2020 Year-End Tax Planning

Constructing a comprehensive forward-looking strategy

GLENMEDE

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Summary

Starting well in advance of year-end provides the time required to optimize tax-saving opportunities encompassing income, charitable gifts, trusts and estates. Following, we provide a framework of general recommendations that include the familiar blocking and tackling tactics and anticipate the possibility of tax changes following the November election.

- Understand and assess potential election-related tax changes and the techniques available to benefit from current low tax rates, low interest rates and high estate and gift tax exemptions.
- Maximize the tax efficiency of your charitable gifts.
- Employ goals-based wealth planning to understand your capacity to use the current gift and estate tax $11,580,000 exemption.

The Election: Uncertainty in the mix

Policy approaches to tax rates, deductions and exemptions differ significantly between the candidates. Whereas President Trump's tax policy would make permanent the 2017 Tax Cuts and Jobs Act (TCJA) and proposes a further middle-class tax cut, former Vice President Biden seeks to roll back the TCJA, revert to 2016 rates and exemptions, and implement select tax increases and expanded deductions (Appendices 2 and 3).

The question at hand: What actions should we take now in anticipation of tax increases? It is possible a Democratic sweep may lead to increased taxes in 2021 and would enable Democrats to take action immediately. It is also quite possible that the first focus of a new administration will be to shore up the economy before introducing a new tax policy. Further, it is possible a Republican administration could raise taxes in response to mounting budgetary concerns and national debt. In all cases, the nature, extent and timing of any tax changes are unpredictable.

Regardless of the election outcome, the possibility of higher future taxes and lower exemptions suggests it would be prudent to plan now for actions that can be implemented after the election and perhaps even unwound later without negative effect. It is important to work with your advisory team now, as many accountants and attorneys have told us they will have little or no capacity after the election to take on new matters.

Planning for higher income taxes

Work with your tax preparer to understand the consequences of accelerating income into 2020. By weighing how long it might take to recoup the cost of paying taxes this year against the cost of paying higher taxes later, you will be able to define your next steps. In each case, the exercise through election day assesses varying scenarios and the tactics you'll need to employ.

Actions to accelerate income into 2020 include:

- Realizing deferred compensation
- Exercising stock options

- Recognizing capital gains earlier than planned
- Converting a traditional IRA into a Roth IRA

Note, if you have a substantial concentration in a low-basis stock position, your portfolio manager might recommend that you diversify the position. Still, you may be reluctant to sell the stock and recognize a taxable gain. Therefore, you might plan to hold that position until the cost basis steps up at your death. The cost basis step-up benefit is one that former Vice President Biden would eliminate, as discussed later.

Planning for higher transfer taxes

Currently, we each have an $11,580,000 exemption from gift and estate tax. For those able to easily gift this amount, outright or in trust, we encourage you to do so before the exemption changes. Taking this action is independent of the pending election because currently, the exemption reverts to one-half of this amount in 2026 ($5,000,000 increased by inflation).

For most, the decision to make large irrevocable gifts to save taxes is complex. While saving may be a goal, other priorities may prompt a different course. A goals-based wealth and investment plan can help you assess whether there are sufficient assets to comfortably and reliably fund one's lifestyle for life. For example, a client with $15,000,000 is unlikely to gift $10,000,000. Yet, a gift of less than $5,000,000 will not preserve the current exemption if the 2021 exemption reverts to the $3 million–-$5 million range.

One technique that can preserve some access to family funds while recognizing the current large exemption is the spousal limited access trust (SLAT). A married couple with $20,000,000 might consider having one spouse create a $10,000,000 trust for the other spouse. So long as the non-donor spouse is living, a trustee can make distributions from the trust to the non-donor spouse. The trust is complex and deserves more time and explanation than can be devoted here but is one option that might be explored with a Glenmede Wealth Planner.

Even if you do not make any large gifts, it is possible to use techniques to remove future appreciation from your estate so the appreciation is not subject to the 40% estate tax at your death. Grantor retained annuity trusts, a loan to an irrevocable trust for your children and other similar techniques work particularly well in this low-interest-rate environment. These techniques preserve your access to the underlying capital should you need it and minimize any taxable gifts that consume your estate tax exemption.

