WHITE PAPER

How the 2020 Election Might Change Your Estate & Tax Plan, and Sooner Than You Think

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The upcoming Presidential election has become a constant focus of the media. While the outcome could result in many changes for the country, our focus is to consider the potential impact on your financial plans. Having initial discussions with your advisors before the election could decrease the risk of missing the opportunity to adjust your plan before the end of 2020 to minimize potential future tax burdens on you and your family.

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Potential Outcomes of the 2020 Elections

While the Presidential election gets most of the headlines, Congressional elections this year could be equally as important. Currently, the Democrats hold 232 of the 435 seats in the House. The only scenario in which the Republicans gain control is a sweep of all of their likely wins and toss up House races, which would require a massive Republican turnout on Election Day, so it appears the Democrats will continue to hold the House. The real focus is on the Senate, where the Republican Party currently holds 53 seats. The Republicans are likely to regain a seat in Alabama, but there are seats in Arizona, Colorado, Maine, and North Carolina where the Democrats could gain ground and an outside chance for them to gain seats in Georgia and Kansas. It is also possible the Senate could end up in a 50/50 split, which would place increased importance on the outcome of the Presidential race, as the Vice President would hold the deciding vote.

When trying to predict the outcome of elections, one reality seen in many recent elections is that voters tend to vote all Republican or Democrat rather than splitting their votes for various offices between the parties. This results in a number of potential outcomes of the election, with the most likely being either status quo or the Democrats holding the House and gaining control of the Senate and White House. If this sweep occurs we expect to see more aggressive tax policy changes on the federal level, which is the scenario requiring the most consideration today from a planning perspective

Many of the tax proposals presented by candidates on all levels of government are typically attempts to stand out during elections and curry support from their "bases." Regardless of which party controls the government, we have seen consistently over the last couple of decades that once the campaigns end and the reality of governing sets in, many promises made on the campaign trail are difficult to implement. This is exacerbated by the Senate legislative rules and what will likely be a small majority for one of the parties. However, from a tax and estate planning perspective, it is important to understand the proposals that are on the table now and to consider your options to prepare for them.

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Differences Between Trump and Biden

The tax policy differences between President Trump and Vice President Biden are stark and include almost all areas of tax. Analyzing these differences is not an exact science because President Trump has not released many specific proposals for additional changes to the tax code. Most of the analysis of the President's positions is based on the 2017 Tax Cuts and Jobs Act, budget proposals and Presidential speeches. Vice President Biden has released some specific proposals, but other parts of his agenda have come from speeches and interviews.

We will focus our discussion on the three main drivers of federal tax liabilities for individuals: employment/payroll taxes, income taxes and the estate and gift taxes.

EMPLOYMENT/PAYROLL TAXES

These taxes are comprised of 1) Social Security taxes of 12.4% (half paid by the employee and half paid by the employer) on the first $137,700 (indexed for inflation) of earned income, and 2) Medicare taxes of 2.9% (half paid by the employee and half by the employer) on all earned income. The last change to these taxes was part of the Obamacare rollout that imposed an additional 0.9% Medicare tax (all paid by the employee) on earned income of individuals exceeding $200,000 and $250,000 for joint filers. Biden has proposed the Social Security tax start again for those earning more than $400,000. This creates a "donut hole" in the Social Security tax where it is imposed on the first $137,700, stops and then starts again at $400,000 of earnings. Under this proposal, employment taxes for earned income above $400,000 increases from 3.8% to 16.2%. The rate would be paid 7.65% by the employer and 8.55% by the employee. Below is an example of the impact of the Biden proposal and the amount paid by the employee only:

INCOME	CURRENT LAW	BIDEN PROPOSAL	DIFFERENCE	% DIFFERENCE
$500,000	$18,487	$24,687	$6,200	34%
$1,000,000	$30,237	$67,437	$37,200	123%

Please note that self-employed individuals would pay both the employee and employer share of these taxes.

President Trump has no specific proposal related to these taxes, but has discussed eliminating them for a period of time as part of a Covid-19 stimulus package.

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INCOME TAX

The income tax is where most of the potential changes occur that impact individuals. President Trump has not released a specific proposal on income taxes other than assuming the current law will become permanent rather than sun-setting in 2026 as it is currently slated to do. He has also mentioned another tax act that would provide additional tax cuts for middle-income families.

Vice President Biden has proposed a number of tax increases that would be focused on those making $400,000 or more. The major changes are:

- The top tax bracket is raised from 37% to 39.6%,
- For those whose taxable income exceeds $1M, long-term capital gains and dividends will be taxed as ordinary income, and
- Restore Pease limitations (disallowing part of the itemized deductions) for those earning $400,000 or more and cap the benefit of itemized deductions at 28%.

