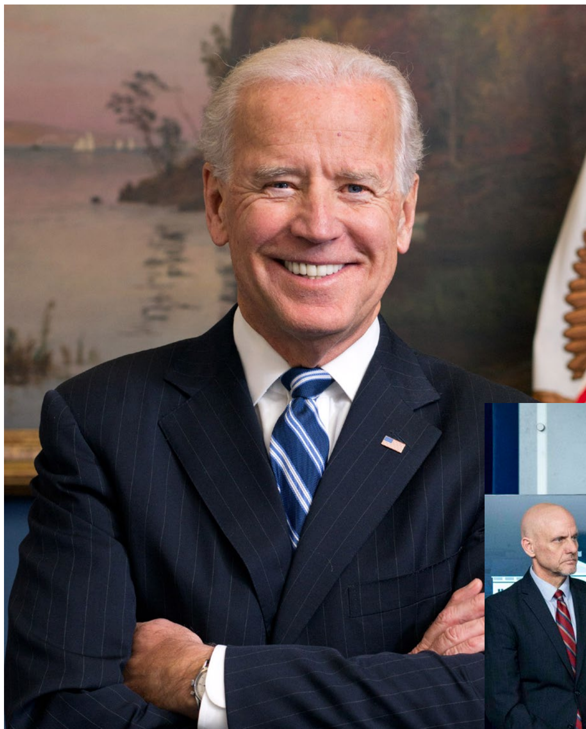
Planning Should there be a Biden Administration

Year-End Planning in 2020

Robert S. Keebler, CPA/PFS, MSP AEP (Distinguished)

Year-End Planning in 2020

A Tumultuous Election Year



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Year-end Planning

Annual General Checklist

- ❑ Bracket Management
  - ❑ Bonuses
  - ❑ Recognition events
  - ❑ Time business expenses – AMT awareness
- ❑ Itemized Deduction Timing
  - ❑ Medical expenses
  - ❑ Property tax
  - ❑ Charitable contributions
  - ❑ Casualty & theft losses
- ❑ Gain Harvesting
  - ❑ Current < Future rate ?
  - ❑ Consider forced recognition events (e.g. warrants)
- ❑ Loss Harvesting
  - ❑ Offset gains
  - ❑ $3,000 ordinary income offset

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Year-end Planning

Annual General Checklist

- ❑ Retirement Planning
  - ❑ Fund IRAs
  - ❑ Fund 401ks
  - ❑ Fund pension plans
  - ❑ Optimize Traditional/Roth mix
  - ❑ Consider Roth conversions
  - ❑ Review RMDs
  - ❑ Review NUA
- ❑ Education Planning
  - ❑ Time tuition payments
  - ❑ Fund 529 plans
  - ❑ Fund Coverdell accounts
- ❑ Executive Planning
  - ❑ Review NQDC
  - ❑ Review NQSOs / ISOs
  - ❑ Review concentrated positions
- ❑ Charitable Planning
  - ❑ Consider QCD
  - ❑ Consider appreciated assets
  - ❑ Consider DAF
- ❑ Estate Tax Planning
  - ❑ Make annual exclusion gifts
  - ❑ Make medical gifts
  - ❑ Make tuition gifts

Year-end Planning

Annual General Checklist

- ❑ Estimated Taxes
  - ❑ Review payments & estimated taxable income
  - ❑ Extra payment to reduce penalty
  - ❑ Additional W-2 withholding to eliminate penalty
  - ❑ AMT review
- ❑ Medical Expense Planning
  - ❑ Review Medicare premiums
  - ❑ Review HSA contributions
  - ❑ Review FSA balance
- ❑ Significant Financial Events Next Year
  - ❑ Recognition events
  - ❑ New investments
  - ❑ Re-allocation plans
  - ❑ Vesting
- ❑ Major Life Events Next Year
  - ❑ Family changes
  - ❑ Job changes
  - ❑ Moving

General Democratic Party Tax Policy Themes

- Additional payroll taxes on high-earners
- Increase the marginal rate imposed on high-income individuals
- Increase the capital gains rate imposed on high-income individuals
- Tax wealth generally; various ideas include an annual wealth tax & greater estate & gift taxes
- Increase the corporate income tax rate

Retro-Activity Risk

- Congress may have the ability to enact retro-active tax legislation thereby limiting the ability to front-run changes
- Retroactive taxation of transactions is possible if rationally related to a legitimate legislative. *Pension Benefit Guaranty Corporation v. R. A. Gray & Co.*, 467 U. S. 717 (1984); *United States v. Carlton*, 512 U.S. 26 (1994).

Former Vice President Biden Tax Policy Proposals

- Tax increases on over **$400,000** of income
  - Expand the 12.4% Social Security tax
  - Restore the 39.6% marginal rate
  - Cap the itemized deduction tax benefit to 28%
  - Restore the 3% PEASE limitation
  - Add a new Section 199A Deduction Phaseout

Former Vice President Biden Tax Policy Proposals

- **Taxes on Capital**
  - 39.6% rate applied to capital gains over $1,000,000
  - Eliminate the Basis "Step-up" at Death

DANGER

Fund CRTs with great caution.

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Former Vice President Biden Tax Policy Proposals

- **Other Tax Ideas for Individuals**
  - Increase the Child and Dependent Care Tax Credit from $6,000 to $8,000
  - Expand the ACA premium credit
  - Expand the EITC for childless workers over 65
  - New renewal energy tax credits
  - First time home buyers tax credit
  - Renters credit for those who are "housing cost burdened"
  - Expanded retirement savings credit

Former Vice President Biden Tax Policy Proposals

- **Proposal to Expand Social Security Tax**
  - Applies to earned income over $400,000
  - The established 12.4% rate & employee/employer split retained
  - Creates a tax-free gap between the Social Security base and the $400,000 threshold

Former Vice President Biden Tax Policy Proposals

- **Solutions for Business Owners if Social Security Tax is Expanded**
  - S-corporation dividends
    - Recall, S-corporation dividends are not subject to employment taxes
    - As a solution, this assumes Congress does not close this “loophole” & the reduced salary is a “reasonable wage”

Former Vice President Biden Tax Policy Proposals

- **Solutions for Business Owners if Social Security Tax is Expanded**
  - Reorganize (or elect to be taxed) as a C-corporation
    - W-2 earners subject to the expanded tax would have a marginal rate of **55.8%** [39.6%+12.4%+2.9%+0.9%]
    - C-corporation owners with $400,000 - $1,000,000 of income under Biden's plan could have a effective rate on dividends of **45.1%** [28% + (1-.28) x 23.8%]
    - C-corporation owners greater than $1,000,000 of income under Biden's plan could have a effective rate on dividends of **51.9%** [28% + (1-.396) x 39.6%]

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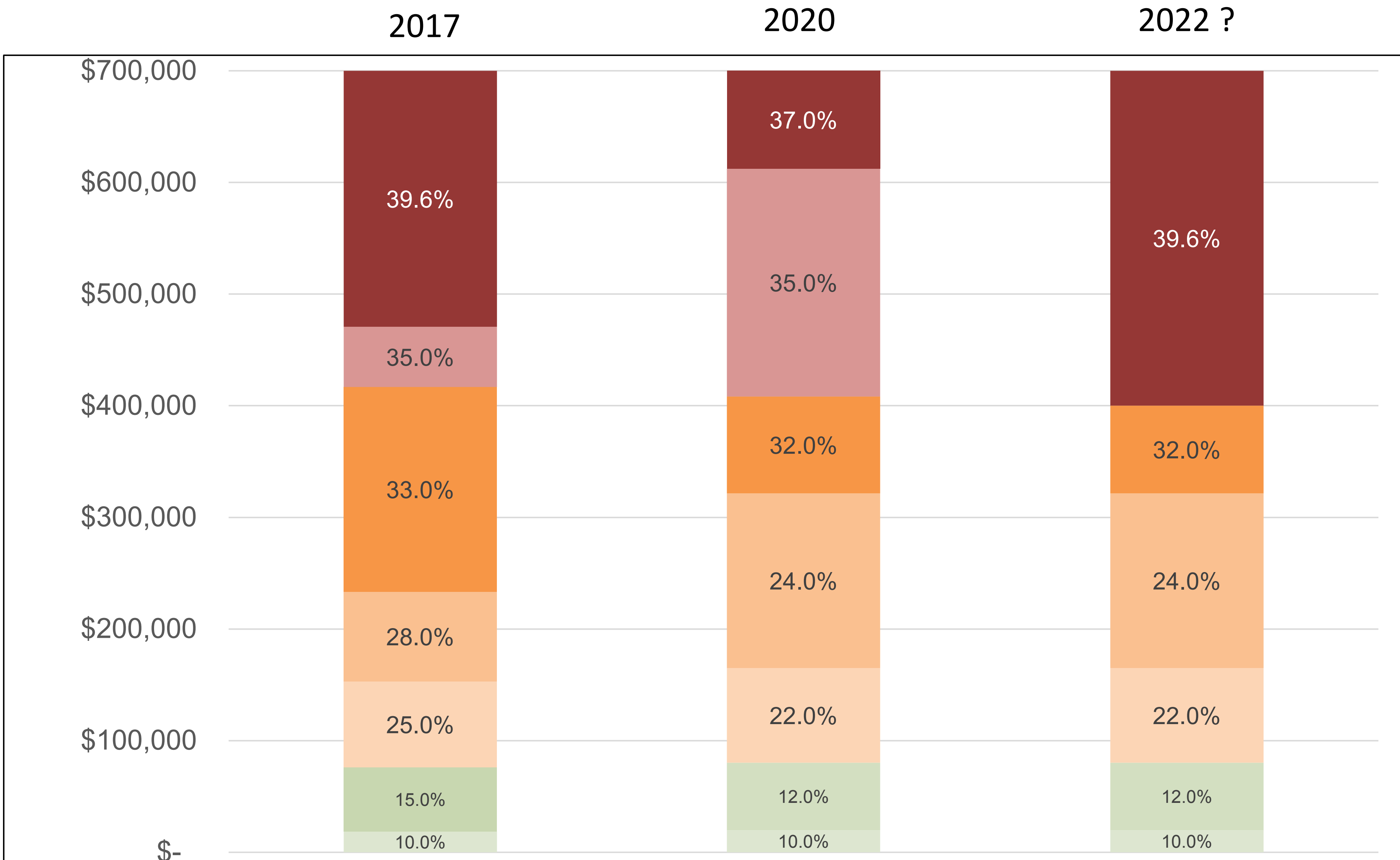
Former Vice President Biden Tax Policy Proposals

- **Solutions for Executive Compensation if the Social Security Tax is Expanded**
  - Incentive Stock Options (ISOs) – No FICA Tax on option spread
  - Non-Qualified Stock Options (NQSOs) – FICA Tax on option spread, but it's delayed until exercise
  - Deferred Compensation – No favorable treatment, but there's a timing benefit and the possibility of taking advantage of the "doughnut hole"

Former Vice President Biden Tax Policy Proposals

- **Proposal to Restore the 39.6% marginal rate**
  - Would apply to income over $400,000
  - Unclear how it is affected by filing status

Married Filing Jointly



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Former Vice President Biden Tax Policy Proposals

- **Accelerating 2020 income to plan for a 39.6%**
  - Roth conversions
  - Harvest gains
    - Real property – consider a “failed” 1031 exchange or opportunity zone
    - Stock
    - Bonds
  - Defer loss harvesting
  - Defer business expenses
  - Exercise NSOs
  - 453 Sales - consider the election to accelerate recognition

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Former Vice President Biden Tax Policy Proposals

- **Proposal to Cap Itemized Deductions to a 28% Tax Benefit**
  - Rough justice to limit the regressive nature of itemized deductions

Itemized Deductions of $40,000

	Marginal Tax Rate				
	22%	**24%**	**32%**	**35%**	**37%**
Current Deduction Tax-Value	$ 8,800	$ 9,600	$ 12,800	$ 14,000	$ 14,800
Proposed Deduction Tax-Value	$ 8,800	$ 9,600	$ 11,200	$ 11,200	$ 11,200

Former Vice President Biden Tax Policy Proposals

- **Proposal to Cap Itemized Deductions to a 28% Tax Benefit**
  - Exact calculation method unclear however perhaps itemized deductions would be reduced by a ratio
  - For example, someone with $40,000 of itemized deductions subject to 39.6% marginal rate would reduce the deducible amount as follows:

$$\$40{,}000 \text{ x } \frac{28\%}{39.6\%} = \$28{,}282.82$$

Former Vice President Biden Tax Policy Proposals

- **Proposal to Restore the 3% Pease limitation**
  - Would apply if income exceeds $400,000
  - Recall, the old Pease Limitation:
    - Applied after $313,800 (2017 MFJ) AGI threshold
    - Reduced itemized deductions by 3% of AGI over the threshold, up to 80% of itemized deductions
    - Standard deduction available if greater
    - Reduction only applied to charitable, SALT, mortgage interest, and miscellaneous itemized deductions only

Former Vice President Biden Tax Policy Proposals

- **Proposal to Restore the Pease limitation**
  - Consider a married couple with an AGI of $1,000,000
  - They have $40,000 of itemized deductions attributable only to SALT, mortgage interest, & charity
  - A new Pease Limitation with the "double" standard deduction quickly eliminates the value of itemizing:

3% x ($1,000,000 - $400,000) = $18,000

$40,000 - $18,000 = $22,000 < $24,800 standard deduction

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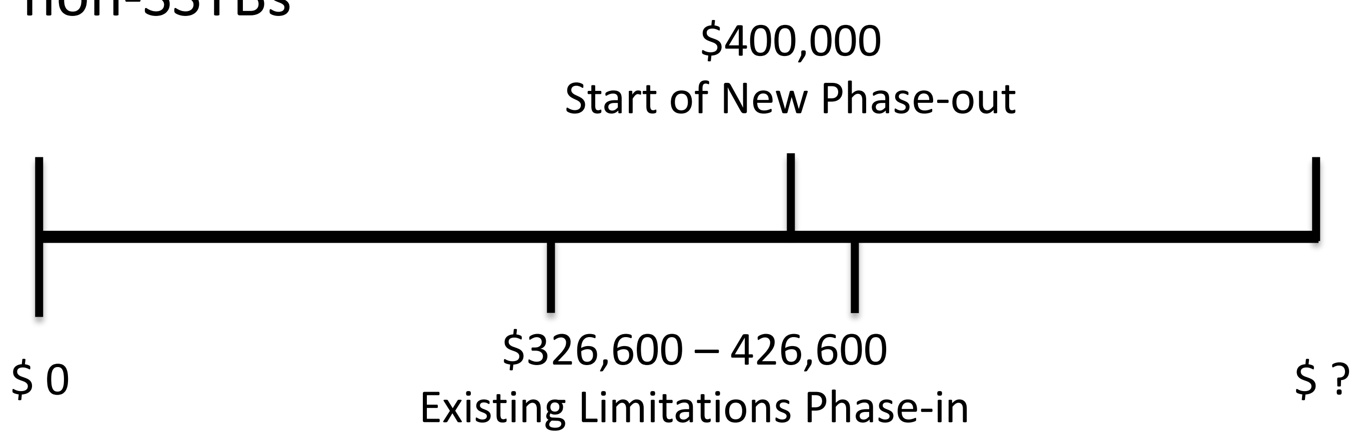
Former Vice President Biden Tax Policy Proposals

- **Proposal to Add a New Section 199A Deduction Phaseout**
  - Would apply if income exceeds $400,000
  - There are few other details; Assumably, it is merely another limitation on the availability of the deduction for non-SSTBs



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Former Vice President Biden Tax Policy Proposals

S-Corp Effective Rate - MFJ			
Shareholder's Income Level	Pre-2018:	Trump / TCJA	Biden Proposal:
$ 50,000	15.0%	9.6%	9.6%
$ 100,000	25.0%	17.6%	17.6%
$ 150,000	25.0%	17.6%	17.6%
$ 200,000	28.0%	19.2%	19.2%
$ 250,000	33.0%	19.2%	19.2%
$ 300,000	33.0%	19.2%	19.2%
$ 350,000	33.0%	25.6%	25.6%
$ 400,000	33.0%	28.0%	31.7%
$ 450,000	35.0%	28.0%	35.6%
$ 500,000	39.6%	28.0%	39.6%
$ 550,000	39.6%	28.0%	39.6%
$ 600,000	39.6%	29.6%	39.6%

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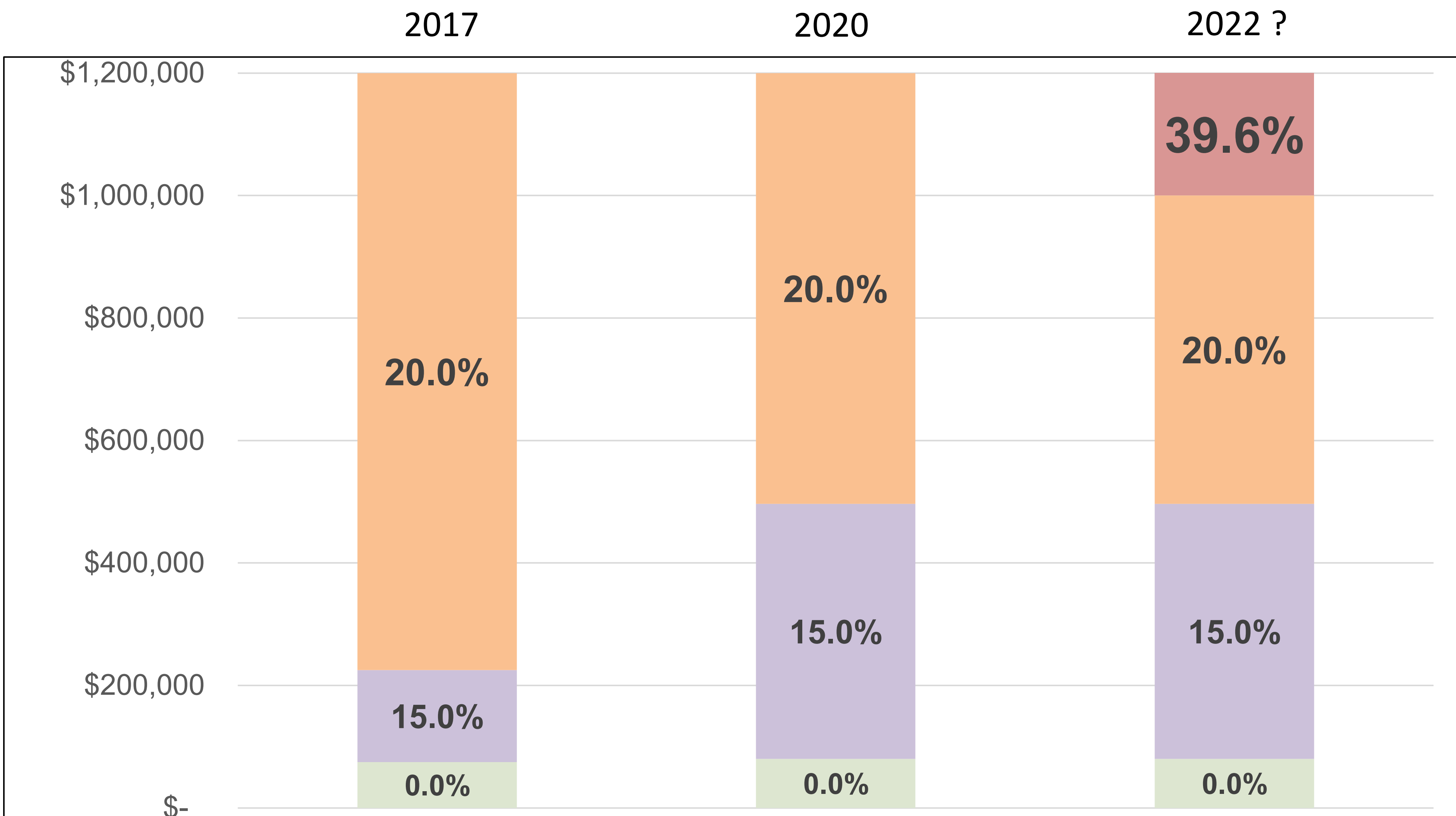
Former Vice President Biden Tax Policy Proposals

- **Proposal to eliminate the preferential rate for long-term capital gains and qualified dividends on income over $1,000,000**
  - Most significant proposal & a fundamental shift
  - Basically an increase from 20% to 39.6%
  - Expect many people to sell assets if it's set to take effect

Consider, for example, how risky funding a substantial sale CRT may be in 2020.

Married Filing Jointly

Capital Gain & Qualified Dividend Rates



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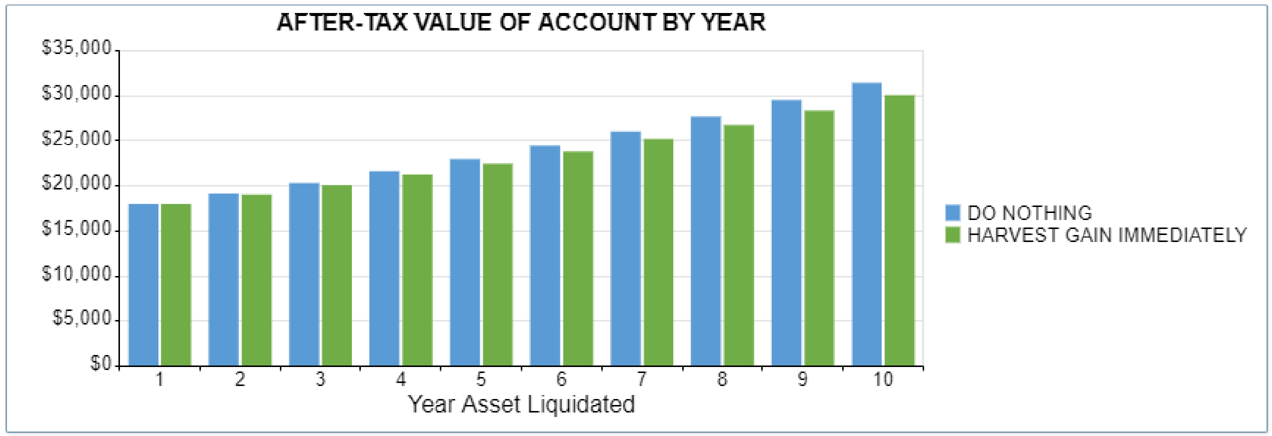
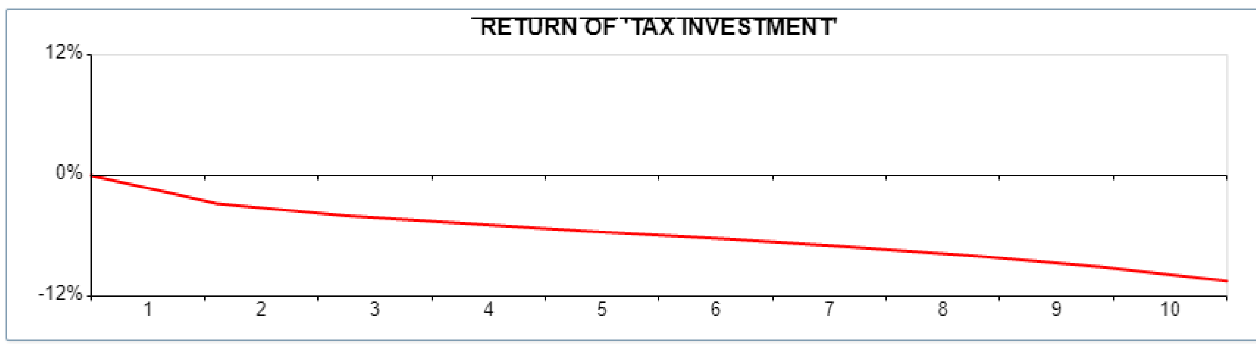
Input & Summary | Detail

GAIN HARVESTING CALCULATOR

CURRENT CAPITAL GAINS TAX RATE	20.0%
FUTURE CAPITAL GAINS TAX RATE	20.0%
BASIS OF ASSET	10,000
FMV OF ASSET	20,000
ASSUMED GROWTH RATE	7.0%





Input & Summary | Detail

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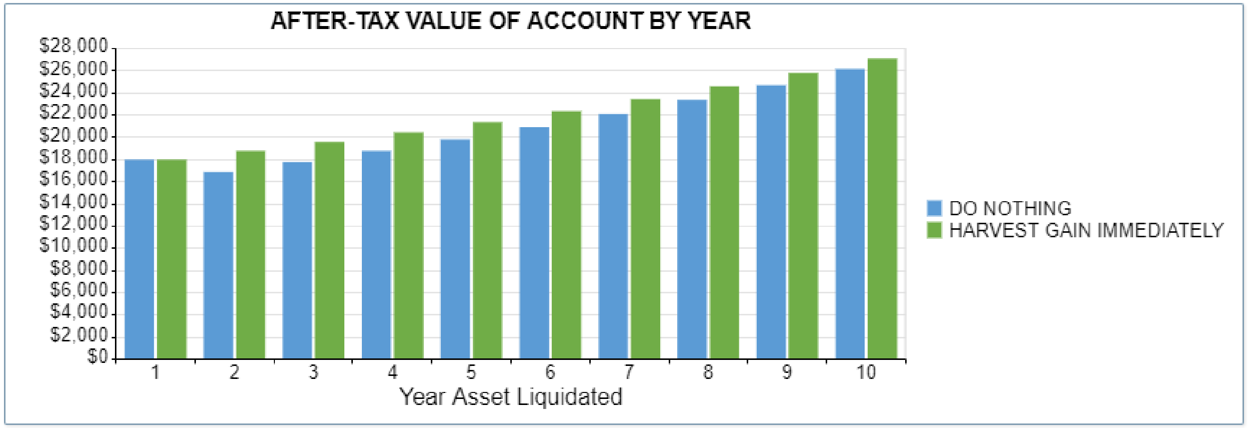

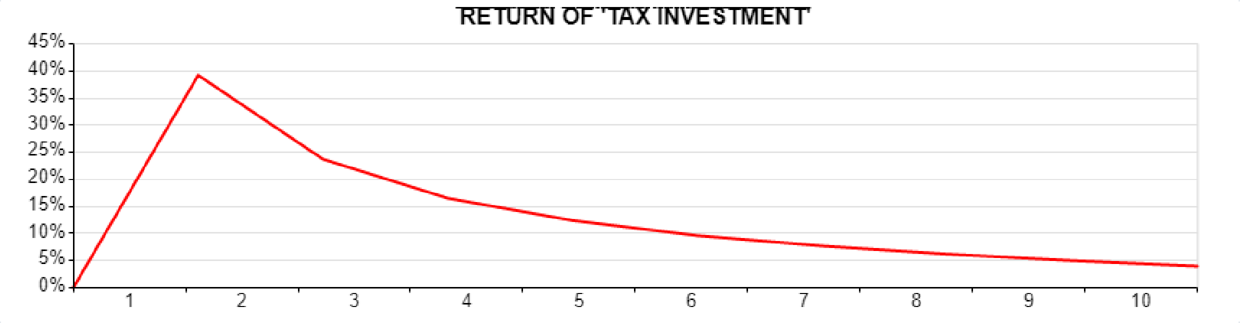

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DO NOTHING

	1	2	3	4	5	6	7	8	9	10
FMV	$20,000	$21,400	$22,898	$24,501	$26,216	$28,051	$30,015	$32,116	$34,364	$36,769
Basis	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
Gain	$10,000	$11,400	$12,898	$14,501	$16,216	$18,051	$20,015	$22,116	$24,364	$26,769
Tax Rate	20.0%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%
Tax	$2,000	$4,514	$5,108	$5,742	$6,422	$7,148	$7,926	$8,758	$9,648	$10,601
NET	$18,000	$16,886	$17,790	$18,759	$19,794	$20,903	$22,089	$23,358	$24,716	$26,169

