EDGE CAPITAL GROUP

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BIDEN TAX PLAN ON HOLD? PLANNING STRATIGIES TO CONSIDER PRIOR TO YEAR END:

During his presidential campaign, Joe Biden outlined his tax policy proposals[1], which included rolling back key provisions from the Tax Cuts and Jobs Act (TCJA). An analysis by the Tax Foundation estimated the Biden plan would raise tax revenue by $3.3 trillion over the next decade.

	Current	Biden Tax Plan
Top Individual Federal Income Tax Rate	Currently 37%	Restore the top rate to the pre-TCJA level of 39.6% for taxable incomes above $400,000
Social Security Payroll Tax	Social Security's Old-Age, Survivors, and Disability Insurance (OASDI) tax (6.2%) is not collected on earnings above $137,700 (2020 earnings limit)	Collect additional OASDI tax on earnings above $400,000; this would effectively create a "donut hole" for the OASDI tax
Long-Term Capital Gains & Qualified Dividends	Top federal tax rate of 20%, plus 3.8% Net Investment Income Tax (NIIT)	Tax at the top (proposed) ordinary income rate of 39.6% for taxpayers with incomes above $1 million
Itemized Deductions	Itemized deductions generally provide a tax benefit equivalent to a taxpayer's income tax bracket	Limit the tax benefit of itemized deductions to 28% for taxpayers earning more than $400,000 Restore the Pease limitation on itemized deductions for taxpayers earning more than $400,000
Estate & Gift Tax Exemption	$11.58 million per person for 2020 $11.70million per person for 2021 *(subject to change)*	Return estate tax to 2009 levels: reduce the estate exemption to $3.5 million per person, with a top federal estate tax rate of 45%
Cost Basis at Death	Heirs receive property with a step-up in cost basis equal to fair market value	Eliminate the step-up in cost basis, though possibly with a base exemption
Corporate Income Tax Rate	21%	Raise to 28%
Section 199A Deduction	The Tax Cuts & Jobs Act created a 20% deduction for pass-through business income for certain eligible taxpayers	No explicit details, but presumed that taxpayers earning more than $400,000 may see the deduction phased out

[1] *The Tax Foundation – "Details and Analysis of President-elect Joe Biden's Tax Plan" (October 22, 2020)*

In order to achieve these tax policy proposals, Democrats would likely need to have control of *both* the House and the Senate. While Democrats ended up retaining control of the House, the path to gaining control of the Senate appears challenging. As it currently stands, Republicans have a narrow lead (50-48) in the Senate, with special run-off elections slated for January 5, 2021 for Georgia's two Senate seats. If Republicans win at least one of the run-off elections, Republicans would maintain control of the Senate.

So where does this ultimately leave taxpayers? The safest bet is to execute certain tax and estate planning strategies prior to year-end 2020 to avoid risks associated with potential tax reform. For those that would prefer a 'wait-and-see' approach to see if tax reform legislation gains traction in 2021, we would offer the following insights:

- **The Senate Matters, A Lot** – The prospects for tax reform largely hinge on which party has control of the Senate. Republicans appear well-positioned to maintain a majority, needing to win only one of the two Georgia run-off elections. Should that occur, the chances for near-term tax reform are substantially diminished.

- **Moderates Matter Too** – Even if Democrats were to win both Senate run-off elections to get to 50 seats (with Vice President-elect Kamala Harris acting as a decisive tie-breaking vote), it is not guaranteed that all Democratic senators would fall in line with broader party proposals. This may particularly be the case for moderate Democrats as well as Democratic senators who hail from states that otherwise lean Republican.

- **Proposals May Only be a Starting Point** – Certain elements of the proposed Biden tax plan could be modified or even scrapped altogether. For example, there is already speculation that eliminating the step-up in cost basis (which could meaningfully impact inherited family businesses or family farms) could fail to gain broad support.

- **Time Still on the Clock?** – The current general consensus is that taxpayers *may* still have additional time to plan in 2021 due to a perceived reluctance by Congress to implement tax increases on a retroactive basis.
    - Mark Luscombe, a CPA, attorney and principal analyst for Wolters Kluwer Tax & Accounting commented that newly elected presidents "have a pretty good record of getting things through during their first year in office… assuming [tax reform is] passed in 2021, any legislation probably won't be effective until 2022. Congress seems to be hesitant to make tax hikes retroactive."

