CLIFFORD SWAN
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WISDOM *for* GENERATIONS

ARE TAX INCREASES ON THE HORIZON?

By Maxwell R. Pray
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As we move into the sixth month of masks, sheltering-in-place and all the awful effects of the coronavirus pandemic, the U.S. government has pledged approximately $3 trillion to battle the virus and stabilize the economy. How can our nation afford this mounting bill on top of an already high level of government debt? Tax increases are one possible source of funds for our indebted government. We are also in an election year, and if the presidency goes to Joe Biden there is a likely chance of taxes increasing. Further, current tax rates are already temporary in nature; most of the individual tax decreases that were part of the 2017 Tax Cuts and Jobs Act are slated to expire on December 31, 2025.

There are arguments that the $3 trillion in additional national debt, which represents a 10% increase, won't need to be addressed soon. Some economists claim that modern monetary theory (essentially, the central bank can print enough money to pay the interest on the debt in perpetuity, hence never having to pay off the debt) may result in not needing higher taxes. With historically low interest rates (not seen since the 1950's) the cost of this debt is more manageable, and the government can handle a much heavier debt load than was previously thought. Regardless, taxes are low relative to history, and our national debt is growing dramatically—it seems to us not a question of *if* but *when* for taxes increasing.

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Beyond the potential tax implications of COVID, if the November election results in the Democratic party controlling both Congress and the Oval Office, a Biden presidency could mean increased income tax rates for high income households and a possible capital gains (and dividend) tax increase from 20% to as high as 39.6%. According to Biden: "A guiding principle across our tax agenda is that the wealthiest Americans can shoulder more of the tax burden, including in particular by making investors pay the same tax rates as workers and bringing an end to expensive and unproductive tax loopholes."

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It may be prudent for investors to start considering their options. One possible strategy is taking more capital gains in 2020. Currently, the long-term capital gains tax is 20% for households that are married and filing jointly with incomes of $496,601 or more in 2020 (the highest tax bracket) and lower for those below this income level. It is unclear whether there are plans to increase capital gains taxes for those in income brackets below the top levels. Know where your household stands relative to your level of income and potential capital gains—this is a discussion to have with your tax professional and investment counselor. Markets tend to overestimate the policy changes that actually take place, but it behooves us to position investment portfolios for potential changes.

Another item up for discussion is the elimination of the step-up in basis for inherited capital assets. This could have significant ramifications

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for households with large holdings in appreciated stocks. This estate planning "what-if" warrants planning on everyone's part, particularly for those with higher incomes. We recommend a team effort with your investment counselor, tax accountant, estate planning attorney, and life insurance professional to develop a coordinated plan to meet your individual goals and objectives.

In addition to a possible new federal tax agenda, consider too that individual states and municipalities have been negatively impacted by the recession the pandemic has caused. It may be coincidental, but there is news circulating of proposals in Sacramento to increase California's marginal tax rate for high income earners from the current rate of 13.3% (already the highest in the nation). With Disneyland closed, restaurants only open to outdoor dining and takeout, and many personal services hindered by social distancing, any tax hike would likely put a strain on the economy. While we may not be able to weather tax increases now, the signs point to increased state and local taxes on the horizon.

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So, what should one do? 2020 might be the year to consider the following strategic actions. Use the following as a checklist of topics to discuss with your investment counselor.

TAKE MORE THAN PLANNED CAPITAL GAINS

As explored above, be prepared to lock in current capital gains tax rates this year if it appears likely (based on the November election) that these rates will increase soon. Have a plan in place before ballots are counted.

CONVERT A TRADITIONAL IRA TO A ROTH

Although the timing advantage of converting a traditional IRA to a ROTH IRA was highest in March (with low stock values), it may still be prudent to consider a ROTH conversion so that the advantages of a ROTH are utilized in the future.

