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POLITICS | ELECTION 2020

Joe Biden Used Tax-Code Loophole Obama Tried to Plug

Former vice president structured his speaking, writing business in a way that cut his tax bill

The presidential candidate and his wife used a strategy that let the couple avoid paying a 3.8% self-employment tax on book and speech income. Above, Mr. Biden speaks in Charleston, S.C., on July 7. PHOTO: RICHARD ELLIS/ZUMA PRESS

By Richard Rubin

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Democratic presidential candidate Joe Biden used a tax loophole that the Obama administration tried and failed to close, substantially lowering his tax bill.

Mr. Biden and his wife, Dr. Jill Biden, routed their book and speech income through S corporations, according to tax returns the couple released this week. They paid income taxes on those profits, but the strategy let the couple avoid the 3.8% self-employment tax they would have paid had they been compensated directly instead of through the S corporations.

The tax savings were as much as $500,000, compared to what the Bidens would have owed if paid directly or if the Obama proposal had become law.

“There’s no reason for these to be in an S corp—none, other than to save on self-employment tax,” said Tony Nitti, an accountant at RubinBrown LLP who reviewed the returns.

“As demonstrated by their effective federal tax rate in 2017 and 2018—which exceeded 33%—the Bidens are committed to ensuring that all Americans pay their fair share,” the Biden campaign said in a statement Wednesday.

BIDEN'S TAX DOCUMENTS

- 2016 Federal Tax Return
- 2017 Amended Federal Tax Return
- 2018 Amended Federal Tax Return

The technique is known in tax circles as the Gingrich-Edwards loophole—for former presidential candidates Newt Gingrich, a Republican, and John Edwards, a Democrat—whose tax strategies were scrutinized and drew calls for policy changes years ago. Other prominent politicians, including former President Barack Obama and fellow Democrat Hillary Clinton, as well as current contenders for the 2020 Democratic nomination Sens. Elizabeth Warren and Bernie Sanders, received their book or speech income differently and paid self-employment taxes.

Some tax experts have pointed to pieces of President Trump's financial disclosures and leaked tax returns to suggest that he has used a similar tax-avoidance strategy.

Unlike his Democratic rivals and predecessors in both parties, Mr. Trump has refused to release his tax returns, and his administration is fighting House Democrats' attempt to use their statutory authority to obtain them. Democratic presidential candidates have released their tax returns and welcomed criticism to draw a contrast with Mr. Trump.

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Mr. Biden, who was vice president from 2009 to 2017, has led the Democratic field in polls since entering the race. He is campaigning on making high-income Americans pay more in taxes and on closing tax loopholes that benefit the wealthy.

Mr. Biden has decried the proliferation of such loopholes since Ronald Reagan's presidency and said the tax revenue could be used, in part, to help pay for initiatives to provide free community-college tuition or to fight climate change.

"We don't have to punish anybody, including the rich. But everybody should start paying their fair share a little bit. When I'm president, we're going to have a fairer tax code," Mr. Biden said last month during a speech in Davenport, Iowa.

The U.S. imposes a 3.8% tax on high-income households—defined as individuals making above $200,000 and married couples making above $250,000. Wage earners have part of the tax taken out of their paychecks and pay part of it on their returns. Selfemployed business owners have to pay it, too. People with investment earnings pay a 3.8% tax as well.

But people with profits from their active involvement in businesses can declare those earnings to be neither compensation nor investment income. The Obama administration proposed closing that gap by requiring all such income to be subject to a 3.8% tax, and it was the largest item on a list of “loophole closers” in a plan Mr. Obama released during his last year in office. The administration estimated that proposal, which didn’t advance in Congress, would have raised $272 billion from 2017 through 2026.

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Under current law, S-corporation owners can legally avoid paying the 3.8% tax on their profits as long as they pay themselves “reasonable compensation” that is subject to regular payroll taxes. S corporations are a commonly used form for closely held businesses in which the profits flow through to the owners’ individual tax returns and are taxed there instead of at the business level.

The difficulty is in defining reasonable compensation, and the IRS has had mixed success in challenging business owners on the issue. The Bidens’ S corporations—CelticCapri Corp. and Giacoppa Corp.—reported more than $13 million in combined profits in 2017 and 2018 that weren’t subject to the self-employment tax, while those companies paid them less than $800,000 in salary.

If the entire amount were considered compensation, the Bidens could owe about $500,000. An IRS inquiry might reach a conclusion somewhat short of that.

“The salaries earned by the Bidens are reasonable and were determined in good faith, considering the nature of the entities and the services they performed,” the Biden campaign statement said.

For businesses that generate money from capital investments or from a large workforce, less of the profits stem from the owner’s work, and thus reasonable compensation can be lower. For businesses whose profits are largely attributable to the owner’s work, the case for reasonable compensation that is far below profits is harder to make.

To the extent that the Bidens’ profits came directly from the couple’s consulting and public speaking, “to treat those as other than compensation is pretty aggressive,” said Steve Rosenthal, a senior fellow at the Tax Policy Center, a research group run by a former Obama administration official.

Mr. Nitti said he uses a “call in sick” rule for his clients trying to navigate the reasonable-compensation question: If the owner called in sick, how much money could the company still make?

"The reasonable comp standard is a nebulous one," Mr. Nitti said. "This is pretty cut and dried. If you're speaking or writing a book, it's all attributable to your efforts."

The IRS puts more energy into cases where the business owners pay so little reasonable compensation that they owe the full Social Security and Medicare payroll taxes of 15.3%, Mr. Nitti said.

In a statement released Tuesday along with the candidate's tax returns, the Biden campaign noted that the couple employs others through its S corporation and calls the companies a "common method for taxpayers who have outside sources of income to consolidate their earnings and expenses."

—Ken Thomas contributed to this article.

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