Post-Election Tax Planning

Planning Update | November 2020

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Key Takeaways:

- Due to concerns about the coronavirus pandemic, short-term economic relief for individuals and businesses, aid to states, and increased infrastructure spending, it is possible that tax legislation may not be a top priority.
- With the probability of a Biden win and a potentially divided Congress, major tax legislation will be difficult to pass. Any tax changes would likely be incremental and focused on ideas that satisfy both sides of the aisle.
- Planning decisions should align with your planning goals, not with changing political proposals. Make sure any strategies offer long-term planning benefits independent of short-term tax impact.
- Meet with your tax advisor to project income for this year and next to plan for multiple scenarios.

In the aftermath of the election, taxpayers should consider tax planning moves to make before year-end, just like any other year.

What We Know, and What We Don't Know

At the time of publication, results announced by state election officials indicate that Joe Biden will win the 2020 presidential election; however, challenges and recounts of the results are possible. Furthermore, it is still uncertain which party will have a majority in the Senate. At this time, two races, both in Georgia, have not been determined and are likely to go to a run-off election on January 5, 2021. The Republicans need to win one of those seats for a GOP majority. Should that happen, the Senate would be unlikely to advance significant tax changes proposed by a Democratic administration. If the Georgia run-off elections result in both races going to the Democrats, intraparty divisions may also be a hurdle to implementing major tax legislation. Therefore, as we approach year-end, planning decisions should focus on achieving your goals, rather than a specific tax law change. In addition, it's always a good idea to review your plan considering different scenarios and outcomes.

What to Watch

It will be important to watch what priorities develop in Congress over the next several months. It is possible that tax legislation won't be at the top of the agenda. Healthcare, short-term relief for individuals and businesses, aid to states and municipalities, and infrastructure spending might all take priority.

The Biden-Harris campaign platform proposed raising taxes on high income and wealthy taxpayers to pay for a variety of proposed new or expanded programs. Those proposals are listed later in this piece as a reference guide. During the campaign, Democrats have also proposed a number of items that would provide modest tax benefits for low- or middle-income taxpayers. Still, campaign promises are not a reliable indicator of the shape that actual legislation will take.

If economic stimulus is viewed as a key goal, policymakers could defer tax legislation for a year. It can take a fair amount of time for Congress to develop tax legislation. Even within the majority party, there will be ideological and policy disagreements that have to be worked out. This was evidenced when President Trump was elected in 2016 and Republicans won the majority of House and Senate seats. Even with the Republican momentum, the tax bill was not signed into law until late December of the President's first year in office.

Considerations for Year-End Planning

Any year-end planning decisions you make should be in line with your wealth planning goals rather than determined by proposals made in an everchanging political climate. If you are evaluating a particular strategy, especially if it involves accelerating taxes into 2020, consider the possibility that any particular proposed change may not happen.

Ensure your strategy offers long-term planning benefits independent of the short-term tax impact. Also remember everyone's situation is different. Tax planning for someone with an upcoming retirement will look different than planning for someone who may be starting required minimum distributions (RMDs) soon or someone with high expected earnings for many more years.

Regardless of the likelihood or timing of tax legislation, you should meet with your tax advisor to project income for this year and next. This will allow you to plan for multiple scenarios. Here are some year-end planning ideas to consider:

- If you anticipate higher taxes in the future, consider accelerating income into years when you expect taxes to be lower. This could include strategies like converting part or all of your retirement plan to a Roth IRA, realizing gains sooner rather than later (especially if you have a concentrated position in one stock or have other reasons to reposition your portfolio), or exercising employer-granted stock options. If your income was low this year as a result of the pandemic, you may consider a withdrawal from your IRA. Taxes may be paid this year or over the next three years.
- For those who have experienced portfolio declines, harvesting capital losses now could be valuable. Any losses that are not fully offset by gains in 2020 could be carried forward into 2021. This strategy is especially true for individuals who expect capital gains in the future through stock sales, business sales, installment sales, or other capital transactions.
- Consider deferring expenses into years when you expect taxes to be higher. This could include deferring the use of losses, depreciating business assets over multiple years rather than choosing immediate expensing, or determining the best timing for the use of charitable deductions. However, if you make substantial charitable contributions you may want to accelerate contributions into 2020 due to favorable changes from the Coronavirus Aid, Relief, and Economic Security (CARES) Act (applicable only to cash gifts; gifts to donor advised funds and private foundations are not eligible).
- Review your wealth transfer plan. If you have reason to be concerned about estate taxes, evaluate strategies to increase or accelerate gifts. Don't think only in terms of taxes—your own financial comfort and the impact of large gifts on future generations also deserve careful thought. The individual tax and estate tax provisions are scheduled to expire December 31, 2025 so even with no changes to legislation there is a limited window to take advantage of the large exemptions.
- Business owners have several unique opportunities:
  - The combination of historically low interest rates prescribed by the IRS that are used for wealth transfer strategies, the temporarily doubled exemption from gift tax, potentially lower business values caused by the coronavirus pandemic, and valuation discounts for business interests creates an opportunity to transfer wealth at a low cost. There most likely will be time to accomplish these goals after 2020 if rates and valuations remain low.
  - The CARES Act provides an opportunity to carry back losses incurred in 2018, 2019, or 2020 to offset income from the prior five years. Generally, losses may not be carried back prior to 2018, which is when corporate tax rates decreased.

Biden's Tax Proposal

The table on the next page includes some of the main proposals[1] that could impact high-income or wealthy individuals as well as some tax credits. As noted earlier there is question as to whether tax legislation will be a focus early in the Biden term, and if it is, what is the likelihood of passage. The final version of a tax bill would likely look different in some or all respects than what is outlined here.

Capital gains and qualified dividends tax rate	For taxpayers with income above $1 million, preferential tax treatment for capital gains and qualified dividends would be eliminated; instead, the top ordinary income rate would apply.
Ordinary income marginal tax rate	The top ordinary income rate for individuals would increase to 39.6% from 37% for individuals with income over $400,000.
Itemized deductions	The value of these deductions would be capped at a benefit rate of 28% for individuals with income over $400,000.
Payroll tax	Social Security tax would be applied to earned income over $400,000.
Qualified business income deduction	The deduction would be eliminated for individuals with income over $400,000.
Cost basis at death	The proposal would end “step-up” in basis at death.
Estate tax	This is unclear. The Biden campaign website does not make any specific proposal about changing the estate tax exemption. The Biden-Sanders Unity Task Force has recommended returning to “historical norms.” Some observers believe this would mean that a Biden administration would propose returning the estate exemption to 2009 levels (approximately $3.5 million per person). It is also possible that Congress could simply leave current law in place, which would cut the existing exemption ($11.7 million per person for 2021) in half after 2025.
First home credit	A credit of up to $15,000 would be available for a first-time home purchase.
Child care credit	The child care tax credit would increase to $8,000.
Caregiver credit	A credit of $5,000 would be available for caregivers.
Energy efficiency credits	This includes new or expanded tax credits for energy efficient purchases including electric vehicles, residential improvements, and solar investments.

Have Those Important Conversations

With the ongoing activity in tax legislation, it will be important to communicate throughout the coming weeks with your tax and legal advisors as well as your Abbot Downing relationship manager in order to be prepared to take advantage of whatever changes or opportunities arise.

Endnotes

[1] Details and Analysis of Democratic Presidential Nominee Joe Biden's Tax Plan, October 22, 2020, https://taxfoundation.org/joe-biden-tax-plan-2020/; Post-2020 Tax Policy Possibilities, October 15, 2020, https://www.ey.com/en_us/tax/post-2020-tax-policy-possibilities