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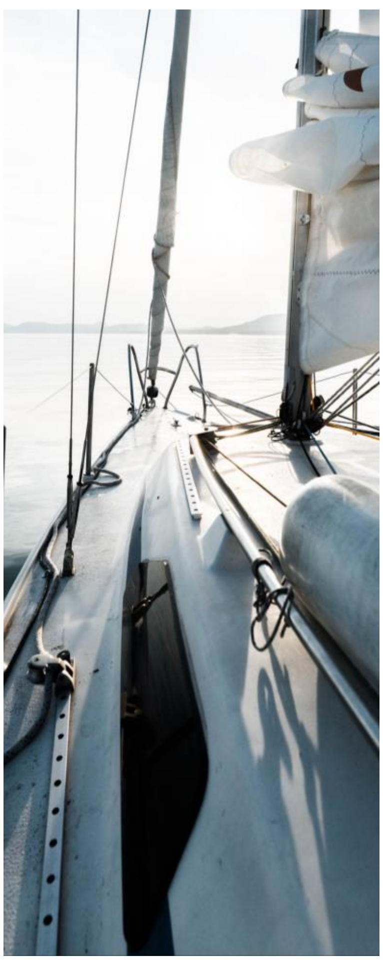
Steady as She Goes: Year-End Planning After the Election

Election day in the United States has come and gone, and it appears that Joe Biden will be the next president. In the weeks and months leading up to the election, much attention was given to the Biden Campaign tax proposals. Pollsters largely predicted a "Blue Wave," and there was an expectation that with control of the White House, Senate, and House of Representatives, Democrats would eye sweeping tax reform.

Proposals included provisions to tax long-term capital gains on those with income greater than $1 million at ordinary income tax rates, increase the corporate tax rate to 28%, and reduce the estate and gift exemption, which is currently at an all-time high of $11.58 million per person. Additional details on noteworthy provisions can be found at the end of this piece.

Now that the dust is nearly settled, it is clear that the "Blue Wave" many anticipated will not come to pass. In fact, while the Democrats will retain control of the House, they will lose seats. However, control of the Senate remains a toss-up as the two Georgia seats will be decided by runoff elections this January.

Americans will be paying close attention to the runoff elections as they will determine the balance of power in Washington and, in turn, could directly impact what, if any, type of tax law changes are in store. Regardless of the results, it is perhaps increasingly likely that we are entering a period marked by a "Steady as She Goes" mentality and limited potential for sweeping tax reform.



2020 Election Results

- All likelihoods point to President-Elect Biden being sworn in on January 20, 2021.
- Senate elections are currently 50 Republican/48 Democrat.
- The two outstanding Senate seats are in Georgia. One is leaning Republican (Perdue-R/Ossoff-D), and the other is a special election (Warnock-D/Loeffler-R) that is less certain.
- The two seats will be chosen by runoff elections set for January 5, 2021.
- The House of Representatives is still Blue, but Democrats are projected to lose between ten and fifteen seats.

Implications of Results

- If Republicans win one of the Georgia Senate seats, they will have a 51-vote majority, and gridlock in Washington is a strong possibility.
- Republican control of the Senate could lead to some level of stimulus without an immediate tax increase.
- If Democrats win both Georgia Senate seats, they will have the ability to pass legislation through the Budget Reconciliation process, which calls for just 50 votes, and Vice President-Elect Kamala Harris as a tie-breaker.
- Democrat driven legislation might be less dramatic than previously anticipated as moderate Democrats could be averse to sweeping tax reform.
- Provisions affecting the Social Security Tax will have an even greater hurdle as they would require a 60-vote majority and cannot be enacted using the Budget Reconciliation process.

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Timing of Potential Tax Law Change

- **Legislation effective retroactively as early as 1/1/2021**. In the absence of a "Blue Wave," this scenario has become much less likely but is not impossible given legal precedent.

- **Legislation effective as of 1/1/2022**. While this scenario is more likely, it is now less probable that we see some of the more dramatic changes initially proposed.

- **Legislation passed after the next mid-term elections**. This will become a more substantial possibility if Democrats break historical norms and add seats in the 2022 mid-term elections. Tax law changes are rarely made mid-term, but this is something to monitor over the next year or two, given the current political environment.

What this Means for Year-End Planning

Wealth Transfer Considerations – Using Lifetime Gift Exemption in 2020

Many families are well underway in effectuating plans to transfer assets to future generations before January 1, 2021, taking advantage of the potentially temporary all-time high lifetime gift exemptions. These individuals may want to revisit the "why" driving gifting strategies.

In plenty of cases, making gifts by December 31, 2020, represents good, thoughtful planning regardless of possible tax changes. In these circumstances, there is no reason to stop, and those families should generally work to complete transfers ahead of year-end.

