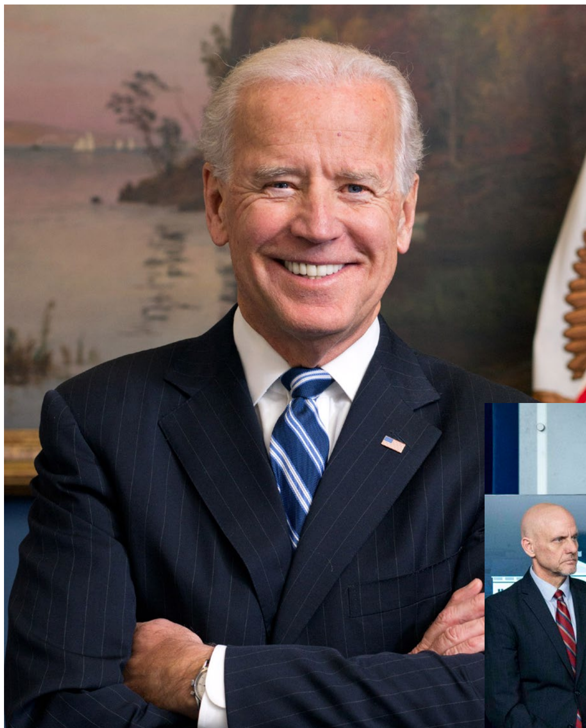
Year-End Planning in 2020

Including Planning for a Biden Administration

Robert S. Keebler, CPA/PFS, MSP AEP (Distinguished)

Year-End Planning in 2020

A Tumultuous Election Year



Year-end Planning

Annual General Checklist

- ❑ Bracket Management
  - ❑ Bonuses
  - ❑ Recognition events
  - ❑ Time business expenses – AMT awareness
- ❑ Itemized Deduction Timing
  - ❑ Medical expenses
  - ❑ Property tax
  - ❑ Charitable contributions
  - ❑ Casualty & theft losses
- ❑ Gain Harvesting
  - ❑ Current < Future rate ?
  - ❑ Consider forced recognition events (e.g. warrants)
- ❑ Loss Harvesting
  - ❑ Offset gains
  - ❑ $3,000 ordinary income offset

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Year-end Planning

Annual General Checklist

- ❑ Retirement Planning
  - ❑ Fund IRAs
  - ❑ Fund 401ks
  - ❑ Fund pension plans
  - ❑ Optimize Traditional/Roth mix
  - ❑ Consider Roth conversions
  - ❑ Review RMDs
  - ❑ Review NUA
- ❑ Education Planning
  - ❑ Time tuition payments
  - ❑ Fund 529 plans
  - ❑ Fund Coverdell accounts
- ❑ Executive Planning
  - ❑ Review NQDC
  - ❑ Review NQSOs / ISOs
  - ❑ Review concentrated positions
- ❑ Charitable Planning
  - ❑ Consider QCD
  - ❑ Consider appreciated assets
  - ❑ Consider DAF
- ❑ Estate Tax Planning
  - ❑ Make annual exclusion gifts
  - ❑ Make medical gifts
  - ❑ Make tuition gifts

Year-end Planning

Annual General Checklist

- ❑ Estimated Taxes
  - ❑ Review payments & estimated taxable income
  - ❑ Extra payment to reduce penalty
  - ❑ Additional W-2 withholding to eliminate penalty
  - ❑ AMT review
- ❑ Medical Expense Planning
  - ❑ Review Medicare premiums
  - ❑ Review HSA contributions
  - ❑ Review FSA balance
- ❑ Significant Financial Events Next Year
  - ❑ Recognition events
  - ❑ New investments
  - ❑ Re-allocation plans
  - ❑ Vesting
- ❑ Major Life Events Next Year
  - ❑ Family changes
  - ❑ Job changes
  - ❑ Moving

General Democratic Party Tax Policy Themes

- Additional payroll taxes on high-earners
- Increase the marginal rate imposed on high-income individuals
- Increase the capital gains rate imposed on high-income individuals
- Tax wealth generally; various ideas include an annual wealth tax & greater estate & gift taxes
- Increase the corporate income tax rate

Retro-Activity Risk

- Congress may have the ability to enact retro-active tax legislation thereby limiting the ability to front-run changes
- Retroactive taxation of transactions is possible if rationally related to a legitimate legislative. *Pension Benefit Guaranty Corporation v. R. A. Gray & Co.*, 467 U. S. 717 (1984); *United States v. Carlton*, 512 U.S. 26 (1994).

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Former Vice President Biden Tax Policy Proposals

- Tax increases on over **$400,000** of income
  - Expand the 12.4% Social Security tax
  - Restore the 39.6% marginal rate
  - Cap the itemized deduction tax benefit to 28%
  - Restore the 3% PEASE limitation
  - Add a new Section 199A Deduction Phaseout

Former Vice President Biden Tax Policy Proposals

- **Taxes on Capital**
  - 39.6% rate applied to capital gains over $1,000,000
  - Eliminate the Basis "Step-up" at Death

DANGER

Fund CRTs with great caution.

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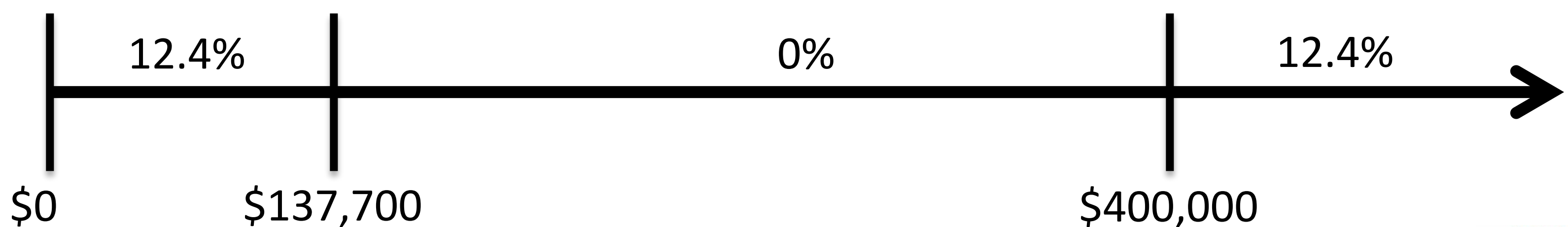
Former Vice President Biden Tax Policy Proposals