HARVEST GAIN IMMEDIATELY

	1	2	3	4	5	6	7	8	9	10
FMV	$18,000	$19,260	$20,608	$22,051	$23,594	$25,246	$27,013	$28,904	$30,927	$33,092
Basis	$18,000	$18,000	$18,000	$18,000	$18,000	$18,000	$18,000	$18,000	$18,000	$18,000
Gain	$0	$1,260	$2,608	$4,051	$5,594	$7,246	$9,013	$10,904	$12,927	$15,092
Tax Rate	20.0%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%
Tax	$0	$499	$1,033	$1,604	$2,215	$2,869	$3,569	$4,318	$5,119	$5,977
NET	$18,000	$18,761	$19,575	$20,447	$21,379	$22,377	$23,444	$24,586	$25,808	$27,116

RETURN OF "TAX INVESTMENT"

	1	2	3	4	5	6	7	8	9	10
"Investment"	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000
Return (Loss)	$0	$1,875	$1,785	$1,688	$1,585	$1,474	$1,355	$1,228	$1,092	$947
Simple RoR	0%	39%	24%	17%	12%	10%	8%	6%	5%	4%

Former Vice President Biden Tax Policy Proposals

- **Eliminate capital gains rate – deeper thinking**
  - A 39.6% capital gains rate will encourage longer holding periods
  - If the "step-up" in basis at death is retained, many people will be substantially more encouraged to hold onto assets until death
  - If the "step-up" in basis at death is repealed in-favor of a forced-recognition event, people will be encouraged recognize gains before death to:

    (1) Find better investments and

    (2) Avoid a 39.6% applying in the year of death instead of a 20% rate during life, for example

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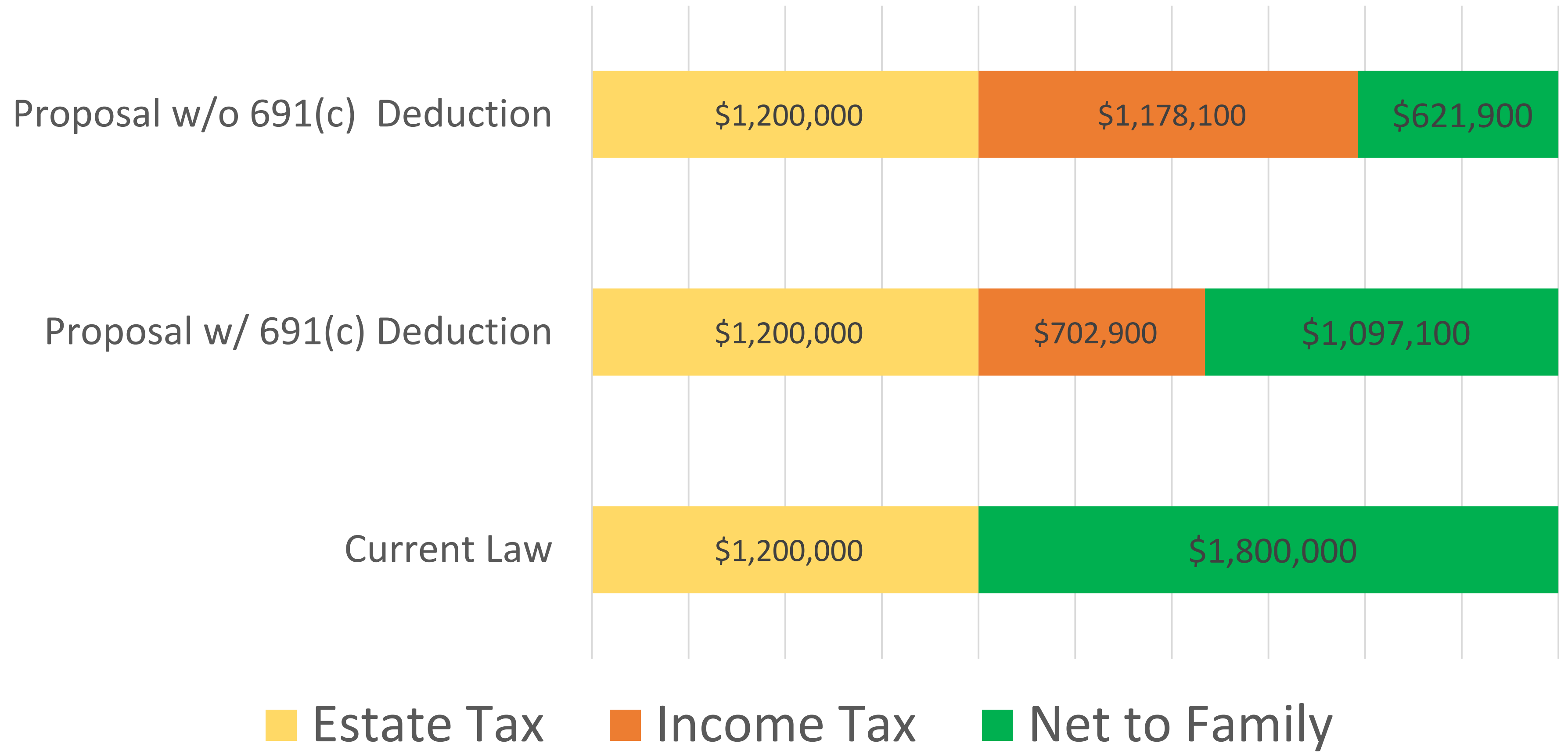
Former Vice President Biden Tax Policy Proposals

- **Proposal to eliminate the Section 1014(a) Basis Adjustment at the – “The STEP-UP”**
  - *Most significant proposal & a fundamental shift in the taxation of wealthy individuals*
  - Unclear whether the proposed 39.6% rate would apply to gains in excess of $1,000,000 at death
  - Unclear whether the proposal includes an income tax deduction for estate tax paid (or vice versa)
  - Presumably, gifting assets would also be a recognition event
  - Expect huge gifts & sales if it’s set to take effect

Consider someone who bought 10,000 shares of Apple at average price of $2.50 just before the ".com bubble" burst and died at a $300 share price.



Former Vice President Biden Tax Policy Proposals

- **Business Income Tax Increase**
  - Increase corporate tax rate from 21% to 28%

C-Corp Effective Rate			
Shareholder's Qualified Dividend Rate	**Pre-2018: 35%**	**Trump / TCJA: 21%**	**Biden Proposal: 28%**
0%	35%	21%	28%
15%	45%	33%	39%
18.8%	47%	36%	42%
23.8%	50%	40%	45%
43.4%			59%

Former Vice President Biden Tax Policy Proposals

- **Other Business Tax Ideas**
  - New corporate minimum tax
  - Double the GILTI rate
  - Manufacturing Communities Tax Credit – would reduce the tax obligations of businesses in communities which experience major layoffs
  - New Market Tax Credit – expand & make permanent

Year-end Planning

A Checklist of Ideas to Prepare for a Biden Administration

- ❑ Bracket Management
  - ❑ Accelerate bonuses to avoid rate increases
  - ❑ Accelerate recognition events to avoid rate increases
  - ❑ Defer business expenses to capture a greater benefit if rates increase
  - ❑ Consider what reinstatement of the AMT would mean

- ❑ Itemized Deduction Timing
  - ❑ Carefully consider property tax payments
    - ➢ Defer to capture a greater benefit due to higher rates
    - ➢ Defer in-case the $10,000 SALT deduction cap is repealed
    - ➢ Accelerate to avoid additional itemized deduction limits
  - ❑ Carefully consider charitable contribution timing:
    - ➢ Defer to capture a greater benefit due to higher rates
    - ➢ Accelerate to avoid additional itemized deduction limits

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Year-end Planning

A Checklist of Ideas to Prepare for a Biden Administration

- ❑ Gain & Loss Harvesting
  - ❑ Harvest gains to avoid rate increases
  - ❑ Defer harvesting losses to offset rate increases
  - ❑ Consider flexible gain recognition strategies
- ❑ Retirement Planning
  - ❑ Roth conversions before rates increase
  - ❑ NUA rollout before rates increase
  - ❑ Diversify concentrated positions before rates increase
- ❑ Executive Planning
  - ❑ Reconsider NQCD funding to avoid rate increases & increased payroll taxes
  - ❑ Consider ISO exercise in case the AMT returns in-force
  - ❑ Consider NQSO exercise to avoid rate increase & increased payroll tax
- ❑ Estate Tax Planning
  - ❑ Consider large lifetime gifts
    - ➢ Capture the large estate tax exemption
    - ➢ Avoid a forced recognition event

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Core Year-End Planning in 2020

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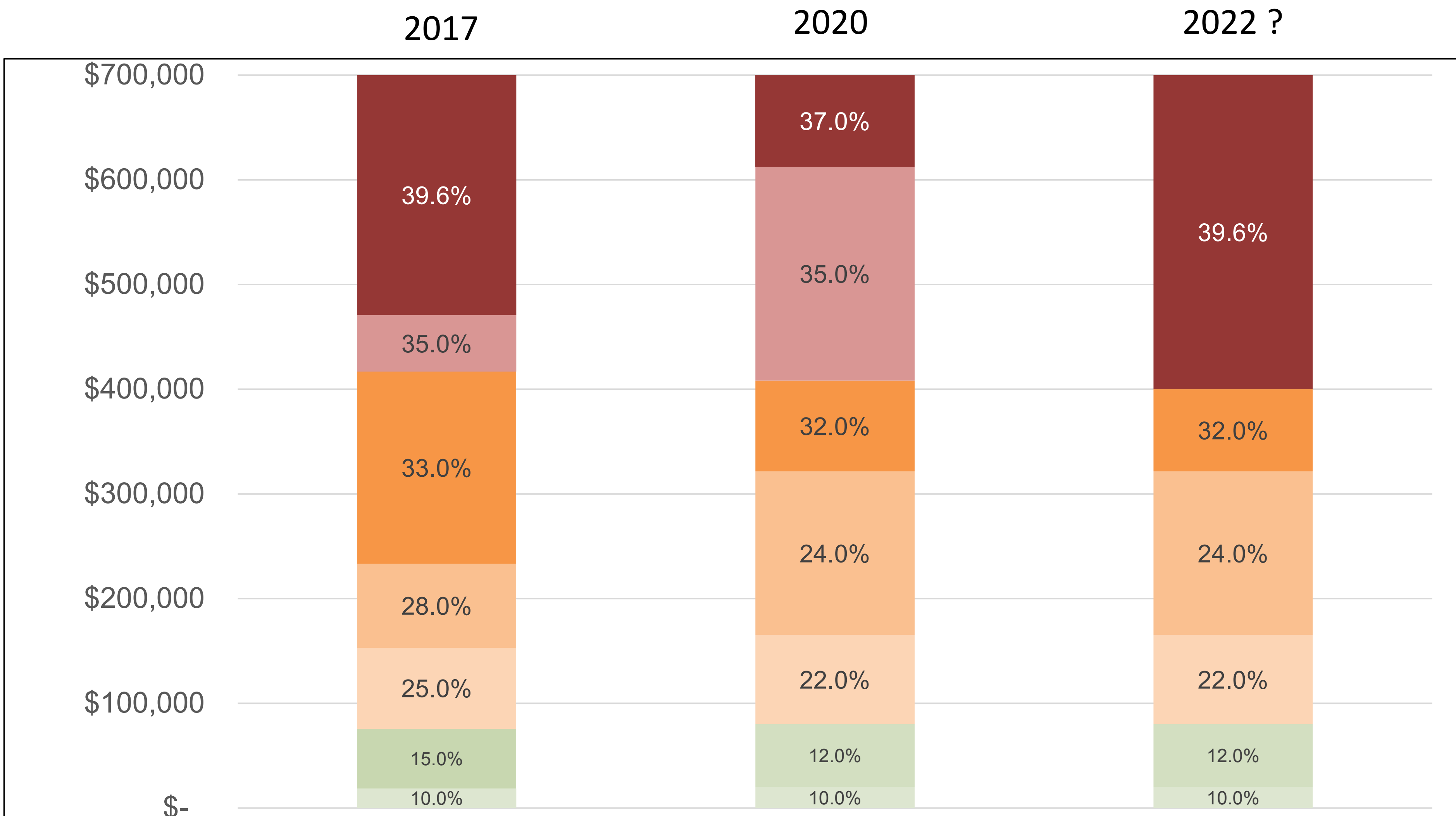
Tax Rates

Married Filing Jointly



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Tax Rates

*Income Tax Rates **2020***

TOP OF EACH BRACKET

	S	MFJ/QW	MFS	HOH	T&E
10%	$ 9,875	$ 19,750	$ 9,875	$ 14,100	$ 2,600
12%	$ 40,125	$ 80,250	$ 40,125	$ 53,700	-
22%	$ 85,525	$ 171,050	$ 85,525	$ 85,500	-
24%	$ 163,300	$ 326,600	$ 163,300	$ 163,300	$ 9,450
32%	$ 207,350	$ 414,700	$ 207,350	$ 207,350	-
35%	$ 518,400	$ 622,500	$ 311,025	$ 518,400	$ 12,950
37%					

