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Essential Estate and Income Tax Planning Considerations for Year-End 2020

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A political power change from the 2020 election in favor of the Democratic Party could be followed by sweeping legislative changes in 2021 impacting high-income and high-net-worth taxpayers in the form of higher income and transfer tax rates and/or severe limitations on, or eliminations of, many common estate planning techniques currently available. The possibility of such changes creates heightened planning considerations for the remainder of 2020:

- The effective date for certain tax law changes could be retroactive to January 1, 2021.[1]
- Many sophisticated income and transfer tax planning techniques may require several steps, weeks or months' worth of time to properly implement to minimize certain tax and legal risks.
- Many financial, tax, legal and valuation professionals, whose guidance and services may be needed to facilitate certain income and transfer tax planning strategies, may be experiencing increased demand for their services by their clients in anticipation of post-election results, which could add more time to the planning process.
- High-net-worth and high-income individuals must begin talking with their advisors and taking action immediately to be in a position to execute certain planning strategies by year-end 2020 and take advantage of current income and transfer tax planning opportunities before they possibly disappear.
- Regardless of any 2021 legislative changes, the growing amount of Government debt and deficit spending that may eventually necessitate raising revenue through taxes combined with the temporarily high transfer tax exemptions that will get cut in half on 1/1/2026 under current law may make many related planning techniques and decisions beneficial to consider now anyway.

Below are highlights from the tax proposals of President Trump vs. Presidential Candidate Biden that primarily affect high-income and high-net-worth individuals and businesses. Democrats would have to keep control of the House of Representatives, win the Presidency and control of the Senate for Biden's proposals to have a chance of becoming law.

SELECT HIGHLIGHTS FROM PRESIDENT TRUMP'S VS. CANDIDATE BIDEN'S TAX POLICY PROPOSALS (NOT AN EXHAUSTIVE LIST)[2]

General themes of Biden's and the Democratic Party's general tax policy proposals include:

- ***Increase tax on income*** for high-income earners through increasing payroll and self-employment taxes, raising the top marginal income tax rate as well as the top capital gains income tax rate or limiting itemized deductions.
- ***Increase tax on wealth*** for high-net-worth individuals through a wealth tax, increasing estate and gift taxes, eliminating the step-up in basis at death for capital assets or limiting various estate planning techniques.
- ***Increase tax on businesses*** through increasing corporate income taxes or limiting or eliminating certain deductions.

[1]Retroactive tax legislation is possible if supported by a rational legislative purpose. See Pension Benefit Guar. Corp. v. R. A. Gray & Co., 467 U.S. 717; United States v. Carlton, 512 U.S. 26; and Quarty v. United States, 170 F.3d 961.
[2]Sources: *Trump, Biden Tax Plan Comparison* by Bloomberg Tax & Accounting, The Bureau of National Affairs, Inc., 2020. *Year-End Planning in 2020:* Including Planning for a Biden Administration by Robert Keebler, Keebler Tax & Wealth Education, 2020.

Tax Item	Trump Proposal	Biden Proposal
INDIVIDUAL INCOME TAXES		
Income Tax Rates	Fiscal Year 2021 Budget extends current Tax Cuts and Jobs Act 2017 (TCJA) provisions beyond 2025 with a top tax rate of 37%.	Increase top tax rate to 39.6% on income over $400,000 (unclear how it is affected by filing status).
Capital Gain Tax Rates	Fiscal Year 2021 Budget extends current TCJA provisions beyond 2025 with a top tax rate of 20% plus 3.8% Medicare surtax.	Increase top tax rate to 39.6% plus 3.8% Medicare surtax for taxpayers with over $1 million income.
Wealth Tax	No wealth tax.	Generally does not support but other Democrat proposals have included a wealth tax.
Itemized Deductions	Fiscal Year 2021 Budget extends current TCJA provisions beyond 2025.	Limit the tax benefit of itemized deductions to 28%. Reinstate PEASE limitation on itemized deductions for incomes exceeding $400,000. Eliminate SALT deduction cap.
Employment And Social Security Taxes	Waive payroll taxes through the end of 2020 to boost economic activity during the COVID-19 pandemic.	Expands the Social Security taxable wage base to include income over $400,000.
INDIVIDUAL TRANSFER TAXES		
Transfer Tax Rates	Fiscal Year 2021 Budget extends current TCJA provisions beyond 2025.	No changes. Various other Democrat proposals have included an increase in the transfer tax rate.
Lifetime Basic Exclusion Amount (BEA) for Gift, Estate and Generation-Skipping Transfer Taxes	Fiscal Year 2021 Budget extends current TCJA provisions beyond 2025.	No changes. Various other Democrat proposals have included a reduction in the BEA.
Step-Up in Basis at Death Rule for Capital Gain Property	No changes to the current rule which relieves unrealized capital gain at death from income taxation.	Eliminate step-up in basis at death rule; possible that death would be a realization event causing a “deemed” sale and income taxation of unrealized gain.
BUSINESS INCOME TAXES		
Corporate Tax Rates	No change. Corporate tax rate of 21%.	Tax rate of 28% with 15% minimum tax for corporations with book profit of $100 million or more but paid $0 or negative federal income taxes.
Carbon Tax on Fuels that Emit Greenhouse Gases	Supported carbon capture efforts under a pro-coal agenda.	Supports a carbon tax.
Depreciation	Fiscal Year 2021 Budget extends current TCJA provisions beyond 2025.	Reverses TCJA provisions that largely benefit corporations.
Fossil Fuel Deductions and Incentives	Supports tax breaks for fossil fuel companies.	End subsidies for fossil fuels.
Qualified Business Income Deduction under IRC § 199A	Fiscal Year 2021 Budget does not include any change to current law.	End special qualification rules, including those for real estate investors. Limit deduction for taxpayers making less than $400,000.

