What's your 2020 tax contingency plan?

Post-election tax planning strategies you may need to consider.

You can only plan so much for the unknown and that's especially true when it comes to politics. But with the upcoming Presidential and general elections in full swing, the candidates have unveiled their economic proposals that could bring about significant changes. What will these proposals mean to you and what planning strategies are important to keep top of mind so you are ready to take action as needed?

Democratic candidates have been on the record in wanting to raise revenues for their policy priorities, such as expanded healthcare. If the Democrats take both the Presidency and the Senate in November, it seems certain that there will be a push to increase taxes on at least the wealthiest of taxpayers.

If President Trump wins and the Senate remains in Republican hands, its still possible that at least some future tax increases may be necessary to offset the massive COVID-19 related stimulus spending.

Among the great unknowns is whether Congress would attempt to make any tax increases retroactive to January 1, 2021—thereby potentially limiting the ability to take a wait and see approach and delay implementing any tax reduction planning strategies until there is more clarity on where future tax legislation is likely heading. Although a retroactive tax increase of any magnitude may be unlikely and could face adverse court action, when Congress passed a tax overhaul following the 2012 election to avoid a fall off the fiscal cliff, the details of that new tax law did catch many people off guard without enough lead time to plan and take action.

So, unfortunately, waiting until after the election to start considering certain contingent planning strategies might leave you unprepared and without sufficient time to take the necessary steps to protect your wealth from taxes. But with over a month to go before the election, there's still ample opportunity to at least evaluate the different proposals, decide how they could impact you and be well prepared to act as the future situation dictates.

We have highlighted below some of the proposed tax law changes in comparison to current law and provided a few potential planning strategies to think about.

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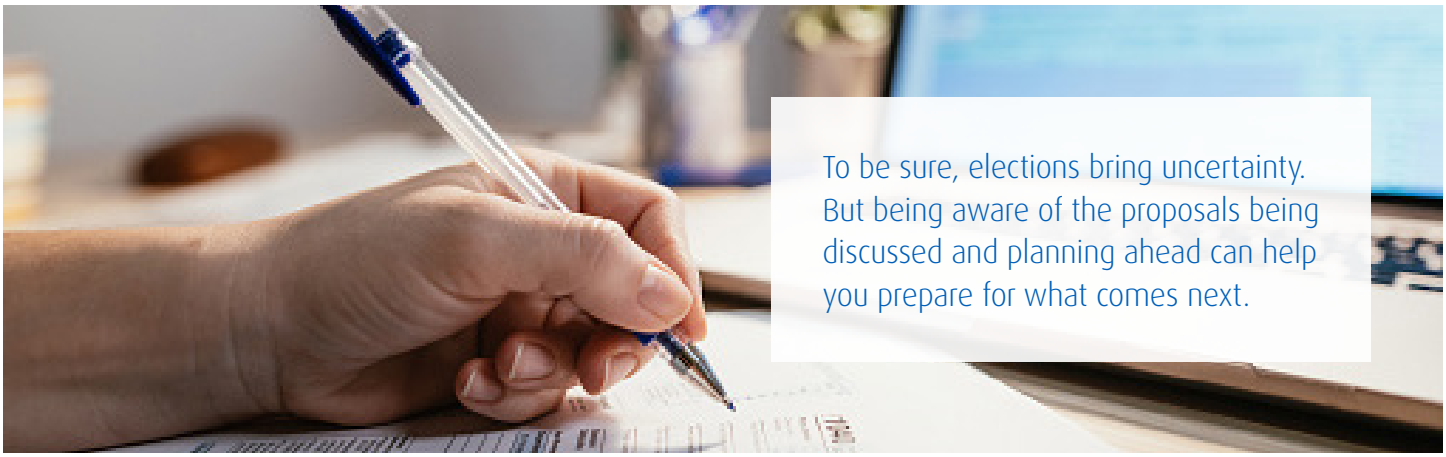
Individual income tax and payroll tax

Democratic lawmakers have long been critical of the Tax Cuts and Jobs Act of 2017 ("TCJA"). The TCJA was passed along strict party lines, so a change in both the White House accompanied by Democratic control of both houses of Congress could result in revisions to many of the TCJA provisions. Not surprisingly, Democratic candidate Joe Biden's tax plan takes direct aim at some of TCJA's key provisions. According to the nonpartisan Tax Foundation, these proposals would increase taxes on the top 1% of taxpayers by 7.8%.

Here is a comparison outlining current law and the Biden platform's proposals:

	Current Law: Trump/Republicans	Proposals: Biden/Democrats	Planning Considerations
Tax rates and brackets	• Top bracket is 37% for incomes over $622,000 married filing joint and $518,000 for single filers • Sunset after 2025 • The campaign is suggesting making this permanent, rather than allowing sunset • Also proposed, is creating a 15% rate for middle class	• Restores top marginal tax rate to pre TCJA rate of 39.6% applicable to income over $400,000	• Accelerate income to 2020/defer expenses to 2021 • Consider non-traditional, tax-advantaged sources of retirement income like life insurance with tax free cash value build up • Consider a Roth IRA conversion to take advantage of today's lower rates
Itemized deductions	• Value of itemized deduction is the top marginal tax rate of 37% • State and local tax deduction is limited to $10,000 • No changes proposed	• Caps the value of itemized deductions to 28% • Removes deduction limitation for state and local taxes	• Accelerate itemized deductions, such as charitable deductions, into 2020 to get a greater tax benefit from these deductions.
Capital gains and dividends	• Maximum capital gains and qualified dividends tax rate is 20% • Nonqualfied dividends are taxed at ordinary rates • 3.8% net investment income tax (Medicare surtax) • Proposal to eliminate 20% rate and establish top 15% rate (indexed for inflation)	• Tax capital gains and qualified dividends at top marginal rate of 39.6% for capital gain and qualified dividends over $1,000,000 • Medicare surtax proposals unknown • Eliminate like-kind exchanges	• Consider selling appreciated capital assets in 2020 if you have already identified potential sales (including a business, real estate, concentrated stock positions, etc.)
Payroll taxes	• No payroll tax on income above $137,000 • Proposal for permanent payroll tax rate cut	• Payroll tax of 12.4% on wages over $400,000—split between employers and employees	• For business owners, consider how salary/distributions are allocated from your business to reduce payroll tax/income tax exposure • Consider choice of business entity



