TOP FIVE

things dentists need to know about the Biden tax proposals

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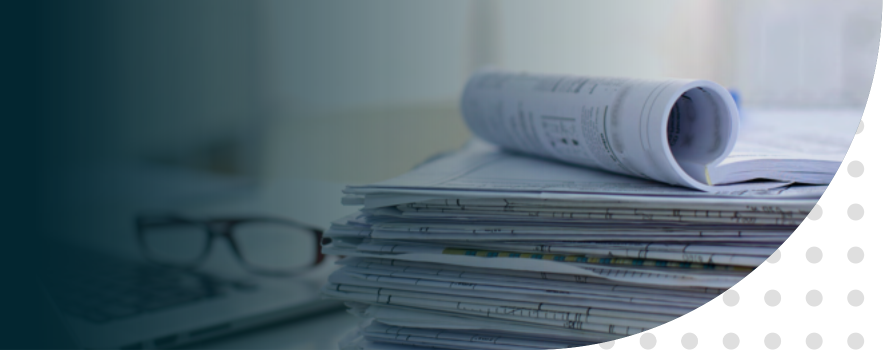


Top five things dentist need to know about the Biden tax proposals

When CPA's everywhere stepped out into the bright spring sunshine from the darkness of another COVID inspired tax season we had two things on our minds: The President's tax proposals, and perhaps a little time off. Unfortunately, the latter appears unlikely as President Biden has fired his opening salvo in what will likely be a long, contentious debate in the esteemed halls of Congress. During the months of March and April, President Biden released The American Jobs Plan and The American Families Plan, respectively. The former is his physical infrastructure plan (i.e. bridges, roads and broadband) that is paid for primarily with an increase in the corporate tax rate from 21% to 28%. The latter is his investment in the nation's families (i.e educational credits, child care and paid time off programs) which will be paid for by individual tax reform. As our clients are dental practice owners we will focus on the individual tax reform provisions of The American Families Plan. This whitepaper will unpack the proposal as it stands now, provide a bit of commentary followed by a few action items you might consider. We'll try and update it as the plan begins to crystallize and certainly once a bill is passed. Before we jump in though, a bit of housekeeping.

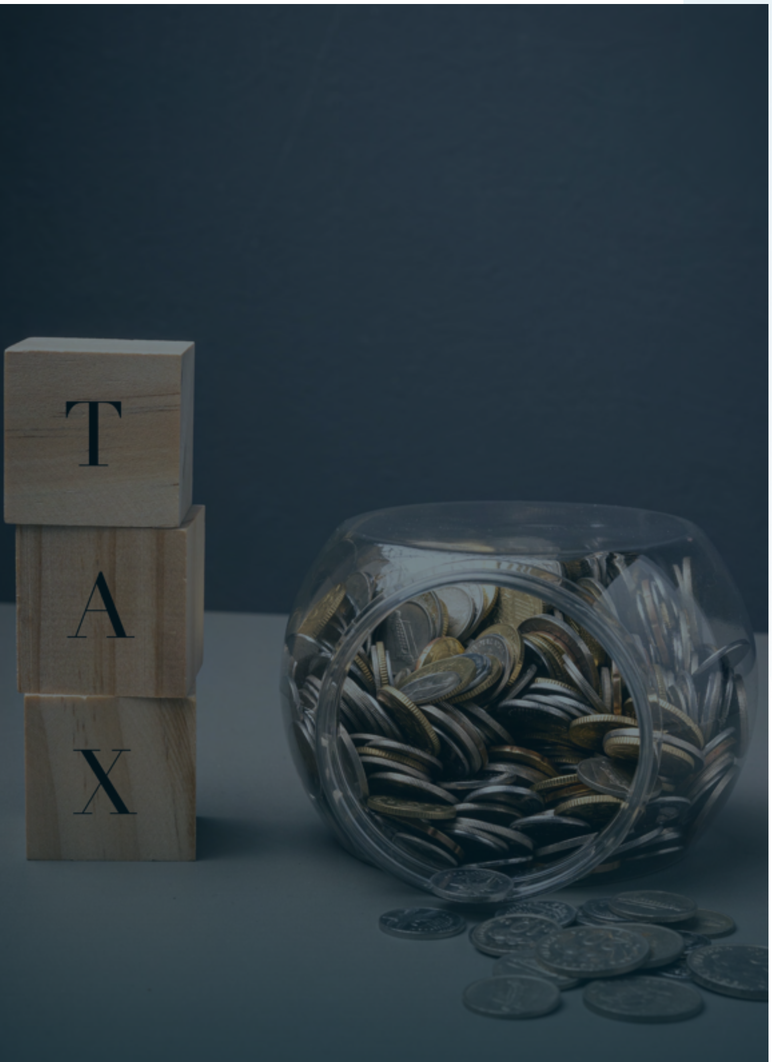
Our goal is to deliver this series of whitepapers with little to no political commentary. We won't spend time unpacking the spending components of the bill, as you can find great commentary on those provisions by folks far more qualified than us. Taxes are our wheelhouse, so we'll focus on the funding provisions (i.e. tax increases) and how they might affect dental practice owners. As we noted above there will likely be a long and vigorous debate in Congress, but at the end of the day it is extremely unlikely this will be a bi-partisan bill. With the run-offs in Georgia turning the state's representation in the upper chamber blue, the Senate Democrats (and the independents with whom they caucus) and Republicans are evenly split 50/50 with Vice President Kamala Harris serving as a tie-breaker on split votes. As was the case with President Trump's signature tax package The Tax Cuts and Jobs Act, this bill will pass through a Budget Reconciliation Act. A couple of things of note here:

1. In order for it to pass, all Democrats (including moderates) must vote in the affirmative allowing Vice President Harris to cast the deciding vote. The logical conclusion is that certain components of this bill will be modified to appeal to the more fiscally conservative centrist Democrats. Stay tuned on that.
2. The budget reconciliation process can only be used once in a fiscal year, and it has already been used for Fiscal Year 2021 for a COVID relief plan. The current fiscal year ends September 30, 2021, so expect any bill to pass later this fall.

Knowing that any bill will likely pass later this fall, the question inevitably comes up "When will it be effective?" The honest answer is we don't know yet. A growing consensus in our industry is that most provisions will be effective January 1. 2022; however, there could be some provisions effective as of the date of enactment. That being the case, it might make sense to let the process play out a bit prior to making any major moves tax-wise.

And finally, the standard tax disclosure. All tax situations are different, and there is no one-size fits all. All thoughts and ideas here are intended to be educational only and should be vetted through your tax accountant and tax attorney.

Make sense? Then enough with the formalities, let's move on to the top five things dentists need to know about the Biden proposals, and how you can begin to prepare for them.



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For 2021, the 37% bracket resides at taxable income over $523,600 for single taxpayers and $628,300 for those filing jointly.   Should this bill pass every dollar above this amount will be tagged with an extra 2.6%

Analysis:

This provision received top billing as far as tax reforms on President Biden's Fact Sheet on The American Family Plan. It is certainly worthy of attention; however, in our opinion it is not the most impactful reform proposed. Granted many dentists are having great years, and some will fall into the highest bracket, however, most will wind up somewhere south of that in a bracket for which no change is proposed. For those of you who do reside in this bracket it's time to revisit tax strategies to ensure you are responsibly minimizing your taxable income.

Action Items:

- Review prior year tax filings and current year income projections to project your taxable income bracket for 2021 and beyond.
- Have your CPA perform an audit of available tax strategies to responsibly minimize your practice's income. Put a plan in place to execute on selected strategies.
- Consider converting traditional IRAs to Roths in 2021. Please note, many factors go into whether this will be a good decision, so be sure to discuss with your tax professional. Also, careful consideration should be given prior to making this change as it can't be reversed.

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Capital Gains and Dividends tax rates will be increased for high income earners

For households earning over $1,000,000, long term capital gains and qualified dividends (which have historically been afforded a more favorable tax rate) will be taxed at the ordinary income rates of 39.6% vs 20%.

Analysis:

This provision hits on the cornerstone principle of President Biden's proposals: "Tax Reform that Rewards Work - Not Wealth." In our opinion this could be one of if not the most relevant components of the proposal. Not necessarily in regard to dentists earning over $1,000,000, instead for retiring dentists who've built their practice over the years and are ready to move on to their next. It is not uncommon for the capital gain on a practice sale to exceed $1,000,000 by itself, not to mention when combined with other income. In effect, this could result in a near doubling of the capital gain rates. Furthermore, when considering state income taxes this total could result in a combined rate nearing 50%. Historically low capital gain rates have allowed retiring doctors to keep more money in their pocket to fund their retirement or next ventures. Raising capital gains to this level would certainly mean less cash available and to enjoy in retirement. How this will affect the practice acquisition/disposition market remains to be seen.