- **Other Tax Ideas for Individuals**
  - Increase the Child and Dependent Care Tax Credit from $6,000 to $8,000
  - Expand the ACA premium credit
  - Expand the EITC for childless workers over 65
  - New renewal energy tax credits
  - First time home buyers tax credit
  - Renters credit for those who are "housing cost burdened"
  - Expanded retirement savings credit

Former Vice President Biden Tax Policy Proposals

- **Proposal to Expand Social Security Tax**
  - Applies to earned income over $400,000
  - The established 12.4% rate & employee/employer split retained
  - Creates a tax-free gap between the Social Security base and the $400,000 threshold



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Former Vice President Biden Tax Policy Proposals

- **Solutions for Business Owners if Social Security Tax is Expanded**
  - S-corporation dividends
    - Recall, S-corporation dividends are not subject to employment taxes
    - As a solution, this assumes Congress does not close this "loophole" & the reduced salary is a "reasonable wage"

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Former Vice President Biden Tax Policy Proposals

- **Solutions for Business Owners if Social Security Tax is Expanded**
  - Reorganize (or elect to be taxed) as a C-corporation
    - W-2 earners subject to the expanded tax would have a marginal rate of **55.8%** [39.6%+12.4%+2.9%+0.9%]
    - C-corporation owners with $400,000 - $1,000,000 of income under Biden's plan could have a effective rate on dividends of **45.1%** [28% + (1-.28) x 23.8%]
    - C-corporation owners greater than $1,000,000 of income under Biden's plan could have a effective rate on dividends of **51.9%** [28% + (1-.396) x 39.6%]

Former Vice President Biden Tax Policy Proposals

- **Solutions for Executive Compensation if the Social Security Tax is Expanded**
  - Incentive Stock Options (ISOs) – No FICA Tax on option spread
  - Non-Qualified Stock Options (NQSOs) – FICA Tax on option spread, but it's delayed until exercise
  - Deferred Compensation – No favorable treatment, but there's a timing benefit and the possibility of taking advantage of the "doughnut hole"

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Former Vice President Biden Tax Policy Proposals

- **Proposal to Restore the 39.6% marginal rate**
  - Would apply to income over $400,000
  - Unclear how it is affected by filing status

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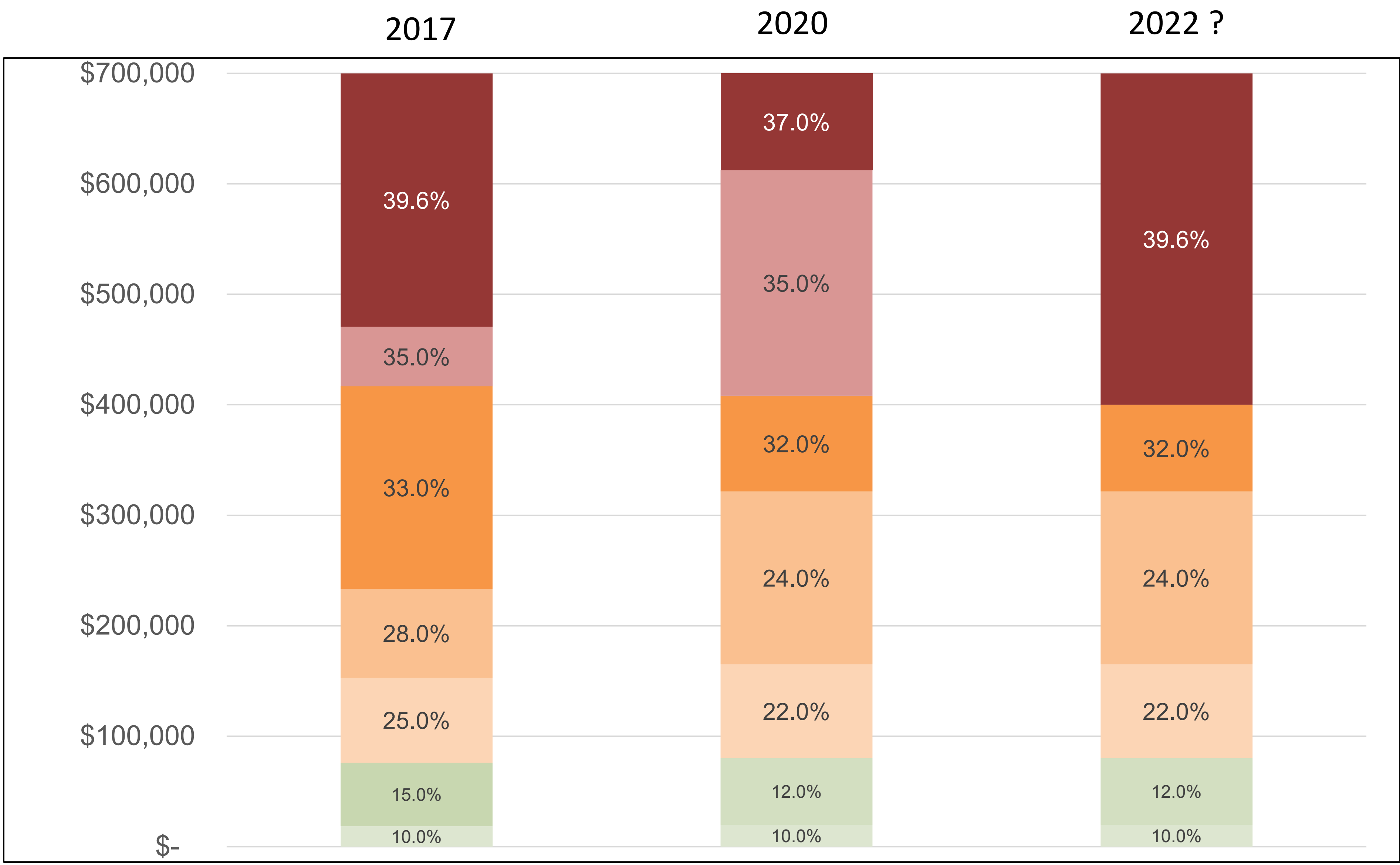
Married Filing Jointly