All individuals should seek guidance from a financial, tax or legal professional regarding any related actions and considerations pertaining to their situations.

PLANNING CONSIDERATIONS FOR YEAR-END 2020[3]

Below are various planning decisions that may be advisable to consider for year-end 2020 in anticipation of potential tax law changes in 2021, depending on the outcome of the election.

Accelerate income in 2020 to avoid a potentially higher tax cost of a 39.6% top rate or higher payroll taxes in 2021+

- Accelerate compensatory bonuses
- Convert traditional IRA or 401(k) plan to a Roth account
- Harvest unrealized gains in capital assets, such as real estate or marketable securities (e.g. diversifying a concentrated stock position)
- Finalize the sale of a privately held business interest
- Exercise Non-Qualified Stock Options or Incentive Stock Options
- Distribute employer stock with Net Unrealized Appreciation from a qualified retirement plan
- Make anticipated C-corporation dividends to shareholders
- Reconsider funding Non-Qualified Deferred Compensation plans
- Elect to accelerate the recognition of gain on a sale of property for an installment obligation under IRC § 453(d)

Defer certain business deductions to get a potentially higher tax benefit from a 28% or 39.6% top rate in 2021+

- Delay harvesting unrealized losses in capital assets, such as those mentioned above
- Delay business-related expenses or those incurred or related to the management of property held, to produce income

Carefully consider the timing of certain itemized deductions in 2020 vs. 2021+ to maximize the tax benefit in anticipation of potential limitations imposed or lifted in 2021+

- Defer payment of property taxes to capture greater tax benefit due to higher top tax rate or repeal of SALT deduction cap vs. accelerate to avoid additional limitations on itemized deductions from PEASE reinstatement or 28% tax benefit cap
- Defer charitable contribution deductions to capture greater tax benefit due to higher top tax rate vs. accelerate to avoid additional limitations on itemized deductions from PEASE reinstatement or 28% tax benefit cap

Make large gifts in 2020 to make use of the lifetime Basic Exclusion Amount (BEA) or mitigate a forced income recognition event at death

- Create an irrevocable trust for the benefit of family members, obtain qualified appraisals of property, if necessary, make gifts to the trust and allocate the available BEA and Generation-Skipping Transfer (GST) Exemption
- Gift more than $5.79MM to make use of the increased BEA that will sunset on 1/1/2026 under current law
- Consider trust strategies that avail the grantor(s) of the flexibility to indirectly access trust property or money, if needed, to help alleviate concerns regarding making gifts hastily, needs changing or loss of control
- Consider certain estate planning strategies that have been the target of proposed limitations by prior Democrat Administrations, such as irrevocable grantor trusts, Grantor Retained Annuity Trusts (GRATs) and valuation discounts on minority or non-managing interests in family-controlled business entities.

Important: To implement gifting strategies properly, several steps and extended time may be required with the guidance of financial, tax, legal and valuation professionals. Waiting until the last minute is not advisable.

[3]Considerations and actions discussed are an oversimplified summary of complicated financial, tax and legal matters that may not be applicable for all individuals. All suggestions are representative, not exhaustive, for discussion purposes only and meant to highlight various topics for individuals to explore with their financial, tax and legal professionals from whom they should seek advice.

CONCLUSION

The end of the year is fast approaching and many financial, tax, legal and valuation professionals may be stretched thin to keep up with increased demand for their services leading up to the election. Procrastination may leave insufficient time to address all the requirements and action items needed to properly implement various income and transfer tax strategies by year-end. High-income and high-net-worth individuals must consult with their advisors immediately to begin taking what steps are needed to be in a position to capitalize on various opportunities that may disappear after this year if there is a sweeping political power change at the federal level from the 2020 election. ***The time to act is now!***

If you have any questions, please reach out to your financial professional.

2003 Cahaba Road

Suite 201

Mountain Brook AL 35223

205 871-2883

ABOUT LION STREET

Lion Street is a leading financial services company based in Austin, Texas. Lion Street provides our elite national network of Firms and financial professionals access to the financial products, intellectual capital, and specialized resources they need to meet the sophisticated needs of high-net-worth and corporate clients. To learn more about Lion Street, please visit www.lionstreet.com or connect with us on LinkedIn.

515 Congress Ave., 25th Floor - Suite 2500 | Austin, TX 78701 | (512) 776-8400

www.LionStreet.com