/participants' retirement savings. This effectively creates a tax benefit equal to the employee's marginal tax rate. Biden feels that those in higher marginal income tax rates get a larger benefit per dollar contributed so that the traditional system is more favorable for highly compensated employees. Biden plans on replacing the current system with a credit or match system instead of a deduction. There would be credit for each dollar saved. (Some sources estimate it to be a 26% credit). For the practical consequences, it means that all employee participants will receive the same benefit for each dollar contributed in the interest of tax fairness. At the same time, many experts claim that it may not have any effect of incentivizing lower income taxpayers to save for retirement, will merely penalize highly compensated employees, and may cripple, weaken and/or undermine the existing retirement plan system. This, in turn, may interfere, damage and injure the stock market and your stock portfolio as pension funds are some of the largest investors in the market.

2. **Increasing the Marginal Tax Rate:** The highest marginal tax rate (for single filers making more than \$518,400 and married filers making over \$622,050) would be increased from 37% to 39.6%. While this will not affect the majority of taxpayers, when combined with higher state income taxes and higher long term capital gain tax rates it may encourage the flight of capital to foreign tax shelters and tax havens, which will affect interest rates and the stock market.

3. **Subjecting High Wage Earners to Social Security Payroll Taxes:** Currently, a 12.4% social security payroll tax is paid on all wages up to \$137,700 (the "Wage Base Limit"). No social security payroll taxes are paid over the Wage Base Limit amount. These taxes are used to help fund Social Security benefits. Usually, the employer pays 6.2% and the employee pays the 6.2%. The reason for the Wage Base Limit is that when determining Social Security Benefits, only the Wage Base Limit is counted and employees making over the Wage Base Limit do not receive any extra social security benefits. The rationale behind the Wage Base Limit is if these employees cannot receive any extra benefits above the Wage Base Limit, it is not fair or equitable for these individuals to pay extra social security payroll taxes on such amounts.

Biden wants to create a "donut hole" where on earning between \$137,700 to \$400,000, no social security payroll taxes would be owed, but on wage amounts over \$400,000, a 12.4% social security payroll tax would be owed without triggering any additional social security benefits. Moreover, experts expect the "donut hole" will gradually narrow over time with inflation and all earnings will be subject to social security payroll taxes. For highly compensated employees and business owners, this is a new 12.4% marginal tax increase on top of the new increased income tax rate and capital gain taxes. While the majority of Americans will not be affected, it will have an effect on the fleeing of capital which means less investment in the US, less investment in the stock market, higher interest rates, and an adverse or detrimental effect to stock prices and retirement plans.

4. **Raising Capital Gains Tax on Filers with Gross Income Above \$1 Million:**

Currently, long term capital tax rates are capped at 20% to encourage investment in capital assets used in the US economy and its infrastructure. Biden wants to increase the long term capital gains and qualified dividends tax rate up to the ordinary income rate, or 39.6%, for individuals with gross income above \$1,000,000 including the capital gains for the taxable year. Again, this will lead to a fleeing of capital, less investments in the US, higher interest rates, and lower stock investments and stock prices. Additionally, dividend stocks may be seriously affected as many pension funds invest in them due to the preferred tax treatment.

5. **Elimination of the Stepped Up Basis at Death:** Currently, upon an individual's death, assets have a step up or down in basis to the fair market value of the assets at death. For instance, if you purchased a capital asset for \$100,000 in 1965 your tax basis is \$100,000. If you sell the capital asset for \$1 million prior to death, you would have a \$900,000 long term capital gain. If you pass away in 2025 and the asset was sold thereafter, the basis would be stepped up to \$1 million and there would be no taxable gain on the sale by your estate or beneficiary. Part of the reason for this stepped up in basis is to counter the fact that your estate may hypothetically be paying 40% marginal federal estate tax and possibly state inheritance/estate taxes. Also, at times businesses and/or capital assets are forced to be sold to pay federal and state death taxes, and the death taxes recapture any long term capital gain taxes lost.

