

# How Biden's planned tax changes could impact you and your business



President Joe Biden has laid out his American Jobs Plan and American Families Plan, which include plans to increase corporate and income taxes—key changes that could, if signed into law, significantly impact business owners.

For C-corps, taxes could go from today's 21% to 28%. For pass-through entities such as S-corps, partnerships and LLCs, income tax increases could impact how much shareholders pay in taxes. Proposed changes relevant to business owners include:

- **Increasing the top income tax bracket** (from 37% to 39.6%) for households earning more than \$400,000 a year.
- **Increasing the capital gains tax rates** from 20% to 39.6% for individuals making more than \$1 million.
- **Imposing the 3.8% Medicare Investment Income Tax** on active income from partnerships and S-corps for owners making more than \$400,000 a year.
- **Instituting two minimum corporate taxes:** a 15% minimum tax on companies with book net income over \$100 million, and a 21% minimum tax on foreign profit.
- **Repealing Section 1031 like-kind exchange rules** for real estate for gains on the sale of real estate investment property in excess of \$500,000.
- **Removing the "step-up in basis"** afforded to heirs when a family member dies, requiring heirs to pay as much as 43.4% in federal taxes (39.6% income plus 3.8% Medicare), though there may be exceptions for family owned businesses and farms that pass to a family member.

## Strategies to consider

There's a lot of information yet to come. Negotiations are in the early stages, and there may be changes to the proposal during the drafting of the bill—and probably more changes after Congress debates the measure. There's no timetable regarding when any changes would be effective, but many expect a January 1, 2022 target date.

The Administration has suggested a 2022 effective date for all changes except capital gains, which they have indicated they would like to see its effective date be the date of the announcement of the changes. At this time, it is fair to say that the timing of the effective date of any change is uncertain. In the meantime, there are strategies that you can consider implementing this year to minimize the impact of these proposed changes.

**Review your corporate structure.** Given the potential increased tax rates for C-Corps and income taxes for shareholders in pass-through entities, companies may want to review whether they have the optimal corporate structure in place. Many businesses underwent this exercise when taxes changed under the Trump administration, but it's worth revisiting given the potentially broad-reaching changes.

**Consider a dividend recap.** In a dividend recap, a business assumes new debt and distributes the proceeds to shareholders in the form of a dividend. Given the potential changes to the capital gains taxes, utilizing this strategy today could prove beneficial for business owners. It's also a way to take money out of the business without changing the ownership of the company. A dividend recap is based

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on a company's ability to take on incremental debt and does not require a valuation. Additionally, a recap offers wealth diversification since it can be invested in other strategies, such as stocks, bonds or real estate.

**Evaluate ownership transition plans.** While there seem to be provisions for family-owned business transitions and no stated change to the lifetime gifting exclusion, it may be worth assessing multiple scenarios to understand what the impact of these potential changes could be for you and your business.

Also, the proposed tax changes could drive some shareholders to sell some or all of their shares. A leveraged share repurchase, which is similar to a dividend recap in that debt is assumed in order to purchase certain shares of the business and retire them, could be an option. This way, the equity ownership of the remaining shareholders will increase.

**Pursue acquisition opportunities.** With many companies looking to transition ownership or sell the business outright, now may be a good time to focus on growing your business. M&A markets are very active; there's ample dry powder in the system with low interest rates. Valuations remain high, however, so understanding that you may have to pay a premium to purchase an attractive business.

**Accelerate changes in real estate investment portfolios.** Biden's tax proposal calls for the elimination of the Section 1031 like-kind exchange for real estate investment property. Section 1031 of the Internal Revenue Code allows for the deferral of capital gains taxes when a real estate investment property is sold and then invested in the purchase of another. If you've been thinking about selling property or shifting real estate in or out of your business and you plan to leverage the tax-deferral rules of Section 1031, you might want to accelerate those plans, assuming this provision will not be retroactive.

**Assess overseas employees and income, as well as the impact this could have on your suppliers and customers.** In the American Jobs Plan, the Biden administration put forth "The Made in America Tax Plan" to "incentivize job creation and investment" in the U.S. Companies with significant off-shore employees or profits generated off-shore may want to assess their global workforce and foreign income on a country-by-country basis.

Even if this doesn't apply to you, it may apply to your suppliers or customers, so understanding the potential supply chain impact of such a change is important.

## Be prepared

There's still a long way to go before any tax changes take effect. We'll likely start to hear more about it this summer. And while we won't know for sure what the changes will be until a bill is signed into law, it's important to get a head start to understand and assess your options now.

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