How the Upcoming Election May Change the Tax Landscape and What It Means for Your High-Net-Worth Clients

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Throughout the 2020 election season, pollsters and political analysts have indicated the Democrats could win the White House, and slightly favored them to win control of the Senate as well. Whether Democrats win one or both prizes, the enormous deficit pressures created by coronavirus-related economic downturn and stimulus measures mean that tax hikes in the near future are nearly inevitable. What can high income and high-net-worth clients anticipate those changes might be, and how can they insulate themselves now from being overwhelmed by a "blue wave"?

A Blue Tsunami?

If Democrats take over both the White House and the Senate, it may lead to the enactment of taxing and spending priorities without any cooperation from Republicans. However, the margin in the Senate is likely to be razor-thin, which will probably deter Democrats from radical proposals. Democrats are more likely to pull familiar and relatively centrist tax proposals "off the shelf," such as these ideas:

Plausible Tax Changes[1]	How Clients Can Prepare Now
Estate and Gift Tax Rates: Return estate and gift tax to "historic norms," such as a $3-5 million unified exclusion, and up to 55% tax rate for excess estate values.	Current regulations specify that lifetime gifts up to the current basic exclusion amount ($11.58 million per person in 2020) will not be taxable if the person dies when the exclusion is lower and/or the tax rate is higher ("anti-clawback"). Clients may want to gift the maximum excluded amount to trusts or family members before the law changes. If your clients don't already have a suitable irrevocable trust, there is no time to lose in getting those drafted by competent local counsel! However, if they're not ready to make multi-million dollar gifts today, they can partially fund the trust by lending funds and taking back a demand note. They can then quickly pivot to a gift by forgiving the loan, or take the money back by calling the loan.
Step-To Basis: Eliminate the "step-up" basis adjustment for inherited assets, or make inheritance a realization event for capital assets.	If a large capital gains tax bill can be anticipated at or because of the owner's death, life insurance on the owner is well suited to provide the liquidity needed to pay taxes. Large policies may take months to underwrite, so start the process now!
Capital Gains: End the preferential income tax rate for capital gains, at least for high earners. The current top effective rate for long-term capital gains is 23.8%; it could end up topping 40%. "1031 exchanges" to defer taxes on the sale of appreciated real estate may also be eliminated.	Accelerate the realization of built-up capital gains where feasible; e.g., selling appreciated assets and forgoing installment sale treatment of proceeds from the sale of a business. Clients should start considering alternatives for repositioning their proceeds from the sale of capital assets or excess cash. Cash accumulation life insurance provides tax deferral for its growth in value, and potentially no taxes at all if the policy is managed correctly.
Income Tax Rates: Individual income taxes return to 39.6% top rate (plus 3.8% Medicare surtax), and lift Social Security tax cap for highest income earners.	Businesses can consider restructuring their compensation packages for key employees and owners to reduce taxable income. Lending premiums to pay for a permanent life insurance policy (loan regime split dollar) is not subject to income or payroll taxes, only interest due on the loan (currently at historically low interest rates).

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A Blue Rip-Tide?

If the Republicans maintain control over the Senate, which pollsters say is almost as likely as not, then wealthy clients have another couple of years before they need to worry about tax hikes—or do they? The national debt problem isn't going to be voted away, and Senate Republicans may be more willing to compromise on some tax increases if they don't have White House backing for their anti-tax position. Some of the tax hikes listed above may still be on the table.

Moreover, a Joe Biden-led Treasury Department has a number of options for raising more revenue *without* involving Congress, through more aggressive audits and enforcement, as well as regulatory changes. Some prognosticators have even speculated that a President Biden might appoint Senator Elizabeth Warren to be Secretary of the Treasury. Regardless of who heads up the IRS, these are examples of tax-raising measures that a potential Biden administration could pursue without legislative changes:

Plausible Regulatory Changes	How Clients Can Prepare Now
Audits: The IRS can sharply increase audit rates, and devote greater resources to strict enforcement of current rules.	Talk with tax and accounting professionals about positions that are particularly susceptible to audit and challenge by the IRS.
Fair Market Value: The IRS can aggressively challenge the valuation of assets that don't have clear fair market value, such as closely-held businesses and in-force life insurance policies.	Complete planned gifts during 2020 calendar year to begin the three-year statute of limitations on IRS challenges as soon as possible (April 15, 2021). Valuations for many assets are also likely to be lower now due to the COVID-related economic slowdown.
Valuation Discounts: Wealthy families frequently claim "valuation discounts" when gifting or selling partial and restricted interests in closely-held assets. Treasury could resurrect proposed regulations to disallow many of these discounts when the transfer is between family members and related parties.	Accelerate the execution of plans to transfer ownership interests in closely-held assets to trusts or family members. Begin drafting the appropriate legal documents with local counsel as soon as possible, if they don't exist already.

Many of these suggestions require clients to rely on the assistance and counsel of lawyers, accountants, and other tax professionals. If clients wait until November 4th (or likely a later date when the outcome of the elections is actually determined), they are likely to find themselves at the back of a line of similar people scrambling for competent counsel. Now is the time to start preparing!

The potential for political and tax changes is on your clients' minds. Show your value with timely strategies for helping your clients stay ahead of the game. Need help starting the conversation? Contact your Crump representative today.

[1] These are only proposals that have been made by Democratic politicians; they may or may not become law in this form.

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