    - An analysis by Grant Thornton[2] noted "retroactive tax rate increases are relatively rare, but not unprecedented. There have been six major rate increases since 1980 and… only the 1993 increases in the corporate and individual rates were retroactive" [passed August 1993, but effective as of January 1, 1993].

- **Legislative Priorities & Economic Health** – Given the ongoing COVID-19 pandemic, additional coronavirus-related stimulus and relief packages may take priority over tax reform legislation, which might further delay the implementation of any tax changes. Senator Richard Blumenthal (D-Connecticut) said Democrats will need to balance raising tax revenue with the health of the U.S. economy, noting, "I think a tax bill can be made effective at a time when we think the economy will be sufficiently robust that some increase in taxes will have no detrimental effect."

[2] *Grant Thornton – "Biden Win Changes Tax Policy and Planning Outlook" (November 9, 2020)*

Final 2020 Planning Considerations:

High net worth individuals are strongly encouraged to coordinate with their accountant and estate planning attorney to review whether potential planning opportunities should be pursued prior to December 31, 2020. Below, we outline planning considerations most closely tied to potential tax reform.

Using the Lifetime Gift Tax Exemption

The Tax Cuts and Jobs Act (TCJA), passed in December 2017, approximately doubled the estate exemption – from $5.49 million per person in 2017 to $11.18 million per person in 2018. The increased exemption amounts, under TCJA, are scheduled to run through 2025, after which the basic exclusion amount (BEA) is set to revert to the 2017 level of $5 million per person, plus inflation adjustments.

The lifetime gifting exemption currently stands at $11.58 million per person (with a top federal estate tax rate of 40 percent), though President-elect Joe Biden has proposed to "return the estate tax to 2009 levels" which would imply an exemption of $3.5 million per person (plus inflation adjustments), with a top federal estate tax rate of 45 percent.

Importantly, the Treasury Department and IRS issued final regulations in November 2019 clarifying that taxpayers taking advantage of the increased exemption amounts would not be subject to a clawback, should the exemption amount decrease from current levels.

High net worth individuals should evaluate current assets and assess how much might be needed for their remaining lifetime, with consideration to gift 'excess assets' to loved ones, which would reduce the size of an otherwise taxable estate. Depending on the size of an outright gift, estate planning which incorporates making gifts to trusts may be advisable to provide parameters/ safeguards for the intended beneficiaries.

Individuals who are likely to one day have a taxable estate should also consider direct payments (to the educational/medical provider) for tuition and medical expenses, which do not constitute gifts, as well as annual exclusion gifts ($15,000 for 2020 and 2021). Such gifts can be an effective strategy for further reducing the size of a taxable estate. Remember that 529 accounts allow for five years of annual exclusion gifts to be pulled forward to the current year for a one-time contribution of $75,000 per recipient.

Keep in mind that any gifts in excess of the annual gift tax exclusion ($15,000 to each donee) should be properly recorded on a gift tax return.

Accelerating Long-Term Capital Gains

The following table summarizes the tax rate for long-term capital gains, as of 2020:

Filing Status	0% rate	15% rate	20% rate
Single	Up to $40,000	$40,001 – $441,450	Over $441,450
Married filing jointly	Up to $80,000	$80,001 – $496,600	Over $496,600
Married filing separately	Up to $40,000	$40,001 – $248,300	Over $248,300
Head of household	Up to $53,600	$53,601 – $469,050	Over $469,050

Source: Internal Revenue Service. Note: the table above does not factor in the 3.8% Net Investment Income Tax (NIIT) to which certain high-income taxpayers may also be subject.

President-elect Joe Biden has proposed increasing the tax on long-term capital gains (as well as qualified dividends) to the top ordinary income rate for individuals with taxable income over $1 million. With a proposal to raise the top ordinary income tax rate from 37 percent to 39.6 percent, this proposed change to the taxation of long-term capital gains, if passed, could be substantial.

High-income taxpayers who could be impacted by this proposal should coordinate with an accountant to determine whether capital gains should be accelerated into the 2020 tax year.

Accelerating Charitable Donations

Itemized deductions typically provide a tax benefit equal to a taxpayer's marginal income tax bracket. A taxpayer in the 37 percent federal income tax bracket generally receives a 37 percent benefit for the total of itemized deductions.

