Wealth Planning Insights

Helpful Tips for Year-End Tax Planning and Charitable Giving

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Highlights

- Major tax legislation is unlikely unless the Democrats gain control of the Senate, which depends on the outcome of two Georgia runoff elections in early January. Democrats would need to win both seats to attain a 50/50 balance, with Vice President-elect Harris tilting control in their favor.
- Tax planning can be challenging in a time of uncertainty. Our advice is to put more weight on major tax planning strategies where the result is certain and give less consideration to approaches based on future events that may or may not occur.
- In this *Wealth Planning Insights*, we provide some helpful tips for your 2020 tax and philanthropic planning, based on what we know as we head into year end, and some planning measures to consider to protect against potential future tax increases.

2020 Year-End Income Tax Planning

Recent history has shown that major tax legislation has only been enacted when one party controls the White House, the House of Representatives, and the Senate. The last successful bipartisan effort was the Tax Reform Act of 1986. Since then, we have seen a direct correlation between the passage of major tax legislation and full control of government (Exhibit 1).

This historical perspective is especially important in the wake of 2020 election results. President-elect Biden has proposed a series of tax law changes that, if enacted, would disproportionately affect higher-income taxpayers (Exhibit 2). Democrats have retained control of the House with a narrower margin, but Senate control hinges on the outcome of two Georgia runoffs in early January 2021. Democrats would need to win both to attain a 50/50 balance in the Senate. Vice President-elect Harris would then tilt control in their favor. Failing this result, Republicans would retain Senate control, and we will have split government for the next two years. As noted, the likelihood of major tax legislation would be all but extinguished in such a case.

Exhibit 1: Major Tax Legislation and Congressional Control

Legislation	President	Senate	House
Deficit Reduction Act of 1993	Clinton		
Bush Tax Cuts — 2001 and 2003	Bush 43		
PPACA — Obamacare	Obama		
TCJA — Tax Cuts and Jobs Act	Trump		

Source: Bessemer Trust

Exhibit 2: Biden — Individual Tax Proposals

Proposal	Who It Would Affect
Top rate on ordinary income increase to pre-Tax Cuts and Jobs Act level of 39.6%	Would apply to taxpayers with income exceeding $400k
Qualified dividends and long-term capital gains taxed as ordinary income	Would apply to taxpayers with income over $1 million; top tax rate would increase to 43.4%
Earned income above $400k would be subject to social security tax	Creates a gap from $143k to $400k
Limit value of itemized deductions to 28%	Would apply to taxpayers with income exceeding $400k
Restrict other Tax Cuts and Jobs Act provisions and CARES Act provisions	199A deduction phased out for taxpayers with income exceeding $400k; repeal of NOL offset and carryback changes
Restore deduction for state and local taxes?	Not a specific Biden proposal, but would be pushed by Schumer and others

Year-end tax planning can be challenging in the face of such uncertainty. Significant tax measures included in recent legislation further complicate matters (Exhibit 3). Our advice in such times is to put more weight on major tax planning strategies where the result is certain and give less consideration to approaches contingent on future events that may or may not occur or be clearly defined at this time. Along these lines, the following discussion will focus on tax planning strategies in calendar year 2020, where the resulting tax treatment is not in doubt. We will close with a few thoughts on planning measures to consider to protect against potential future tax increases.

Required Minimum Distributions

We would normally advise clients to time the receipt of required minimum distributions (RMDs) from retirement accounts toward the end of the year to maximize growth within a tax-deferred account. However, a key provision of the Coronavirus Aid, Relief and Economic Security Act (CARES Act), enacted March 2020, suspends RMDs for 2020. This applies to traditional IRAs, SEP IRAs, SIMPLE IRAs, 401(k)s, 403(b)s, and 457(b) retirement plans. There is no requirement to “make up” this distribution in 2021. To the extent you have not taken your RMD for 2020, we recommend you consider suspending this payment. Benefits include a lower tax liability in 2020 and additional tax-deferred growth within the account.

On a related note, the Setting Every Community Up for Retirement Enhancement Act (SECURE Act) increased the RMD age from 70½ to 72 and eliminated beneficial distribution rules for non-spouse Roth IRA beneficiaries beginning in tax-year 2020.

Tax-Advantaged Retirement Accounts

Clients with self-employment income should consider setting up and funding a self-employed retirement plan. In most cases, the contributions are tax-deductible, such that the government is effectively paying you with current-year tax savings to fund your own retirement plan. Account balances enjoy tax-deferred growth until taxable distributions are required in retirement.

Roth IRAs

Although the ability to stretch the payout period for non-spouse Roth IRA beneficiaries has been limited to 10 years by the SECURE Act, these accounts are still a powerful wealth transfer tool. Clients should consider so-called “backdoor” Roth IRAs, which can also be funded for non-working spouses, as well as Roth IRAs for children with earned income.