TOP OF EACH CAPITAL GAINS BRACKET

	S	MFJ/QW	MFS	HOH	T&E
0%	$ 40,000	$ 80,000	$ 40,000	$ 53,600	$ 2,650
15%	$ 441,450	$ 496,600	$ 248,300	$ 469,050	$ 13,150
20%					

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Tax Rates

Standard Deductions

2020

CURRENT STANDARD DEDUCTION

S	MFJ/QW	MFS	HOH
$ 12,400	$ 24,800	$ 12,400	$ 18,650

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Tax Reform

Itemized Deductions

THE <u>OLD RULE</u> WAS TO

<u>ACCELERATE</u> DEDUCTIONS

THE <u>NEW RULE</u> IS TO

<u>TIME</u> DEDUCTIONS

Bracket Management

Itemized Deductions

- Art and Alice are married taxpayers filing a joint return.
- They typically give about $15,000 to charity annually at the end of the year
- The SALT deduction, capped at $10,000, is the only other itemized deduction they can claim

Bracket Management

Itemized Deductions

- If they make their annual donation as usual, they will have $25,000 of itemized deductions, which only decreases their taxable income by $200 in 2020 since they are already entitled to a $24,800 standard deduction
- However, if they lump together their 2020 and 2021 contributions in 2020, their taxable income will be reduced by an additional $15,000 in 2020 and their total deductions will be relatively unchanged in 2021

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Bracket Management

Itemized Deductions

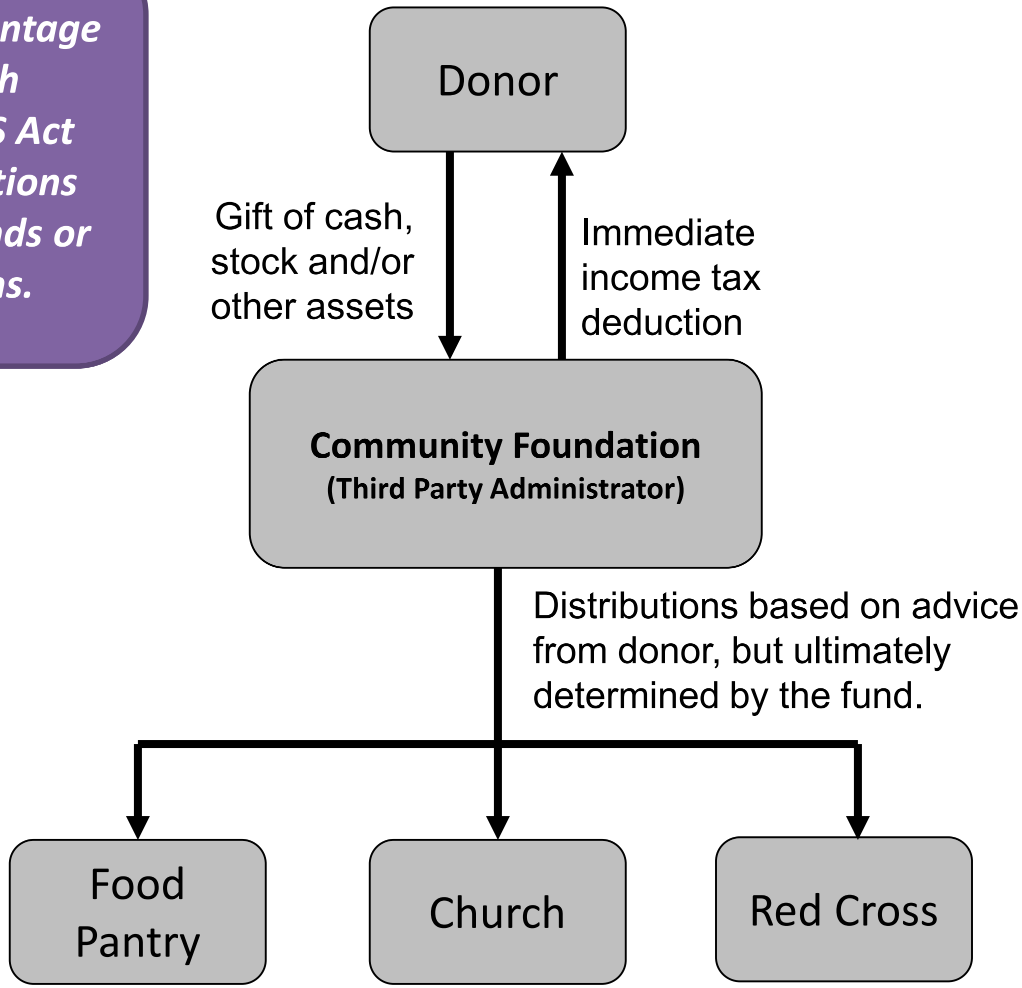
Important for 2020

The CARES Act
allows a charitable contribution
of cash up to 100% of AGI in 2020.

Donor Advised Fund

Overview

The elimination of the percentage limitations for 2020 cash contributions by the CARES Act does not apply to contributions made to Donor Advised Funds or Supporting Organizations.



Donor Advised Fund

Who does it appeal to?

- Donors with a high income year, but distributed charitable intent
- Donors who plan relatively small annual charitable gifts who otherwise would not benefit from itemizing
- Donors who plan to fund many small charitable gifts with proceeds from securities
- Donors whose planned contributions are insufficient to justify the costs of a private foundation
- Donors who wish to avoid or be relieved of the administration of a private foundation

Gain & Loss Harvesting

Bracket Management

Harvest Capital Gains

- Strategy:
  - Taxpayer expects to be in a higher tax bracket in the future
  - Sells assets in the current year, pays tax a lower tax rate and steps up basis
  - Repurchases the same or similar assets
- Effect: Shifts recognition of capital gain from a higher future rate to a current lower rate

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Bracket Management

Capital Gain Harvesting – Tradeoffs

- On the surface, it appears that taxpayers should always harvest gains
- However, harvesting gains introduces a tradeoff between lower tax rates versus the loss of tax deferral
  - Tax is paid at a lower rate, but it is paid sooner
  - Need to determine a crossover point at which selling sooner makes more sense; A way to conceptualize this would be to use a return on investment (ROI) approach

Bracket Management

Harvest Capital Losses

- Harvesting Capital Losses: Selling assets at a loss to offset capital gains
- Reduces or eliminate tax on current capital gain
- On the surface, loss harvesting produces an economic benefit equal to the tax saved, however it generally only provides a timing benefit.
  - Assets purchased with the proceeds have a lower basis than the assets sold
  - Therefore, more capital gains tax is owed in the future
  - However, deferral remains valuable

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Bracket Management

Efficiency of Harvesting Capital Losses

- Capital losses are more tax effective if they can be used to offset income taxed at higher rates

	Short-Term Gain	Long-Term Gain
Short-Term Loss	NEUTRAL	INEFFECTIVE
Long-Term Loss	EFFECTIVE	NEUTRAL

- *Remember:* Capture the up to $3,000 capital loss which can offset ordinary income!
- *Warning:* Remember the wash sale rule prevents taxpayers from repurchasing a substantially similar security within 30 days of selling at a loss

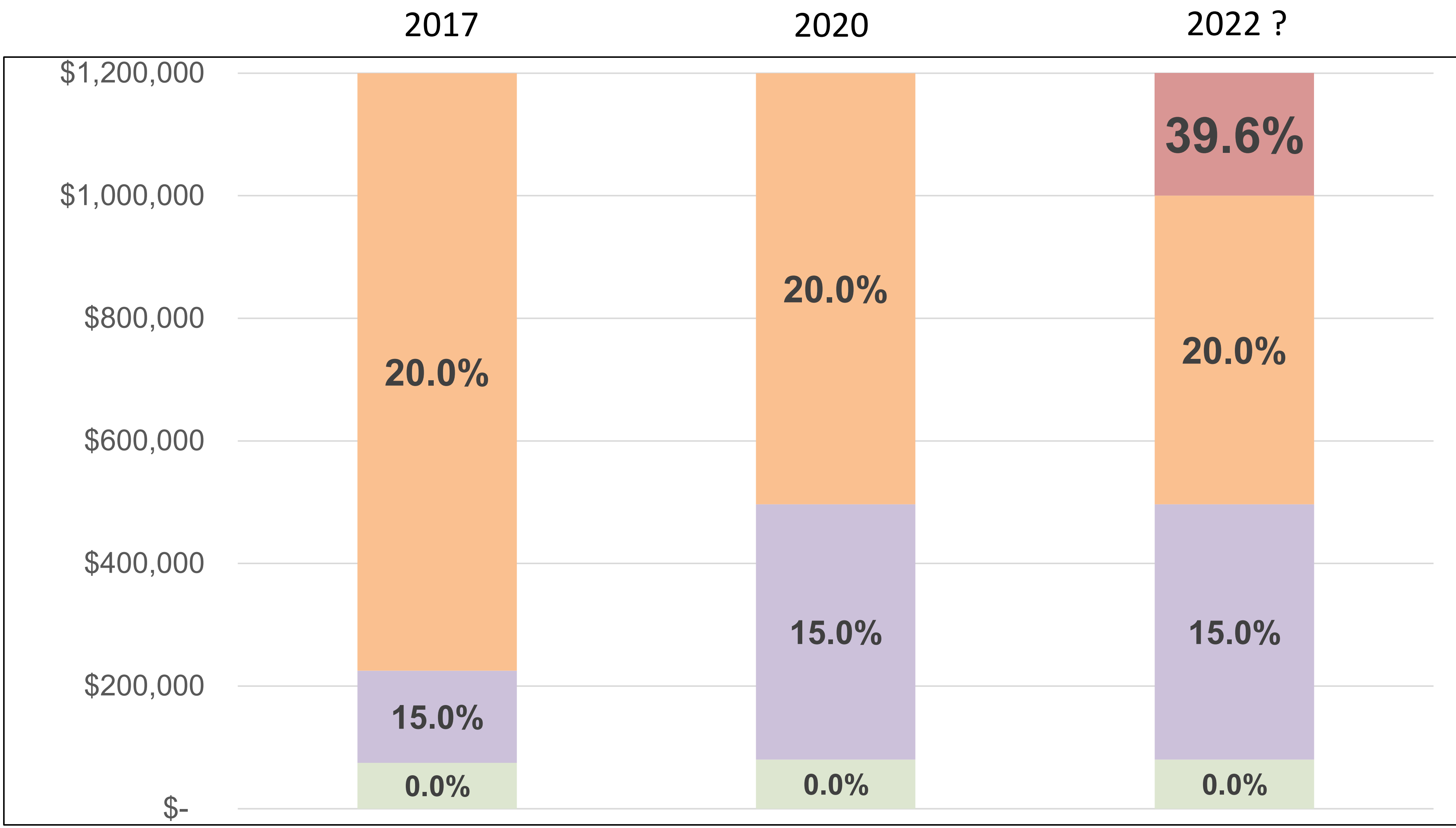
Former Vice President Biden Tax Policy Proposals

- **Proposal to eliminate the preferential rate for long-term capital gains and qualified dividends on income over $1,000,000**
  - Most significant proposal & a fundamental shift
  - Basically an increase from 20% to 39.6%
  - Expect many people to sell assets if it's set to take effect

Consider, for example, how risky funding a substantial sale CRT may be in 2020.

Married Filing Jointly

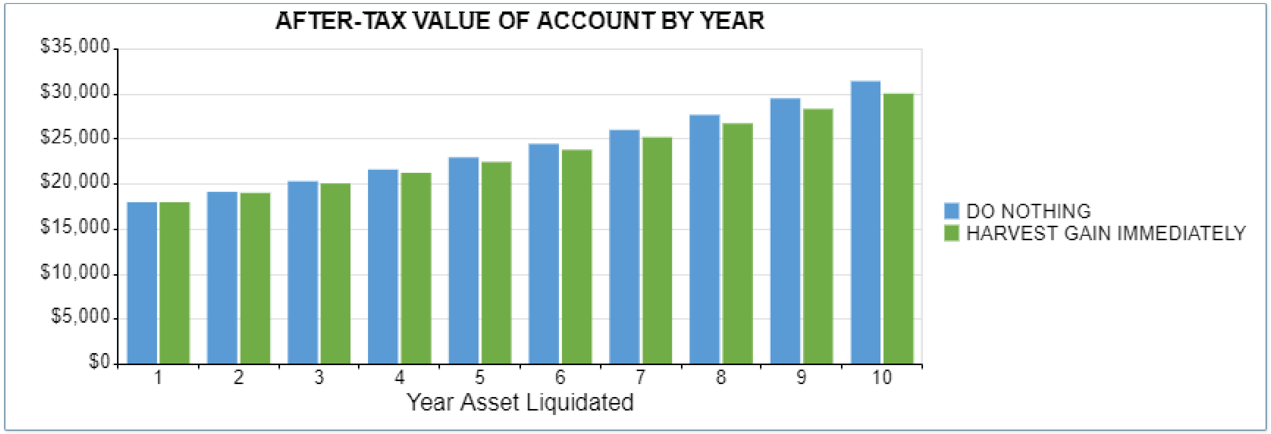
Capital Gain & Qualified Dividend Rates

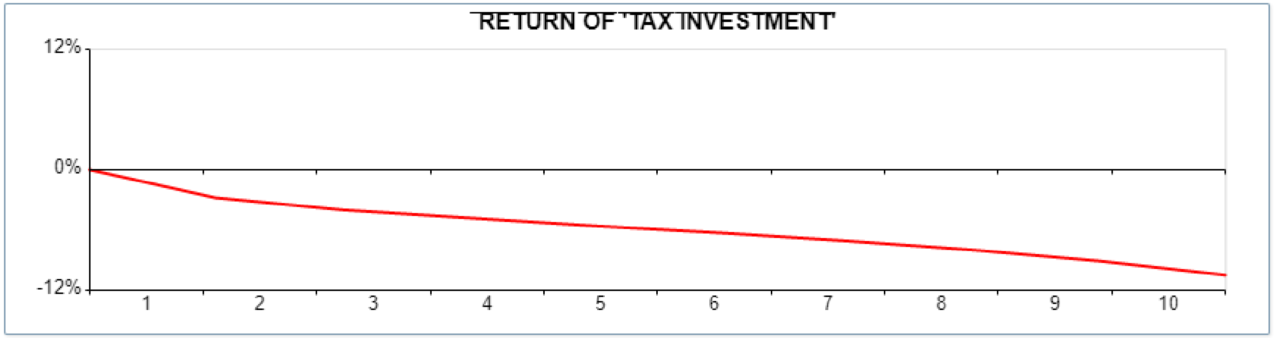


Input & Summary | Detail

GAIN HARVESTING CALCULATOR

CURRENT CAPITAL GAINS TAX RATE	20.0%
FUTURE CAPITAL GAINS TAX RATE	20.0%
BASIS OF ASSET	10,000
FMV OF ASSET	20,000
ASSUMED GROWTH RATE	7.0%