The important message here is to understand what is possible and to be prepared to execute on a plan later this year if circumstances warrant.

Income tax planning: Blocking and tackling

Independent of election-related planning, certain tactics should be revisited annually.

- Volatility and tax-loss harvesting

Year-end volatility and resulting paper losses, although perhaps unwelcome, can lessen the tax burden of gains taken earlier in the year or paid out by mutual funds. You may opt to sell some loss positions to minimize your tax bill. To keep your portfolio properly balanced, your advisor can discuss purchasing a similar security or exchange-traded fund (ETF) to replace the sold security. This avoids "wash sale" treatment, a tax rule disallowing a capital loss if you purchase the same or "substantially identical" security within 30 days before or after the sale. Care is warranted. Wash sales can occur not only in a single investment account, but across multiple accounts having the same ownership, even if those accounts are with multiple managers or are separate IRA accounts.

- Consider tax-efficient trust distributions

  Often, a beneficiary's marginal income tax rate is lower than a trust's, as a trust's highest tax bracket of 37% begins at just $12,950. Trusts also pay the 3.8% Net Investment Income Tax (NIIT) at that same breakpoint. If a family trust is not distributing all its income this year, consider whether (a) it makes sense within the context of the family and the trust document to make current distributions to certain beneficiaries and, if it does, (b), whether the distributions can be made tax-efficiently.

- Beware the kiddie tax

  The kiddie tax has reverted to its pre-2018 incarnation. Changes brought by the 2017 TCJA brought unintended tax increases to many. A child's net unearned income (investment income and capital gains) is taxed at the child's parents' highest rate. The kiddie tax applies to all children under age 18 and most between the ages of 18 and 23 who are full-time students.

- Take advantage of breakpoints in the long-term capital gains rate schedule

  There are a few transitions in our lives when we may take advantage of the 0% capital gains rate if income is below a certain level. You will pay a 0% capital gains rate if your aggregate income (including the capital gains) is less than $40,000, or $80,000 if married filing jointly. Income is more likely to meet the threshold when a young person enters the workforce or an older person is retiring. Taxable retirement account and trust distributions are part of the income calculation, but careful planning can lead to excellent results.

  Example: A young person entering the workforce, who is the beneficiary of a minor's trust or UTMA account, might take a complete distribution from the trust, sell the highly appreciated securities and pay no capital gains tax — provided the total income is less than $40,000. Similarly, a retiring person age 70 or younger owning highly appreciated securities might plan their retirement date to avoid income in the following year and defer Social Security and taxable distributions from retirement accounts until a later year. They may be able to sell their highly appreciated securities and avoid some capital gains tax. If they have no other taxable income and are married, they will pay 0% on the first $80,000 of capital gains and 15% on the next $416,600. This technique requires careful planning with your accountant and a full understanding of your income sources.

Long-Term Capital Gains Rate	Single	Married Filing Jointly
0%	$0 – $40,000	$0 – $80,000
15%	$40,001–$441,450	$80,001 – $496,600
20%	Over $441,450	Over $496,600

- Fully fund your IRA or 401(k)

  Contributions to an IRA or 401(k) are deducted from income, subject to limitations. Revisit the limits if you are over age 50 to be sure you are taking full advantage of the opportunity.

- Consider converting a traditional IRA to a Roth IRA

  Although the converted amount is included in your taxable income in the year of conversion, the Roth IRA then continues on tax-free and is not subject to income tax when withdrawn.

There are many inflection points to be considered, including your current age and circumstances. Still, the long-term tax effectiveness of a conversion should be discussed with your income tax preparer, particularly when circumstances anticipate a future rise in income tax rates.

- Make annual exclusion gifts

  Every taxpayer may give up to $15,000 per year to an unlimited number of individuals free of gift tax. Giving property to heirs in a lower income tax bracket during the donor's lifetime is one way to realize income tax savings. To maximize the value received by your heirs, give cash or high-basis assets so the recipient isn't burdened with income tax consequences. Low-basis, highly appreciated assets are used more tax-efficiently for charitable gifts.

