NATIONAL WEALTH ADVISORS Inc.

Business & Personal Financial Planning

Michael A. Caputo, MSFS, AEP®

President

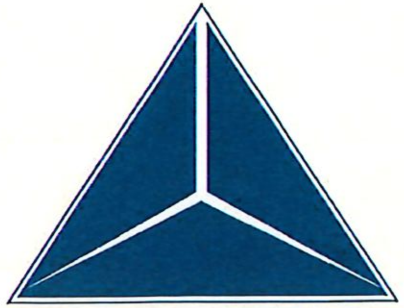
SUMMIT FINANCIAL, LLC.

Planning Alert- November 2020

Election Aftermath Tax Considerations

National Wealth Advisors, Inc. is a DBA of Summit Financial, LLC. Investment advisory and financial planning services offered through Summit Financial, LLC, an SEC Registered Investment Advisor. Insurance services offered through Summit Risk Management, LLC, an affiliate of Summit Financial, LLC. Securities brokerage offered through Purshe Kaplan Sterling Investments, Member FINRA/SIPC Headquartered at 80 State Street, Albany, NY 12207 ("PKS"). PKS and Summit Financial, LLC, are not affiliated companies.

11122020-1223



Planning Alert
November 2020

Election Aftermath Tax Considerations

Now that the 2020 elections have been held, the affluent are measuring how voting outcomes may financially impact them.

While the Electoral College has not officially cast its votes to certify either Presidential candidate as "winner," Joe Biden now seems to be headed for the White House, leaving court intervention as the only path for Donald Trump to remain in office for a 2nd term.

However, no matter which candidate wins the Presidency, neither is likely to implement any tax policy without support from both houses of Congress. A Biden Presidency could face legislative gridlock from a Republican majority in the Senate, depending on runoff elections for 2 Senatorial seats in Georgia. Similarly, a 2nd Trump Administration almost certainly would contend with a Democrat-controlled House of Representatives.

Given the possibility that either candidate may wrestle with an opposing Congress if he is elected, there may be a window of time between now and the 2022 mid-term races during which clients should consider updating their financial & estate plans before the specter of tax change arises once again. Although here, it is important to note that the window to engage in planning which addresses potential tax reform may close as early as the end of this year, since there remains a chance for Democrats to take control of the Senate starting in 2021.

With a presumptive Biden Presidency bringing the most likelihood of tax changes in either 2021 or 2023, clients are asked to consider his campaign's tax proposals, plus a few forward planning thoughts, as they update their financial & estate arrangements.

Candidate Biden's Key Tax Proposals[1]

- Repeal income tax cuts for people making over $400,000 annually, raising the highest personal income tax rate from a current 37% back to 39.6%
- Cap the value of itemized deductions at 28% for taxpayers with incomes of over $400,000 per year, instead of valuing those deductions at the taxpayers' higher ordinary income tax rate
- Subject capital gains and dividends to ordinary income tax rates for people with yearly income exceeding $1,000,000
- Close the "loophole" which taxes private equity & hedge fund managers' carried interest at 20% capital gains rates by taxing that carried interest at a recipient's higher ordinary income tax rate
- Tax unrealized capital gains at death, even if none of the deceased's appreciated assets are sold; thus, eliminating the basis "step-up" to fair market value at death
- Implement a refundable 1st-time homebuyer credit of up to $15,000 which is advanceable to provide funds that are needed when purchasing the home

Candidate Biden's Key Tax Proposals ~ (Continued)[1]

- Collect Social Security tax on earned income over $400,000 subjecting both the first $142,800 of earned income & earned income above $400,000 to the tax, using numbers for 2021
- Replace the deduction for retirement account contributions with an estimated 26% refundable credit, limiting the tax benefit of those contributions for people who pay higher ordinary income tax rates
- Reinstitute the PEASE limit on itemized deductions, lowering the value of those deductions once taxable income exceeds $400,000
- Raise the top estate & gift tax rate to as high as 45% and reduce the lifetime exemption for gift & estate tax from $11,580,000 back to either $5,000,000 where it was set in 2011 or even $3,500,000 where it was set in 2009
- Phase out the qualified business income deduction for people with annual income exceeding $400,000
- Increase the highest corporate income tax rate from 21% to 28% and subject corporate book income of $100,000,000 or more to a 15% alternative minimum tax
- Double the tax rate on global intangible low tax income (GILTI) earned by foreign subsidiaries of American businesses from 10.5% to 21%
- Impose a 10% surtax for U.S. companies that move manufacturing & service jobs to another country and then provide services or products for sale back to the American market
- Create an advanceable 10% "Made in America" credit for manufacturers' revitalizing, re-tooling and hiring costs

Responsive Planning

Given Biden's above proposals, there is great uncertainty surrounding future tax policy as 2021 nears. Even if Congress does not repeal some of the more benign tax provisions now in effect, many of those provisions are scheduled to sunset at the end of 2025 already.

