Key Private Bank

Top 10 year-end planning ideas 2020 – individuals

Year-end tax planning for 2020 brings new challenges as we consider flexibility in being able to change the tax planning course if there is a change in administration with the coming election. Broadly speaking, some of the proposals aim to raise the tax rate on upper-income earners (generally defined as those earning more than $400,000/year) in a variety of ways. Without going into detail on these potential changes, we highlight some strategies to consider with the mindset of remaining nimble in case of change.

As a reminder, below is the current individual tax landscape:

- For the wealthiest taxpayers, personal income is subject to a top ordinary rate of 37% and a potential high-wage earners Medicare tax of .9%.
- Special maximum tax rates generally apply to long-term capital gains and qualified dividends (0%, 15%, or 20%).
- There is still a 3.8% Medicare surtax on Net Investment Income.
- Fewer taxpayers are affected by alternative minimum tax (AMT).
- Many more taxpayers are using the increased standard deduction.
- Many itemized deductions have been repealed or significantly reduced. State and local tax deductions are capped at $10,000, qualified home interest deduction rules have changed, the Pease limitation is no longer in place, and some prior miscellaneous itemized deductions are gone.
- The qualified business income deduction for pass-through income remains.

Here are 10 wealth planning ideas to consider for 2020:

1. Tax bracket management

Accelerate income and defer deductions

With the potential for an increase in tax rates, those with income above $400,000 might want to consider accelerating income into 2020. Roth conversions, harvesting gains and deferring loss harvesting, exercising stock options, accelerating bonuses, accelerating the installment sale gain, or moving up the closing date of a sale are just a few strategies to consider. Defer deductions that can be used to offset future income that could be taxed at higher rates.

2. Itemized deduction timing

Accelerating or deferring deductions

Many more taxpayers are using the standard deduction. Therefore, to maximize itemized deductions in certain years, consider the tactic of “bunching” expenses into this year or next year. This helps to get around deduction restrictions imposed by the Tax Cuts & Jobs Act. Again, this applies to deductions such as charitable, state and local taxes (up to $10,000), mortgage interest, and miscellaneous itemized deductions. If tax rates are higher in the future, consider deferring itemized deductions, as previously mentioned. If itemized deductions are capped in the future, or the 3% Pease limitation is restored in the future, rather than deferring deductions, consider accelerating them into 2020 to avoid additional itemized deduction limits.

3. Gain/loss harvesting

Make the most of the reduced capital gain tax rates

Long-term capital gains are taxed at rates of 0%, 15%, or 20%. And, the 3.8% surtax on net investment income may apply. If these preferential rates are eliminated for those over $1,000,000 (or some other threshold), long-term capital gains could be subject to ordinary income tax rates up to 39.6%. You may consider accelerating sales of capital assets into 2020. For those capital assets with gains, they can be sold now and repurchased with a higher basis so that future sales will have less capital gains that could be taxed at higher rates. Whether the preferential rates stay the same or increase, always work with your tax advisor and portfolio strategist near year-end for strategies to match capital gains and capital losses. Remember that for individuals, capital losses can't be carried back, but can be carried forward indefinitely.

Taxpayers wanting to realize paper losses on stocks while still retaining the same investment position can sell shares and buy shares in the same company or another company. They just need to avoid the wash-sale rules, which disallow the loss if substantially the same shares are acquired within the 61-day period beginning 30 days before and ending 30 days after the sale.

The potential future change in preferential rates also applies to qualified dividend income. This could affect your investment strategy of shifting investments out of holdings that generate income taxed at ordinary rates (e.g., bonds) and into dividend-paying stocks to achieve tax savings. Dividend-paying stock may not be as advantageous. You may consider tax-exempt bonds for additional tax savings. If this future change is more likely to occur, review your investment allocation and adjust accordingly.

4. Roth conversions

Especially this year, with the waiver of the Required Minimum Distribution (RMD) requirement as a result of the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), many more individuals are considering a Roth conversion. With the potential for future higher tax rates paying the tax on the conversion now at the lower rates, may seem like a good idea. If you had your RMD waived this year, consider converting the RMD amount to a Roth (Roth conversions are not available for non-spouse inherited IRAs.) Converting an RMD this year is a one-time opportunity since RMDs in a normal year cannot be converted. As you get closer to year-end, determining your 2020 marginal tax bracket and projected investment income can be done with more certainty. If you are trying to convert your traditional IRA to a Roth IRA to fill up a tax bracket, start those conversations now. Traditional IRA to Roth IRA conversions can reduce future required minimum distributions and create a potential tax-free inheritance for children. Under present law, there are no required distributions by the participant from the Roth IRA in future years. There are, however, required minimum distributions for the beneficiaries of a Roth IRA (generally within 10 years of the original Roth IRA owner's death for non-eligible designated beneficiaries). If your beneficiaries are in lower tax rates than yourself, then conversion may not be the right strategy. Higher earning taxpayers who cannot contribute directly to a Roth IRA may be able to contribute to a non-deductible IRA that might later be converted to a Roth IRA. Just be mindful that you can no longer recharacterize Roth conversion contributions as a result of the TCJA.