Biden plans to terminate this step up in basis at death. The result of this would mean large estates would pay a 40% marginal federal estate tax, another 4 to 16% in state death taxes, and a proposed 39.7% federal long term capital gain taxes as outlined in 4 above ( plus any state capital gain taxes) on the eventual sale of estate assets owned at death. In states like New Jersey there are situations where that is a whopping 105% of the value of the asset!!! Again, this will lead to a fleeing of capital, lowered US investments, higher interest rates, lower stock investments and lower stock prices.

6. **Increase the Corporate Tax Rate:** President Trump slashed the corporate tax rate from 35% to 21% hoping to make American businesses more competitive against foreign businesses that have lower tax rates. Biden does not plan to increase the corporate tax rate back to 35%, but proposes to increase it to 28%. Note, this will have an effect on the corporate bottom line if you own a business and possibly your expansion plans as the lower tax rate has buoyed the investment in businesses' capital assets and expansion during the last four years.

7. **Minimum Corporate Tax:** Biden proposes to add a minimum corporate tax of 15% for companies with \$100 million or more in annual net income. Where this will come into effect is investments in your business expansion including capital assets. A number of the recent internet companies such as Amazon pay little or no federal income taxes as they apply loss carry forwards from its early years of operations while the companies grew and expanded while losing millions of dollars. This would limit the use of loss carry forwards and lead to higher after tax expenses, lower profitability, lower stock prices and lower investments in US capital assets and expansion.

8. **Increasing Global Intangible Low-Tax Income:** President Trump lowered this tax to 10.5% to help encourage US multinational companies to keep assets in the US and not seek out foreign tax shelters. The purpose of this lower tax rate was to encourage US investments and avoid the flee of capital to foreign countries. Biden proposes to double this tax to 21%. The result of this will, again, affect the investment in US capital assets and expansion and the stock market as the large multinational will be less profitable and thus it will affect stock prices.

9. **Financial Risk Fee on Large Banks:** This proposal is to charge a fee on large banks to help the FDIC cover the expenses of large failed financial institutions. The theory is that only the large banks will pay for this, however, as everyone knows, the banks will simply pass on the fee to its customers. This may lead to higher loan rates, lower returns on deposits, the reduction of services, and the charging of more fees on customers to recoup the payment. Additionally, it will affect the capital and stock market hindering investment and stock prices.

10. **Limiting Itemized Deductions to 28%:** Biden proposes to limit itemized deductions to 28%, many of which are already subject to floors and maximums. This means if your marginal tax rate is 35%, you will only be able to offset 28% of that 35% with itemized deductions. Relevant common itemized deductions are medical and dental expenses, home mortgage interest, state taxes paid, charitable donations, casualty and theft loss, investment interest expenses, and other similar deductions. This will have a myriad of negative effects including fleeing high tax states, a reduced incentive for buying real estate, making charitable contribution, investing, etc. All of this will also lead to a fleeing of capital which will also reduce investment, raise interest rates, and lower stock prices.

11. **Simplifying the Small Business Income Deductions:** President Trump created a 20% deduction for business income of filers under thresholds of \$163,300 for single filers, and \$326,600 for married filers. There were a myriad of rules for incomes above this. Biden wants to simplify this credit so it is phased out with incomes over \$400,000. This does not change the current benefit much, but would simplify the treatment of it, so likely will not have any major detrimental effects to the economy.

12. **First-Time Homebuyer's and Renters' Tax Credit:** Biden plans to introduce a first time homebuyer's and renters' tax credit. The homebuyer's credit would be up to \$15,000. For renters, it would be to provide Section 8 vouchers so eligible families would not spend more than 30% of their income on rent. This could be a good or bad idea depending on how it is implemented and how it is funded.

13. **Increase the Child and Dependent Care Tax Credit:** President Trump created a child and dependent care tax credit which provided a credit of 35% of up to \$3,000 of qualified expenses for one dependent and \$6,000 for two or more dependents. Biden would increase the allowable expenses from \$3,000 and \$6,000 to \$8,000 and \$16,000. Theoretically this is an excellent concept to help with child and dependent care, but as with everything else it depends on how it is implemented and funded.