Action Items:

- If the sale of your practice is eminent, 2021 is likely the year to make it happen (pending any retroactive changes). Make sure your financial house is in order.
- If your sale looks to occur in 2022 or beyond, it might be worth looking into a seller carryback with payments structured to keep your income under the $1,000,000. This structure may not make sense for everyone, so be sure to contact your CPA and attorney before making any decisions.

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Eliminating the step-up in basis on inherited assets

Currently, when a taxpayer passes away, their assets are typically "stepped up" to the fair market value on their date of death. These assets are then aggregated to see if there is an estate filing requirement along with any estate taxes due. The estate exemption amounts were raised to historically high levels under the Tax Cuts and Jobs Act and currently reside at $11,700,000 per individual (effectively shielding $23,400,000 of a married couple's estate from taxation). Under President Biden's proposal, any appreciation on assets that occurred prior to death in excess of $1,000,000 ($2,500,000 per couple) would be immediately taxed unless the property is donated to charity. There will also be provisions that allow certain family owned businesses and farms to avoid this tax.

Analysis:

Generally speaking, this is one of the least taxpayer friendly provisions in this bill. The ability for a taxpayer to inherit an asset and liquidate with little or no gain yielded substantial benefit for many. Certainly most taxpayers will still be afforded this benefit; however, it will put taxpayer's who inherit highly appreciated assets in a tough spot. Either liquidate, donate to charity, or come out of pocket on taxes due.

The devil will be in the details on the provision, and we expect it to be hotly contested. How this taxable event upon death interplays with the estate tax will need to be laid out, as well as any changes made to the estate tax exemption (which will likely be lowered). Our outlook is assuming no retroactive changes are made, many will consider gifting assets under the historically high estate exemptions. Many will also be dusting off their estate planning documents, and setting meetings with their attorneys once the rules of the game are known.

Action Items:

- Begin a dialogue with your estate/tax attorney. Discuss gifting strategies and entity structuring in regard to assets you are set to inherit, or those in which you are set to pass to your children should this provision make it to the final bill.
- Update your charitable/giving plan to determine if the donation route would be appropriate for any highly appreciated assets.

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Eliminating "Like Kind" Exchanges for gains in excess of $500,000

Currently a taxpayer is able to defer capital gains by exchanging (swapping) certain real estate property with other like kind properties. Under the Biden proposal, like kind exchanges would be disallowed for real estate property sold at a gain in excess of $500,000.

Analysis:

Many of our dental clients invest in real estate or own their own practice building that has historically allowed them to consider a like kind exchange to defer capital gains tax. Many of these assets will not have seen the type of appreciation that would generate a $500,000 gain, but it's certainly not out of the question that some have. Careful analysis will need to be performed prior to entering into a 1031 exchange to ensure the gain is not above the $500,000 threshold. This provision will also need to be analyzed in conjunction with the capital gain tax increases noted above. Proactivity in capital asset sales will be key here - seek out professional help as the rules are complicated.

Action Items:

- Analyze your real estate holdings for any assets that you are considering selling. As of the writing of this white paper (early Q2 of 2021) the real estate market is extremely hot, and it might make sense to take some chips off the table. Keep in mind this is assuming no retroactive changes to any legislation, so you might let the dust settle a bit before pursuing this strategy.

05 Increased funding to the IRS for enforcement

President Biden's proposal would increase the investment in the IRS enforcement (i.e. audit) department. These resources would be used for enforcement against those with the highest incomes.