However, there are some cases where plans to gift assets were driven mainly by the legislative opportunity that may now be delayed. It may be appropriate to press pause and re-evaluate comfort level in making sizeable gifts ahead of year-end in these circumstances. Families will want to consider factors such as age, cash flow needs, and whether suitable vehicles to receive gifts have already been established.

Income Tax Planning Considerations – Capital Gain Harvesting

Conventional tax advice is centered on the concept of deferring tax liabilities by delaying income events and accelerating deductions. Over the past several months potential tax law changes threatened the status quo as individuals wrestled with the idea of accelerating income and deferring deductions in anticipation of rate increases.

Taxpayers considering the potential impact of the Biden proposal to apply ordinary income tax rates to long-term capital gains and qualified dividends for those with income greater than $1mm were particularly focused on this change in thinking. Attention, in some cases, shifted from harvesting capital losses to harvesting capital gains ahead of year-end.

At this point, realizing long-term capital gains solely for tax purposes is likely not a prudent strategy. While we may still see income tax increases, activity in Washington has reduced the likelihood that those changes are retroactive effective January 1, 2021. As a result, the basic tenets of tax planning likely still ring true ahead of year-end, and tax deferral remains the focus.

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Quick Action for Wealth Transfer

With year-end rapidly approaching, some individuals may be looking to implement wealth transfer strategies in a compressed time frame. Below are some actions to consider in effectuating those strategies ahead of December 31:

- **Gifting to existing Irrevocable Trusts.** This requires a thorough review of the document to ensure that it aligns with your present intent but can offer an efficient vehicle for year-end gifting with minimal drafting.

- **Forgiving Existing Loans.** If any intra-family loans are outstanding, forgiving some or all principal value can be a quick way to use up lifetime exemption.

- **Funding Annual Premiums.** For individuals who have life insurance policies held outside of heir estates in a trust (often called Irrevocable Life Insurance Trusts or ILITs), pre-funding the remaining premiums can be a way to use up exemption at current levels to satisfy an ongoing obligation. This can be done by "paying up" the policy or simply transferring a reserve amount into the trust that will fund annual premiums in the future.

- **Using formula clauses in documents.** To the extent a valuation is being performed but will not be complete before 12/31, a formula clause can be incorporated into the trust document to "right-size" the transfer amount once the valuation is complete.

- **Gifting real estate assets.** It depends on each family's situation, but this can offer a large balance sheet line item for transfer with minimal cash flow effect. This can be a good strategy for families who want to use exemption now, but they would like to retain access to income-producing assets because of cash flow uncertainty.

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Key Individual Income Tax Provisions

	Current Law	President-Elect Biden
Ordinary Income	10%: $0 – $9,875 12%: $9,876 – $40,125 22%: $40,126 – $85,525 24%: $85,526 – $163,300 32%: $163,301 – $207,350 35%: $207,351 – $518,400 37%: $518,400 – More	10%: $0 – $9,525 15%: $9,526 – $38,700 25%: $38,701 – $82,500 28%: $82,501 – $157,500 33%: $157,501 – $200,000 35%: $200,001 – $500,000 39.6%: $500,001 – More *No formal rate structure announced but expressed desire to roll back to pre-TCJA levels.
Itemized Deductions	Common deductions include mortgage interest, charitable donations, state and local taxes and investment interest. State and local taxes limited to $10,000.	• Itemized deductions would carry a maximum tax benefit of 28% of total deductions. • Reinstatement of the 3% Pease Limitation.
Capital Gains	0%: $0 – $40,000 15%: $40,000 – $441,450 20%: $441,451 + *Applicable to Long Term Capital Gains and Qualified Dividends	Long Term Capital Gains and Qualified Dividends would be taxed at ordinary rates for taxpayers with annual income greater than $1 Million.
Carried Interest	Treated as long-term capital gain if held for at least three years.	Taxed as ordinary income.
Payroll Tax	• 6.2% Social Security tax on wages up to $137,700 (employer and employee). • 1.45% Medicare tax on all wages (employer and employee). • 0.9% Medicare tax on wages over $200,000, $250,000 if married (employee only).	Eliminate Social Security tax exemption for wages above $400,000 (wages between $137,700 and $400,000 would still not be taxed).

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Key Estate & Gift Tax Provisions

	Current Law	President-Elect Biden
Exemption Thresholds	$11.58 million per individual (indexed for inflation).	President Elect Biden has been silent, but the Biden-Sanders task force expressed support for returning estate taxes to the historical norm. The pre-TCJA exemption level was $3.5 Million per individual, and the Obama Biden Administration had implemented $5.25 Million per individual (adjusted for inflation) under ATRA in 2013.
Basis Step-Up	Heirs receive an increased basis in inherited assets equal to the current fair market value.	Eliminate the step-up in basis for inherited assets
Tax Rate	Top Rate of 40%.	No changes reported.

Key Corporate Tax Provisions

	Current Law	President-Elect Biden
Corporate Tax Rate	21%	28%