Some other revenue raising changes Biden has proposed are the elimination of like-kind exchanges for certain taxpayers, more restrictions and oversight of Opportunity Zones, taxing carried interest at ordinary rates and phasing out Section 199A deductions for filers with income greater than $400,000. Assuming all these changes are implemented, higher income taxpayers would see large increases in their tax liability.

ESTATE AND GIFT TAX

Estate and Gift taxes are a third area where there are large differences between the tax policies of President Trump and Vice President Biden. Again, the President has not released any specific changes to these taxes other than assuming the current law would be made permanent in his budget blueprints.

Under current law, the amount of an estate excluded from estate taxes ("Unified Credit") is $11,800,000 per person (2020) and is indexed for inflation. This amount is scheduled to return to prior law (estimated to be $6,000,000) in 2026. Estates are subject to a 40% tax for amounts over the Unified Credit. A Biden White House is likely to accelerate a reduction in the Unified Credit to $6,000,000 per person. Biden has also proposed eliminating the step-up in basis for assets in a decedent's estate. A result of this elimination might mean a taxable estate having to sell assets to pay estate taxes as well as selling additional assets to pay the capital gains taxes associated with the estate tax liability. Assuming zero basis assets at death (like many family businesses) and after

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usage of the Unified Credit, the combination of Biden's estate and income tax proposals would result in an effective 70% tax rate on these assets at death.

Detailed below is comparison of the major tax policy differences between the two candidates:

	TRUMP	BIDEN
Top Income Tax Bracket	37%	39.6%
Long-Term Capital Gains	Top Rate of 20%	Taxed at Ordinary Income Rates Where Income Exceeds $1m
Estate Basis Step-Up	Yes	No
Itemized Deductions	Reduced with TCJA	Further Reduced for Income Over $400k, with reinstatement of Pease Limitation
Social Security Tax	6.2% for Employees and Employers on Wages up to $137,700 (2020)	Additional 6.2% for Employees and Employers on Income Over $400k
Corporate Income Tax	21%	28%*
Like-Kind Exchanges	No income limitations.	No like-kind exchanges for those with income in excess of $400k (including the gain involved in the exchange).
Estate Tax Exemption	$10,000,000, adjusted for inflation	$5,000,000, adjusted for inflation

**Biden also contemplating a corporate minimum tax on book income.*

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Potential Timeline of Changes Post-Election

How quickly things move depends on the outcome of the election. If Trump maintains the Presidency and/or the Senate remains Republican, we don't expect large changes to current tax policy. If a Democratic sweep unfolds, Democratic leadership would likely prioritize the timetable for tax change and the depth of those changes. The focus will then become the Senate procedural rules and if the Republicans can use them to slow the Democratic agenda without the Democrats changing the rules. If new tax legislation is enacted next year, it could be retroactive to the beginning of 2021.

The federal government is not the only source of potential tax changes as some states are also raising taxes on the wealthy. In addition to income taxes, another area that is starting to be discussed is state wealth taxes. California is at the forefront of this idea with a proposal to impose an annual tax of 0.4% for couples or individuals worth more than $30M (excluding real estate). Additionally, people who move from California would be subject to the tax for 10 years after changing residency. Forgetting about the compliance difficulties and potential constitutional issues associated with the 10-year tail, the focus should be on the fact that states were experiencing funding issues before Covid-19, and they are starting to get more creative in ways to impose new taxes.

What Should Taxpayers Be Doing Now?

Uncertainty around the election and the stark contrast in tax policy between the candidates creates impetus to review your financial and estate plan now so you are properly prepared. There are potential income

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and gift tax steps you can consider before the law potentially changes:

- **Lock-In Unified Credit** - The simplest, most direct action for many families will be to fund trusts or make other gifts to utilize their Unified Credit amount before it is lowered. Families can potentially remove an extra $10,000,000 or more from their potential estate, saving millions of dollars in taxes in the event of their death in 2021.

- **Accelerate Capital Gains Taxes** - Another consideration is to recognize and pay tax on capital gains during 2020 that might otherwise be recognized in the next couple of years. This would allow taxpayers to lock in the current tax rate rather than risk a higher rate in future years. It's important to calculate the impact of paying these taxes now versus later because there is no rule of thumb that applies for all circumstances.

Although the outcome of the elections remains uncertain, waiting until afterwards to review planning options may be too late because legal and tax advisors will likely be inundated. It's important to have the time to properly review your options, determine if there are changes you should make, and then execute them. Please contact us to discuss the potential impact on your plan and the alternatives you should consider.

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