Exhibit 3: Key Changes by Planning Area

Charitable Contributions	60% AGI deductibility limit for cash to public charities	TCJA
	For 2020 only, 100% AGI deductibility for qualified contributions	CARES Act
Qualified Plans	Roth recharacterizations suspended	TCJA
	"Stretch" Roth IRAs eliminated	SECURE Act
	RMDs required at age 72	SECURE Act
	RMDs suspended for 2020	CARES Act
	No age limit for IRA contribution eligibility	SECURE Act
Business Income	199A deduction for qualified business income	TCJA
	NOLs/excess business losses	CARES Act

Source: Bessemer Trust

Roth IRA Conversions

Converting a traditional IRA into a Roth IRA can produce significant economic benefits, however, the amount converted must be included in taxable income in the year of conversion. The related tax cost can be offset in some cases, for example, if significant charitable contributions are planned or if deductible losses are triggered on the disposition of passive activity investments. It is important to note that the Tax Cuts and Jobs Act (TCJA) suspended the ability to recharacterize or undo a Roth conversion in the following tax year. The individual tax provisions in the TCJA are slated to expire at the end of 2025.

Net Operating Losses and Excess Business Losses

The CARES Act temporarily reinstated net operating loss carrybacks and temporarily suspended the excess business loss limitation. These rules only apply to 2018, 2019, and 2020. Taxpayers should consult with their tax advisors regarding potential deadlines for capturing tax benefits from these losses.

Charitable Planning

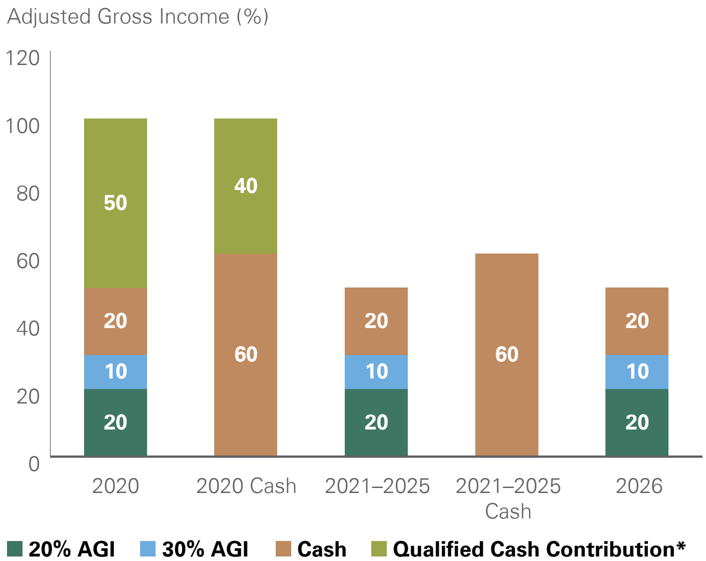
Recent legislation has significantly enhanced the deductibility of charitable contributions. The TCJA raised the yearly deduction limit from 50% of adjusted gross income (AGI) to 60% of AGI for cash contributions to public charities, including donor-advised funds. The CARES Act went further, enacting a 100% of AGI limit for cash contributions to qualified public charities, excluding donor-advised funds. Unlike prior law, for 2020 only, these cash contributions can be used to "top off" otherwise allowable contributions up to 100% of AGI.

Charitable contributions of long-term appreciated securities provide an additional tax benefit. A full fair market value deduction is permitted, although the true economic value of the securities is actually a lower amount due to the related tax liability on the underlying appreciation. The deduction for long-term appreciated securities is limited to 20% of AGI if made to a private foundation and 30% of AGI if made to a public charity, including a donor-advised fund.

Exhibit 4 illustrates the current and future AGI limits for deducting charitable contributions. Excess contributions can be carried forward for up to five years, but must be deducted within that time frame or they will be lost.

Exhibit 4: Charitable Planning — Adjusted Gross Income Limitations

Limited by Type of Gift and by Recipient



* Cash contribution to public charities, excluding donor-advised funds and 509(a)(3) supporting organizations.

Source: Bessemer Trust

State and Local Taxes

So far, we have discussed tax planning strategies to consider in 2020 because we are certain of the tax result. Here is an action you should probably *not* take in 2020 — for the same reason. The TCJA limited the deduction for state and local taxes to $10,000; most clients will have already reached this limit, so no additional tax benefit can be gained with further payments this calendar year. We recommend holding off on any remaining estimated state income tax payments or real estate taxes due and make these payments in January 2021. As noted earlier, the possibility of Democratic control of Congress remains. The restoration of the full deduction for state and local taxes has been a Democratic priority since it was suspended by the TCJA.

