



The Elections and Taxes – Accelerate Your Estate Planning Now Before Its Too Late

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By Brian Luster

Sitting down with your advisor to discuss Tax & Estate planning can be stressful enough for most families. After all, not many are willing to recognize, let alone prepare for their own mortality. Yet with the prospect of significant legislative change as a result of the upcoming Trump-Biden presidential election and the need to fund deficits as a result of stimulus measures enacted as a response to the COVID-19 pandemic, now more than ever is the time to explore your options.

As you may recall, the 2016 election led to a flurry of action as a result of Hillary Clinton proposing a 65% estate tax and lowering the ceiling for the estate and gift tax exemption from \$5.45 million down to \$3.5 million. Donald Trump, on the other hand, had proposed repealing the estate tax altogether. Following the Republican victory, the Tax Cuts and Jobs Act of 2017 came to pass, which amongst other provisions raised the standard deduction, lowered ordinary income tax rates, increased the estate and gift tax exemption from \$5.45 million to \$11.4 million, and kept the estate tax rate at 40%.

With the November 2020 Biden-Trump election fast approaching, investors are now faced with another potentially monumental change in tax policy resulting from the Biden Tax Proposal. Some key highlights of Biden's proposal include lowering the estate and gift tax exemption from \$11.4 million to as low as \$1 million, raising estate taxes from 40% to as much as 80%, eliminating tax basis step up at death, raising the top marginal income tax rate, eliminating like-kind exchanges for those earning over \$400,000, placing caps on itemized deductions, raising corporate tax rates from 21% to 28%, raising small business tax rates, and raising payroll taxes (*For a detailed comparison of the Tax Cuts and Jobs Act of 2017 and the Biden Tax Proposal, see table on the following page*).

Even with a Republican victory, the current law is set to sunset in December 2025. Yet with increasing odds of a Democratic victory, it would be wise to consider accelerating estate planning strategy prior to January 20, 2021, when leadership change could potentially take place. As we have stated previously, this is a "use it or lose it moment", where thoughtful planning in advance of elections could grandfather clients under provision of the Tax Cuts and Jobs Act of 2017, saving themselves from paying substantial estate and gift taxes after their passing. In fact, in November of 2019 the Department of Treasury issued final regulations eliminating any "clawback", should individuals utilize their full \$11.4 million gift exclusion today, yet die at a future date when this exclusion amount could potentially have been decreased (26 CFR Part 20).

Comparison of Tax Cuts and Jobs Act vs. Biden Tax Proposal

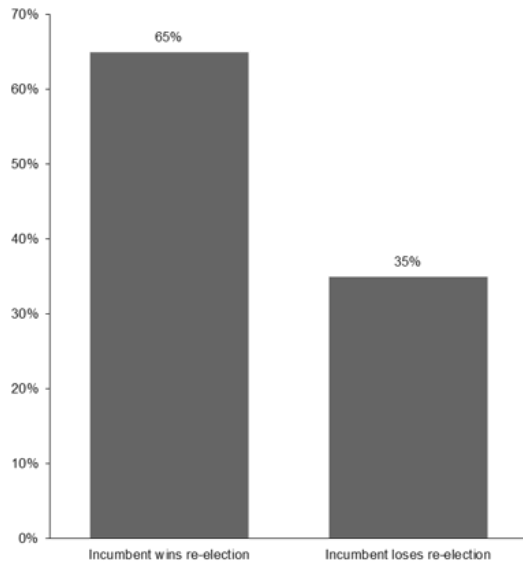
Category	Impact	Current Law (Tax Cuts and Jobs Act of 2017)	Biden Tax Proposal
Estate	Estate and Gift Tax Exemption	\$11.58 million per individual; \$23.16 million per couple	\$1-5 million per individual; \$2-10 million per couple
Estate	Estate Tax Rates	40%	40%-80%
Investment / Estate	Tax Basis Step Up	Step up in basis at death	Eliminates step up in basis at death; replaces it with carryover basis with possible "deemed" sale at death
Investment /Estate	1031 "like-kind" Exchanges	Deferral of capital gains upon the sale of investment real estate if proceeds are reinvested in other like-kind property	Would eliminate like-kind exchanges for taxpayers with annual taxable income over \$400,000
Investment	Long Term Capital Gains and Dividends Tax Rate	20% (plus 3.8% net investment tax)	39.6% on taxable income over \$1 million (plus 3.8% net investment tax)
Income	Individual Ordinary Income Tax Rates	10%/12%/22%/24%/32%/35%/37% tax brackets	39.6% on taxable income over \$1 million
Income	Standard Deduction	Standard Deduction of \$12,000 for individual and \$24,000 for married filers	No guidance
Income	Itemized Deductions	Eliminate Pease deductions through 2025. \$10,000 cap of State and Local income and property tax deduction. Limits on mortgage interest deduction. Suspension of miscellaneous itemized deductions.	Caps value of itemized deductions at 28%
Income / Business	Payroll Taxes	12.4% on taxable income up to \$137,700, indexed for inflation	Would expand to include all taxable income over \$400,000
Business	Corporate Tax Rates	21%	28%
Business	Small Business Tax Rates	37% top bracket	39.6%; phases out 20% qualified business deduction for taxable income over \$400,000

