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LEGAL UPDATES

Transaction Related Tax Planning In 2021

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by Sepi Ghiasvand

As anticipated, President Biden's tax plan will impact tax planning for corporations and high net worth individuals. Generally, deferral has been the income tax planning approach for most taxpayers. Although, increase in taxes is generally anticipated, the proposed tax law changes bring this issue into focus. Is tax deferral still the planning tool or are taxpayers better off recognizing income now rather than putting off transactions or income tax recognition?

Currently the corporate income tax rate is at 21%, President Biden proposes to increase the income tax rate to 28%. Additionally, the long term capital gains rate would no longer apply to sale transactions for individuals who earn $1,000,000.

Therefore, C corporations and their shareholders considering transactions should consider moving up the time table on closing their transaction given this possible tax law change. Specifically, in a sale of shares, a corporate taxpayer will be taxed at the shareholder level only but these shareholders could be adversely impacted if they cannot use the long term capital gains tax rates on their gains. In the case of a sale of assets of a corporation, there is tax at both the corporate and shareholder level, and therefore there would be a higher tax as a result of the increase in the corporate income tax rate. Again, if individual shareholders are in the $1,000,000+ income bracket, the taxpayer could also get hit with the ordinary income tax rates.

As for taxpayers selling real estate, the long term capital gains rate would not apply to gains recognized by taxpayers earning $1,000,000+. Therefore, for certain real estate investors who are also high income earners contemplating sale transactions, the sale of real estate prior to the tax law changes could have a significant tax impact.

For intra-family transactions the above tax considerations would apply if they are contemplating sale transactions. If the family members are looking to inherit shares or real estate they may consider the fact that the benefit of a stepped up basis in the shares or real property may be gone. Therefore, lifetime gifts may become more attractive to these taxpayers.

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For taxpayers making more than $400,000, the top tax rate of 39.6% would apply, which is currently the top rate applied to joint filers making $622,050 in 2020 and $518,400 for singles in 2020. This adds more incentive to finalize transactions now rather than later since the applicable income tax rates will be higher in the near future.

Of course, there is always the possibility that the tax law changes will become retroactive (although this is not likely) and/or tax law changes may not be permanent – these factors should be taken into consideration. Furthermore, tax deferral tools such as tax free reorganizations may not have the same lure.

Although the tax tail should not wag the dog, for clients who are considering pulling the trigger on a transaction, the looming tax law changes should be considered.