Election Year Tax Planning

The upcoming election could lead to significant changes in the tax laws if the Democrats gain control of the White House and Congress, especially for high income and high net worth individuals. Of course, the election outcome is a matter of speculation, and predicting which, if any, of the Democrats' proposals would be enacted is even more speculative. Still, given the scope of potential changes and the possibility that some or all of these changes could be made effective as of January 2021, it is worth considering if you would benefit from implementing any changes to your tax planning.

Moreover, many of the changes to the tax laws are scheduled to take place automatically at the end of 2025 under current law, and many economists believe that taxes will be increased sooner or later regardless of who is in power so as to address the deficit. As such, these tax strategies might be useful in the longer term even if the Democrats do not sweep the upcoming election.

Strategies to Consider

High income and high net worth individuals should focus on certain strategies that could prove beneficial if the Democrats win in November, but that have limited downside risk if the Republicans maintain control. Doing this analysis now will put you in a position to act quickly after the election, whereas delaying until the election might not give you enough time to act before year-end.

- <u>Accelerate income into 2020; defer deductions to 2021</u>. A sweep by the Democrats could lead to higher income tax rates and the reinvigoration of the Alternative Minimum Tax. In that event, it may make sense to incur more ordinary income this year than next. Owners of businesses held in pass-through tax entities such as S corporations and LLCs may be able to do this by, for example, deferring expenses to 2021. Owners of certain stock options could elect to exercise those options before the end of 2020. Anyone considering converting an IRA into a Roth could do so in 2020 rather than waiting for next year. Executives could explore whether bonuses might be paid to them early.

- <u>Recognize gains this year</u>. Often, year-end tax planning involves realizing any losses on investments so as to reduce the capital gains tax. While for most people that plan may still make sense, it might not for those with income over $1 million. The reason for this is that the Biden tax plan would tax capital gains and all dividends as ordinary income, but only for people who earn over $1 million. For those people, the change would translate to a tax rate of 43.4% (which is the reinstated top income tax rate of 39.6% plus the "Obamacare tax" of 3.8%). The prospect of an increased tax rate would be a significant incentive for those taxpayers to realize gains in 2020 and pay the current rate of 23.8%. One hidden trap here could be for anyone who has set up a "grantor trust," which passes its income and realized gains through to the grantor (usually the person who set up the trust). If you have established a grantor trust, the trust income would likely be added to your personal income when determining whether your income exceeds $1 million and therefore whether the higher rate applies.

- Make gifts to family. The Biden tax plan would reduce the estate, gift and generation-skipping tax exemption, which is the amount of property you can leave to a non-spouse as a lifetime gift or upon your death without incurring any of these taxes. The current exemption level of $11.58 million would be dropped to the 2017 level (plus inflation adjustments) of approximately $5.65 million. Married couples can combine their tax exemptions, so their exemption level would drop from $23.16 million to about $11.3 million. Most estates fall below all of these figures and therefore would not pay any of these taxes regardless of the election outcome. But for estates that exceed these values, this change would translate to about $2.38 million of additional estate tax for an individual estate and $4.75 million for married couples upon the death of the surviving spouse. It is important to note that this change is scheduled to take place at the end of 2025 regardless of who wins the election, but making gifts in 2020 to family members in lower generations, or to trusts for their benefit will ensure heirs benefit from the tax savings. For those unsure about gifting such large amounts, use of "spousal lifetime access trusts" are a way to make a gift while still preserving the possibility of distributing some of those assets out of the trust to one's spouse, should that prove to be necessary. Moreover, gifts to a "quiet trust" can help address concerns about negatively affecting a trust beneficiary's work ethic. More details about these and other estate planning strategies can be found here.

- Accelerate charitable gifts into 2020. In the wake of COVID-19, Congress enacted certain incentives to encourage people to make charitable gifts in 2020, including the ability to deduct up to 100% of adjusted gross income for cash gifts to public charities. Some of these incentives will expire at the end of 2020 regardless of the election outcome. In addition, the Biden tax plan calls for re-imposing certain limitations on charitable deductions by high income individuals, including re-introducing the Pease limitations on itemized deductions. Accordingly, a charitable gift in 2020 may be more valuable from a tax perspective than a charitable gift in 2021.

Act Now

Many of these strategies require advanced planning and time to execute. By considering your options now and developing a plan, you will be prepared to act if and when the time comes.

Additional Resources:

- COVID-19 and Presidential Election Have Significant Effect on Estate Planning
- 2020 Personal Tax Planning Update
- Pitfalls and Opportunities Under the New Federal Tax Law – 3 part series

Contact Us

If you have questions or want to discuss your plan, please contact a member of Hemenway & Barnes LLP’s Private Client Group, or the authors of this alert:

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