Spotlight on Individual Tax Matters in the 2020 Election

Election season 2020 is in full swing. Over the next few weeks, both parties will be hard at work, trying to win your vote for their presidential candidate.

As you watch social media ads and listen to interviews and debates, pay close attention to the candidates' federal tax plans. Their stances could have a major impact on the amount of taxes you'll owe in the future and how much you can transfer to loved ones without triggering federal gift or estate taxes.

Also remember that tax laws can be used to help promote policy initiatives. In some instances, you might be willing to accept tax increases in the name of causes that you care about, such as clean energy, universal health care or school choice.

Here's a quick summary of recent federal tax law changes and how the candidates would like to build on — or change — the rules that affect the amount of taxes that you and your family will owe in 2021 and beyond.

Where Are We Today?

The GOP-backed Tax Cuts and Jobs Act (TCJA) was signed into law in December 2017. It included a number of *temporary* federal tax cuts and breaks for individuals and families for 2018 through 2025, such as:

***Lower rates*.** The TCJA reduced most individual income tax rates, with new thresholds for each bracket. Currently, there are seven tax brackets: 10%, 12%, 22%, 24%, 32%, 35% and 37%.

***Higher standard deduction*.** The TCJA nearly doubled the standard deduction amounts to $12,000 for single filers, $18,000 for heads of household and $24,000 for joint filers, with annual inflation adjustments. For 2020, the inflation-adjusted standard deductions are $12,400 for single filers, $18,650 for heads of households and $24,800 for joint filers. As a result, more taxpayers currently claim the standard deduction in lieu of itemizing. (However, the TCJA also suspended personal exemptions for 2018-2025.)

***Credits for children and dependents*.** The TCJA doubled the refundable child tax credit to $2,000 per eligible child and increased the income phase-out thresholds to be eligible. An additional $500 credit may be available for other qualified dependents, including a 17- or 18-year-old child, a full-time student under age 24, a disabled child of any age and certain nonchild relatives. (However, the TCJA also suspended dependent exemptions.)

***More-favorable AMT rules*.** The TCJA retained the alternative minimum tax (AMT) for individuals, but it raised both the exemption amounts and the exemption phaseout thresholds. As a result, fewer people are subject to the AMT under current law.

***Gift and estate tax cuts*.** The law increased the unified federal gift and estate exemption from $5 million to $10 million, indexed for inflation. For 2020, the inflation-indexed unified exemption is $11.58 million ($23.16 million for married couples). As a result, fewer families will owe federal gift or estate taxes under current law.

The TCJA also included offsetting, revenue-generating provisions, including new limits on itemized write-offs for home mortgage interest and a new limit on state and local tax (SALT) itemized deductions. These changes have adversely affected homeowners with large mortgages and residents of high-tax states.

Important: Most of the TCJA provisions that affect individuals are scheduled to expire after 2025.

In March 2020, Coronavirus Aid, Relief and Economic Security (CARES) Act was signed into law. It provided direct payments to certain individuals and families, temporarily expanded unemployment benefits for workers and waived retirement account required minimum distributions for 2020. The law also allows IRA owners and qualified retirement plan participants to take certain tax-free, coronavirus-related withdrawals in 2020. These changes are intended to provide temporary financial relief during the pandemic.

What Does Trump Promise if Elected to a Second Term?

In general, Republican presidential nominee Donald Trump has indicated support for preserving tax reforms under the TCJA — and possibly providing additional breaks for individuals and families. During his acceptance speech at the Republican National Convention, Trump promised, "Just as I did in my first term, I will cut taxes even further for hardworking moms and dads, not raise them."

The White House budget document for the government's 2021 fiscal year (which starts on October 1, 2020) indicates support for extending these TCJA individual tax provisions beyond 2025:

- The current federal income tax and estate tax regimes,
- The expanded child and dependent tax credits (along with continued disallowance of dependent exemptions),
- Increased standard deduction amounts (along with continued disallowance of personal exemptions),
- More-favorable AMT rules, and
- Continued limitations on itemized deductions for home mortgage interest and state and local taxes.

Trump has floated the idea of a middle-class tax cut without providing specifics. In addition, he supports reducing the maximum capital gains rate to 15%. After adding on the 3.8% net investment income tax (NIIT), the maximum effective rate would be reduced from the current 23.8% (the 20% top rate + 3.8% for the NIIT) to 18.8% (15% + 3.8%). He has also floated the idea of making annual inflation adjustments to the rate brackets for net long-term capital gains and qualified dividends.

In August, Trump promised that, if he's reelected, he'll find a way to forgive federal payroll taxes that were temporarily deferred for September 1, 2020, through December 31, 2020, by an executive action issued on August 8. This could provide an extra boost to people earning less than $4,000 every two weeks (about $104,000 annually). He has also mentioned permanent federal payroll tax cuts, without providing details. However, forgiving or cutting payroll taxes would need to be part of a bill passed by Congress.

Trump's plan doesn't indicate whether he supports extending other CARES Act tax relief measures for individuals beyond 2020.

Unless the Republicans regain control of the House and retain control of the Senate, any tax cut proposals are likely to face strong opposition from congressional Democrats. And if reelected, Trump is unlikely to sign any legislation that calls for major federal tax *increases* for individuals and families.

What Does Biden Promise if He's Elected?

If Democratic presidential nominee Joe Biden is elected, he has expressed support for major federal tax law changes. During his acceptance speech at the closing of the Democratic National Convention, Biden declared, "It's long past time the wealthiest people and the biggest corporations in this country paid their fair share."