Former Vice President Biden Tax Policy Proposals

- **Accelerating 2020 income to plan for a 39.6%**
  - Roth conversions
  - Harvest gains
    - Real property – consider a "failed" 1031 exchange or opportunity zone
    - Stock
    - Bonds
  - Defer loss harvesting
  - Defer business expenses
  - Exercise NSOs
  - 453 Sales - consider the election to accelerate recognition

Former Vice President Biden Tax Policy Proposals

- **Proposal to Cap Itemized Deductions to a 28% Tax Benefit**
  - Rough justice to limit the regressive nature of itemized deductions

Itemized Deductions of $40,000

	Marginal Tax Rate				
	22%	**24%**	**32%**	**35%**	**37%**
Current Deduction Tax-Value	$ 8,800	$ 9,600	$ 12,800	$ 14,000	$ 14,800
Proposed Deduction Tax-Value	$ 8,800	$ 9,600	$ 11,200	$ 11,200	$ 11,200

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- **Proposal to Cap Itemized Deductions to a 28% Tax Benefit**
  - Exact calculation method unclear however perhaps itemized deductions would be reduced by a ratio
  - For example, someone with $40,000 of itemized deductions subject to 39.6% marginal rate would reduce the deducible amount as follows:

$$\$40{,}000 \text{ x } \frac{28\%}{39.6\%} = \$28{,}282.82$$

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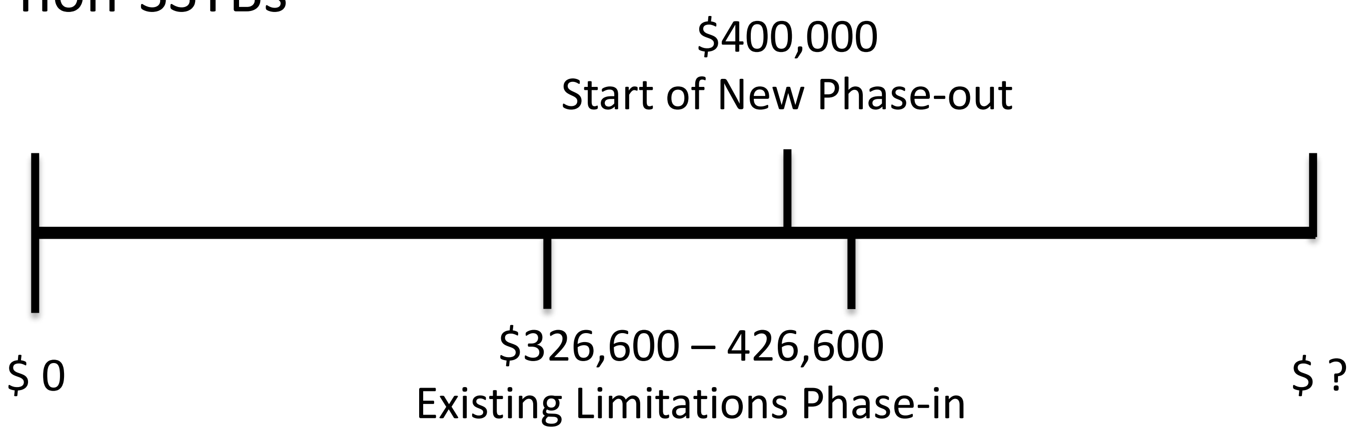
Former Vice President Biden Tax Policy Proposals

- **Proposal to Restore the 3% Pease limitation**
  - Would apply if income exceeds $400,000
  - Recall, the old Pease Limitation:
    - Applied after $313,800 (2017 MFJ) AGI threshold
    - Reduced itemized deductions by 3% of AGI over the threshold, up to 80% of itemized deductions
    - Standard deduction available if greater
    - Reduction only applied to charitable, SALT, mortgage interest, and miscellaneous itemized deductions only

Former Vice President Biden Tax Policy Proposals

- **Proposal to Add a New Section 199A Deduction Phaseout**
  – Would apply if income exceeds $400,000
  – There are few other details; Assumably, it is merely another limitation on the availability of the deduction for non-SSTBs



Former Vice President Biden Tax Policy Proposals

S-Corp Effective Rate - MFJ			
Shareholder's Income Level	Pre-2018:	Trump / TCJA	Biden Proposal:
$ 50,000	15.0%	9.6%	9.6%
$ 100,000	25.0%	17.6%	17.6%
$ 150,000	25.0%	17.6%	17.6%
$ 200,000	28.0%	19.2%	19.2%
$ 250,000	33.0%	19.2%	19.2%
$ 300,000	33.0%	19.2%	19.2%
$ 350,000	33.0%	25.6%	25.6%
$ 400,000	33.0%	28.0%	31.7%
$ 450,000	35.0%	28.0%	35.6%
$ 500,000	39.6%	28.0%	39.6%
$ 550,000	39.6%	28.0%	39.6%
$ 600,000	39.6%	29.6%	39.6%

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Former Vice President Biden Tax Policy Proposals

- **Proposal to eliminate the preferential rate for long-term capital gains and qualified dividends on income over $1,000,000**
  - Most significant proposal & a fundamental shift
  - Basically an increase from 20% to 39.6%
  - Expect many people to sell assets if it's set to take effect

Consider, for example, how risky funding a substantial sale CRT may be in 2020.

