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What Would the Biden Tax Proposal Mean for You?

Elections are full of surprises (Exhibit A: 2016). But barring something extraordinary, signs point to an impending win for former Vice President Joe Biden to succeed President Donald Trump in January of 2021. Moreover, Democrats are favored to keep the house, and slightly favored to obtain a slim majority in the Senate.

Politics and ideology aside, what impact would a Biden Administration have on your pocketbook? Who the President is, and who controls Congress, makes a big difference in terms of tax policy.

Vice President Biden made public the details of his tax plan in October of 2020. If he has a friendly Congress to enact them, here's what they could mean for you:

The Good:

- **Tax Credits in Place of Deductions for Retirement Plans.** The Biden plan proposes replacing retirement-plan contribution tax deductions with tax credits, making it more affordable to save and invest for retirement at lower- and middle-income levels. The Biden plan also proposes equalization of retirement plan benefits, which could reduce the amount of tax savings available to higher-income taxpayers.
- **Increased Childcare and Dependent Care Tax Credits.** The Biden Plan would increase the Child and Dependent Care Tax Credit from $3,000 per child to $8,000 per child, with a cap of $16,000. The credit can be claimed by declaring qualified childcare and dependent care expenses.

  The plan also calls for the separate Child Tax Credit to increase from $2,000 to $3,000 for children aged 6-17, $3,600 for children under 6. It also calls for the credit to become fully-refundable, and to remove phase-in limitations and thresholds.
- **First-Time Homebuyer Credit to be Reinstated.** The First-Time Homebuyer Credit was created in 2009, while Biden was sitting Vice President, to stimulate home-buying during the Great Recession. It ended in 2010, having raised from $7,500 to $8,000.

  Biden has proposed reinstating the credit, increased to $15,000, fully-refundable, and also eligible for advance, so first-time homebuyers don't have to wait until April of the next year to reap the savings.
- **Student Debt Relief.** Current laws on student debt relief require the forgiven balance to be declared as income, potentially increasing the debtor's tax liability. Biden has proposed removing this provision, imposing no tax consequences for student debt forgiveness.
- **Health Care Premium Tax Credits.** Biden has proposed graduated tax credits aimed at keeping individuals' and families' health insurance premiums at no more than 8.5% of their income.

The Bad:

- **A Return to Pre-Trump Rates for the Top Tax Bracket.** President Trump's signature tax plan, the Tax Cuts and Jobs Act of 2017 reduced the tax rate for the highest income bracket from 39.6% to 37%. Biden has promised a return to the pre-Trump rate of 39.6%.

  In 2020 the top tax bracket kicked in at $518,401 for single, head-of-household, or individually filing married persons; $622,051 for married couples. People who declare individual income north of these rates can expect to pay a little more in taxes under an enacted Biden tax plan.

- **A Return to Pre-Trump Corporate Rates.** The 2017 tax plan also reduced the corporate tax rate from 28% to 21%. Biden's plan promises a return to the 28% rate, but profitable companies would have the option of a 15% alternative minimum tax rate on book income. The tax rate on foreign income for US corporations would double from 10.5% to 21%.

  The plan also hints at disincentives for shipping jobs overseas, as well as new tax credits available for investments in green energy, infrastructure, manufacturing, and transportation.

- **Extra Payroll Taxes on High Incomes.** On incomes over $400,000, Biden has proposed doubling the 12.4% Social Security payroll tax, paid in full by self-employed individuals or split between employer and employee.

- **A Return to Pre-Trump Estate Tax Exemptions:** Trump's 2017 plan nearly doubled the estate tax exemption to over $11 million. Biden has proposed returning the estate tax exemption to pre-Trump levels.

- **Repealing the "Step-Up in Basis" Rule for Inherited Assets.** The current "step-up in basis" rule allows assets to be passed down the generations with the original tax basis preserved. This rule helps all heirs but is a particular boon to wealthy families with expensive assets passed down through generations, often avoiding huge tax liabilities.

What Does the Future Hold for 401(k) Taxation?

In September 2020 Vice President Biden called for significant changes to the way 401(k) plans and other retirement accounts are taxed. We expect to see them as part of the tax plan of a hypothetical Biden Administration in 2021.

These changes are worthy of special mention in that they could represent substantial tax savings for low- and middle-income taxpayers who contribute to 401(k) plans but reduce the tax savings for high-income taxpayers who contribute to 401(k) plans.

Currently, 401(k) contributions are **tax-deductible.** Biden is proposing replacing that deduction with a **tax credit.** On average, taxpayers benefit more from tax credits—money in their pockets—than they do from deductions—a reduction in their taxable income.

Moreover, Biden's plan scales the tax credits in an attempt to equalize the tax benefit of contributions. This helps taxpayers at the lower end of the income spectrum, but reduces the tax benefit of retirement savings at the high end of the income spectrum.

For example, a single taxpayer with $100,000 in declared income who contributes 10% of his/her income ($10,000) to a 401(k) would be entitled to a $2,600 tax credit under the Biden plan, compared to a $2,400 deduction under the current rules.

Meanwhile, a single taxpayer with $40,000 in declared income who contributes 10% ($4,000) to a 401(k) would be entitled to a **$1,040** tax credit under the Biden plan, compared to a $480 deduction under the current plan due to the low tax bracket. That's a much bigger tax credit proportionally.

People in upper tax brackets who max out their 401(k) contributions will see their tax savings decline. Take a single taxpayer who declares $300,000, putting him/her in the 35% bracket. If the Biden rules applied to this year's maximal 401(k) contribution of $19,500, this individual would see his/her tax savings decline from $6,580 to $3,900.

What Would a Divided Government Do About Taxes? About 401(k)s?

A Biden Administration with a friendly Congress could portend big changes in the tax code … but what if Biden faces a hostile Congress? What if the Democrats fail to retake the Senate, even lose the House?

In all honesty, if Democrats blow their house majority, we're probably looking at a Republican upset and four more years of President Trump. But if we instead face a divided government, we face it in an era of unprecedented mistrust and unwillingness to work across the aisle. We see it right now in the conflicts between President Trump and the Democratic House.

Here's what will probably happen in the event of a Biden Administration that faces a Republican Congress:

- **401(k) taxation:** Republicans claim that Biden's 401(k) plan will create an undue burden on employers, but House Republicans' own plan to raise revenue by reducing401(k) contribution savings was derided, in a rare moment of agreement, by Congressional Democrats and President Trump. Biden may be able to squeak his 401(k) plan past a close Senate; otherwise, we get nothing. Status quo.
- **The Biden Tax Plan:** Don't expect a Republican Senate to warm to Biden's plans to roll back tax benefits to the wealthy, to say nothing of his plans like the increased payroll tax on high incomes. A Republican Senate will probably block those proposals on principle.

  Biden's plan already doesn't go far enough for left-wing Congressional Democrats, who would prefer to see a Wealth Tax and provisions for Medicare for All. Biden may be able to win some Republicans over to his proposed tax savings for lower-income brackets, but if his healthcare premium and homeownership get tagged with Obama fatigue, they may not budge.

  Biden may be able to build consensus around childcare and student debt relief, but Republicans will sweat him about the cost. Biden, his allies in Congress, and his left flank aren't going to like any cost-cutting proposals the Republicans are likely to float.

Sad to say (or perhaps not), with any level of gridlock in Washington, the smart money is on the status quo to continue, with no big moves.