Source: Tax Foundation, Wells Fargo, Collective Family Office

THE ODDS OF AN INCUMBENT BEING RE-ELECTED

Incumbent presidential candidates have won re-election 65% of the time since the Civil War. Yet in every instance that the incumbent was NOT reappointed, there was either a recession or a depression that took place during their term in office. Following the global COVID-19 pandemic, the US is in the midst of its deepest recession since World War II, with unemployment hovering at 10.2% in July, and the country suffering the additional impacts of a health crisis and civil unrest over social inequalities. Considering this, Vice President Joe Biden is gaining popularity. Rather than running on a strong economy, President Trump will need to either convince voters that he has successfully managed this crisis, or focus on his signature issues of immigration, trade protectionism (i.e. China) and infrastructure.

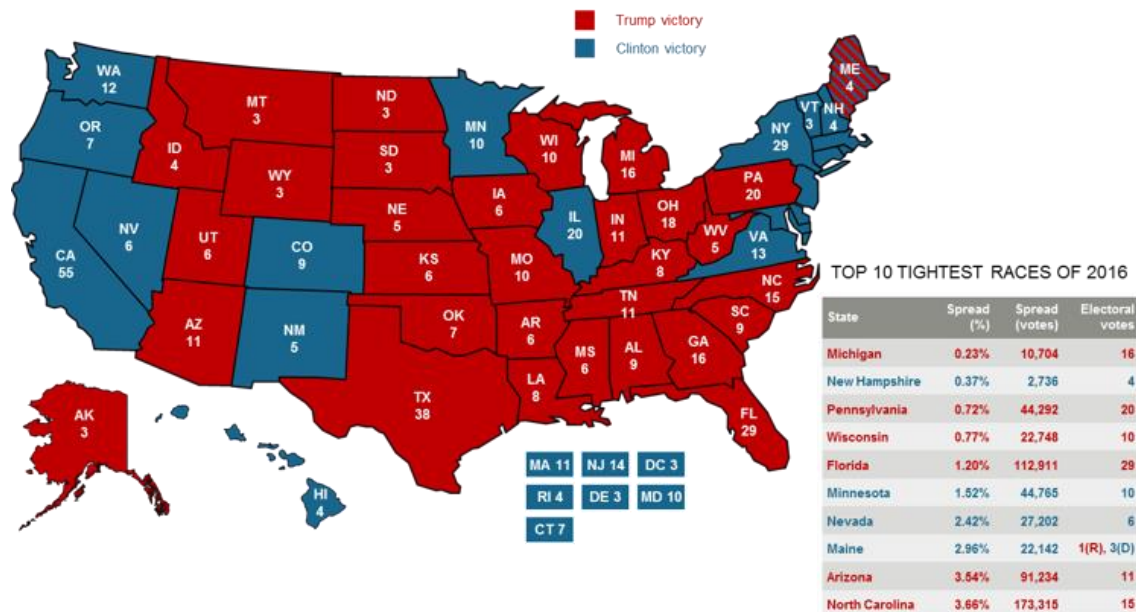
Re-election Rates in Presidential Elections (Civil War to Present)



Source: Bureau of Labor Statistics, Britannica, Five Thirty Eight, J.P. Morgan Asset Management. Of the 39 elections since 1864, 20 were re-election campaigns. Of those, the incumbent won in 13 races and lost in 7 races.

