The Colony Group

SHOULD YOU PLAN FOR HIGHER TAXES NOW? YES, SAY TAX PROFESSIONALS.

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With the election just around the corner, we thought it would be helpful to alert you to some of the tax planning ideas we are currently considering for clients. Normally, year-end tax planning is focused on one simple concept: defer income and accelerate deductions. This year, however, the opposite may be true. Depending on the outcome of the election, the potential for higher tax rates in 2021 makes accelerating income into 2020 a viable tax planning strategy for some. As for accelerating deductions, that strategy, too, may need reconsideration this year because it's possible that the value of certain deductions will be limited starting in 2021.

Of course, the timing of any of the proposed tax changes described here is uncertain. Tax legislation enacted early in 2021 may very well be grandfathered back to a start date of January 1, 2021. Any legislation passed later in the year may not take effect until 2022. Despite this uncertainty, now is the time to consider strategies and steps that may be taken before year-end.

What tax changes could impact my tax planning?

There are several key tax law changes that former Vice President Biden has proposed during his campaign. While Biden has promised not to raise taxes for any taxpayer earning less than $400,000, his tax plan proposes the following changes for taxpayers earning above $400,000:

- Raise the personal income tax top marginal rate back up to 39.6%, from its current 37% rate
- Apply a Social Security payroll tax of 12.4% on income over $400,000
- Limit itemized deductions at 28% of value
- Phase out the 20% qualified business income deduction
- Limit like-kind exchanges by real estate investors
- Provide a First-Time Homebuyer Credit of up to $15,000

Depending on the outcome of the elections, taxpayers should consider accelerating income and deductions before any proposed tax changes would take effect, potentially as early as 2021. One income-accelerating idea is a Roth IRA conversion. Pair this with a deduction-accelerating strategy, such as bunching charitable contributions, and you can minimize the tax hit from the additional IRA income while maximizing tax savings from claiming deductions in 2020. Furthermore, IRA assets would now be tax-free for the designated beneficiary, reducing their future income tax burden upon inheriting the IRA.

What about capital gains taxes and qualified dividends?

One other major change Biden has proposed is to tax long-term capital gains and qualified dividends at ordinary rates if a taxpayer's income exceeds $1 million. The current maximum long-term capital gains rate is 20%, while the proposed new maximum ordinary rate is 39.6%. Again, while we need to see what happens in the election, taxpayers with appreciated securities should consider realizing some of their gains this year. You may also want to consider deferring capital losses. Your tax or financial advisor can run a tax projection to analyze the actual tax outcome of any planning decision.

What about my estate planning and gifting strategy?

Depending on how the election goes, we could be facing vastly different scenarios for estate planning in 2021 and beyond. Currently, we are enjoying a lifetime estate exclusion amount of $11,580,000 (or $23,160,000 for married couples, indexed for inflation) with an estate tax of 40% assessed on the excess. This is set to expire in 2025 upon the sunset of the Tax Cuts and Jobs Act (TCJA), and the amounts will revert to $5,000,000 (or $10,000,000 for married couples, again indexed for inflation) unless Congress votes to extend the provision.

President Trump is in favor of making permanent the current exemption amounts. Biden's proposals include a provision to decrease the exemption amounts, possibly even to pre-TCJA amounts of $3.5 million (or $7 million for married couples) with a 45% estate tax on the excess. In addition, Biden has also proposed an elimination of the current "step-up" in basis of inherited assets. How this will be implemented is still up in the air. One possibility is that beneficiaries will inherit the decedent's basis. The other main option is that the gains will be taxed at death.

The next few months provide an opportunity to plan with some certainty. High net worth individuals may want to consider current significant gifting to take advantage of the higher lifetime exemption before a possible reduction. The current historically low interest rates present some unique trust planning opportunities. Charitable Lead Annuity Trusts (CLATs), for example, provide a way to make a charitable contribution while also shifting wealth to future generations. It's possible that the present gift and estate tax environment that we now enjoy may be the most favorable we will see for years to come.

How could proposed tax changes affect business taxes for corporations and small businesses?

In addition to the individual and estate tax changes, there may also be tax changes for corporations. The proposed changes under the Biden tax plan would increase the corporate tax rate from 21% to 28%. Therefore, it is important for owners of small businesses and corporations to consider accelerating income to 2020. Similarly, partners and shareholders in LLC's, S-Corps and partnerships should consider year-end tax projections to decide if it makes sense to recognize income in 2020 as opposed to 2021.

Are there any potential surprises to my state taxes?

One side effect of the pandemic is that many taxpayers have adjusted or eliminated their typical travel schedules. Many states maintain laws that consider individuals to be residents for income tax purposes if they maintain a "permanent place of abode" (owned or rented) and spend more than 183 days in the state within a tax year. Changes in travel due to the pandemic could therefore end up having a significant tax impact.

HERE IS AN EXAMPLE:

A client considers his/her permanent home or domicile to be in Florida. However, they maintain a vacation home in Massachusetts. This vacation home is heated and could be used as a full-time home if desired.

In 2020, client traveled to Massachusetts on Memorial Day (May 25, 2020). Client usually returns to Florida after Labor Day (September 7, 2020, or 105 days spent in MA), but, due to COVID, client decided to remain in Massachusetts.

If this client does not return to Florida before spending 183 days in Massachusetts (November 24, 2020 or just before Thanksgiving), then the client will be considered as having statutory domicile in Massachusetts for income tax purposes in 2020. Their income will be subjected to Massachusetts income tax in 2020.

This example considers a client who has homes in Massachusetts and Florida. However, an even more extreme example would be Massachusetts and Colorado.

Both Massachusetts and Colorado have an income tax (unlike Florida). If a client considers their permanent home or domicile to be Colorado but inadvertently becomes a statutory resident in Massachusetts, then they will need to pay income tax to both Massachusetts and Colorado in 2020. And, under these circumstances, it's possible that neither state would allow a credit for the tax paid to the other state.

> **The results of the election could have a major impact on taxes over the next few years, regardless of the outcome. Now is the time to work with a tax or financial advisor who can help you understand the latest tax laws and can apply them to your personal circumstances.**

DISCLOSURE:

This letter is general and educational in nature and is not to be construed as investment, tax, or legal advice. Individuals should seek advice from their wealth advisor or other tax advisors before undertaking actions in response to the matters discussed.