COVID-19 State Residency Implications

Taxpayers may find themselves with unintended state income tax consequences resulting from office closures, state COVID-19 travel restrictions, or simply by temporarily relocating to a second home in another state. In many states, extended physical presence may create tax liability as a statutory resident. States are addressing these situations differently, and the outcomes are often fact driven. Taxpayers should consult with their tax advisors regarding potential state tax residency implications.

Annual Tax Planning Strategies

Exhibit 5 includes several planning strategies discussed earlier and additional approaches to consider. Annual giving should be coordinated with your overall estate plan.

Protective Planning Measures

As noted above, the potential for significant tax changes under a Biden administration depends largely on two Senate races in early January. And even in the event of Democratic control, there is no guarantee the Biden tax platform would be enacted as proposed and no indication what the effective date might be. However, some taxpayers may still want to consider protective measures in light of this potential outcome.

The tax proposal that would likely have the greatest effect on high-income taxpayers is the removal of the preferential tax rates for long-term capital gains and qualified dividends. This would apply to taxpayers with income over $1 million and would nearly double the current level of 23.8% to a new top rate 43.4%.

Higher-income taxpayers with significant low-basis appreciated holdings may want to consider disposing of some portion of these by year end, especially if there is an intention to sell within the next few years. A similar approach may be considered for owners of C corporations with significant retained earnings. A dividend distribution this year may make sense for taxpayers concerned about the potential for higher rates. We do know that long-term capital gains and qualified dividends will be taxed at a top rate of 23.8% this year. There is no indication this rate is headed any lower.

This piece has focused on income tax planning, but as our Estate Planning group has written about recently (see *Is Now the Time to Consider a Spousal Lifetime Access Trust?*) there are also some changes to the estate, gift, and generation-skipping transfer (GST) tax exemptions on the horizon. These exemptions are set at $11.58 million per person in 2020 and are set to revert back to $5 million, indexed for inflation, on January 1, 2026. However, President-elect Biden's tax platform includes provisions to accelerate this reversion, and some believe the reductions could be accelerated to as soon as the beginning of 2021. Thus, there is a possibility of a "use it or lose it" situation. In this context, "using it" means making gifts of amounts in excess of $5.79 million up to the full $11.58 million exemption (and possibly double that for a married couple) before the end of the year.

Tax Planning in Uncertain Times

Major tax changes in 2021 are possible but far from certain. Our advice is to make major planning strategies where you are confident in the tax result. We will continue to monitor the legislative landscape closely and keep you fully informed of all developments.

If you have any questions, please contact your client advisor or one of our senior tax consultants. We are happy to discuss your personal situation and share our thoughts.

As we head toward the end of a remarkably challenging year, we hope that you and your families are well and wish you a safe and healthy holiday season and new year.

Exhibit 5: Annual Tax Planning Strategies to Consider

Action Step	Income and/or Transfer Tax Benefit
Consider selling investments to realize losses.	Losses reduce current year capital gains.
Fund a self-employed retirement plan (must have self-employment income).	Current year income tax deduction; tax-deferred growth of plan assets.
Use long-term appreciated securities for charitable contributions.	Full FMV charitable deduction up to 30% of adjusted gross income (AGI) – income tax liability on appreciation amount is eliminated.
Fund a so-called "backdoor" Roth IRA (must have earned income). Can also fund for non-working spouse.	Up to $7,000 per year ($14,000 if married). No required minimum distributions (RMDs). Roth income and distributions excluded from taxable income.
Front-load several years of charitable giving with a donor-advised fund.	Potential income tax benefit from increased standard deduction under the Tax Cuts and Jobs Act (TCJA).
Make a Qualified Charitable Distribution (QCD) from an IRA if 70½ or older.	Can satisfy RMD, will reduce AGI such that limitations on tax benefits tied to AGI levels may not apply.
Make direct payments of tuition and medical expenses for children/grandchildren.	These payments will not use the donor's annual exclusion or reduce the remaining gift tax or GST lifetime exemption.
Fund a 529 plan for children or grandchildren with annual exclusion gifts. Consider front-loading up to five years.	Funds are removed from taxable estate and invested in an income tax-free account. Account balance can be used to pay education expenses beyond tuition, such as room, board, and supplies. State income tax deduction may be available.
Fund Roth IRA or so-called "backdoor" Roth IRA for children or grandchildren with earned income. Limited to lesser of earned income or $6,000.	Funds are removed from donor's taxable estate and invested in a retirement account with no RMDs for plan participant. Income and qualified distributions are free from income tax.

Source: Bessemer Trust

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