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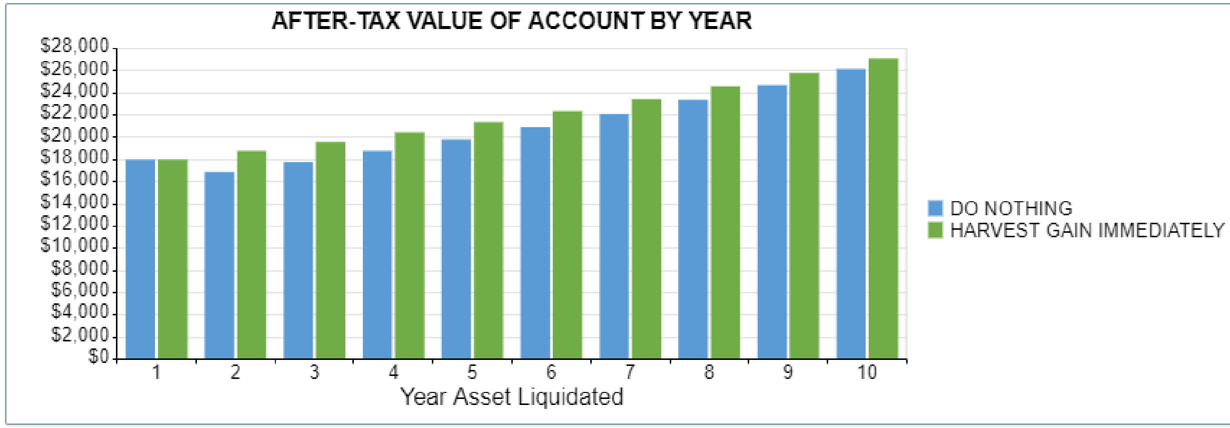
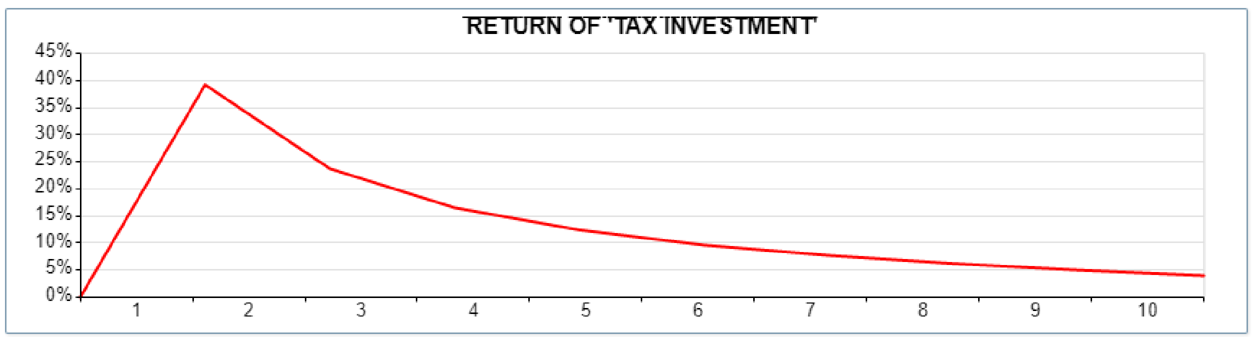
Input & Summary | Detail

GAIN HARVESTING CALCULATOR

CURRENT CAPITAL GAINS TAX RATE	20.0%
FUTURE CAPITAL GAINS TAX RATE	39.6%
BASIS OF ASSET	10,000
FMV OF ASSET	20,000
ASSUMED GROWTH RATE	7.0%





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DO NOTHING

	1	2	3	4	5	6	7	8	9	10
FMV	$20,000	$21,400	$22,898	$24,501	$26,216	$28,051	$30,015	$32,116	$34,364	$36,769
Basis	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
Gain	$10,000	$11,400	$12,898	$14,501	$16,216	$18,051	$20,015	$22,116	$24,364	$26,769
Tax Rate	20.0%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%
Tax	$2,000	$4,514	$5,108	$5,742	$6,422	$7,148	$7,926	$8,758	$9,648	$10,601
NET	$18,000	$16,886	$17,790	$18,759	$19,794	$20,903	$22,089	$23,358	$24,716	$26,169

HARVEST GAIN IMMEDIATELY

	1	2	3	4	5	6	7	8	9	10
FMV	$18,000	$19,260	$20,608	$22,051	$23,594	$25,246	$27,013	$28,904	$30,927	$33,092
Basis	$18,000	$18,000	$18,000	$18,000	$18,000	$18,000	$18,000	$18,000	$18,000	$18,000
Gain	$0	$1,260	$2,608	$4,051	$5,594	$7,246	$9,013	$10,904	$12,927	$15,092
Tax Rate	20.0%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%	39.6%
Tax	$0	$499	$1,033	$1,604	$2,215	$2,869	$3,569	$4,318	$5,119	$5,977
NET	$18,000	$18,761	$19,575	$20,447	$21,379	$22,377	$23,444	$24,586	$25,808	$27,116

RETURN OF "TAX INVESTMENT"

	1	2	3	4	5	6	7	8	9	10
"Investment"	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000
Return (Loss)	$0	$1,875	$1,785	$1,688	$1,585	$1,474	$1,355	$1,228	$1,092	$947
Simple RoR	0%	39%	24%	17%	12%	10%	8%	6%	5%	4%

Former Vice President Biden Tax Policy Proposals

- **Eliminate capital gains rate – deeper thinking**
  - A 39.6% capital gains rate will encourage longer holding periods
  - If the "step-up" in basis at death is retained, many people will be substantially more encouraged to hold onto assets until death
  - If the "step-up" in basis at death is repealed in-favor of a forced-recognition event, people will be encouraged recognize gains before death to:

    (1) Find better investments and

    (2) Avoid a 39.6% applying in the year of death instead of a 20% rate during life, for example

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College Planning

College Planning

Encourage Clients Fund Saving Plans

- Education Savings Accounts (ESAs) & Qualified Tuition Programs (QTPs/529s)
- Both provide annual tax-free growth & tax-free withdrawals for “qualified education expenses”
- QTPs offer a variety of annual savings incentives which vary by state: deductions, credits & grants
- ESAs can be used for primary & secondary in addition to higher education expenses
- The TCJA expanded QTP “qualified education expenses” to include primary & secondary higher education expenses

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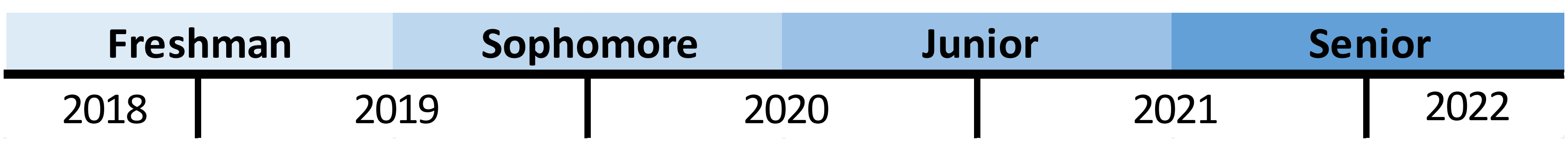
College Planning

Carefully Claim the AOTC

- American Opportunity Tax Credit (AOTC) can only be claimed for the first four academic years of a college student and can only be claimed in four tax years.
- This dual limitation can make choosing when to claim the credit difficult because tax years and academic years do not align:



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College Planning

Claiming College-Aged Dependents

- Despite the suspension of dependency exemptions by the TCJA, dependency remains an issue
- Education credits can be claimed by parents who have a student dependent:
  - Students who receive ½ of their support from their parents are dependents
  - Students 24 and over must also not earn more than $4,050 in 2018 to be dependents
- However, parents do not have to claim the child as a dependent – which is beneficial for parents phased out of education credits

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Retirement Income Tax Planning

Bracket Management

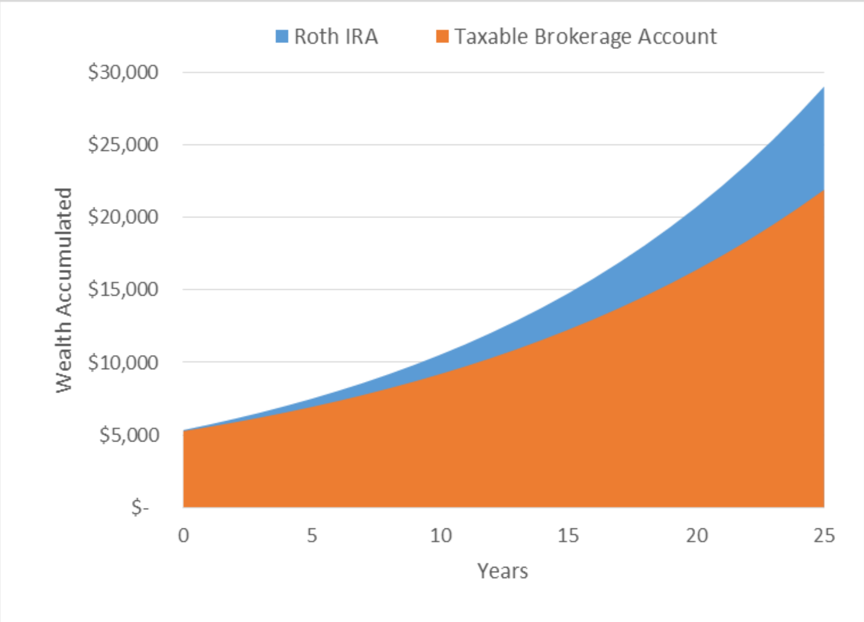
Encourage Retirement Plan Funding

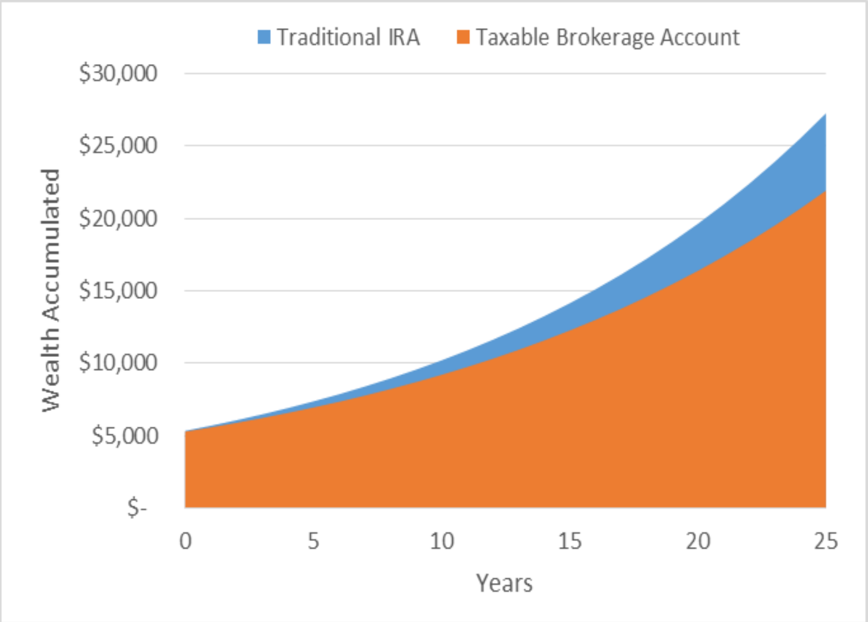
- The 401k and IRA are excellent statutory tax-shelters.
- Remember IRA contributions can be made up to April 15 for the previous tax year
- Deductible contributions can be deceptively valuable by <u>reducing the impact of certain phase-outs.</u>
- Most importantly, the lack of annual "tax-drag" is valuable and therefore an investment in a qualified account will always outperform a taxable investment

Bracket Management

Encourage Retirement Plan Funding

Compare the after-tax value of $5,000 growing in a Traditional or Roth IRA/401k compared to a taxable brokerage account over a significant period of time:





Assumptions: 5% growth rate, 2% yield, 5% annual account turnover, 25% ordinary income tax rate, and a 15% capital gains tax rate.