DEFER CHARITABLE GIFTS

Instead of gifting in 2020, it may make sense to delay charitable donations to 2021; this must be balanced with limits on deductions in 2020 and 2021 (remember that the CARES Act raised the limit on deductible charitable contributions of *cash* for 2020 to 100% of gross income; the limits for *stock* gifts remain the same). Another argument for deferring gifts to 2021 is not new: given the high current standard deduction, "bunching" multiple years of gifting into one year may be more effective.

UPDATE YOUR ESTATE PLAN

There are many irrevocable estate planning vehicles, such as irrevocable life insurance trusts (ILITs), grantor retained annuity trusts (GRATs), or charitable remainder trusts (CRTs), that may provide distinct benefits in a higher tax rate environment.

REVIEW YOUR LIFE INSURANCE

Payouts from a life insurance policy can be a planned source of funds to help pay estate taxes.

Beyond planning for possible tax increases, as we approach year-end we urge you to take stock of your full financial picture—see my partner, Erica White's article, *Financial Planning in a Pandemic: More Important Than Ever*. While tweaks to your financial plan or specific strategic actions like those explored above might be appropriate, don't underestimate the power of a long-term investment plan in concert with appropriate estate planning, tax, and insurance strategies. At Clifford Swan, we build portfolios security-by-security and spend considerable time researching companies and municipalities to build portfolios that are designed to meet our clients' long-term goals in many environments. ◆

FINANCIAL PLANNING IN A PANDEMIC: MORE IMPORTANT THAN EVER

By Erica S. White
CFA

None of us could have planned perfectly for 2020. This year has delivered a marked departure from the norm, as the COVID-19 pandemic has changed the routines, finances, and sense of security of many. As summer begins to fade and we naturally look towards year-end, we always recommend a check-in with your investment counselor to make sure your portfolios are well positioned to line up with your goals. This kind of planning may prove even more important this year. COVID-19 has changed not only some of the rules that inform our investment

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work but also our individual circumstances and values.

First, certain legislative changes enacted in response to the coronavirus may impact your financial plans. Notably, as part of the CARES Act passed earlier this year, all required minimum distributions ("RMD's") from retirement plans in 2020 have been waived. In other words, investors of a certain age who are typically required, per Internal Revenue Service

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rules, to make annual withdrawals from IRAs and/or defined contribution plans like 401(k)s or 403(b)s no longer have to this year. For some clients, this may mean more flexibility in planning and also a smaller income tax liability. Additionally, if you or a dependent of yours has been diagnosed with the coronavirus, or if you have experienced other certain financial hardships as a result of the virus, there is some favorable tax treatment available in relation to retirement plan withdrawals, should you choose to make them. It's worthwhile to discuss these scenarios and particulars with your investment counselor.

Second, you may find that your income or expenses have changed. Are you earning or spending money differently than you have in the past? COVID and the related shutdowns have affected everyone's bottom line differently. For some of us, income and employment may have been reduced. For others, reduced discretionary spending on items like travel and entertainment may be contributing to a cash surplus in our budgets. Some of us may have increased care burdens for parents or children that require additional resources. For many of us,

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technology spending has become a priority, as we rely on our computers, cameras, and internet more and more. For our institutional clients, fundraising efforts may be changing in this current environment, or perhaps there is a desire to increase spending to support your mission this year.

Third, 2020 seems to be an opportune time to revisit our values and goals, to make sure our investments, earnings, and spending line up with our priorities. Focusing on the controllable in our financial lives—and applying those decisions towards our values and planning efforts—can be cathartic in what feels like an increasingly chaotic world. For some of us, this may mean revisiting our estate plans to

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make sure that our wishes are accurately translated and understood by our families or heirs. For others, this may mean financially supporting causes that are important to us, whether they are charitable, local, or political. And perhaps saving for a future splurge, like a family trip or reunion, can provide some escapism and excitement in our planning efforts this year.

At Clifford Swan, we know that all our clients have unique circumstances. We also know that 2020 has been a challenge for many. We welcome the opportunity to strategize together with you to ensure we're all working towards a financially successful tomorrow. ◆

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