- Fund 529 plans

  Over 30 states currently offer a state income tax credit or deduction for a contribution to a 529 plan for an individual. Often the 529 beneficiary is your child or grandchild but need not be a related person. Funds in the plan accumulate income tax-free and are never subject to income tax unless used for unapproved purposes. A 529 plan can even be the recipient of an annual exclusion gift. Recent federal legislative changes now permit the use of 529 plan funds for K–12 private education, college and graduate school and vocational and trade schools.

Tax-efficient charitable gifts

- Make a charitable gift from an IRA

  After reaching age 70½, you may make a Qualified Charitable Distribution (QCD) of up to $100,000 per year from your IRA to a public charity (other than a donor-advised fund). This is true even in 2020 when there is no required minimum distribution (RMD) from an IRA. The amount of the QCD is excluded from your taxable income and is not deductible.

- Bunching charitable gifts

  The new, higher standard deductions ($12,400 for single filers, $24,800 for a married couple in 2020) significantly benefit many taxpayers. The higher standard deduction also means a taxpayer will not itemize if total itemized deductions are less than the standard deduction. For example, a married couple with a $10,000 state tax deduction and $14,000 of charitable contributions will choose the greater $24,800 standard deduction. They will get no separate tax benefit from charitable contributions. If this pattern persists year after year, taxpayers will not realize any tax benefit for charitable contributions.

  However, if charitable gifts that would have been made over a two- or three-year period are instead made in one year, a portion will become tax efficient. If the same couple makes all of their anticipated 2020 and 2021 gifts outright to their charities or to a donor-advised fund in 2020, their aggregate 2020 deductions will equal $38,000 (2020 real estate taxes plus $28,800 in charitable gifts), making $13,200 of the charitable deductions tax efficient. By using a donor-advised fund, the couple may identify specific charitable beneficiaries in 2020 and 2021, even though they will revert to using the $24,800 standard deduction in 2021.

  For more on this topic see *Bunching Charitable Gifts Maximize Tax Savings* and information about Glenmede's Donor Advised Fund.

- Defer tax on capital gains with a charitable remainder trust

  Charitably inclined investors can defer capital gains by creating a charitable remainder trust (CRT).

By contributing the gain property to the CRT before it is sold, the investor will be taxed with the realized capital gain only as it is paid out to him over time. The actuarial interest payable to the charity at the termination of the trust must be equal to at least 10% of the value of the trust at inception. A charitable deduction for that 10% remainder interest may be available to the settlor in the year the trust is established. A 65-year-old investor can expect a 19% annual distribution from the trust based on the value of the trust at the beginning of each new year, paid to him for the remainder of his life or until the trust is earlier exhausted. There are many variations of this trust that can be implemented to meet a variety of goals and payouts. Note, however, that if capital gains rates rise in the future, the taxpayer may pay more tax over time by using this technique.

Estate and gift tax planning

The aggregate amount exempt from estate and gift tax per individual in 2020 is $11,580,000. This amount reverts to half that amount ($5,000,000 increased for inflation) on January 1, 2026, and may also be reduced sooner by the possible tax law changes previously discussed.

The starting point for all estate and gift tax planning is to understand your goals-based wealth plan. Before you make any asset transfer, understand whether your assets are sufficient, within a reasonable degree of certainty, to achieve your personal goals, most notably your lifestyle. Then, with the help of your Glenmede relationship manager, you can decide whether to make gifts for charitable purposes, to minimize estate tax or to transfer future asset appreciation to your heirs.

- Annual exclusion gifts

  Annual exclusion gifts of $15,000 per recipient accumulate over time to reduce a taxable estate. Any assets removed from your estate through non-taxable gifts avoid the potential 40% tax at your death. Of note, a gift of a check to an individual is considered completed only when the check is deposited. If your child or grandchild does not deposit a $15,000 holiday check until January 2, the gift will be attributed to 2021, not 2020.

