Market Strategy
by STRATEGAS A BAIRD COMPANY

BAIRD
Private Wealth Management

Washington Policy Research

June 16, 2021

President Biden is proposing that investment income be taxed at the same rate as ordinary income, or as high as 43.4%. A key part of his plan is an unrealized capital gains tax that will be difficult to get through Congress. **We think an effective rate of 25%–28% is a more likely outcome.**

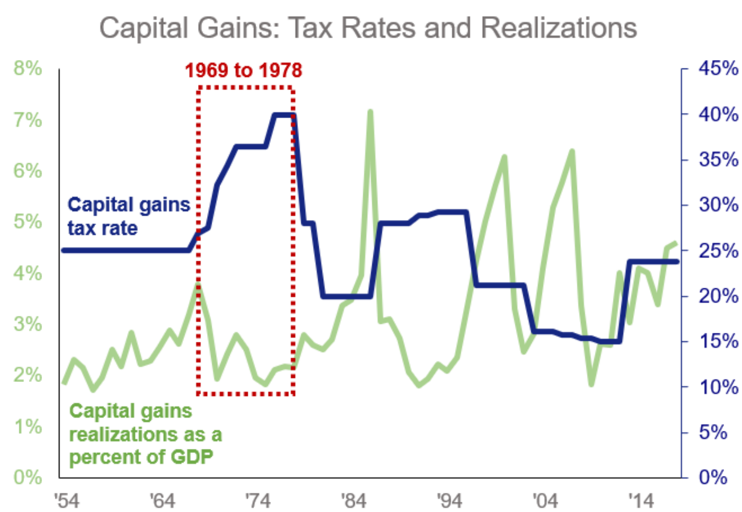
Strategas Washington Research
Dan Clifton
Courtney Rosenberger
Jeannette Lowe
Christopher McGrath

BIDEN'S CAPITAL GAINS TAX PROPOSAL IS LIKELY TO BE WATERED DOWN

President Biden's plan would increase the current maximum capital gains and dividend tax rate to 43.4% (top individual income tax rate of 39.6% and the 3.8% net investment income tax, or NIIT). In addition, Biden is proposing unrealized capital gains over $1 million to be taxed at the time of death. The increase in tax revenue will be used to pay for expanded child care, education, paid leave, and health care.

If enacted, Biden's proposal would push the capital gains tax rate above 30% for the first time since 1978. Policymakers have resisted this in the past, arguing that higher capital gains tax rates result in fewer realizations and thus lower tax revenue. As the chart on the right shows, after the capital gains tax rate was raised to 40% from 25% (starting in 1969), tax revenues did slow considerably. As a result, Congress reversed course and lowered the rate to 28% in 1978.

Biden understands that the higher rate will lead to fewer realizations. That is why he is also proposing to tax unrealized capital gains at the time of death. **Since taxpayers cannot change their behavior after death, an unrealized capital gains tax would allow the US to raise the capital gains tax rate above 30%.**



Members of Congress, particularly from farm states, are expressing opposition to this unrealized gains provision despite proposed exemptions for farms. If the unrealized capital gains tax is removed from the legislation, then the rate will have to be lower than ordinary income levels and is more likely to end up at 25%–28% (plus the 3.8% NIIT, as mentioned above).

Republicans have said that they will not support tax increases. Therefore, for the tax increase to happen, Democrats need to pass the legislation through budget reconciliation, a complicated process that requires just 51 votes for passage rather than the normal 60-vote process. **We do not see 51 senators supporting a 43.4% tax rate.**

President Biden has proposed April 28 as the effective date for capital gains tax changes. The US has never had a retroactive capital gains tax increase—and while that does not mean it could never happen, members of Congress are sensitive to transactions being made based on the current rate. We think it is more likely that the effective date will be closer to when Congress actually passes the legislation. When might that be? **The legislative process will take time to work itself out, so a bill may not get through Congress until late Q3 or even Q4.**

You'll hear from our team again before that point, as we will keep a close eye on the details and keep you up to date.

Disclosures

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

This report does not provide recipients with information or advice that is sufficient to base an investment decision on. This report does not take into account the specific investment objectives, financial situation, or need of any particular client and may not be suitable for all types of investors. Recipients should consider the contents of this report as a single factor in making an investment decision. Additional fundamental and other analyses would be required to make an investment decision about any individual security identified in this report.

For investment advice specific to your situation, or for additional information, please contact your Baird Financial Advisor and/or your tax or legal advisor.

Fixed income yield and equity multiples do not correlate and while they can be used as a general comparison, the investments carry material differences in how they are structured and how they are valued. Both carry unique risks that the other may not.

Past performance is not indicative of future results and diversification does not ensure a profit or protect against loss. All investments carry some level of risk, including loss of principal. An investment cannot be made directly in an index.

Strategas Asset Management, LLC and Strategas Securities, LLC are affiliated with and wholly owned by Robert W. Baird & Co. Incorporated, a broker-dealer and FINRA member firm, although the firms conduct separate and distinct businesses.

Other Disclosures

UK disclosure requirements for the purpose of distributing this research into the UK and other countries for which Robert W. Baird Limited holds an ISD passport.

This report is for distribution into the United Kingdom only to persons who fall within Article 19 or Article 49(2) of the Financial Services and Markets Act 2000 (financial promotion) order 2001 being persons who are investment professionals and may not be distributed to private clients. Issued in the United Kingdom by Robert W. Baird Limited, which has an office at Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB, and is a company authorized and regulated by the Financial Conduct Authority. For the purposes of the Financial Conduct Authority requirements, this investment research report is classified as objective.

Robert W. Baird Limited ("RWBL") is exempt from the requirement to hold an Australian financial services license. RWBL is regulated by the Financial Conduct Authority ("FCA") under UK laws and those laws may differ from Australian laws. This document has been prepared in accordance with FCA requirements and not Australian laws.