From Pacific Life's Advanced Designs Unit

Potential Tax Law Changes Based on President-elect Joe Biden's Tax Plan

December 2020

<u>Topic:</u> President-elect Joe Biden's Potential Tax Law Changes

<u>Analysis</u>: Whether the fate of Biden's potential tax law changes affects you will depend on whether you're on the higher or lower end of the income scale. If you're on the higher end, you'll likely pay more.

<u>Summary:</u>

Biden's potential tax increases may result in a reduction in after-tax income for those earning between $400,000 and $790,000. Those who earn more than $790,000 may experience a much greater increase in taxes.[i] The main reason for the increase is due to dividend and capital gains tax rates liking increasing almost twofold (when income exceeds $1,000,000), as well as changes to the estate tax.[i]

The following chart is a summary of highlights of Biden's potential tax law changes and current tax laws under the Tax Cuts and Jobs Act (TCJA)

Current Tax Laws[ii] Tax Cuts and Jobs Act (TCJA)	**Potential Tax Law Changes**[i]
<u>Top Rate on Ordinary Income</u> • Rates begin at 10% and climb to 37%. The top rate is 37%. • The current 37% top rate applies for single taxpayers with income in excess of $529,000 and married taxpayers with income in excess of $620,000	***<u>Top Rate on Ordinary Income</u>*** • Raising only the top rate from 37% to 39.6%. • The top rate of 39.6% would apply for taxpayers with income in excess of $400,000
<u>Top Rate on Long-Term Capital Gains and Qualified Dividends</u> • The top rate is 20%	***<u>Top Rate on Long-Term Capital Gains and Qualified Dividends</u>*** • Increase the top rate from 20% to 39.6% for taxpayers earning more than $1,000,000 and eliminate step-up in basis for capital gains taxation[iii]

This material is for educational purposes only.

Payroll Taxes • In the employer-employee context, the employer and employee split a 12.4% tax on earnings up to the Social Security wage base, which in 2020 is $137,700. The employer and employee also split a 2.9% Medicare tax. • If you're self-employed, you pay the full 15.3% • Those who earn more than $200,000 (single) and $250,000 (married) are subject to an additional 0.9% payroll tax	***Payroll Taxes*** • Lift the cap on the Social Security payroll tax only for those who have wages in **excess** of $400,000 • Example: An employee makes $600,000 in wages. Employee pays 6.2% Social Security tax on the first $137,700, no Social Security tax on wages from $137,700 to $400,000, and then another 6.2% tax on the wages between $400,000 and $600,000. Employee would also pay the 1.45% Medicare tax on all wages and the 0.9% payroll tax on wages over $200,000/$250,000
Itemized Deductions • Taxpayers are entitled to deduct the greater of 1) the standard deduction, or 2) the sum of the itemized deductions (things like mortgage interest, medical expenses, state and local income and property taxes, and charitable contributions). The TCJA nearly doubled the standard deduction (from $6,350 to $12,400 for single taxpayers, $12,700 to $24,800 for married couples), while limiting or eliminating certain itemized deductions.	***Itemized Deductions*** • Reinstate the Pease limitation for those earning in excess of $400,000[iv] • Cap itemized deductions at a 28% rate when income exceeds $400,000
Elimination of the 20% Qualified Business Income (QBI) Deduction • Pass-through businesses that operate as an S-Corporation, partnership or sole proprietorship may claim a 20% deduction on qualified income earned in the business.[v] This reduces the effective top rate on this type of income from 37% to 29.65%	***Elimination of the 20% Qualified Business Income (QBI) Deduction*** • There would be a phase-out of the deduction for those taxpayers with taxable income in excess of $400,000 regardless of whether a business is considered a specified service, trade or business
Corporate Tax • Corporate tax rate of 21% • No corporate alternative minimum tax (AMT)	***Corporate Tax*** • Increase the corporate tax rate from 21% to 28% • Implement a new form of the alternative minimum tax (AMT) by requiring corporations with financial statement income in excess of $100 million to pay tax of 15% on its financial statement income
Estate Tax • Temporarily doubling of the federal estate and gift tax exemption from $5 million (annually indexed for inflation) to $10 million (annually indexed for inflation) through the end of 2025 with a top tax rate of 40%. • In 2026, the federal estate, gift and generation skipping transfer (GST) tax exemption	***Estate Tax*** • Decrease the estate tax exemption to $3.5million with a top tax rate of 45% • Decrease the lifetime exemption amount to $1million with a top tax rate of 45% • Any appreciation in assets would be taxed at death regardless of whether the asset is sold

amounts are scheduled to revert to $5,000,000 per person (indexed for inflation for tax years after 2011	

Despite Biden's potential tax increases for large income earners, there are a number of potential tax credits:

- An expanded child tax credit (CTC). Increase the CTC which currently tops out at $2,000 up to a maximum of $3,600 per child and make it FULLY refundable.
- An expanded child and dependent care credit. Expand the maximum credit to $8,000 (for one child and to $16,000 for two or more children) from the current maximum of $3,000. Fifty percent of the credit would be refundable.
- A new $5,000 credit for informal caregivers (family members or loved ones who do this work unpaid).
- A new credit of up to $15,000 for first-time homebuyers.
- An expansion of the existing premium tax credit that potentially makes state-sponsored health plans more affordable.
- A renter's credit to reduce rent and utilities to 30% of income for low-income taxpayers.
- An expansion of the earned income credit to workers older than 65 who do not have a qualifying child

To Contact Pacific Life's Advanced Designs Unit: 800.800.7681 x3690 or Advanced.Designs@pacificlife.com.

---

[i] "Details and Analysis of President-elect Joe Biden's Tax Plan" Garrett Watson et al, available at https://taxfoundation.org/joe-biden-tax-plan-2020/#Key (October 22, 2020).

[ii] See https://www.irs.gov/tax-reform; See also https://www.irs.gov/newsroom/the-highlights-of-tax-reform-for-businesses

[iii] Joe Biden Campaign, "A Tale of Two Tax Policies: Trump Rewards Wealth, Biden Rewards Work," https://joebiden.com/two-tax-policies/ (last seen on December 1, 2020).

[iv] The Pease limitation (repealed under TCJA) reduces the value of itemized reductions for high income taxpayers. It works by reducing the value of a taxpayer's itemized deductions by 3 percent for every dollar of taxable income above a certain threshold.

[v] Not all pass-through businesses are eligible for the 199A 20% deduction. Once a business passes over an income threshold ($164,900 for individuals, $329,800 if married in 2021), then businesses that are considered a specified service trade or business (SSTB) start to get phased out of the 20% deduction. Businesses that are Non-SSTB do not have this limitation, however, once they pass an income threshold ($164,900 for individuals, $329,800 if married in 2021), they have their own test that must be passed in order to the get the deduction. See IRC Section 199A.

Pacific Life, its affiliates, their distributors and respective representatives do not provide tax, accounting, or legal advice. Any taxpayer should seek advice based on the taxpayer's own particular circumstances from an independent tax advisor or attorney.

Pacific Life is a product provider. It is not a fiduciary and therefore does not give advice or make recommendations regarding insurance or investment products.

PACIFIC LIFE

(800) 800-7681 • www.PacificLife.com

Pacific Life refers to Pacific Life Insurance Company and its affiliates, including Pacific Life & Annuity Company. Insurance products are issued by Pacific Life Insurance Company in all states except New York and in New York by Pacific Life & Annuity Company. Product/material availability and features may vary by state. Each insurance company is solely responsible for the financial obligations accruing under the products it issues.

Pacific Life Insurance Company's Home Office is located in Newport Beach, CA.

This material is for educational purposes only.