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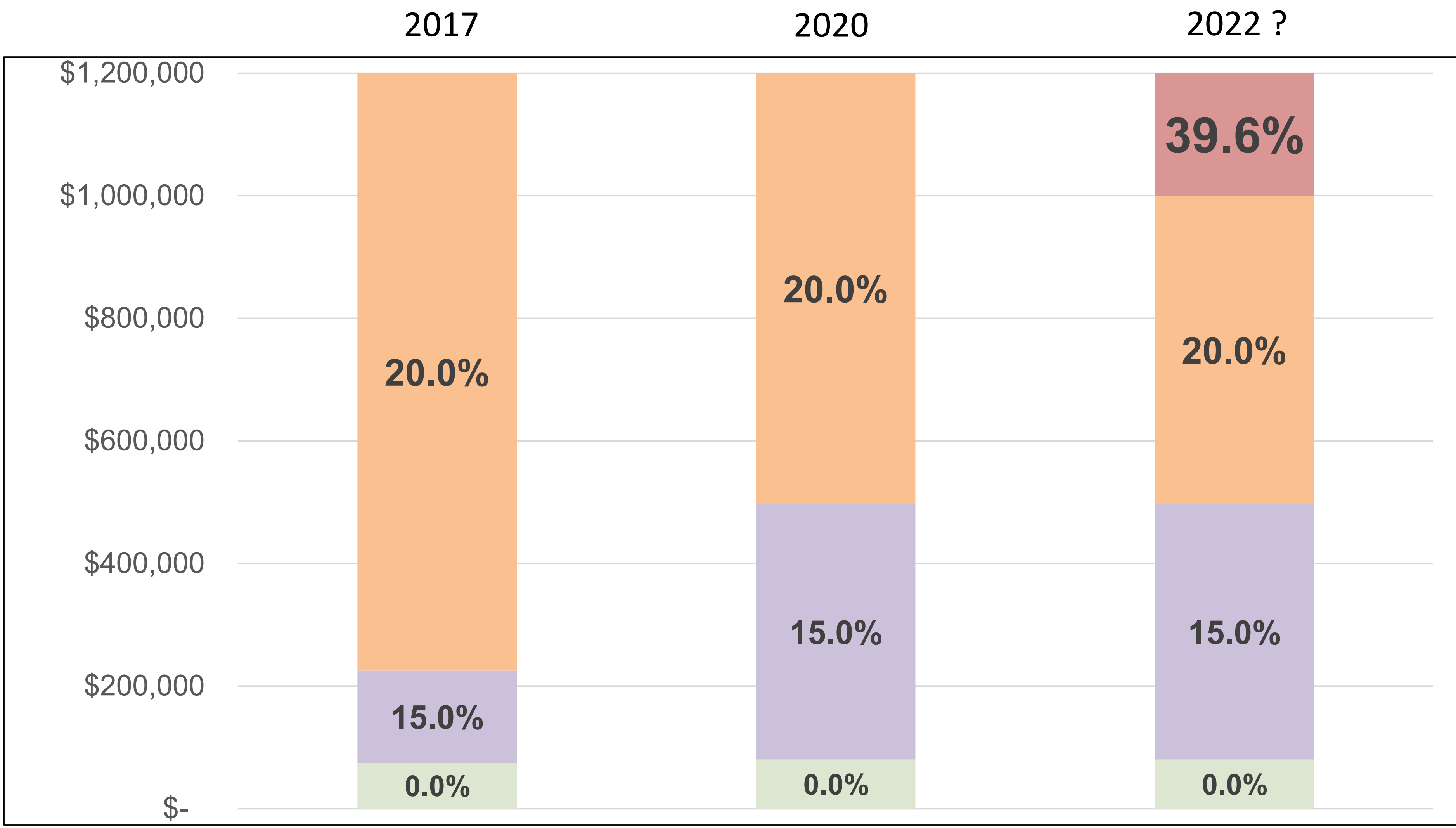
Married Filing Jointly

Capital Gain & Qualified Dividend Rates



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- **Eliminate capital gains rate – deeper thinking**
  – A 39.6% capital gains rate will encourage longer holding periods
  – If the "step-up" in basis at death is retained, many people will be substantially more encouraged to hold onto assets until death
  – If the "step-up" in basis at death is repealed in-favor of a forced-recognition event, people will be encouraged recognize gains before death to:

    (1) Find better investments and

    (2) Avoid a 39.6% applying in the year of death instead of a 20% rate during life, for example

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- **Proposal to eliminate the Section 1014(a) Basis Adjustment at the – "The STEP-UP"**
  - *Most significant proposal & a fundamental shift in the taxation of wealthy individuals*
  - Unclear whether the proposed 39.6% rate would apply to gains in excess of $1,000,000 at death
  - Unclear whether the proposal includes an income tax deduction for estate tax paid (or vice versa)
  - Presumably, gifting assets would also be a recognition event
  - Expect huge gifts & sales if it's set to take effect

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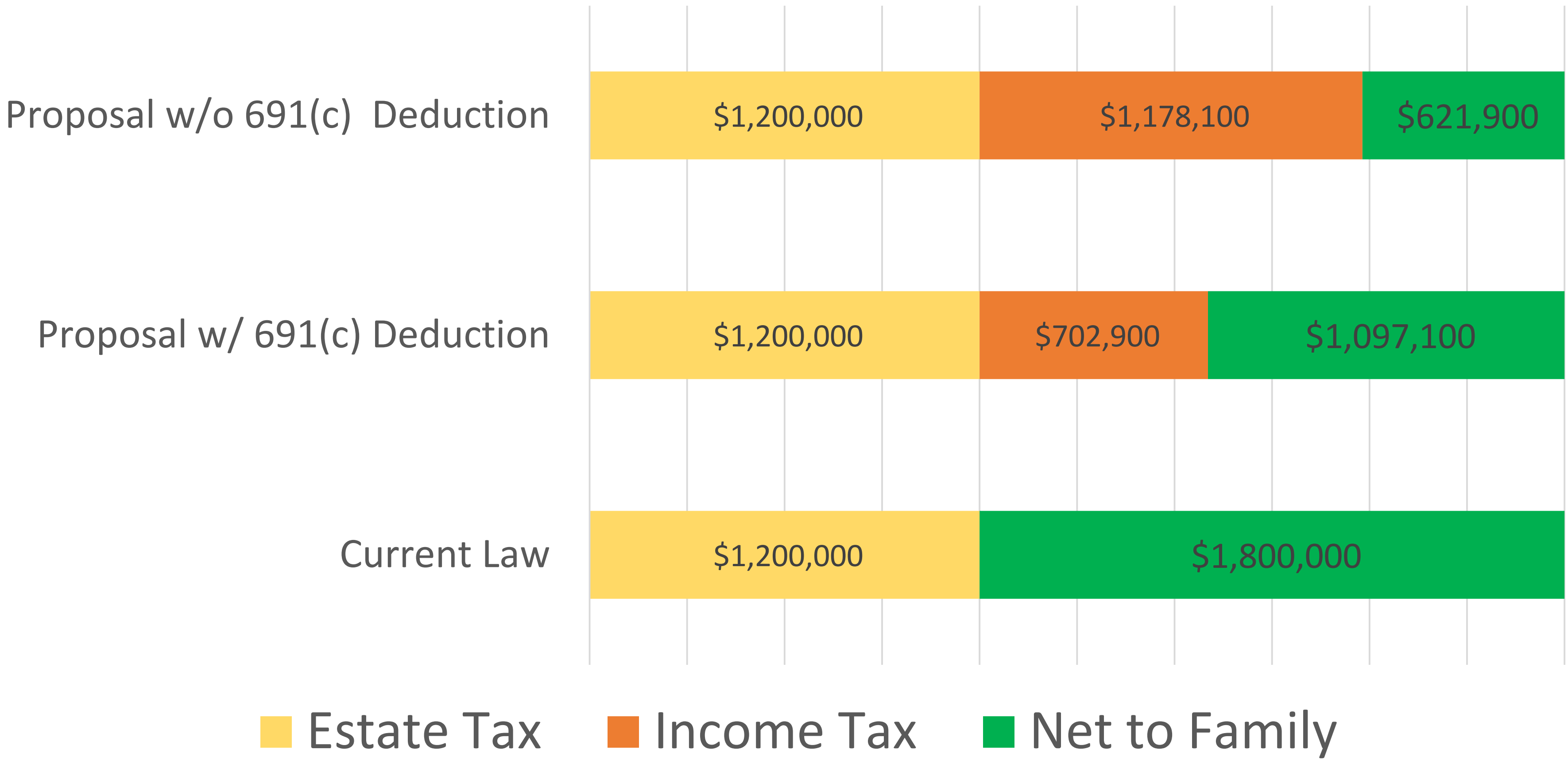
Consider someone who bought 10,000 shares of Apple at average price of $2.50 just before the ".com bubble" burst and died at a $300 share price.