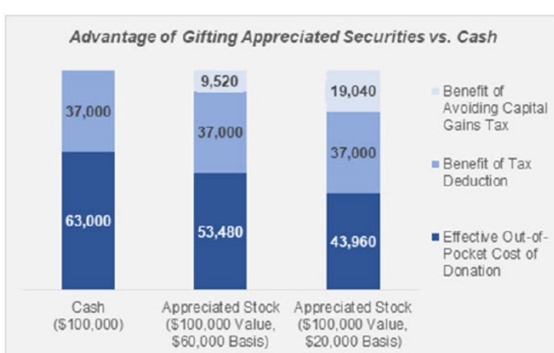
President-elect Joe Biden proposed limiting the benefit of itemized deductions to 28 percent for individuals with more than $400,000 of taxable income. If passed, there could be a significant disconnect between a taxpayer's marginal tax bracket (say, 37 or 39.6 percent) versus the benefit provided by itemized deductions (28 percent).

Charitably inclined individuals who could be affected by this change should evaluate whether to accelerate charitable gifts prior to year-end. This consideration may also be particularly beneficial for taxpayers who experienced higher-than-normal income in 2020, as increased charitable giving shields a portion of income from otherwise being taxed at a higher rate.

Coordination with an experienced accountant is advisable, given certain adjusted gross income (AGI) limits that apply to charitable gifts. Should charitable gifts exceed the AGI limits, the excess becomes a charitable carryforward to be used within the next five years, albeit potentially subject to the proposed 28 percent limit.

Gifting Cash Rather than Long-Term Appreciated Securities
Of special note, while the Tax Cuts and Jobs Act increased the deduction for cash contributions to public charities to 60 percent of adjusted gross income (previously 50 percent AGI limit), the Coronavirus Aid, Relief, and Economic Security (CARES) Act increased the deduction for contributions to public charities (other than donor-advised funds) to 100 percent of AGI for the 2020 tax year. As a result of this CARES Act-provision, high income taxpayers may have a unique 2020 charitable planning opportunity.

Gifting Long-Term Appreciated Securities Rather than Cash
With equity markets near all-time highs, investors with taxable accounts may hold highly appreciated equity positions. From a tax planning standpoint, gifting long-term appreciated securities is an efficient charitable-giving strategy as the charity receives the same economic benefit as a cash donation, while the taxpayer receives a tax deduction for the full market value of the gift and avoids paying capital gains taxes on the gifted security.



Analysis assumes taxpayer subject to highest federal tax bracket (37%) and capital gains subject to 23.8% federal tax rate. Analysis assumes charitable gifts to qualified public charities.

Investors who have a portfolio overweight to equities may use charitable gifting as a means to rebalance back to target weights. In doing so, an investor is able to achieve philanthropic goals while avoiding having to sell appreciated equities to return to a desired target allocation.

Keep in mind that gifts of long-term appreciated securities to qualified public charities (including donor-advised funds) are limited to 30 percent of adjusted gross income (AGI) while similar gifts to a private foundation are limited to 20 percent of AGI. As noted earlier, charitable gifts in excess of the AGI limits result in a charitable carryforward that can be used over the next five years.

Consider a Roth Conversion

With income tax rates at historically favorable levels, individuals who believe their future tax rate might be higher than their current tax rate might consider converting a portion, or all, of existing Traditional IRA assets to a Roth IRA. Assuming the Traditional IRAs have no basis, the amount of the conversion is treated as taxable income. In exchange, the Roth IRA grows tax-free with qualified distributions also treated as tax-free.

This strategy can be beneficial for individuals with a taxable estate, as the tax cost for the conversion effectively reduces the size of the estate, while the named beneficiaries one day receive a very tax-favorable asset (compared to inheriting a Traditional IRA). In some cases, high net worth individuals might pair a Roth conversion with the aforementioned accelerated charitable giving strategy, as the charitable deduction reduces the effective tax cost of the conversion.

Individuals with notable assets, but with lower-than-normal income in 2020, might also consider this strategy, as it allows the taxpayer to essentially pay a reduced rate on the conversion while taxable income is low.