Estate, gift and generation skipping taxes

The current $11.58 million estate, gift and generation skipping tax exemption amounts are slated to sunset after 2025, but Democrats might push for an earlier expiration date. The exemption amounts could then revert back to the previous $5.49 million level ($5 million indexed for inflation). Some political commentators, however, aren't ruling out an even more drastic reduction in the exemption amount, perhaps even as low as $3.5 million which was the exemption in 2009.

In addition, the Biden campaign has other proposals that could affect the estate tax, including eliminating the "step-up" in basis for inherited capital assets. Heirs would have to pay capital gains tax on those assets using the "carry-over" cost basis of the deceased.

	Current Law: Trump/Republicans	Proposals: Biden/Democrats	Planning Considerations
Estate, gift and generation-skipping tax exemptions	• Estate, gift and generation-skipping tax exemption is $11.58 million per individual until 2026 (sunsets after 2025) • Proposal to retain and extend TCJA provisions	• Lower the estate, gift and generation skipping tax exemptions to pre-TCJA level of $5.49 million ($5 million indexed for inflation)	• Make lifetime gifts to take advantage of the generous $11.58 million exemption. This will also remove future appreciation from your estate now, enhancing the value removed from taxes and given to heirs.
"Step-up" in basis	• Capital assets of deceased receive a "step-up" in basis to fair market value at date of death for inheritor • Plan is to retain the "step-up" in basis	• Remove the "step-up" in basis for inheritor. Instead, inheritor would have carryover basis—the inheritor's basis would be the deceased's basis at their death.	• Consider shifting low basis assets to irrevocable trusts • Gift low basis assets to charity and high basis assets to heirs

In 2018, the Internal Revenue Service issued a ruling reassuring taxpayers that it will not "clawback" and tax large gifts if the estate tax exemption ever reverts back to the prior lower threshold. So any current planning undertaken with today's larger exemption amounts will be upheld should the law change. But bear in mind that if the estate tax exemption ends up being reduced in the future, you won't be able to make gifts retroactively using current law. So depending upon what the future holds in Washington, this may be a "use it or lose it" situation when it comes to taking advantage of the current exemption amount which is the highest in the history of the estate tax.

For married couples who are considering utilizing the estate tax exemption amount prior to any potential law changes, one strategy to consider is transferring assets to an irrevocable spousal lifetime access trust ("SLAT"). With a SLAT, a spouse can be included as a beneficiary along with other family members and receive distributions without causing estate tax inclusion. With proper structuring, you and your spouse could establish SLATs for the benefit of each other and provide for trust distributions to be made if needed to help support your accustomed manner of living.

Corporate taxes

Democrats have also taken issue with the corporate income tax rate enacted in 2018, which reduced corporate tax rates to 21% down from 35%.

	Current Law: Trump/Republicans	Proposals: Biden/Democrats	Planning Considerations
Corporate tax rate	• Corporate tax rate is 21% • Proposal to retain and extend TCJA provisions	• Increases corporate tax rate to 28%	• Shift income into 2020 to take advantage of lower corporate tax rates • Shift expenses into 2021 to take advantage of a greater offset with higher corporate tax rates • Consider your choice of business entity and tax implications (for both corporate and individual with a flow through entity such as an S corporation, LLC, LP)
Minimum tax	• No minimum tax. It was repealed. • Proposal to retain and extend TCJA provisions	• Impose a 15% tax on book income (for corporations with greater than $1 million of income)	• Consider your choice of business entity and tax implications (for both corporate and individual with a flow through entity such as an S corporation, LLC, LP)
Deduction on qualified business income	• 20% pass-through deduction on qualified business income (subject to thresholds) • Proposal to retain and extend business tax breaks from TCJA	• Eliminate 20% pass-through deduction for taxpayers with income over $400,000	• Consider your choice of business entity and tax implications (for both corporate and individual with a flow through entity such as an S corporation, LLC, LP)

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Start considering your planning options now

If tax law changes do come in 2021, it is possible that they will have an immediate effective date and while perhaps unlikely could even be made retroactive to January 1. So by the time any new law passes, it might already be too late to implement any meaningful planning. For example, trusts receiving gifted assets may need to have already been established and funded prior to the passage of any new tax legislation in order to utilize the current high gift tax exemption amount.

To be sure, elections bring uncertainty. But being aware of the proposals being discussed and planning ahead can help you prepare for what comes next. Be sure to review your options and chart your best course of action to get ready. BMO will continue to keep you apprised of proposals and planning implications. We're here to help.

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