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- **Business Income Tax Increase**
  - Increase corporate tax rate from 21% to 28%

C-Corp Effective Rate			
Shareholder's Qualified Dividend Rate	**Pre-2018: 35%**	**Trump / TCJA: 21%**	**Biden Proposal: 28%**
0%	35%	21%	28%
15%	45%	33%	39%
18.8%	47%	36%	42%
23.8%	50%	40%	45%
43.4%			59%

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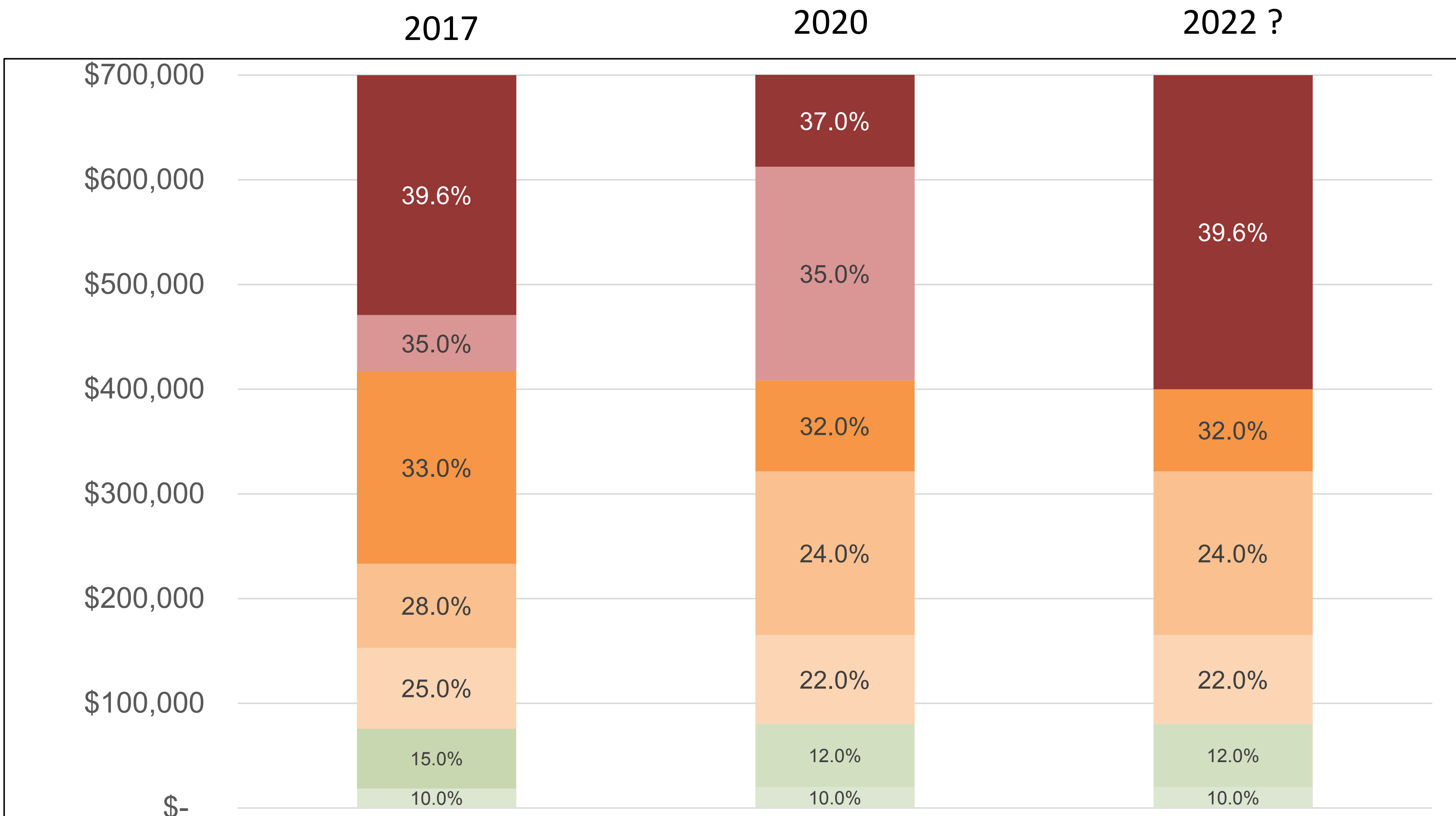
Former Vice President Biden Tax Policy Proposals