Review Estate Plans & Retirement Account Beneficiaries

The Setting Every Community Up for Retirement Enhancement (SECURE) Act, enacted on January 1, 2020, effectively eliminated what was known as “the stretch IRA,” for which a beneficiary could stretch required minimum distributions (RMDs) for an inherited IRA over their lifetime (example: John Smith, age 92, names his great grandson Billy, age 20, as the beneficiary of his $2 million Traditional IRA). Under the SECURE Act, most non-spouse beneficiaries will be required to fully withdraw all inherited IRA assets by the end of the tenth year after the IRA holder died. Estate plans which previously incorporated this “stretch” strategy are now outdated and in need of updating.

Periodically reviewing and updating estate plans is a recommended best practice in light of potentially changing estate planning rules and limits. Individuals who have recently experienced a significant life event (marriage, divorce, birth/adoption) may also need to make updates to existing estate plans.

Harvest Losses

Review unrealized gains and losses in taxable investment accounts and harvest losses where available. Realized losses can offset other realized gains; to the extent that realized losses exceed realized gains, net realized losses can offset up to $3,000 of ordinary income with any remainder resulting in a loss carryforward to be used in future years.

With markets having recovered substantially from the March 2020 lows associated with the COVID-19 pandemic, investors may have limited loss harvesting opportunities, although international equity value funds, REITs and MLPs could be potential candidates.

Analyze Mutual Fund Year-End Capital Gain Distributions

Mutual funds are required to pass along capital gains to fund shareholders. Regardless of whether the fund shareholder actually benefited from the fund's sale of underlying securities, the shareholder will receive the capital gain distribution if the mutual fund is held as of the dividend record date.

Mutual fund families typically provide estimates for year-end dividend distributions over the course of October and November, with such distributions most commonly paid in December. Capital gain distributions can be either short-term or long-term. Short-term capital gain dividends are treated as *ordinary income* and thus *cannot* be offset by realized losses. In contrast, long-term capital gain dividends are treated as capital gains and can be offset by realized losses.

It is important to review unrealized gains and losses across mutual fund holdings in taxable accounts and to compare those figures against capital gain distribution estimates to determine if selling a mutual fund position before the year-end distribution would produce a tax savings.

Satisfy Required Minimum Distributions (RMDs) using the IRA Charitable Rollover

The SECURE Act raised the beginning age for required minimum distributions (RMDs) to 72, from age 70½, previously. However, the Coronavirus Aid, Relief, and Economic Security (CARES) Act waived Required Minimum Distributions (RMDs) for the 2020 tax year.

The SECURE Act did not adjust the age 70½ requirement for taxpayer eligibility to make a Qualified Charitable Distribution (QCD) up to $100,000 each year from an IRA to qualified 501(c)(3) charitable organizations (donor-advised funds, private foundations and supporting organizations are excluded). A qualified charitable distribution neither counts as an itemized deduction nor as taxable income, though it does count towards satisfying the RMD for that year. This strategy may be beneficial for charitably inclined individuals who receive a greater tax benefit from the increased standard deduction rather than itemized deductions.

> *Note: While taxpayers can still make a QCD in 2020, with 2020 RMDs being waived under the CARES Act, it may instead be beneficial to delay any QCDs until 2021.*

Evaluate When to Collect Social Security Retirement Benefits

Individuals nearing eligibility for Social Security retirement benefits should give proper consideration for when to start benefits. A recent study[3] estimated that only 4 percent of retirees start their Social Security benefits at the most optimal time, with retirees effectively forfeiting a collective $3.4 trillion in potential retirement income. A review of 2016's new Social Security recipients[4] showed nearly 60 percent of individuals collected benefits before their full retirement age (FRA), with only 10 percent waiting beyond full retirement age. Nearly a third opted to begin receiving benefits at age 62, despite a significant benefit reduction. While general guidance is to wait (if possible) until age 70 to collect a higher benefit, there are a number of important factors to consider including anticipated life expectancy, income needs for the interim years when benefits would be delayed, and availability of spousal benefits.

Consider a Change in State Residency?

Changing your primary state of residency is not as simple as spending more than half the year in a new state. With many states more aggressively contesting such residency changes, individuals should take extra precaution to ensure that "facts and circumstances" support the case for changing resident states. Some of the factors that support a new domicile include days spent in the new state for the year, driver's license registration, voter registration, medical and dental care providers, country club or social club memberships, official mailing address to which mail and bills are sent, location of family heirlooms and artwork and more.

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