The goal of former Vice-President Biden's proposals is to raise \$3.3 to \$3.7 trillion in federal revenue over the next ten years. The effect of this is to directly affect high wage earners. While most of us will not be directly affected, many of us will be indirectly affected through lower stock prices lowering our retirement funds, higher interest rates directly attributable to overall lower investment in the US and US jobs. Then again, on the other side of the political coin, there will be more tax dollars for possible government aid spending. Whether this is a fair tradeoff or not depends on which political side you stand on, but it is important to understand the effects of these possible changes and what steps can be done to protect yourself.

Possible actions to take advantage of the positives and minimize negative effects from Biden's proposed increased taxes are as follows:

i. Nothing: In the short run, this will likely not affect the majority of the taxpayers. Where this will hurt you is the stock market may take a dip as businesses invest money out of the country and US corporations have lower bottom lines including less money for capital assets and expansion. . However, if you do not have substantial stocks and bonds and/or you have a long time horizon until retirement, the drop will likely be a blip in the long term growth.

ii. Reallocate Income from Wage Income to Non-Wage Income: While this is not easy to do overnight, if you as a highly compensated wage earner focus on growing passive income through real estate, stocks, bonds, and other capital investments. This will arguably limit the exposure to the social security payroll tax for high wage earners even though the proposed long term capital tax rates eliminates the current benefits of such passive investments if your gross income including capital gains exceeds \$1,000,000. This will take specific, intentional, focused planning.

iii. Pull out of the Stock Market: If the proposed long term capital tax rate is implemented if Biden is elected, many individuals may withdraw or retreat from the stock market in anticipation of the higher taxes, and their potential negative after tax income effects. At the same time, other investors may sell to avoid the initial drop and buy in again when the market is cheaper.

iv. Gift Assets: If the stepped up basis rule is removed, it may be wise to gift assets that you might have otherwise held onto to obtain the stepped up in basis at death. Unless you want to maintain control of certain assets, gifting may be more favorable. Although it would have the similar estate/gift transfer tax consequences other than the annual gift tax exclusion, gifting would remove all future income and appreciation out of your estate.

v. Sell Assets Now: If you are a high income wage earner, there are situations where it may be favorable to pre-emptively sell highly appreciated assets with low basis. For instance, if you have a \$1 million FMV asset with little or no basis and the capital gains rate increases from 20% to 40%, selling prior to the tax change would save \$200,000 in taxes. Even a lower sales price of \$900,000 may be more desirable given you are saving 20% in taxes. Thus, if you are planning to sell in the foreseeable future, it may be wise to accelerate the sale to prior to the tax changes.

vi. Move Assets: You may decide to move certain assets to countries with favorable tax treaties. For instance, if all taxable income from a country is limited to 20%

regardless of whether someone is a citizen or not, you may move a number of assets to that country.

vii. Change Citizenship: While this is drastic and most people will not, some people may change their citizenship or change the home country of their company to avoid being subject to US taxes.

viii. Pushing off Expenses to the Future: Corporations may postpone expansion and expenses to the future to minimize the possible loss of operating loss carryforwards. This will temporarily increase income in the current year but offsets the loss of such loss carryforwards that may be limited in future years under Biden's minimum tax proposal.

ix. Move from High Tax States: As with the controversy when President Trump limited the state tax deduction, if the deductions are reduced further by Biden, taxpayers may decide to move to a state with lower taxes. Taxpayers are leaving high tax states like New Jersey, New York, and California in droves for lower tax states such as Florida, South Dakota and Wyoming as a result of the state tax deduction limit.

x. Buy a House: If you or your children are first time homebuyers, you may help them buy a house to take advantage of the first time homebuyer credit and the current gift tax annual exclusion.

In summary, whether or not you are the specific high income earner to be taxed at a higher rate under former Vice- President Biden's proposals, or simply someone interested in politics and/or Biden's proposals, the bottom line is that the Biden plan will lower the individual and business "after tax disposal income" for all income levels. As stated above, whether this will affect your personal views on whether this country needs a change in the Presidency are your individual choice, preference and option. That is the beauty of this country. If you have any questions or comments on Biden's tax proposal feel free to call Joe Pozzuolo a 215-977-8201 or Jeffrey Pozzuolo at 215-977-8203.

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This newsletter is courtesy of Pozzuolo Rodden, P.C.

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