- **Other Business Tax Ideas**
  - New corporate minimum tax
  - Double the GILTI rate
  - Manufacturing Communities Tax Credit – would reduce the tax obligations of businesses in communities which experience major layoffs
  - New Market Tax Credit – expand & make permanent

Core Year-End Planning in 2020

Tax Rates

Married Filing Jointly



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Tax Rates

*Income Tax Rates **2020***

TOP OF EACH BRACKET

	S	MFJ/QW	MFS	HOH	T&E
10%	$ 9,875	$ 19,750	$ 9,875	$ 14,100	$ 2,600
12%	$ 40,125	$ 80,250	$ 40,125	$ 53,700	-
22%	$ 85,525	$ 171,050	$ 85,525	$ 85,500	-
24%	$ 163,300	$ 326,600	$ 163,300	$ 163,300	$ 9,450
32%	$ 207,350	$ 414,700	$ 207,350	$ 207,350	-
35%	$ 518,400	$ 622,500	$ 311,025	$ 518,400	$ 12,950
37%					

TOP OF EACH CAPITAL GAINS BRACKET

	S	MFJ/QW	MFS	HOH	T&E
0%	$ 40,000	$ 80,000	$ 40,000	$ 53,600	$ 2,650
15%	$ 441,450	$ 496,600	$ 248,300	$ 469,050	$ 13,150
20%					

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Tax Rates

Standard Deductions

2020

CURRENT STANDARD DEDUCTION

S	MFJ/QW	MFS	HOH
$ 12,400	$ 24,800	$ 12,400	$ 18,650

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Tax Reform

Itemized Deductions

THE OLD RULE WAS TO

ACCELERATE DEDUCTIONS

THE NEW RULE IS TO

TIME DEDUCTIONS

Bracket Management

Itemized Deductions

Important for 2020

The CARES Act
allows a charitable contribution
of cash up to 100% of AGI in 2020.

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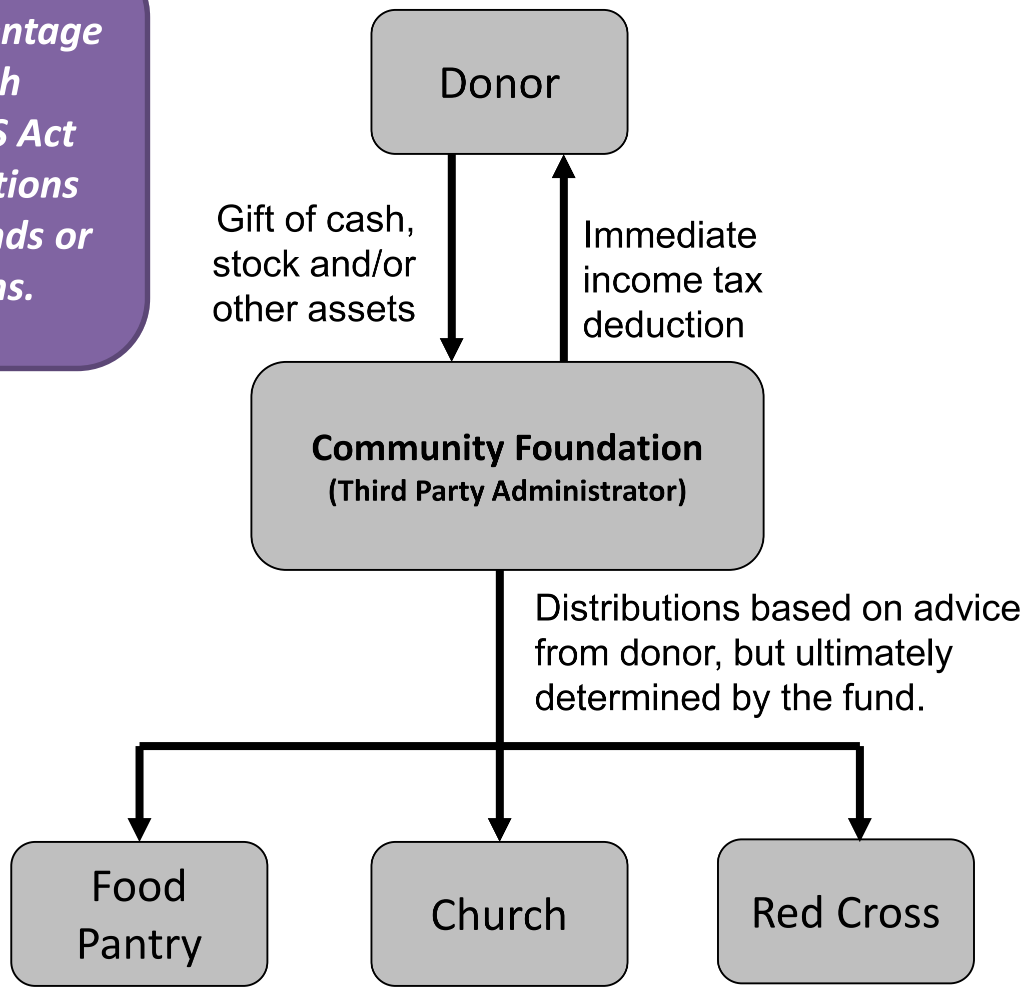
Donor Advised Fund

Overview

The elimination of the percentage limitations for 2020 cash contributions by the CARES Act does not apply to contributions made to Donor Advised Funds or Supporting Organizations.