The Biden plan would raise the top individual rate on ordinary income and net short-term capital gains back to 39.6%, the top rate that was in effect before the TCJA lowered it to 37% (for 2018 through 2025). Biden also has promised not to increase taxes for those who make under $400,000. But it's unclear whether that limit refers to taxable income, gross income or adjusted gross income — or whether it would apply equally to singles, heads of households and married joint-filing couples.

Other elements of Biden's plan that would affect individual taxpayers include:

Limits on itemized deductions. For upper-income individuals, Biden would reinstate the pre-TCJA rule that reduces total allowable itemized deductions above an applicable income threshold. Prior to the TCJA, allowable deductions were reduced by 3 cents for every dollar of income above a threshold. Regardless of who's elected president in 2020, the pre-TCJA limits will be reinstated in 2026 under current law, unless they're extended by Congress.

In addition, Biden's plan would limit the tax benefit of itemized deductions to 28% for upper-income individuals. That means each dollar of allowable itemized deductions could not lower your federal income tax bill by more than 28 cents, even if you were in the proposed 39.6% maximum tax bracket.

Relief for certain homeowners. Biden is calling for elimination of the TCJA's $10,000 cap on itemized SALT deductions, which mainly affects residents of high-tax states. His plan also would create a new refundable tax credit of up to $15,000 for eligible first-time homebuyers that would be collected when a home is purchased, rather than later at tax-return filing time.

New credit for low-income renters. Biden would like to establish a new refundable tax credit for low-income renters that's intended to hold rent and utility payments to 30% of monthly income.

Expanded breaks for eligible families. His plan includes a refundable federal tax credit of up to half of a family's costs to care for children under 13 and other disabled dependents. He would like the maximum credit to be $8,000 for one qualifying child or $16,000 for two or more qualifying children. Families earning between $125,000 and $400,000 could qualify for partial credits. He's also proposed implementing an income-based cap on child-care costs for many families.

Under current law, a tax credit of up to $2,100 is allowed to cover expenses to care for a qualifying dependent, including an eligible child, or up to $4,200 for expenses to care for two or more qualifying dependents. However, in most cases, an income limitation reduces the maximum allowable credit to $1,200 or $2,400 for two or more qualifying dependents.

His plan would also establish a new credit of up to $5,000 for "informal" caregivers, who are family members or loved ones who do this work for no pay.

Elimination of basis step-up for inherited assets. Under current law, the federal income tax basis of an inherited capital-gain asset is stepped up fair market value as of the decedent's date of death. So, if heirs sell inherited capital-gain assets, they owe federal capital gains tax only on the post-death appreciation, if any.

This provision can be a huge tax-saver for an inherited asset that has appreciated significantly over the years — such as stock shares that were acquired many years ago for a small amount and are now worth millions. The Biden plan would eliminate this tax-saving provision.

Biden hasn't yet clarified whether he would also like to see a lower unified federal gift and estate tax exemption, which is currently set at $11.58 million ($23.16 million for married couples).

Higher maximum rate on long-term capital gains. Higher-income individuals would face higher capital gains taxes under the Biden plan. Under current law, the maximum effective federal income tax rate on net long-term capital gains and qualified dividends recognized by individual taxpayers is 23.8% (20% top rate + 3.8% for the NIIT).

Under the Biden plan, net long-term gains (and presumably dividends) collected by those with incomes above $1 million would be taxed at the same 39.6% maximum rate that he would apply to ordinary income and net short-term capital gains. With the 3.8% NIIT add-on, the maximum effective rate on net long-term gains would be 43.4% (39.6% + 3.8%). That would be almost double the current maximum effective rate for high income individuals.

Payroll tax hike for higher-income individuals. Under current law, the 12.4% Social Security tax hits the first $137,700 of 2020 wages or net self-employment income. Employees pay 6.2% through withholding from paychecks, and employers pay the remaining 6.2%. Self-employed individuals pay the entire 12.4% out of their own pockets via the self-employment (SE) tax. For 2020, the 12.4% Social Security tax stops once 2020 wages or net SE income exceed $137,700. The Social Security tax ceiling is adjusted annually to account for inflation, so it usually goes up every year under current law.

The Biden tax plan would restart the 12.4% Social Security tax on wages and net SE income above $400,000. This is the so-called "donut hole" approach to increasing the Social Security tax. Over the years, the donut hole would gradually close as the lower edge of the hole is adjusted upward for inflation while the $400,000 upper edge of the hole remains static. This change in the Social Security tax regime would raise an estimated $800 billion to $1 trillion over 10 years.

Green tax breaks. Biden supports reinstating or expanding tax incentives intended to reduce carbon emissions, including credits for buying electric vehicles produced by manufacturers with credits that have been phased out under current law.

Biden's plans could gain traction if Democrats retain control of the House and gain control of the Senate. This would mean rollbacks or revisions of various TCJA provisions. Biden considers these changes necessary to pay for his plans to rebuild the U.S. economy and support various causes, including clean energy and improvements in education, health care and elder care.

What's Next?

The candidates' current positions on individual tax matters may sometimes contrast with their parties' platforms, so it's important to watch their statements and websites closely. More details may be revealed during interviews, ads and another scheduled debate in the coming weeks.

No matter who wins the presidency, we can help you implement planning strategies to keep your tax bill as low as possible.

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