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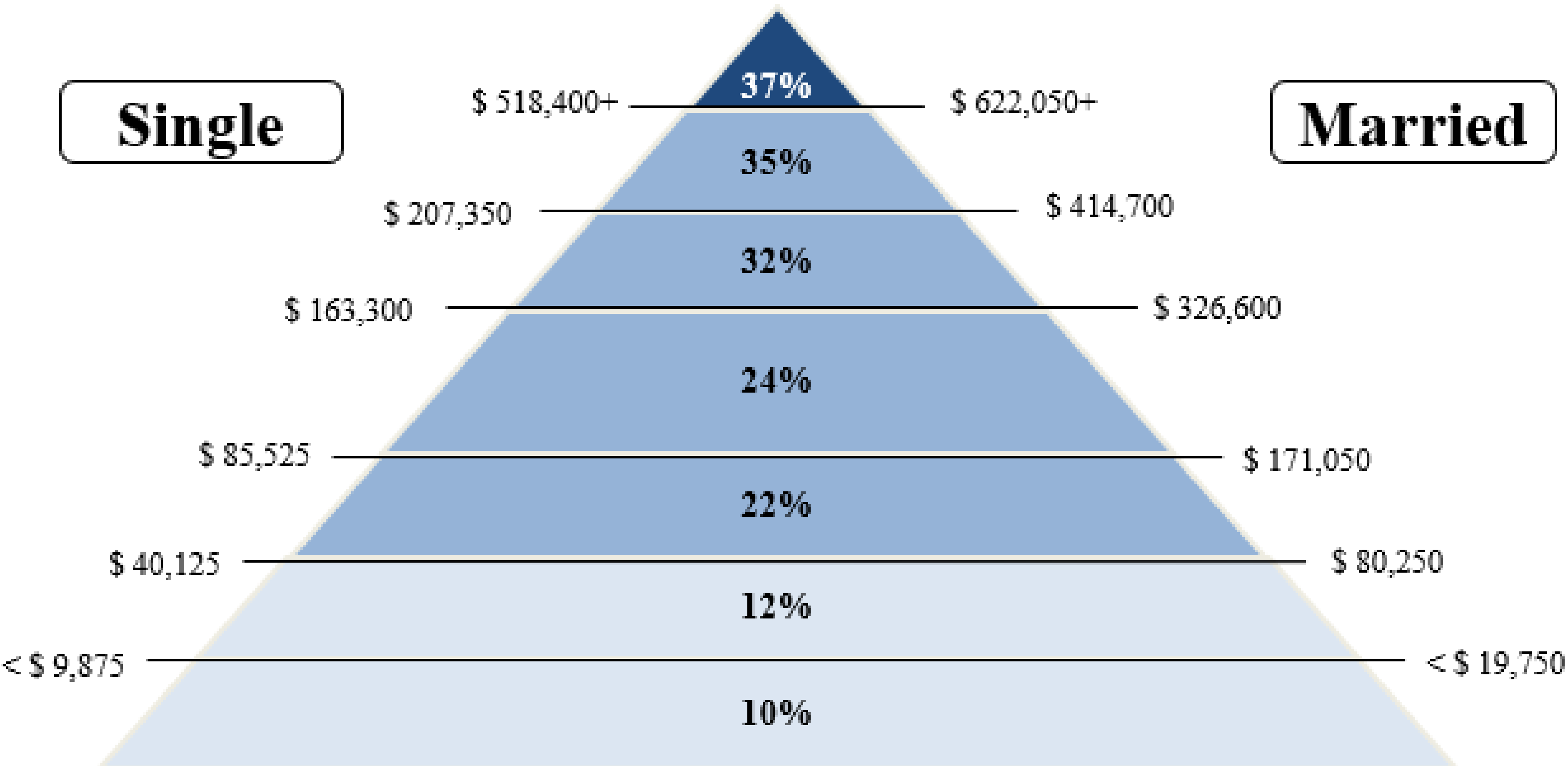
2020 Rates


Single
Married
37%
$ 518,400+
$ 622,050+
35%
$ 207,350
$ 414,700
32%
$ 163,300
$ 326,600
24%
$ 85,525
$ 171,050
22%
$ 40,125
$ 80,250
12%
< $ 9,875
< $ 19,750
10%

Defined Contribution Plan 2020 Limits

DEFINED CONTRIBUTION PLAN LIMITS

IRA / ROTH IRA CONTRIBUTION LIMIT	$ 6,000
IRA / ROTH IRA "CATCH UP"	$ 1,000
401k ELECTIVE DEFERRAL	$ 19,500
401k ELECTIVE DEFERRAL "CATCH UP"	$ 6,500
SIMPLE IRA CONTRIBUTION LIMIT	$ 13,500
SIMPLE IRA "CATCH UP"	$ 3,000
SEP IRA EMPLOYEE PERCENTAGE MATCH LIMIT	25%
SEP IRA SELF-EMPLOYED PERCENTAGE MATCH LIMIT	20%
OVERALL LIMIT ON CONTRIBUTIONS TO DCPs	$ 57,000

“Asset Location”

37%
35%
32%
24%
22%
12%
10%
0%

Tax-Free
- Roth IRAs
- Life Insurance
- Tax-Exempt Interest Income

Tax-Deferred
- IRAs, 401(k)s, 403(b)s
- Non-qualified Deferred Annuities

Taxable
- Interest Income
- Capital Gains
- Qualified Dividends

"Asset Location"

Interest Income	Dividend Income	Capital Gain Income	Tax Exempt Interest	Pension and IRA Income	Real Estate and Oil & Gas	Roth IRA and Insurance
• Money market • Corporate bonds • US Treasury bonds <u>Attributes</u> • Annual income tax on interest • Taxed at highest marginal rates	• Equity Securities <u>Attributes</u> • Qualified dividends at LTCG rate • Return of capital dividend • Capital gain dividends	• Equity Securities <u>Attributes</u> • Deferral until sale • Reduced capital gains rate • Step-up basis at death	• Bonds issued by State and local Governmental entities <u>Attributes</u> • Federal tax exempt • State tax exempt	• Pension plans • Profit sharing plans • Annuities <u>Attributes</u> • Growth during lifetime • RMD for IRA and qualified plans • No step-up	<u>Real Estate</u> • Depreciation tax shield • 1031 exchanges • Deferral on growth until sale • 199A Deduction <u>Oil & Gas</u> • Large up front IDC deductions • Depletion allowances • 199A Deduction	<u>Roth IRA</u> • Tax-free growth during lifetime • No 70½ RMD • Tax-free distributions out to beneficiaries life expectancy <u>Life Insurance</u> • Tax-deferred growth • Tax-exempt payout at death

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Qualified Account Basics

A Quick Refresher

	Traditional IRA	Roth IRA	Non-Deductible IRA
Tax Deduction for Contribution	✓		
Tax-free Distributions		✓	Contribution returned tax-free
Tax-free Compounding	✓	✓	✓
Required Minimum Distributions	✓		✓

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Roth Conversions

Roth Conversions

2017 Tax Reform Refresher

TAX REFORM REPEALED THE ABILITY TO RECHARACTERIZE A ROTH CONVERSION

However, it is still possible to recharacterize a Roth contribution.

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Mathematics of Roth IRA Conversions

- In simplest terms, a traditional IRA will produce the same after-tax result as a Roth IRA provided that:
  - The annual growth rates are the same
  - The tax rate in the conversion year is the same as the tax rate during the withdrawal years

$$A \times B \times C = D$$

$$A \times C \times B = D$$

Mathematics of Roth IRA Conversions

	Traditional IRA	Roth IRA
Current Account Balance	$ 1,000,000	$ 1,000,000
Less: Income Taxes @ 40%	-	(400,000)
Net Balance	**$ 1,000,000**	**$ 600,000**
Growth Until Death	200.00%	200.00%
Account Balance @ Death	$ 3,000,000	$ 1,800,000
Less: Income Taxes @ 40%	(1,200,000)	-
Net Account Balance to Family	**$ 1,800,000**	**$ 1,800,000**

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Mathematics of Roth IRA Conversions

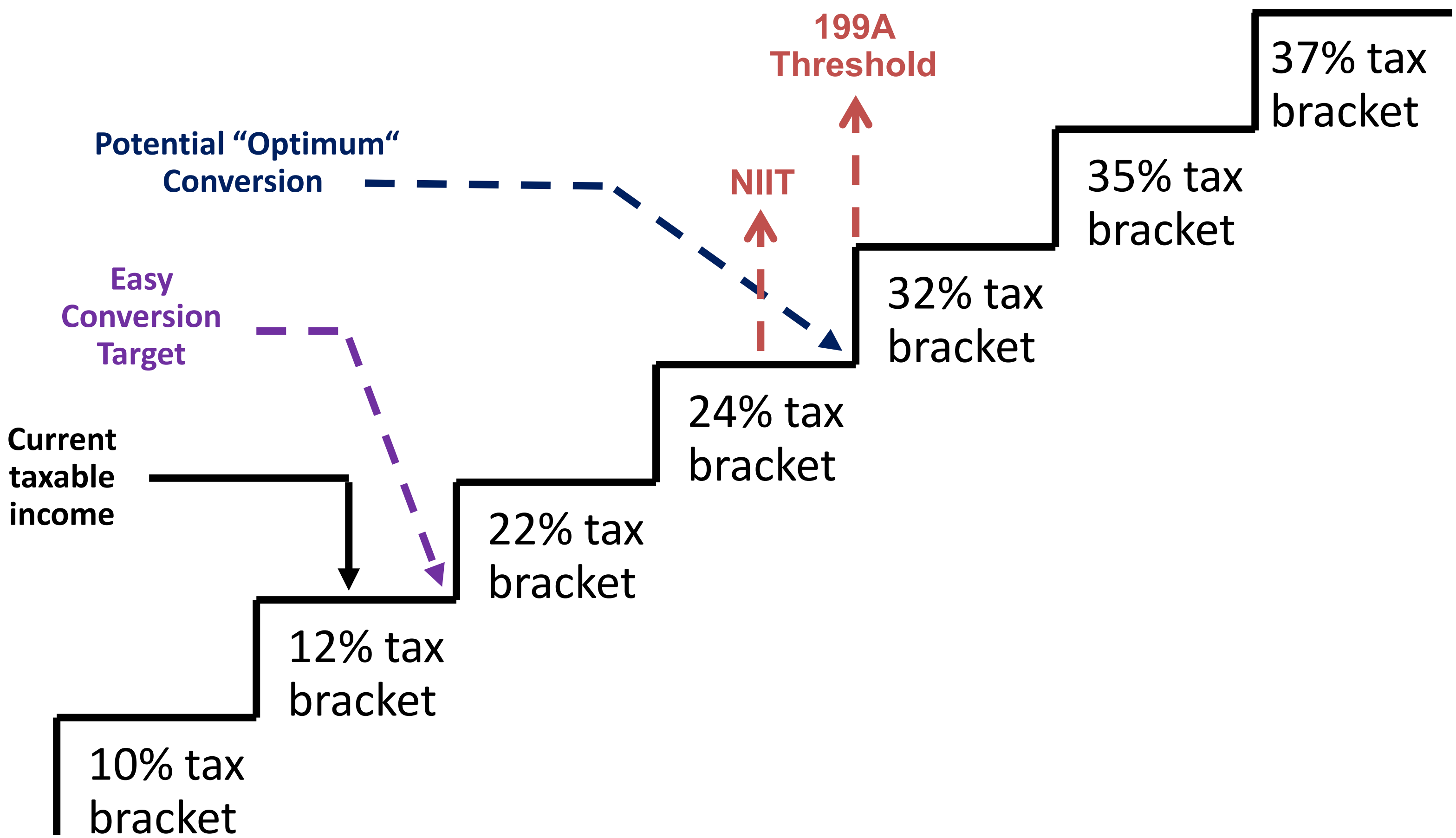
Reasons for converting to a Roth IRA

1. The taxpayer have special favorable tax attributes that need to be consumed such as charitable deduction carry-forwards, investment tax credits, NOLs, etc.…
2. The client expects the converted amount to grow significantly
3. Current marginal income tax rate is likely lower than at distribution
4. Cash outside the qualified account is available to pay the income tax due to the conversion
5. The funds converted are not required for living expenses, or otherwise, for a long period
6. The client expects their spouse to outlive them and will require the funds for living expenses
7. The client expects to owe estate tax

Mathematics of Roth IRA Conversions

- The key to successful Roth IRA conversions is often to keep as much of the conversion income as possible in the current marginal tax bracket
  - However, there are times when it may make sense to convert more and go into higher tax brackets
  - Need to take into consideration the 3.8% Medicare "surtax"
  - Need to take into consideration phase-outs of tax-benefits
  - Need to take into consideration the impact of AMT

Mathematics of Roth IRA Conversions



Retirement Account “DrawDown”