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Gain & Loss Harvesting

Bracket Management

Harvest Capital Gains

- Strategy:
  - Taxpayer expects to be in a higher tax bracket in the future
  - Sells assets in the current year, pays tax a lower tax rate and steps up basis
  - Repurchases the same or similar assets
- Effect: Shifts recognition of capital gain from a higher future rate to a current lower rate

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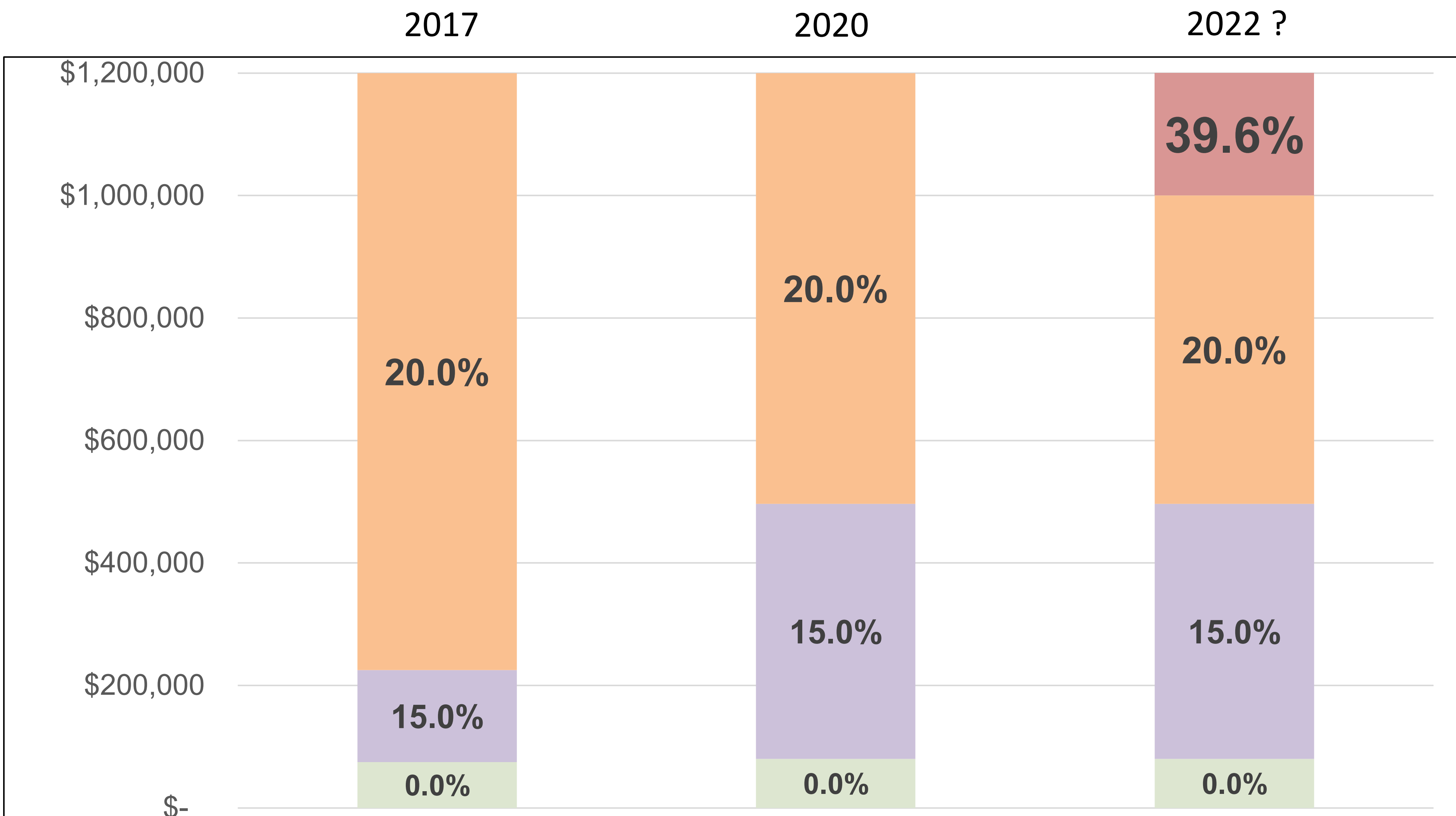

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Roth Conversions

Roth Conversions

2017 Tax Reform Refresher

TAX REFORM REPEALED THE ABILITY TO RECHARACTERIZE A ROTH CONVERSION

However, it is still possible to recharacterize a Roth contribution.

Mathematics of Roth IRA Conversions

- In simplest terms, a traditional IRA will produce the same after-tax result as a Roth IRA provided that:
  - The annual growth rates are the same
  - The tax rate in the conversion year is the same as the tax rate during the withdrawal years

$$A \times B \times C = D$$

$$A \times C \times B = D$$

Mathematics of Roth IRA Conversions

	Traditional IRA		Roth IRA	
Current Account Balance	$	1,000,000	$	1,000,000
Less: Income Taxes @ 40%		-		(400,000)
Net Balance	**$**	**1,000,000**	**$**	**600,000**
Growth Until Death		200.00%		200.00%
Account Balance @ Death	$	3,000,000	$	1,800,000
Less: Income Taxes @ 40%		(1,200,000)		-
Net Account Balance to Family	**$**	**1,800,000**	**$**	**1,800,000**

