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Three Certainties in Life: Death, Taxes ... and Estate Planning

Planning considerations due to the November 2020 elections.

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With more clarity surrounding the November elections, we can now examine how the new administration could potentially affect estate planning and taxes. As of the writing of this article, party control of the Senate remains undecided. If Republicans won one seat in Georgia's runoff election in January, they would maintain a majority. The Democratic Party retained a majority in the House of Representatives and gained control of the White House with former Vice President Joe Biden's recent inauguration.

Regardless of the future legislative landscape, the need to help clients articulate and create an estate plan that reflects their values is as critical as ever. As practitioners have these conversations with clients, encourage them to keep some key considerations in mind, but not to let political uncertainties prevent them from creating a plan now.

First and foremost, politics do not diminish the importance of estate planning.

On March 23, 2020, the S&P 500 dropped 34% from its February high to its March low.[1] Wealth management professionals sprung into crisis-prevention mode, focusing on easing client concerns, evaluating asset allocation, and reinforcing a long-term perspective. The pandemic has caused more clients to procrastinate in this area of financial planning. No one wants to talk about death and dying, especially during a global pandemic with reminders of the fragility of human life abounding every day.

Amid this major market volatility, estate planning may not be on the top of the client's list of priorities. But wealth management professionals have a duty to preserve clients' assets and ensure a seamless transfer of wealth. Because financial professionals historically have done little to prepare for this transfer of wealth, 90% of the time when a client passes away, the surviving spouse moves the assets elsewhere.[2] Firms lose the assets 98% of the time when that surviving spouse passes away.[3]

What should a planner do to avoid losing oversight of those hard-earned assets? Play defense now. Have those difficult conversations with each client about where they want their money to go after their death. They spent a lifetime growing those assets. If the planner and client don't work together to implement a plan to help protect client assets, the state

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will have a plan for them. Being proactive will also assure the clients that planners have their long-term best interests at heart. In conjunction with helping clients create a plan for their assets, begin building a relationship with their heirs.

Leverage the power of gifting, especially in the current environment.

Despite the vast benefits of gifting for both charities and individuals, many clients opt against this wealth transfer strategy to remain in control of their assets throughout their lifetimes. However, gifting has the potential to give clients' heirs a greater inheritance. Making gifts to heirs before death not only saves paying an inheritance tax later, it also allows those assets to potentially appreciate over time.

There are more gifting opportunities available this year than in recent history. In response to the COVID-19 pandemic, the Coronavirus Aid, Relief, and Economic Security (CARES) Act temporarily increased the limit on income tax deductions from 60 to 100% of adjusted gross income for charitable contributions in 2020. Additionally, the Republican-controlled Congress doubled the permanent estate and gift tax exemption under the Tax Cuts and Jobs Act (TCJA) this year. Individual taxpayers can now gift up to $11.58 million out of their estates in 2020 if they have not yet used any of their lifetime exemption. This allowance is scheduled to sunset in 2026.

The divided government outcome suggests that these historically high gift and estate tax exclusion amounts within the TCJA will likely remain intact at least for the next two years until the midterm elections, and possibly until they're scheduled to sunset under the TCJA. At that time, exclusions will automatically revert to $5 million per individual, with adjustments for inflation. That being said, if a client can afford to make gifts — and it is in line with their long-term goals — they should consider doing so sooner rather than later to ensure any future appreciation occurs outside of their taxable estate regardless of future tax policy changes.

Plan (do not act) based on political expectations.

Estate planning and tax-efficient wealth transfer are important regardless of the political regime, but it is worth examining some of the Biden administration's specific plans. President Biden has referenced the step-up in basis loophole: Assets transferred from an estate at death get a new basis for income tax purposes equal to their value.

If an individual purchases an asset for $1,000 then later sells it for $3,000, the capital gain for income tax purposes is the sale proceeds minus the cost basis, or $2,000. If the owner of that asset passes away when the value is $3,000, the basis changes from $1,000 to the date-of-death value of $3,000, which is the step-up in basis. If the asset is then sold for $3,000, there's no capital gain and no income tax (that's the loophole).

Biden previously proposed treating death the same as a sale. In this instance, the basis steps up to $3,000, but that $2,000 step up would be taxed as capital gain. With a divided Congress, this proposal would be unlikely to become law.

The outcome of the federal election could, however, have implications on state budgets. Under a divided government, large-scale economic support to struggling state and local governments is less likely. Forty-nine states are required to balance their budgets, and the impact of the pandemic has created substantial shortfalls. This puts pressure on states to raise taxes. Consider individual state tax rates in your planning.

While administrations come and go, death and taxes do not. The need to have this conversation about the transfer of wealth with clients does not change. Ask clients if they have an estate plan. If they do not, work with them to develop one that considers their long-term goals regardless of the political backdrop. A comprehensive estate plan includes a will or trust, outlines health care directives, names powers of attorney, and documents any necessary trust accounts. If a planner is not looking at their clients' entire financial life holistically, someone else will. ■

1 https://finance.yahoo.com/quote/%5EGSPC/

2 https://www.nexus-strategy.com/files/nexus_strategy.5-mega-trends-in-wealth-management_whitepaper.pdf

3 https://www.thinkadvisor.com/2012/10/25/successful-wealth-transfer-demands-strong-relation/