The Electoral College determines our future president, with the winner decided by who receives 270 of the 538 Electoral College votes. This differs from the popular vote. In fact, in 2016 President Trump was elected with 306 Electoral College votes yet lost the popular vote by nearly 3 million votes. This is largely due to the fact that all but 2 states (Maine and Nebraska) provide a “winner takes all” approach to their Electoral College votes. President Trump won Pennsylvania, Michigan, and Wisconsin in 2016 by a 0.8% margin (80,000 votes) across the three states yet received all 46 Electoral College votes, winning the election. This year ten states will likely determine the outcome of the 2020 election. Seven of those states have Democratic governors, who control the pace of shutdowns and re-opening. The question will be whether voters attribute their economic difficulties to the President or the Governor leading their state.

2016 Electoral College Map



Source: 270toWin, J.P. Morgan Asset Management. Data as of August 10, 2020.

WHAT TO DO, WHAT TO DO?

Given the uncertainty around the upcoming election, and the asymmetric risk-reward with respect to taxes (either they remain the same under Trump or get worse under Biden), we are encouraging clients to actively engage in discussions to explore their Tax and Estate Planning opportunities before it is too late.

The biggest opportunity for high net worth individuals is the ability to gift up to \$11.58 million in 2020 free of transfer taxes. For those with expected estates between \$10 and \$20 million, this could mean a substantial reduction in estate-tax liability. Spousal Lifetime Access Trusts (SLATs) and Beneficiary Defective Inheritor's Trusts (BDITs) are examples of strategies that would remove assets and their subsequent appreciation from an individual's taxable estate, yet may still allow grantors to indirectly benefit from or maintain control of their assets.

A SLAT is an irrevocable trust set up for the benefit of a spouse that is funded by gift while the grantor-spouse is still alive. The ultimate goal is to move assets out of the grantor spouse's name into a trust that can provide some financial assistance to a beneficiary-spouse (and thus indirectly to the grantor themselves), in a manner that shelters the property from the beneficiary spouse's future creditors and taxable estate.

A BDIT is an irrevocable trust that allows one to enjoy the benefits of a traditional trust without giving up control of their property. BDITs can hold a variety of assets, but they are particularly effective for assets that have significant appreciation potential or that may be entitled to substantial valuation discounts, such as interests in family limited partnerships and limited liability companies (LLCs).

Additional strategies to consider include those that "freeze" the value of a business or investment portfolio at current values yet transfer the growth from those assets to future generations. To accomplish this, strategies such as the use of Grantor Retained Annuity Trusts (GRATs) or the gift or sale of an interest in a Family Limited Partnership (FLP) may be appropriate.

Finally, those that are charitably inclined, yet would like to receive financial benefits as a result of their philanthropic efforts during their lifetime, or who would like to provide those financial benefits to their heirs may consider incorporating Charitable Lead Trust (CLTs) or Charitable Remainder Trusts (CRTs) into their planning.

CONCLUSION

Just as we routinely review investment allocations in advance of anticipated secular changes in the economy, the implications of secular changes to tax policy warrant a second look at your personal Balance Sheet, and a better understanding of the spectrum of Estate and Tax Planning opportunities that should be considered today.

As we have written in our previous article *Estate Planning in a Low Interest Rate Environment*, low interest rates further enhance the benefits of implementing many of these strategies. Yet, regardless of what is most appropriate for your family, the uncertainty over the upcoming election outcome and the asymmetric risk of change to tax legislation warrant a determination as to whether or not there are opportunities to proactively preserve assets, mitigate taxes, and advance your legacy for future generations.

As always, we look forward to answering any questions you may have for our team.

ABOUT THE AUTHOR

BRIAN LUSTER is a Principal and Chief Investment Officer of Collective Family Office located in York, Pennsylvania. With over 20 years of Wealth Management experience, Mr. Luster has previously served as Founder and CEO of a boutique Multi Family Office in New York City, as the Managing Member and Portfolio Manager of a long/short US event-driven value-oriented hedge fund in New York, and as a Senior Wealth Manager for BNY Mellon Wealth Management in Central Pennsylvania.

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