2021 U.S. TAX FORECAST: HOW THE NOVEMBER ELECTIONS COULD LEAD TO SIGNIFICANT TAX CHANGES AFFECTING YOU AND YOUR BUSINESS

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U.S. Corporate Tax Alert

By: Mary Burke Baker, Elizabeth C. Crouse, Jared D. Mobley, Joel D. Almquist, Lauren M. Flynn

Depending on the results of the presidential and congressional elections in November 2021 could usher in major changes in tax policy. You should be thinking about those potential changes now for purposes of 2020 year-end tax planning, assessing any potential impact on your personal or business affairs, and to consider what you can do to protect yourself and your company from undesirable outcomes. This is the first in a series of K&L Gates alerts looking ahead to 2021 and potential legislative and regulatory changes to the federal tax code.

THE SHAPE OF THINGS TO COME: THREE ELECTION SCENARIOS

There are three probable outcomes to the November elections and each will differently affect the likelihood and potential shape of changes to the tax code:

1. *President Trump wins reelection, the Senate stays under Republican control, and the House remains under Democratic control.* Under this scenario major changes to the tax code or to tax regulations may be limited, but proposals will be made on both sides of the aisle that could gain traction so will bear watching. House Democrats would be expected to continue to push the party's tax agenda, including claw backs of the 2017 Tax Cuts and Jobs Act (TCJA), i.e., raising corporate taxes and individual taxes on the wealthy, and to enhance family friendly tax credits, but Republicans will be able to block those changes--for now. The Republican "Commitment to America" agenda proposes making the temporary individual and small business tax cuts in the TCJA permanent, including reduced individual tax rates, the 199A pass-through deduction, and 100% bonus depreciation. Reductions in capital gains rates and payroll taxes have also been floated by the White House. Democrats in the House would be able to block these Republican priorities--for now. However, once proposals are made, they rarely disappear and often re-emerge during negotiations or when the balance of power shifts. Retirement security reform is one example where there is potential for bipartisan legislative action and such legislation could serve as a vehicle for some horse-trading of each party's tax priorities. As for regulations, the Treasury and the IRS are nearing completion of regulatory projects related to the TCJA and would not be expected to change course.

2. *Former Vice President Biden wins the White House, the Senate stays under Republican control, and the House remains under Democratic control.* Similar to the previous scenario, major legislative changes to the tax code may be limited but proposals will be made that should not be ignored. We also could see claw backs to the TCJA and other tax policies through regulatory action. As described above, Senate Republicans generally would be able to block House Democratic tax priorities. Likewise, the White House and House Democrats generally could block the Republican tax agenda. However, each party will be

motivated to act on particular tax priorities which could lead to compromise, especially when added to bi-partisan legislation like retirement security. One notable difference with a Democrat controlling the executive branch is that significant tax policy changes could be effected through regulatory projects, for example, reopening TCJA regulations and rolling back rules that Democrats perceive to be inconsistent with the party's priorities such as policies that inadvertently encourage companies to locate offshore.

3. *Former Vice President Biden wins the White House, at least 50 Democrats hold seats in the Senate, and the House remains under Democratic control.* Full Democratic control of the White House, the Senate (which can be as few as 50 senators, with the vice-president casting the tiebreaking vote), and the House will almost certainly lead to significant tax changes beginning as soon as January, modeled after the Biden campaign's tax agenda. Repeal or revisions of major portions of the TCJA will be on the list of priorities, including international provisions like the global intangible low-taxed income (GILTI) rule that is perceived by many Democrats as encouraging United States companies to locate offshore; increasing corporate tax rates; instituting a minimum tax on book income; repealing business tax "loopholes" like deferral mechanisms; and targeting benefits for certain industries, including real estate, may be on the table. Tax incentives for locating manufacturing in the United States and disincentives for operating outside the United States are expected. Making the tax code more progressive by increasing taxes on the wealthy, including higher marginal tax rates, a wealth tax, a financial transactions tax, taxing capital gains at ordinary rates, imposing social security taxes on higher levels of income, and eliminating the estate tax step-up in basis, also are part of the Biden tax plan.