- Payment of tuition and medical expenses

  Payments of medical expenses directly to the provider and payments of tuition directly to an educational institution are accorded special status. They are not considered taxable gifts and therefore do not consume any of the payer's lifetime gift and estate tax exemption. These payments are especially important for families already making their annual exclusion gifts or who have fully used the $11,580,000 exemption.

- Complete large gifts

  Independent of who wins the presidential election, we know the current estate tax exemption amount is slated to revert to $5 million (increased by inflation) in 2026. Individuals who can afford to make gifts to use up this exemption would be well served to do so and thus preserve the larger exemption. There are all sorts of techniques available to make gifts outright and in trust. Those are best discussed with your relationship manager on an individual basis.

Appendix 1: 2020 Income Tax Rates and Deductions

Individual income tax rates and brackets	7 brackets, 37% top rate at $518,400/$622,051 (single/joint); 20% top rate for qualified dividends and long-term capital gains
Standard deduction	$12,400 per person
Personal exemption	None
State and local tax (SALT) deduction	$10,000 cap on deductions for aggregate state, local and property tax
Mortgage interest deduction	Deduction for new mortgage interest limited to $750,000 acquisition indebtedness; no deduction for home equity loan; this is the same whether you are filing single or jointly
Medical expense deduction	Deduction for expenses in excess of 10% of income
Charitable deduction	Deduction for cash gifts to qualified public charities up to 100% of adjusted gross income (AGI)(2020 only), 60% in 2021; $300 for non-itemizers; 30% for marketable securities.
Miscellaneous itemized deductions	None. No deduction for investment fees, unreimbursed business expenses, tax prep fees, etc. Casualty and theft deduction only for federal disaster areas.
Alternative minimum tax	In place but applies to very few because of limited deductions
Retirement accounts	No RMDs required in 2020; RMD beginning date age 72; IRA non-taxable Qualified Charitable Distribution up to $100,000 (over age 70½); review other new beneficiary rules

Appendix 2: Income Tax Proposals

	Current/TCJA*	Trump	Biden
Top marginal tax bracket	37% top rate at $500,000/$600,000 (Individual/joint)*	Make current TCJA permanent; enact 10% middle-class tax cut	39.6%, pre-TCJA rates
Long-term capital gains and dividend rate	20% top rate	Make current TCJA permanent	20%, but increase to 39.6% for income >$1 million
Medicare contribution tax (NII)	3.8% on net investment income	Eliminate	Retain
Social Security Tax	12.4% on earned income up to $137,700*	No proposed change; has discussed eliminating employee payroll taxes permanently	12.4% on all earned income, with exemption "hole" 0% for $137,701–$400,000
Itemized deductions	SALT deduction capped at $10,000; limited itemized deductions*	Make current TCJA permanent	Repeal TCJA, revert to 2016 , permit deduction for state and local taxes, impose Pease limitations
199A real estate deductions	Deduction for up to 20% of qualified business income	Retain	Phase out for taxpayers with income > $400,000
IRA and 401(k) deductions	Contributions deductible to individual limits	Retain	Replace with 26% credit paid to the IRA
Financial transaction tax	None	None	Yes, no details
Corporate tax rate	21% top marginal rate*	Make current TCJA permanent	28% top marginal rate

**Most elements of the 2017 Tax Cuts and Jobs Act expire December 31, 2025, and tax rates and deductions revert to 2016 law.*

Appendix 3: Estate and Gift Tax Proposals

	Current/TCJA*	Trump	Biden
Estate and gift tax	40% tax over $11,580,000 exemption ($10 million exemption with COLA from 2017)*	Make current TCJA permanent	• Revert to "historical norm" • A reversion to 2009 levels would be 45% on assets greater than $3,500,000 • A return to 2016 levels would be $5,00,000 increased by inflation
Cost basis step-up at death	Full cost basis step-up of assets to fair market value at death	Retain	Step-up eliminated; not clear if proposal would tax gains at death or at later sale or whether assets passing to spouse or charity would be exempt
Limiting of Irrevocable Grantor Trusts (including GRATs)		No proposed changes	The Obama administration proposed limiting many favorable techniques but candidate Biden does not have an official position

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