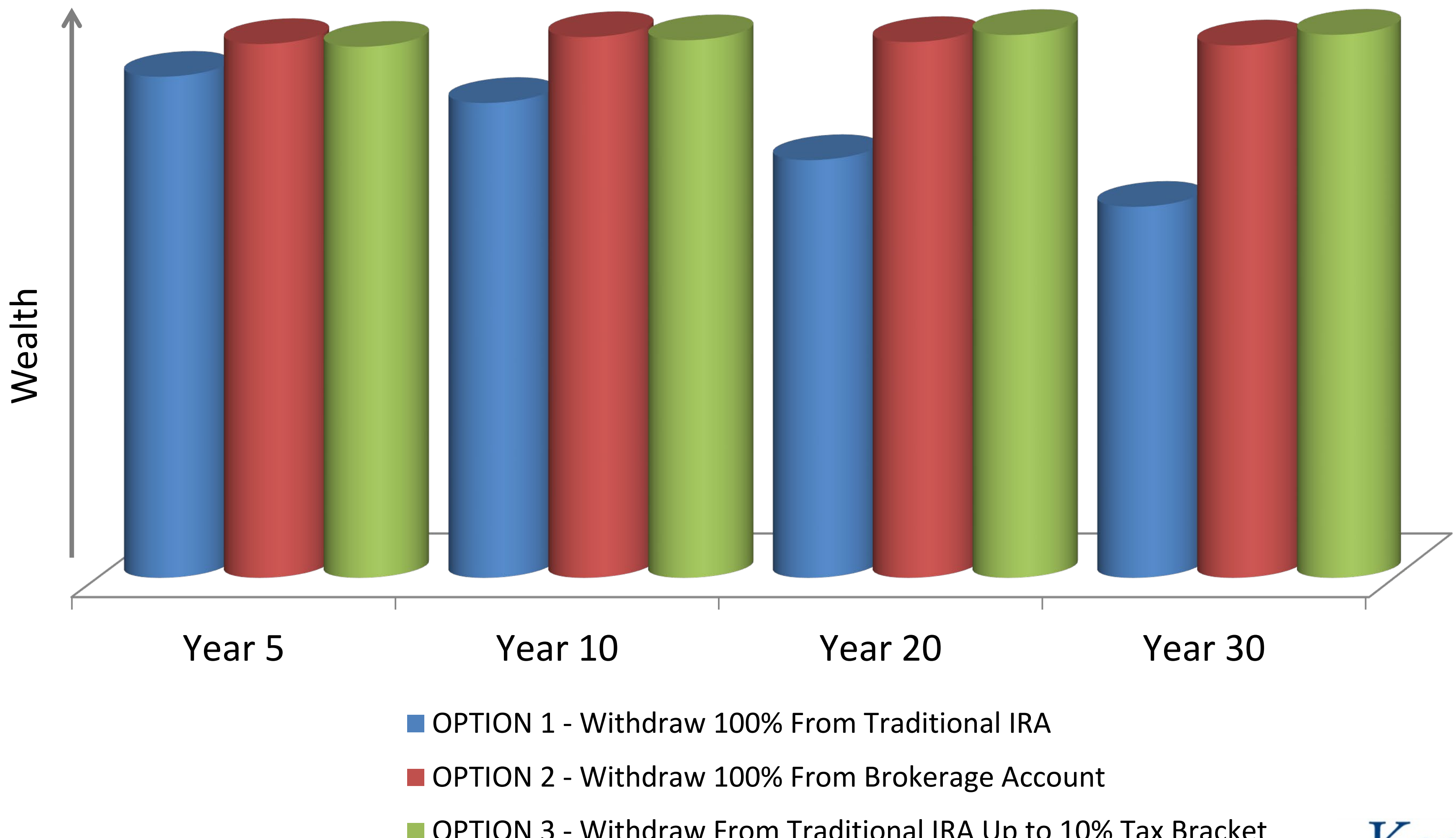
Retirement Account "DrawDown"

Distribution Planning

Perhaps one of the most important decisions a retiree must make is to determine from which retirement assets to withdraw funds to meet everyday living expenses.

Retirement Account "DrawDown"

Distribution Planning



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Retirement Account "DrawDown"

Distribution Planning

- Decision factors
  - Size of accounts
  - Investment mix / performance
  - Marginal income tax bracket
  - Time horizon

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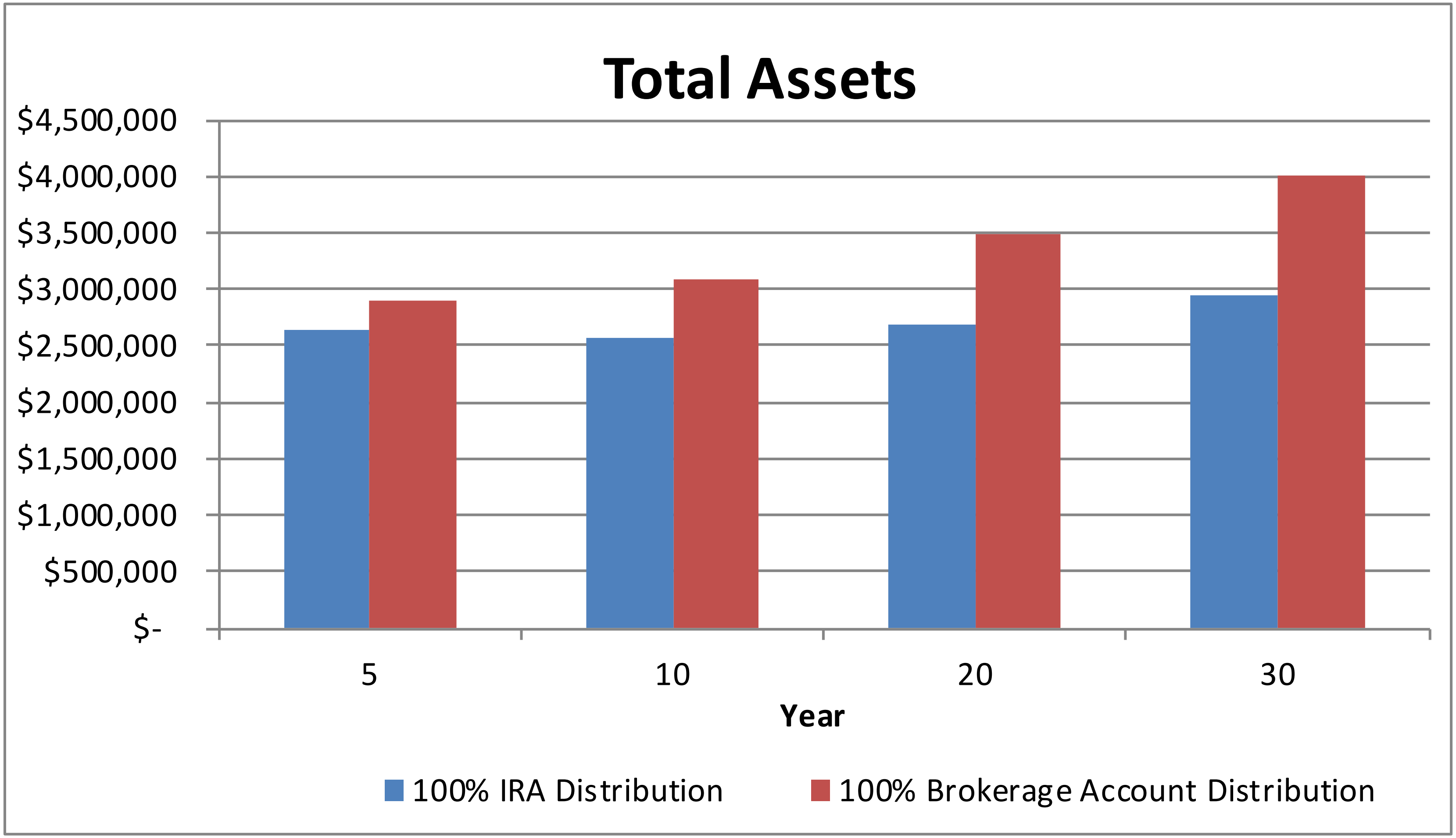
Retirement Account "DrawDown"

Value of Account Preservation – Example



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The SECURE Act

RMDs after Death

H.R. 1994 – Sec. 401

Modification of

Required Minimum Distribution Rules

for Designated Beneficiaries

Basically, requires all IRAs and Qualified Plans to be distributed within 10-years of death

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Opportunity Zones

Opportunity Zones

Overview

- "Qualified opportunity zones" are certain designated low-income census tracts.
- On cdfifund.gov you can find an interactive map showing the areas which qualify.
- The tax incentives for investing in qualified opportunity zones include:
  - Deferral of unrecognized gain
  - Reduction or elimination of unrecognized gain

Opportunity Zones

Overview

- Capital gain from the sale of an investment is not recognized if rolled into a Qualified Opportunity Zone Fund within 180 days
- Moreover, the longer the investment is held the amount of gain ultimately recognized is reduced:

Years Held	Basis Increase
5	**10%**
7	**+5%** (15% total)
10	**100%** (no gain recognized)

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Trusts & Estates

Estate & GST Taxes

- The TCJA doubled the Basic Exclusion Amount and GST exemption in 2018-2024 ($10,000,000 in 2011 dollars)
- In 2025 the exemptions revert to pre-TCJA law (5,000,000 in 2011 dollars)
- Should the Democrats do well in the 2020 elections, we should expect exemption to substantially decrease

POTENTIAL
"USE-IT-OR-LOSE-IT"
OPPORTUNITY

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Estate & GST Taxes

Exemption Sunset Math

- Option 1
  - No planning
  - “Double” exemption sunsets 1/1/26 and is lost
- Option 2
  - Couple gifts $5,000,000 each to trust in 2019
  - Their previous gifts reduce their exemption by $5,000,000 to $0 (ignoring inflation adjustments) in 2026
  - Gifting during the “double period” accomplished nothing
- Option 3
  - Couple gifts $10,000,000 each to trust in 2019
  - Their previous gifts reduce their exemption $0 in 2026
  - $5,000,000 each (ignoring inflation adjustments) of additional exemption is captured

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Estate & GST Taxes

IDEAS

- **Continue annual exclusion gifts ($15,000 exemption in 2020)**
- Continue medical & education gifts

- Tax-free gifts to use higher exemptions
- Portability elections to preserve exemptions
- Five-year GRATs (for ETIP to end before sunset)
- Five-year SCIN or private annuity
- "Springing" SLATs (i.e. SLAT with contingent GPOA provision)

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Estate & GST Taxes

IDEAS

- **Use Trusts to Create Additional Taxpayers**
  - $10,000 SALT deduction per trust
  - $163,300 199A Threshold Amount per trust

Estate & GST Taxes

IDEAS

- **Use trusts to avoid state income taxation**
  - Incomplete Gift Non-grantor Trusts –
    - A trust settled in state with a trust code which facilitates the strategy
    - Transfer to the trust is not a completed gift and therefore does not incur gift tax because the settlor retains certain powers
    - Trust is a non-grantor trust
    - Useful to avoid income taxation in the settlor's resident state
    - Only possible in certain states including: Alaska, Delaware, Nevada, Wyoming

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Estate & GST Taxes

IDEAS

- **Use trusts to avoid state income taxation**

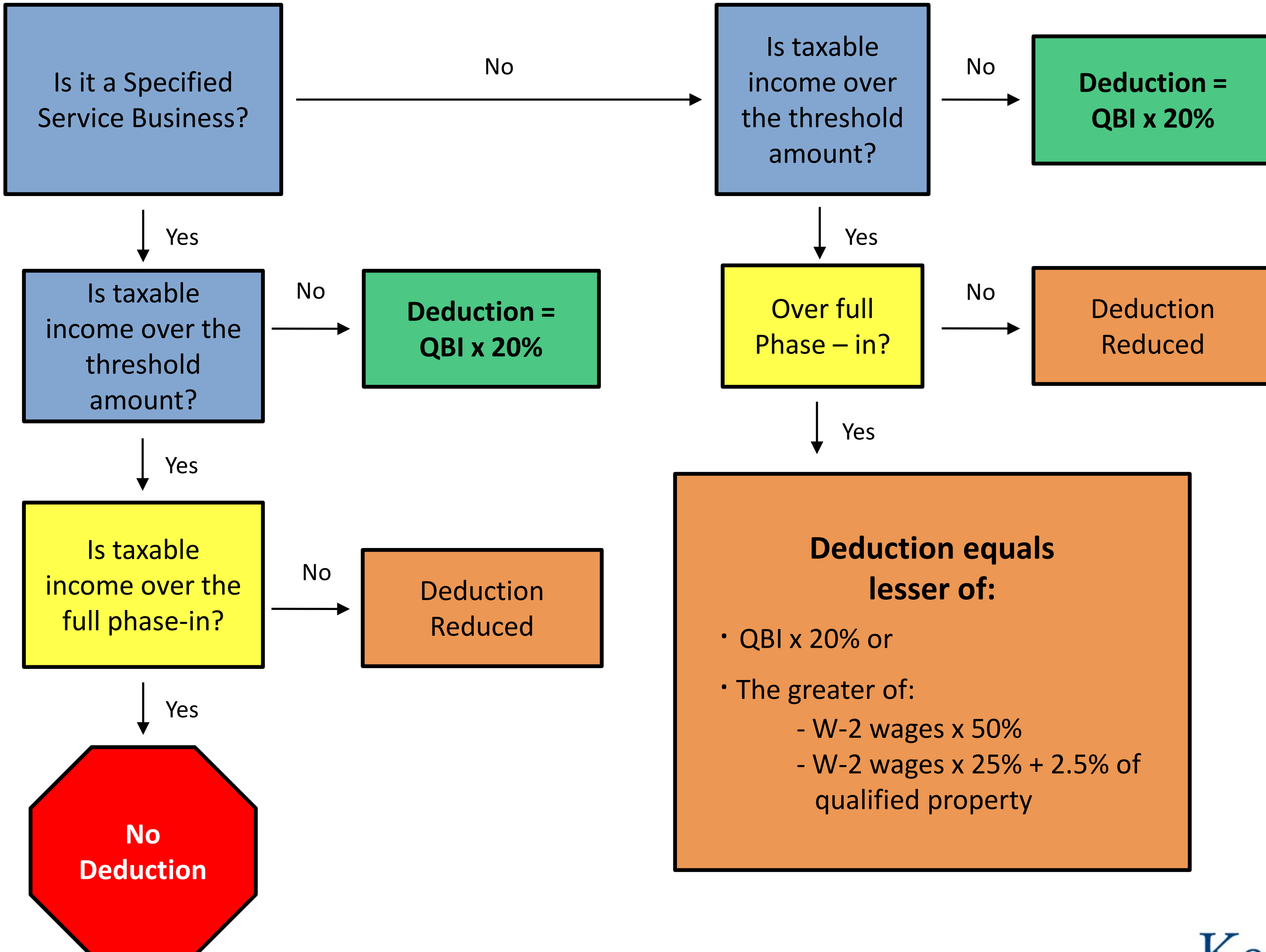
		Current		No SALT Deduction		W/ING	
Income		$	100	$	100	$	100
State Tax	5%		(5)		(5)		
Federal Tax	35%		(33)		(35)		(35)
		$	62	$	60	$	65