These changes would bring concomitant changes to tax regulations. Also, issues not generally associated with tax, like green energy, infrastructure, and health care, usually have a tax component to them or will require offsets to pay for them, posing additional risk. Even if proposals ultimately do not become law, they can still create uncertainty while they are pending that can make decision-making and planning difficult.

OVERCOMING THE 60-VOTE THRESHOLD IN THE SENATE

Generally, 60 votes are required in the Senate to approve legislation. However, there are two possible workarounds that would reduce the threshold to only 51 votes, potentially making it easier for Democrats to pass meaningful tax legislation. One requires the same party to control both chambers of Congress and the White House while the other requires only control of the Senate. The first is the budget reconciliation process. This is the procedure that was used by Republicans in 2017 to enact the TCJA. While hampered somewhat by arcane budgetary restrictions, significant legislative changes can be accomplished through reconciliation—the TCJA being a case in point. A second work-around to the 60 vote threshold is effectively nullifying the filibuster rules in the Senate through yet another arcane set of procedures called the "nuclear option." Previously used for the purpose of confirming judges with only a majority vote, Democrats already are talking about the possibility of using it for other types of legislative action. Elimination of the filibuster would relieve Democrats of the restrictive budget reconciliation rules and allow even broader changes to the tax code. However, it is worth noting that some Democratic senators are not keen on enacting such bold changes to the Senate rules.

PAYING FOR TAX REFORM AND OTHER POLICY PRIORITIES

Tax reform and other policy priorities, like infrastructure, green energy, health care and social security reform, will be expensive and Democrats will be looking to the tax code to pay for them. In some cases, the need to find revenues, called PAYGO, can be waived, as it was for the various COVID-19 relief bills enacted in the current Congress. However, the national debt has increased significantly and even Members who are not fiscal hawks are becoming more serious about paying for future policy changes using tax revenue or otherwise. This will put pressure on Congress to scour the tax code and use techniques like increasing taxes and eliminating loopholes to offset costs. Since loopholes are in the eye of the beholder, this could include tax preferences, deductions and credits that you and your business rely on to be tax efficient.

CONCLUSION

Over the next several weeks, we will be releasing alerts taking a deeper dive into several of these issues. We hope you find them informative and that they will encourage you to begin thinking about how the election results could potentially affect you and your company. Our Tax and Tax Policy teams will be happy to discuss how these changes could affect your tax liability and influence efficient tax planning, and ways you can engage with the Administration and Capitol Hill in 2021 to help shape emerging tax policies.

KEY CONTACTS

MARY BURKE BAKER
GOVERNMENT AFFAIRS COUNSELOR

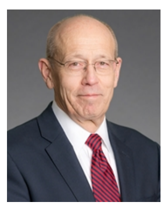
WASHINGTON DC
+1.202.778.9223
MARY.BAKER@KLGATES.COM

ELIZABETH C. CROUSE
PARTNER

SEATTLE
+1.206.370.6793
ELIZABETH.CROUSE@KLGATES.COM

JARED D. MOBLEY
PARTNER

CHARLOTTE
+1.704.331.7535
JARED.MOBLEY@KLGATES.COM



JOEL D. ALMQUIST
PARTNER

BOSTON
+1.617.261.3104
JOEL.ALMQUIST@KLGATES.COM

GIOVANNI CAMPI
GOVERNMENT AFFAIRS ADVISOR

BRUSSELS
+32.(0)2.336.1910
GIOVANNI.CAMPI@KLGATES.COM

LAUREN M. FLYNN
GOVERNMENT AFFAIRS ANALYST

WASHINGTON DC
+1.202.778.9051
LAUREN.FLYNN@KLGATES.COM

WILLIAM A. KIRK
PARTNER

WASHINGTON DC
+1.202.661.3814
WILLIAM.KIRK@KLGATES.COM

KARISHMA SHAH PAGE
PARTNER

WASHINGTON DC
+1.202.778.9128
KARISHMA.PAGE@KLGATES.COM