One provision that will automatically sunset is today's gift & estate tax exemption of $11,580,000 per person or $23,160,000 for married couples which will revert back to pre-2018 levels in 2026, unless Congress chooses to lower the exemption before then. With calls for tax change perhaps coming as early as 2021, wealthy Americans see an opportunity to use further gifting now to lock-in the extra lifetime exemption they currently have before a large part of the exemption sunsets or is repealed.

Though there are many ways to use the lifetime exemption from gift tax, a common concern when doing so is retaining access to the property transferred. Below, are a few strategies which could provide flexibility to clients wishing to freeze or reduce their taxable estates, while retaining an interest in the assets transferred.

Spousal Lifetime Access Trusts ("SLATs")

People with an overriding need to access property they transfer often view SLATs as a nice fit for utilizing their gift tax exemption, since a person's spouse can access the trust's holdings. Specifically, a grantor creates a trust with the discretion to make payments to both his or her

Spousal Lifetime Access Trusts ~ (Continued)

spouse and possibly descendants, until the spouse later dies, at which point trust assets will pass outright or in-trust to the grantor's ultimate beneficiaries.

The grantor's spouse can serve as trustee of a SLAT, allowing the grantor to indirectly retain control of the assets he or she places into the trust. Should the grantor's spouse serve as trustee, that spouse's discretion to distribute assets must be limited by an ascertainable standard to prevent the SLAT from being included in the spouse's taxable estate. An Independent Trustee can be used to make discretionary distributions to for any reason, expanding access to the trust's holdings beyond using them merely to fund healthcare, education, maintenance & support needs.

If a couple divorces or the spouse who is lifetime beneficiary dies before the trust's grantor, the grantor will lose access to the trust's assets. To address the possibility of a spouse predeceasing, some couples divide assets between two SLATs which name the other spouse as beneficiary; however, dual trusts should not contain identical terms to prevent each trust from becoming taxable in its grantor's estate under the "reciprocal trust doctrine."

A SLAT can be drafted so that it grants beneficiaries withdrawal rights over future trust additions, in order to qualify those additions as present interests and facilitate annual exclusion gifting through the trust. SLATs may be structured as grantor trusts for federal income tax purposes, causing the grantor to be taxed on all trust income & realized gains. This feature enhances the SLAT's effectiveness as a family wealth shifting & tax saving device, since the grantor is essentially making tax-free gifts of the income taxes paid.

Grantor Retained Annuity Trusts ("GRATs")

Someone who is not intent upon making a transfer to grandkids or great-grandkids can create a trust that will pay him or her a yearly sum for a set period after which the trust's assets will pass to people or further trusts whom the grantor names as remainder beneficiaries. The trust's grantor can serve as trustee of a GRAT, allowing him or her to retain control over the assets held in-trust for the future enjoyment of beneficiaries.

The gift value of a GRAT's remainder is derived by subtracting the value of the grantor's retained payment stream from the value of the property transferred & can be manipulated to be as low as zero. If a GRAT's assets grow by more than the amount required to fund the grantor's payment stream, that excess growth will pass to the trust's ultimate beneficiaries gift & estate tax-free.

When a GRAT's annual income is not sufficient to fund the yearly payout owed to its grantor, the trust will distribute assets in-kind to make up any shortfall, unwinding some of the valuation discount taken on assets placed into the trust and eroding the estate taxes saved by making the transfer.

GRATs are grantor trusts for federal income tax purposes, causing the grantor to be taxed on all trust income & realized gains, even if that tax liability exceeds the grantor's annual payment from the trust. This feature enhances a GRAT's power as a family wealth shifting & tax saving vehicle, since the grantor is basically making tax-free gifts of the income taxes paid.

Short-term "rolling GRATs" for periods as brief as 2 years are sometimes funded with scheduled trust payments the grantor receives. Once more, a trust's asset growth must outpace its payments to the grantor; otherwise, the GRAT will fail and return it assets to his or her estate with

Grantor Retained Annuity Trusts ~ (Continued)

no transfer tax consequences – just the cost of administration. During the Obama-Biden years, changes designed to limit a GRAT's effectiveness were proposed but never enacted. Given the chance that GRATs may come under attack again, using short-term "rolling GRATs" to freeze the value of an estate should be undertaken with care.

Sale to Intentionally Defective Grantor Trust ("IDGT")

People looking for a strategy that facilitates transfers by both gift and sale should consider an IDGT.