5. Charitable planning

This year, in particular, presents some opportunities with maximizing the deductibility of charitable contributions. Donors can deduct cash donations to public charities (excluding donor-advised funds and supporting organization) up to 100% of adjusted gross income (AGI) for 2020 only, up from 60% in 2019. For those considering large charitable contributions and potentially pairing it with a gift to a donor-advised fund or gifting of appreciated assets, there is even more planning to consider regarding the various donor AGI limits. Although the RMD requirement for account owners is waived for 2020, there is still some benefit to considering the charitable IRA rollover. This allows an individual age 70½ or older to make a qualified charitable distribution (QCD) from their IRA directly to a charity (the age for QCDs is still 70½ despite that the beginning RMD age is now 72) and exclude the distribution from gross income (up to $100,000 per year). QCDs may be good strategies for those that file their taxes using the standard deduction. Those who itemize may want to weigh other options for their 2020 charitable gifting using cash or appreciated stock. Or, you may consider a smaller charitable contribution in 2020 and use the QCD in early 2021, allowing you to offset up to $100,000 of your 2021 RMDs.

6. Review your estate plan

With the federal estate and gift exemption amount nearly doubled now to nearly $11.58 million per person, those with taxable estates should make use of the increased exemptions with the use of lifetime gifts. Remember, the estate tax exemption reverts to the old levels (those that existed prior to the Tax Cuts and Jobs Act) at the end of 2025 (if not sooner by an act of Congress or change in administration). Also, for transfers that could potentially be subject to the generation-skipping tax, take advantage of the increased generation-skipping transfer (GST) tax exemption as well by making current gifts to skip persons or making late allocations of GST exemption to trusts that previously were not exempt. When reviewing your estate plan, consider the possibility that a reference to the exemption amount in an estate planning document that was drafted before the enactment of the Tax Cuts and Jobs Act could create an undesirable result.

7. Low interest rate environment

With interest rates currently at or near historic lows, the benefits of some estate planning strategies are enhanced. For those who expect a taxable estate, current conditions favor estate-freeze strategies like grantor retained annuity trusts (GRATs), which provide an annuity to the grantor for a period of time; charitable lead annuity trusts (CLATs) to benefit charity and provide for beneficiaries in the future, with the added benefit of a charitable income tax deduction; and installment sales, all of which allow you to give away the upside appreciation potential of assets tax-free.

8. Review your portfolio

This past year's volatility in the markets has tested an individual's true propensity for risk. You should maintain a long-term perspective and not overreact to short-term volatility. As a result of the volatility, it is a good idea to make sure your asset allocation is appropriate and risk tolerance remains in line and review your time horizon. For those with trusts that have asset substitution language, consider how this can be used to achieve optimal basis planning. Also, with the potential for loss of the step-up in basis rule at death, you may need to consider what this means for a concentrated stock position and how this can impact your diversification strategy.

9. Maximize the use of tax-advantaged savings vehicles

With the potential for future tax rate increase, maximizing tax-advantaged vehicles may be more important. Reduce taxable income by increasing pre-tax salary deferrals to employer-sponsored retirement plans (401(k), 403(b), 457, & SEP-IRA plans). If your plan allows after-tax Roth contributions, these should be considered because of the lack of an income-level phase out for contributions and the potential for tax-free growth. Don't forget to consider contributions to IRAs for non-working spouses as well. Also, maximize savings using tax-favored health plans such Health Savings Accounts (HSAs). Remember that if you become eligible in December to make an HSA contribution, you can make a full year's worth of deductible HSA contributions for 2020. And parents and grandparents, don't forget to fund those 529 accounts for post-secondary (and now K-12) qualified education expenses.

10. Review beneficiary designations in light of the SECURE Act

With IRA planning, the Setting Community Up for Retirement Act (the SECURE Act) basically eliminated the "stretch IRA", a concept for non-spousal and non-eligible designated beneficiaries. This concept previously allowed IRA or defined contribution plan beneficiaries to draw down the remaining plan benefits over the beneficiary's life expectancy. Inherited IRAs and inherited defined contribution plans must now be distributed within 10 years of the original owner's death. Review your beneficiary designations to see how the SECURE Act impacts the future distribution to those who inherit your retirement accounts. There are ways to simulate a stretch IRA using lifetime income strategies such as naming a charitable remainder trust (CRT) or a charitable gift annuity (CGA) as beneficiary of the account or using the RMD to purchase life insurance that will provide a tax-free benefit to heirs. Discuss any possible risk with these strategies with your advisors.

The end of 2020 is fast approaching. Review your tax situation with your tax advisor now and make adjustments before time runs out.

If you have any questions or need more information, please contact your Key Private Bank Advisor.

Key Private Bank

200910-871524