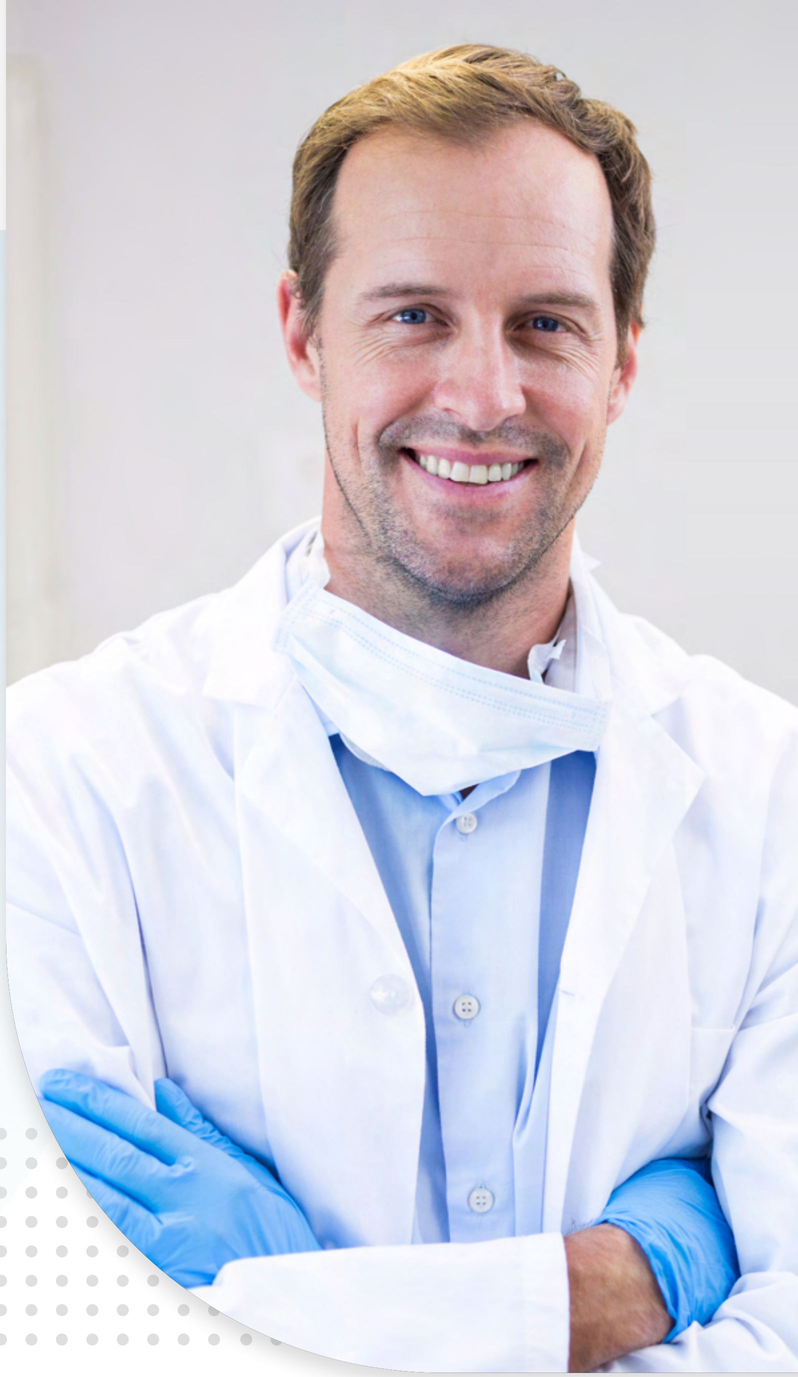
Analysis:

As a professional service firm that deals with the IRS regularly, we would like to have seen some resources devoted to the taxpayer services, as they are drastically understaffed; however, the sentiment is clear more audits will be forthcoming for high-income earners. To what extent no one knows. What is known, is that in a higher tax rate environment, there will be sellers of tax strategies (promotors) coming out of the woodwork. Some will be legit and battle tested, and others will be of little substance with little chance of withstanding IRS scrutiny. Choose your strategic partners wisely here. A good tax attorney and CPA will go a long way in helping you save where you can, and sleep better at night.

Action Items:

- Begin proactive discussions with your CPA and tax attorney now. Understand where your return stands now (risk-wise) and any blindspots you might have. Shore up and course correct as necessary.
- Most of your income is likely coming from your practice. Ensure your books and records are tight. One of the biggest escalators during audits are tax returns that don't agree to your books and records. Spend the time to tighten this up, or invest in having someone help you.
- Run any promoted tax strategies by your trusted attorney and accountant. In our firm, we've come across great promoters with rock-solid strategies as well as those we felt exposed our clients to undue risk. Hire professionals who can help you understand the difference.

There you have it. Five items in President Biden's tax proposal for which all practice owners should be aware. As noted above, these are the President's opening stance, and this will be a long process. Through all the back room meetings, this proposal will be reassessed and refined and will likely wind up quite a bit different, but at least it's a starting point. With mid-term elections occurring in 2022, there is a sense of urgency by the President and Democrats to get something passed. The purpose of this white paper is to raise awareness, and allow you to begin to conceptualize what a plan could mean to you and your tax situation.



One final note. There were several items not explicitly addressed in the Fact Sheet for The American Families Plan upon which President Biden campaigned that could work their way into the final legislation. These include revisions to the 199A Qualified Business Income Deduction, an increase in social security taxes on high W-2 earners, lowering the estate tax exemptions and decreasing the benefit of itemized deductions for higher income taxpayers.   Stay tuned, more information will be forthcoming, and we'll try to update accordingly. In the meantime, begin discussing this with your CPA/tax attorney. It's never too early to start planning!

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