Estate & GST Taxes

Decanting

- Decanting Ideas
  - Turn a grantor trust into a non-grantor trust
  - Turn one non-grantor trust into several (e.g. one for each beneficiary)
  - Add a Power of Appointment (or other terms to force inclusion) in order to capture the basis “step-up”

IRC § 199A


Is it a Specified Service Business?
No
Is taxable income over the threshold amount?
No
Deduction = QBI x 20%
Yes
Is taxable income over the threshold amount?
No
Deduction = QBI x 20%
Yes
Over full Phase – in?
No
Deduction Reduced
Yes
Is taxable income over the full phase-in?
No
Deduction Reduced
Yes
No Deduction
Yes
Deduction equals lesser of:
• QBI x 20% or
• The greater of:
- W-2 wages x 50%
- W-2 wages x 25% + 2.5% of qualified property

Eligible Taxpayers

TYPES OF TAXPAYERS	THRESHOLD AMOUNT
Married persons	$ 326,600
All other taxpayers	$ 163,300

Four Business Classifications

And the Limitations

	Non-Service	Service
Taxable income less than $326,600 (MFJ)	**20% deduction**	**20% deduction**
Taxable income greater than $326,600 but less than $426,600	Limitation phased-in	Deduction phased-out
Taxable income greater than $426,600	**Wage/Capital Testing**	**No deduction**

THE HEART OF PLANNING IS MANAGING TAXABLE INCOME AND THE WAGE / CAPITAL LIMITATION.

Basics

"Income Deficit"

- The deduction also cannot exceed the lesser of
  - The "Combined QBI Amount," or
  - 20% x (total taxable income – capital gain)

- Combined QBI amount = deduction for each qualified trade or business ***PLUS*** **20% of REIT dividends and PTP income**

§ 199A, § 11011

Calculation of the Deduction

Simplified

- For taxpayers with income in excess of $426,600 (MFJ) the deduction for pass-through income from a non-service trade or business is limited to the greater of:
  - 50% of W-2 Wages, or
  - 25% of W-2 Wages plus 2.5% of "unadjusted basis immediately after acquisition"

- This limitation for is phased-in from $326,600 - $426,600 (MFJ) of taxable income

- **Additionally, for Specified Service Businesses, the entire deduction is phased-out from $326,600 - $426,600 (MFJ) of taxable income**

§ 199A, § 11011

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Calculation of the Deduction

Simplified

- W-2 Wages
  - Equal to wage expense [§199A(f)(1)]
  - Does not include guaranteed payments or payments to independent contractors
- Qualified Property
  - Tangible property being depreciated (e.g. does not include land)
  - Depreciation period is the later of the regular depreciation period or 10-years
- Unadjusted Basis
  - Equal to basis immediately after acquisition
  - Not adjusted for depreciation

§ 199A, §11011

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Key Planning Ideas

- **Reduce Taxable Income below the threshold amount**
  - Tax-free bonds
  - Life insurance & annuities
  - Real estate investments
  - Oil & gas investments
  - Recognize losses
  - Avoid recognizing gains
  - Charitable contributions
  - Pension plan contributions
  - Increase payroll
  - Accelerate business expenses
  - Cost segregation studies
  - Captive insurance companies
  - Broaden ownership group to those with lower taxable income
  - Gifts to taxpayers with lower taxable income (e.g. children & trusts)

Key Planning Ideas

- **Increase QBI for those below the threshold amount**
  - Defer business expenses (e.g. insurance premium or property tax payment plans)
  - Defer acquisitions of new property eligible for 179 or bonus treatment
  - Reduce wages paid
  - Drop S-election to avoid owner's wage
  - Reduce leverage

Key Planning Ideas

- ❑ **Pass the "Wage" or "Capital" Test**
  - ❑ **Increase qualified property**
    - ❑ Acquire or improve property before year-end
    - ❑ Carefully consider whether items are capitalized or expensed
    - ❑ Understand what property will "roll-off" at year-end
  - ❑ **Increase Wages**
    - ❑ Employee bonuses
    - ❑ S-election
  - ❑ **REVIEW AND COMPUTE THE EFFECTIVENESS OF BOTH AGGREGATION ELECTIONS**

Traditional v. Roth v. Life Insurance

It's all about marginal rates !

- If a business owner can claim 199A in full, their actual current rate is 80% of the scheduled tax rate:

$$35\% \times 20\% = 7\%$$

$$35\% - 7\% = 28\%$$

$$28\% \div 35\% = 80\%$$

- This changes the mathematics of the Traditional v. Roth v. Life Insurance analysis we are familiar with

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Traditional v. Roth v. Life Insurance

It's all about marginal rates !

Equal Rates at Contribution & Distribution
199A Doesn't Apply

	Traditional 401(k)	Roth 401(k)
Annual Savings	$ 19,500	$ 19,500
Less: Income Tax Cost (35%)	-	(6,825)
Net Balance	$ 19,500	$ 12,675
Growth Until Death	200%	200%
Account Balance @ Death	$ 39,000	$ 25,350
Less: Income Tax Cost (35%)	(13,650)	-
Net to Family	$ 25,350	$ 25,350

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Traditional v. Roth v. Life Insurance

It's all about marginal rates !

Equal Rates at Contribution & Distribution
199A Applies

	Traditional 401(k)	Roth 401(k)
Annual Savings	$ 19,500	$ 19,500
Less: Income Tax Cost (80% of 35%)	-	(5,460)
Net Balance	$ 19,500	$ 14,040
Growth Until Death	200%	200%
Account Balance @ Death	$ 39,000	$ 28,080
Less: Income Tax Cost (35%)	(13,650)	-
Net to Family	$ 25,350	$ 28,080

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Personal Trainer Example

Roth Contributions & Conversions to Increase the Deduction

- Your personal trainer, Tom, will make $100,000 (QBI) in 2020 giving his clients fitness lessons and nutritional advice
- He operates as a sole proprietor and just files a Schedule C to report his business income
- He diligently contributes to his IRAs and has done well in the market, but basically has no other sources of income

Personal Trainer Example

Roth Contributions & Conversions to Increase the Deduction

- He will claim the $12,400 standard deduction for single filers and plans a $6,000 contribution to his IRA – his taxable income will be about $81,600

You explain he will not be entitled to a full 199A deduction if his taxable income is too low

Taxable Income x 20% < QBI x 20%

Personal Trainer Example

Roth Contributions & Conversions to Increase the Deduction

- You therefore advise Tom to consider Roth IRAs to increase his 199A deduction in 2020
- You explain that if Tom makes a Roth IRA Contribution instead of a Traditional IRA contribution this will not decrease his deduction.
- You also explain that if he makes a $12,400 Roth Conversion, he will be entitled to the full 199A deduction

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Personal Trainer Example

Roth Contributions & Conversions to Increase the Deduction

- Your simple advice increases Tom's deduction and allows him to save more for retirement on an after-tax basis

- His effective Roth IRA contribution and conversion rate will only be 19.2% (24% x 80%)

Dentist Example

- Lisa is a married dentist who receives $400,000 of pass-through income from her practice, organized as an S-corporation, and pays herself a wage of $150,000.
- Her taxable income exceeds the threshold amount and phaseout – she is ineligible for the 199A deduction.

No Deduction for a Service Business

Income > Threshold Amount + Phaseout

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Dentist Example

- Lisa lives modestly relative to income and invests the majority of her earnings
- Therefore, you advise her to look into whether her retirement plans are fully funded

Contributions to Pre-tax Retirement Funds Reduce Taxable Income

Dentist Example

DEFINED CONTRIBUTION PLAN LIMITS	
IRA / ROTH IRA CONTRIBUTION LIMIT	$ 6,000
IRA / ROTH IRA "CATCH UP"	$ 1,000
401k ELECTIVE DEFERRAL	$ 19,500
401k ELECTIVE DEFERRAL "CATCH UP"	$ 6,500
SIMPLE IRA CONTRIBUTION LIMIT	$ 13,500
SIMPLE IRA "CATCH UP"	$ 3,000
SEP IRA EMPLOYEE PERCENTAGE MATCH LIMIT	25%
SEP IRA SELF-EMPLOYED PERCENTAGE MATCH LIMIT	20%
OVERALL LIMIT ON CONTRIBUTIONS TO DCPs	$ 57,000

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Dentist Example

Current Age	DC/401k Contribution	Cash Balance Allocation	Total
35	54,000	70,000	124,000
40	54,000	90,000	144,000
45	54,000	115,000	169,000
50	60,000	145,000	205,000
55	60,000	190,000	250,000
60	60,000	245,000	305,000

Please note these are prior-year figures.

A Special Thanks to Shore-Tompkins for Providing this Slide.

Dentist Example

- Next, you point out if she invests in an Oil & Gas operating interest, she is specifically exempt from the passive loss rules and therefore can reduce her income

- Oil & Gas investment incentives
  - Intangible drilling costs (IDCs) are the majority of the costs of drilling a well and 100% deductible in the year incurred with an election
  - Tangible drillings costs allow for depreciation deductions
  - Depletion provides an additional deduction
  - Usually, well over 80% of the investment is deductible in the year made

Dentist Example

- Lisa is also charitably inclined and you point out the deduction is phased-out based on her taxable income
- You explain the following options might allow her to lump a large charitable contribution into a single year:
  - Donor advised funds
  - Supporting organizations
  - Community foundations
  - Private foundations
  - Charitable gift annuities
  - Pooled income funds
  - Charitable remainder trusts

Dentist Example

- Example of steps Lisa might take to reduce her taxable income and be eligible for the deduction:

	Income (Deduction/Loss)
W-2 Income	$ 150,000
Pass-through Income	400,000
Defined Benefit Plan (DBP) Contribution	(150,000)
Oil & Gas Partnership ($65,000 investment)	(50,000)
Accelerated Charitable Contribution to DAF	(30,000)
Taxable Income	**$ 320,000**

- Lisa could reduce her income to a level that allows her to fully claim the 199A deduction

2020 Action Steps

2020 Action Steps

Checklist

- ❑ Bracket Management
  - ❑ Bonuses
  - ❑ Recognition events
  - ❑ Business expenses
  - ❑ AMT awareness
- ❑ Significant Financial Events Next Year
  - ❑ Recognition events
  - ❑ New investments
  - ❑ Re-allocation plans
  - ❑ Vesting
- ❑ Itemized Deduction Timing
  - ❑ Medical expenses
  - ❑ Property tax
  - ❑ **Charitable contributions**
  - ❑ Casualty & theft losses
- ❑ Major Life Events Next Year
  - ❑ Family changes
  - ❑ Job changes
  - ❑ Moving

2020 Action Steps

Checklist

- ❑ Retirement Planning
  - ❑ Fund IRAs
  - ❑ Fund 401ks
  - ❑ Fund pension plans
- ❑ Education Planning
  - ❑ Fund 529 plans
  - ❑ Fund Coverdell accounts
- ❑ Executive Planning
  - ❑ Review NQCD
  - ❑ Review NQSOs / ISOs
  - ❑ Review concentrated positions
- ❑ Estate Tax Planning
  - ❑ **Plan lifetime exemption gifts**
  - ❑ Plan annual exclusion gifts
  - ❑ Plan medical gifts
  - ❑ Plan tuition gifts

Year-end Planning

A Checklist of Ideas to Prepare for a Biden Administration

- ❑ Bracket Management
  - ❑ Accelerate bonuses to avoid rate increases
  - ❑ Accelerate recognition events to avoid rate increases
  - ❑ Defer business expenses to capture a greater benefit if rates increase
  - ❑ Consider what reinstatement of the AMT would mean

- ❑ Itemized Deduction Timing
  - ❑ Carefully consider property tax payments
    - ➢ Defer to capture a greater benefit due to higher rates
    - ➢ Defer in-case the $10,000 SALT deduction cap is repealed
    - ➢ Accelerate to avoid additional itemized deduction limits
  - ❑ Carefully consider charitable contribution timing:
    - ➢ Defer to capture a greater benefit due to higher rates
    - ➢ Accelerate to avoid additional itemized deduction limits

Year-end Planning

A Checklist of Ideas to Prepare for a Biden Administration

- ❑ Gain & Loss Harvesting
  - ❑ Harvest gains to avoid rate increases
  - ❑ Defer harvesting losses to offset rate increases
- ❑ Retirement Planning
  - ❑ Roth conversions before rates increase
  - ❑ NUA rollout before rates increase
  - ❑ Diversify concentrated positions before rates increase
- ❑ Executive Planning
  - ❑ Reconsider NQCD funding to avoid rate increases & increased payroll taxes
  - ❑ Consider ISO exercise in case the AMT returns in-force
  - ❑ Consider NQSO exercise to avoid rate increase & increased payroll tax
- ❑ Estate Tax Planning
  - ❑ Consider large lifetime gifts
    - ➢ Capture the large estate tax exemption
    - ➢ Avoid a forced recognition event

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