Mathematics of Roth IRA Conversions

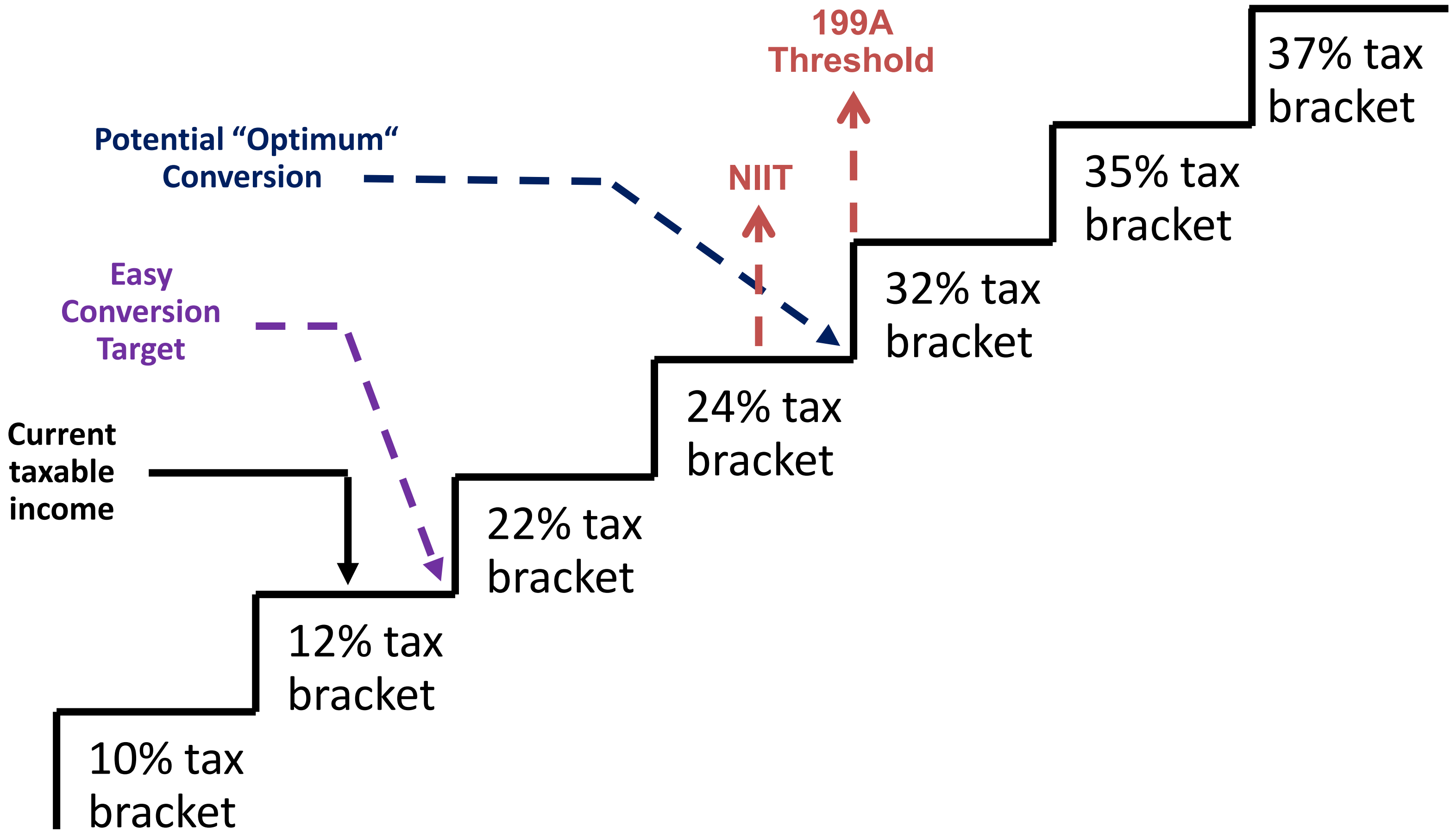
Reasons for converting to a Roth IRA

1. The taxpayer have special favorable tax attributes that need to be consumed such as charitable deduction carry-forwards, investment tax credits, NOLs, etc.…
2. The client expects the converted amount to grow significantly
3. Current marginal income tax rate is likely lower than at distribution
4. Cash outside the qualified account is available to pay the income tax due to the conversion
5. The funds converted are not required for living expenses, or otherwise, for a long period
6. The client expects their spouse to outlive them and will require the funds for living expenses
7. The client expects to owe estate tax

Mathematics of Roth IRA Conversions

- The key to successful Roth IRA conversions is often to keep as much of the conversion income as possible in the current marginal tax bracket
  - However, there are times when it may make sense to convert more and go into higher tax brackets
  - Need to take into consideration the 3.8% Medicare "surtax"
  - Need to take into consideration phase-outs of tax-benefits
  - Need to take into consideration the impact of AMT

Mathematics of Roth IRA Conversions



The SECURE Act

RMDs after Death

H.R. 1994 – Sec. 401

Modification of

Required Minimum Distribution Rules

for Designated Beneficiaries

Basically, requires all IRAs and Qualified Plans to be distributed within 10-years of death

Trusts & Estates

Estate & GST Taxes

- The TCJA doubled the Basic Exclusion Amount and GST exemption in 2018-2024 ($10,000,000 in 2011 dollars)
- In 2025 the exemptions revert to pre-TCJA law (5,000,000 in 2011 dollars)
- Should the Democrats do well in the 2020 elections, we should expect exemption to substantially decrease

POTENTIAL
"USE-IT-OR-LOSE-IT"
OPPORTUNITY

Estate & GST Taxes

Exemption Sunset Math

- Option 1
  - No planning
  - “Double” exemption sunsets 1/1/26 and is lost
- Option 2
  - Couple gifts $5,000,000 each to trust in 2019
  - Their previous gifts reduce their exemption by $5,000,000 to $0 (ignoring inflation adjustments) in 2026
  - Gifting during the “double period” accomplished nothing
- Option 3
  - Couple gifts $10,000,000 each to trust in 2019
  - Their previous gifts reduce their exemption $0 in 2026
  - $5,000,000 each (ignoring inflation adjustments) of additional exemption is captured

Estate & GST Taxes

IDEAS

- **Continue annual exclusion gifts ($15,000 exemption in 2020)**
- Continue medical & education gifts

- Tax-free gifts to use higher exemptions
- Portability elections to preserve exemptions
- Five-year GRATs (for ETIP to end before sunset)
- Five-year SCIN or private annuity
- "Springing" SLATs (i.e. SLAT with contingent GPOA provision)

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Estate & GST Taxes

IDEAS

- **Use Trusts to Create Additional Taxpayers**
  - $10,000 SALT deduction per trust
  - $163,300 199A Threshold Amount per trust

Estate & GST Taxes

IDEAS

- **Use trusts to avoid state income taxation**
  - Incomplete Gift Non-grantor Trusts –
    - A trust settled in state with a trust code which facilitates the strategy
    - Transfer to the trust is not a completed gift and therefore does not incur gift tax because the settlor retains certain powers
    - Trust is a non-grantor trust
    - Useful to avoid income taxation in the settlor's resident state
    - Only possible in certain states including: Alaska, Delaware, Nevada, Wyoming

Estate & GST Taxes

IDEAS

- **Use trusts to avoid state income taxation**

		Current	No SALT Deduction	W/ING
Income		$ 100	$ 100	$ 100
State Tax	5%	(5)	(5)	
Federal Tax	35%	(33)	(35)	(35)
		$ 62	$ 60	$ 65

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Estate & GST Taxes

Decanting

- Decanting Ideas
  - Turn a grantor trust into a non-grantor trust
  - Turn one non-grantor trust into several (e.g. one for each beneficiary)
  - Add a Power of Appointment (or other terms to force inclusion) in order to capture the basis "step-up"