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FROM THE WEALTH STRATEGY GROUP

Wealth Planning Strategies for 2020 Election and Beyond

As we wrote last March in "Strategic Thoughts in Times of Sweeping Change," none of us can see the future, but revisiting your financial plan can lead to positive actions that can help mitigate losses in difficult markets and bring greater peace of mind.

Looking ahead to the upcoming presidential election, wealthy families may be concerned about potential changes to a historically favorable tax environment.

Looking ahead to the upcoming presidential election, wealthy families may be concerned about potential changes to a historically favorable tax environment. Various outcomes to the presidential and Senate races could lead to very different tax environments. Of particular concern to some wealthy families is taxes on intra-family transfer of assets, whether during lifetimes or at death.

Consider exploring options now, so that after the November election you are ready to have planning conversations with your Advisor and review strategies before year-end to protect against law changes that might be retroactive to the beginning of the calendar year 2021.

Keep in mind that some estate-planning strategies have legal components that are document-intensive. They require attention by attorneys with respect to forming new entities (e.g. LLC, FLP, trusts) and funding them. Given continuing pressures due to coronavirus on service providers and government agencies, some people may be unable to complete the process in time.

Many people may find the following review useful even if potential changes to the law don't specifically prompt action. Other factors may need attention, and many taxpayers have not updated their estate plans in several years—perhaps because they considered themselves well "protected" by the $11.58 million Federal Estate Tax exemption introduced in the 2017 Tax Cuts and Jobs Act (TCJA).

Income Tax:

Current: Capital gains and qualified dividends are taxed at 20% for single households with more than $441,451 in taxable income in 2020, plus a 3.8% net investment income for a total of 23.8%.

Potential Change: The maximum tax rate could increase to up to 39.6% for income above $400,000. That would bring the tax rate on capital gains and dividends for these taxpayers to 43.4% (39.6% plus 3.8%) before state and local taxes.

In addition, there are other potential changes:

- Restore the pre-TCJA limitation on itemized deductions for taxable income above $400,000.
- Institute a 12.4% Social Security payroll tax, divided between employers and employees, on income earned in excess of $400,000.

Strategies to consider:

If applicable, those with large unrealized capital gains may want to consider harvesting because capital gains rates are lower.

Federal Estate and Gift Tax Exemptions

Current Exemption:
Individuals: $11.58 million; Married Couples: $23.16 million
Amount in excess taxed at 40%

Potential Change to Exemption:
Individuals: $5 million; Married Couples: $10 million
Amount in excess taxed up to 55%

The Tax Cuts and Jobs Act (TCJA) of 2017 increased the exemption for individuals from $5.49 million to $11.58 million with future inflation adjustments scheduled for 2021-2025. Gifts in excess of the exemption amount are taxed at a flat 40% rate.

Like estate taxes, the gift tax regime is currently very favorable by historical standards. Some families with adequate assets may be able to make direct gifts or fund multigenerational trusts to use their exemptions easily. However, no one should rush to those decisions without assessing their own lifetime spending needs and selecting the right estate planning vehicle to accomplish their goals.

At present, the annual limit on gifts to non-charitable individuals that avoids taxation is $30,000 per couple per year (or $15,000 per individual).

Strategies to consider:

1. Use lifetime exclusion now using estate planning techniques and trust arrangements.
2. Consider intra-family gifts in trust during lifetime with asset protection provisions.
3. Annual gifting through the use of Life Insurance trusts.
4. Philanthropic planning using retirement assets.
5. Conversions of Traditional IRAs to Roth IRAs.
6. Parents who are considering a gift to children may wish to do so yet this calendar year.
7. Consider establishing spousal limited access trusts during lifetime (SLAT) – See white paper from December 2019; Wealth Strategy: Spousal Lifetime Access Trusts (SLATs) – or possibly domestic asset protection trusts (DAPTs), which are available to non-married individuals but are more limited by one of 19 states that permits their use.

Step-up in Basis

Current: Gifts to heirs of appreciated assets at death receive a basis "step-up" to their current value. Currently, beneficiaries pay little to no taxes when they sell off inherited assets using the step-up basis rules, as most of the appreciation was captured by decedents over their lifetimes.

Potential Change: Gifts of appreciated assets at death to heirs earning more than $1 million per year DO NOT receive a "step up" to current value. Rather, assets become subject to a capital gains tax applied to the amount the asset has increased over its original cost.

Strategies to consider (consultation with Advisor recommended):

1. Consider gifting highly appreciated assets into a trust.
2. If applicable, recognize capital gains now to ensure taxation at a lower tax rate.

Portability of Estate Tax Exemption for Married Couples

Current: Surviving spouse is allowed to claim the unused spouse's exemption amount.

Potential Change: Portability of the unused exemption amount will be eliminated.

Strategies to consider:

1. Make intra-spouse trust arrangements during lifetime before it goes away.
2. Equalize estates.
3. Review beneficiary designation for retirement assets.

Like-Kind Provision (IRC Section 1031)

Current: Taxes on proceeds from the sale of qualified real property are deferred if the proceeds are used to purchase a "Like-Kind" asset (real property).

Potential Change: If the Like-Kind provision was repealed, taxpayers with over $400,000 would be taxed on proceeds from the sale of qualified real property.

Frequently, generational wealth is held in illiquid assets such as multi-family rental properties or businesses. This provision allows investors to defer tax on gains from sales of qualified real property (see Section 1031 of the U.S. tax code), not including personal or primary residences, by rolling a sale's proceeds over into a subsequent "like-kind" real property purchase.

Charitable Contributions

Although not yet confirmed, there is speculation about charitable deduction reform and changes on the itemized deduction features currently in place.

Strategies to consider:

1. Large donations into a donor-advised fund to take a large deduction this year.
2. If a donor is 70 ½ years old or above and has a qualifying IRA, consider using a Qualified Charitable Distribution, by redirecting the distribution from the IRA directly to a charity. There is a donation limit of $100,000. The entire donation is considered tax-neutral since it is going to a charity.

Conclusion:

Although it is difficult to predict the outcome of November's election and the changes to tax policies, it is important to remember that key provisions of TCJA will sunset in 2025. The next few months may allow families with the opportunity to work with their advisory team to address a variety of planning situations.

In addition, there is an emotional component to consider when making transfers, gifts or creation of trusts. These include examining your willingness to give your wealth away as well as the appropriate trust arrangement and the type of asset selected to transfer. For those with substantial wealth, certain issues such as valuation of real estate or partnerships may create more complexity—making it all the more important to use the right resources and involving a team of professional experts to establish a solid plan.

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