Potential Tax Changes to Consider

***July 15th, 2020 -** Several media outlets and tax research sources are beginning to report on former Vice President Biden's tax plan. Details of such a plan seem to be coming from past speeches or talking points made by the presumptive Democratic Party Nominee, so we've yet to see much current detail. Given the importance of tax changes to a potential business sale we wanted to provide our clients with some comments and observations if such changes were to occur*.

What is the Situation

(Eliminate capital gains, AGI $1mm etc..)

Last Summer, Mr. Biden released a health-care plan and to pay for it, mentioned increasing both ordinary income and capital gains to rates last seen under the Clinton and Obama administrations. He suggested reverting the top individual income tax rate for taxable incomes above $400,000 from 37 percent under current law to the pre-Tax Cuts and Jobs Act level of 39.6 percent. He also suggested taxing long-term capital gains and qualified dividends at the ordinary income tax rate of 39.6 percent on income above $1 million (see: https://taxfoundation.org/joe-biden-tax-proposals/).

What Would Need to Take Place

(Biden gets elected, Democrats secure majority)

As presented, this appears to be an expansion of the Affordable Care Act (ACA) passed during President Obama's administration, and seems most likely to come through Congress rather than through the President's budget process, although who can be sure of the path anymore. The ACA was highly contested when passed and has been since; it is uncertain even if Mr. Biden becomes president that Congress would expand the ACA; doing so would seem most likely to require Democratic control of both houses, in addition to the presidency.

When Would it Take Effect?

(Based on historical precedent)

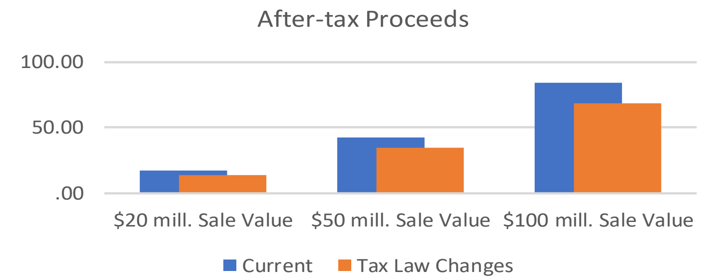
Most laws affecting taxes coming through Congress are not retroactive and making rate changes mid-year are a significant tax-compliance problem. It seems most likely we would not see a change here until 2022. However, some tax law changes, and some budget-driven tax law impacts, have been retroactive to a date before they were enacted. A Democratic landslide that sweeps firm control of both houses of congress and the White House conceivably could mean a 2021 effective date for higher tax rates.

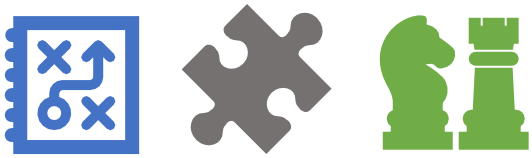
Changes to Net Liquidity

(What's the potential impact?)

Capital gains taxes, regardless of the rates, are assessed on the difference between basis and sales price, so basis is a key component of any illustration of how such a change might affect taxes paid at the time of a sale. We can worry about tax rates a lot, but high basis can reduce or eliminate their practical effect. However, if we assume a relatively low basis (20%) for the purposes of illustration, the following chart shows a potential increase in taxes on a business sale of $20M, $50M, and $100M (ignoring state taxes and 3.8% NIIT).

Sale Amount (millions)	$20.00	$50.00	$100.00
- Basis (20%)	-4.00	-10.00	-20.00
Gain	16.00	40.00	80.00
Taxes on Gains			
Current CG Rate (20%)	3.20	8.00	16.00
Potential Maximum Rate (39.6%)	6.34	15.84	31.68
Potential Increase in Gains Taxes	$3.14	$7.84	$15.68





What Can I do?

(Strategy ideas)

- Get ahead of any tax law changes by completing sales in 2020, or before 2022 (or before whatever potential effective date of tax rate increases)
- Mergers (if taxed as a corporation)
- Sales to ESOPs
- Section 1031 exchanges of commercial real estate
- Tax elections and practices that drive basis up
- Donations to charity/charitable trust well ahead of a sale
- QSB (Qualified Small Business Stock) sales
- Opportunity Zone reinvestment of sales proceeds
- Use suspended gains to offset taxation

Conclusion?

The current political climate appears to offer a reasonable chance of limiting President Trump to a single term. This is by no means certain (by example, Hillary Clinton led in the polls at this point in the last election cycle). But, if Mr. Biden gains the White House, it seems reasonable to believe tax rate increases could not be far behind. Without trying to predict the upcoming election’s outcome, it seems reasonable to consider the potential result on large transactions within the next 2 – 4 years.

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