



Don't let the tax tail wag the dog

By **Colin Carter and Steve Aucamp**, Managing Directors at Tiedemann Advisors
January 29, 2021

For those navigating estate and tax planning as Biden takes office, keep the entire picture in mind.

After what seemed to be an extraordinarily lengthy election cycle, we finally have clarity on who controls the branches of government. Following the inauguration of President Joe Biden and recent Senate run-off races in Georgia, Democrats now control the White House, and both Chambers of Congress – which ultimately increases the likelihood of federal tax hikes. Between Biden's agenda outlined in his proposed tax and stimulus plans and the current deficit because of the pandemic, these revenue-raising measures are almost inevitable.

But with that political certainty comes income and estate tax planning uncertainty. Although none of us have a crystal ball, there are a few tax changes that will likely become law:

1. At the top of the list is an increase in the highest marginal federal income rate from 37% to 39.6% for married couples with incomes over \$400,000. That was the top rate during much of the Obama administration. The same rate, 39.6%, could be applied to capital gains (top capital gains rate is currently 23.8%) and qualified dividends for those with incomes over \$1M.
2. Additionally, President Biden may increase the estate tax. The changes could include reducing the current federal exemption from \$11.70 million to approximately \$3.5-5M and push the top tax rate from 40% to 45%.

Other tax increases that can't be ruled out include:

- a. Imposing the 12.4% Social Security tax rate to incomes over \$400,000.
- b. Capping the benefit of itemized deductions to 28%.
- c. Eliminating the “step up” in basis for assets left to heirs, a move that would significantly increase the tax bills of heirs who sold those assets.
- d. Reducing or eliminating the qualified business income deduction for incomes over \$400,000.

While no one can say for sure what will be proposed or enacted, there are steps individuals can take now to alleviate some of the guesswork and start the year strong:

Space it Out: At this point in the government regime change, it is impossible to say whether any potential tax hikes would be made retroactive to 2021 or start in 2022. But, when it comes to income taxes, people have some control over how their income is classified. Where possible, take steps to stay below the tax thresholds – \$400,000 for income, \$1M for the application of ordinary rates on capital gains and dividends – to lessen the impact.

Prioritize Gifting Now: Given the potential tax hikes, consider boosting the size of annual gifts to heirs and, where appropriate, think about utilizing your entire estate tax exemption amount. Another option could be setting up a Grantor Retained Annuity Trusts (GRAT), a vehicle that allows for the transfer of rapidly appreciating assets such as stock free of estate and gift tax. Although there is the possibility that GRATs could become a target of politicians and regulators, the trust can be particularly attractive in periods when interest rates are low.

Start Now – But Take a Breath: While it is important to be ready to react to possible changes in the tax code, it is equally important not to overreact. Over the last few decades, federal taxes have been raised and cut multiple times. The changes tend to be incremental, rather than dramatic and weighed along with other factors, such as the outlook for inflation and the prospects for economic growth. It is important to take the long view.

As Biden takes the helm and Congress gets to work, we will likely see these changes start to trickle in. These changes will be important, but they are just one piece of the puzzle when it comes to managing your wealth.

We have a saying in our business: Don't let the tax tail wag the dog. In other words, don't make moves to minimize taxes that you may come to regret later. We'd recommend sitting down with your adviser to figure out what is the best long-term strategy for you.