If a grantor wishes to sell assets to an IDGT for an installment note, bearing interest at a rate set by the IRS, the trust must first have sufficient resources to qualify it to finance the purchase in an "arm's length transaction." Here, an IDGT must be seeded with enough resources, so that its starting asset base equals at least 10% of the sum which the trust finances, when it buys assets from the grantor on an installment basis. Typically, the grantor seeds an IDGT by making an upfront gift to the trust.

Since an IDGT's grantor is treated as owning the trust's assets for income tax purposes, his or her sale to the trust will not trigger capital gains tax on any appreciation of the asset sold. In fact, the trust's provisions will cause all of its yearly income & realized gains to be taxable to the grantor for federal income tax purposes, enhancing the trust's power as a family wealth shifting & tax saving mechanism, since the grantor is essentially making tax-free gifts of the income taxes paid.

When an IDGT's annual income is not sufficient to fund the yearly payout owed to its grantor, the trust will distribute assets in-kind to make up any shortfall, unwinding some of the valuation discount taken on assets inside the trust and eroding the estate taxes saved by making the transfer. Any appreciation of the IDGT's assets over the installment note's stated interest rate remains in-trust for others outside the grantor's taxable estate.

Should using the lifetime exemption from gift tax grow more important to a grantor, the IDGT can forgive the promissory note he or she is owed at any time, converting the outstanding note principal and unpaid interest into a completed gift.

Intra-Family Loans

For people with a jaundiced view of trust complexity, making loans to adult descendants serves as another option for transferring wealth into the hands of future generations. Adult loan recipients can invest the borrowed funds or use those funds to buy a house, start a business or repay higher interest debt. Like both GRATs & sales to defective trusts, intra-family loans can provide family members with low-cost capital yet remove appreciation in excess of the loan's stated interest from the lender's estate. If gifting is the main impetus behind an intra-family loan, the lender can simply forgive that loan at a later date.

Income Tax Considerations

Along with markedly reducing the lifetime exemption for gift & estate tax, the Biden campaign has proposed changes to the capital gains tax. Currently, the tax basis of a deceased's capital assets increases to each asset's fair market value when the owner dies, but the Biden campaign seeks to eliminate this "basis step-up," plus raise the top capital gains and individual income tax rates

to 39.6%. Consequently, many wealthy Americans are now deciding whether to harvest all their tax losses to offset 2020 capital gains, harvest some of their tax losses to offset 2020 capital gains & wait until next year to harvest remaining losses, or wait until next year to harvest all their tax losses to offset gains.

Where retirement assets are concerned, people age 70 ½ or older can make donations from IRAs of up to $100,000 annually directly to public charity, so that the distributions are not deemed as "income" for tax purposes but qualify as required minimum distributions ("RMDs") in years which mandate RMDs for folks who are at least age 72. Here, it is crucial to remember that the SECURE Act raised the RMD age to 72 for people younger than 70 ½ at the end of 2019 and that the CARES Act suspended RMDs for 2020. There are added benefits to keeping "income" low for retirees, regardless of whether they take standard or itemized deductions, given that Social Security benefit taxation, medical expense deductions and Medicare premium surcharges are all based on adjusted gross income[2].

Alternatively, folks may consider using a donor advised fund to lump charitable donations into one year, in order to facilitate itemizing their deductions for the year. A donor-advised fund allows a taxpayer to stake an account for purposes of making charitable contributions. All contributions to a donor-advised fund are deductible in the year of donation and must be used for charitable purposes but need not be used for charity in the current year. A donor advised fund should not trigger capital gains tax on appreciated assets which it receives and later sells.

---

[1]These Biden campaign tax proposals were found in a 10/22/2020 article, entitled "Details and Analysis of Democratic Presidential Nominee Joe Biden's Tax Plan," posted online at taxfoundation.org.

[2]New Jersey, where Summit is headquartered, does not recognize Qualified Charitable Distributions for state income tax purposes and, instead, treats them as income to the IRA account owner.

<u>DISCLAIMER:</u> This material was produced by Summit Financial, LLC, 4 Campus Drive, Parsippany, NJ 07054, Phone (973) 285-3600. Investment advisory and financial planning services are offered through Summit Financial, LLC, an SEC Registered Investment Adviser ("Summit"). This material is for information and guidance purposes only and is not intended as legal or tax advice. The Summit financial planning design team which produced this material includes admitted attorneys and/or CPAs, who act exclusively in a non-representative capacity with respect to Summit's clients. Neither they nor Summit provide tax or legal advice to clients. Clients should make all decisions regarding the tax and legal implications of their investments and plans after consulting with their independent tax or legal advisors. Any tax statements contained herein were not intended or written to be used, and cannot be used, for the purpose of avoiding U.S. federal, state or local taxes.

11092020-1209