

# What to Expect Out of the Election

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*\*Does not provide legal advice or practice law as an attorney for The Prudential Insurance Company of America.*

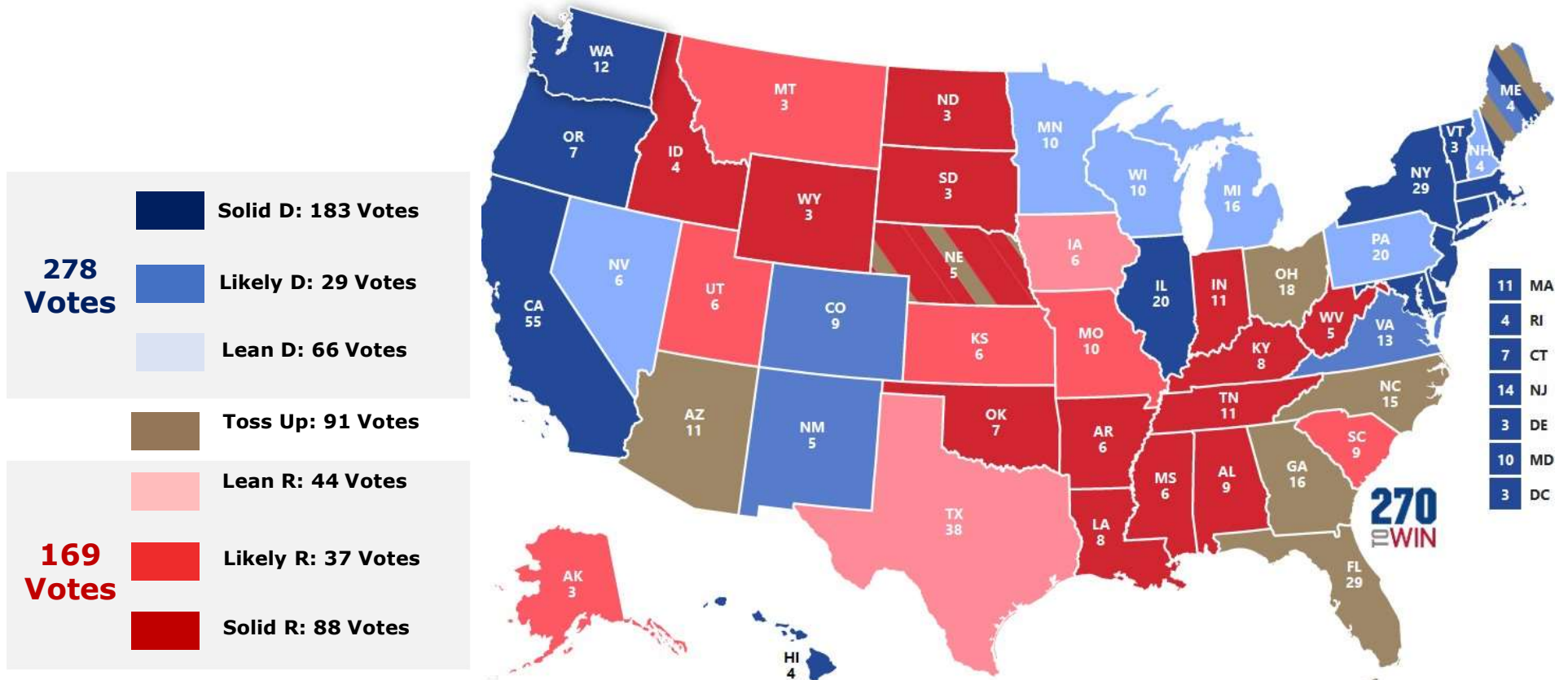


1041651-00001-00 Ed. 10/2020 Exp. 10/30/2020



# 2020 Presidential Map

*Biden Currently has a Decisive Lead in Electoral College Voting*



Source: 270towin.com, 8/31/2020

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# WHO BENEFITS FROM HIGHER TURNOUT?... THAT DEPENDS

## Eligible Citizens Who Didn't Vote in 2016

State/2016	Non-College White	College White	Non-White
<b>MI</b>	<b>1,563,809</b>	<b>412,191</b>	<b>643,000</b>
<b>MN</b>	<b>786,284</b>	<b>210,716</b>	<b>259,000</b>
<b>NH</b>	<b>220,282</b>	<b>68,924</b>	<b>24,795</b>
<b>PA</b>	<b>2,289,875</b>	<b>603,125</b>	<b>695,000</b>
<b>WI</b>	<b>819,356</b>	<b>160,644</b>	<b>306,000</b>
<b>AZ</b>	<b>683,831</b>	<b>228,169</b>	<b>904,000</b>
<b>FL</b>	<b>2,565,664</b>	<b>719,336</b>	<b>2,565,000</b>
<b>GA</b>	<b>1,171,614</b>	<b>327,386</b>	<b>1,303,000</b>
<b>NC</b>	<b>1,105,431</b>	<b>320,569</b>	<b>834,000</b>
<b>TX</b>	<b>2,665,119</b>	<b>812,881</b>	<b>4,274,000</b>

**Trump Opportunities: Rust Belt**

**Biden Opportunities: Sun Belt**

Source: [Dave Wasserman](#), Cook Report

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MEHLMAN CASTAGNETTI  
ROSEN & THOMAS

# BECAUSE, 2020...

*There are 64 possible combinations that would result in a 269-269 tie in the Electoral College... the most "2020" outcome imaginable*

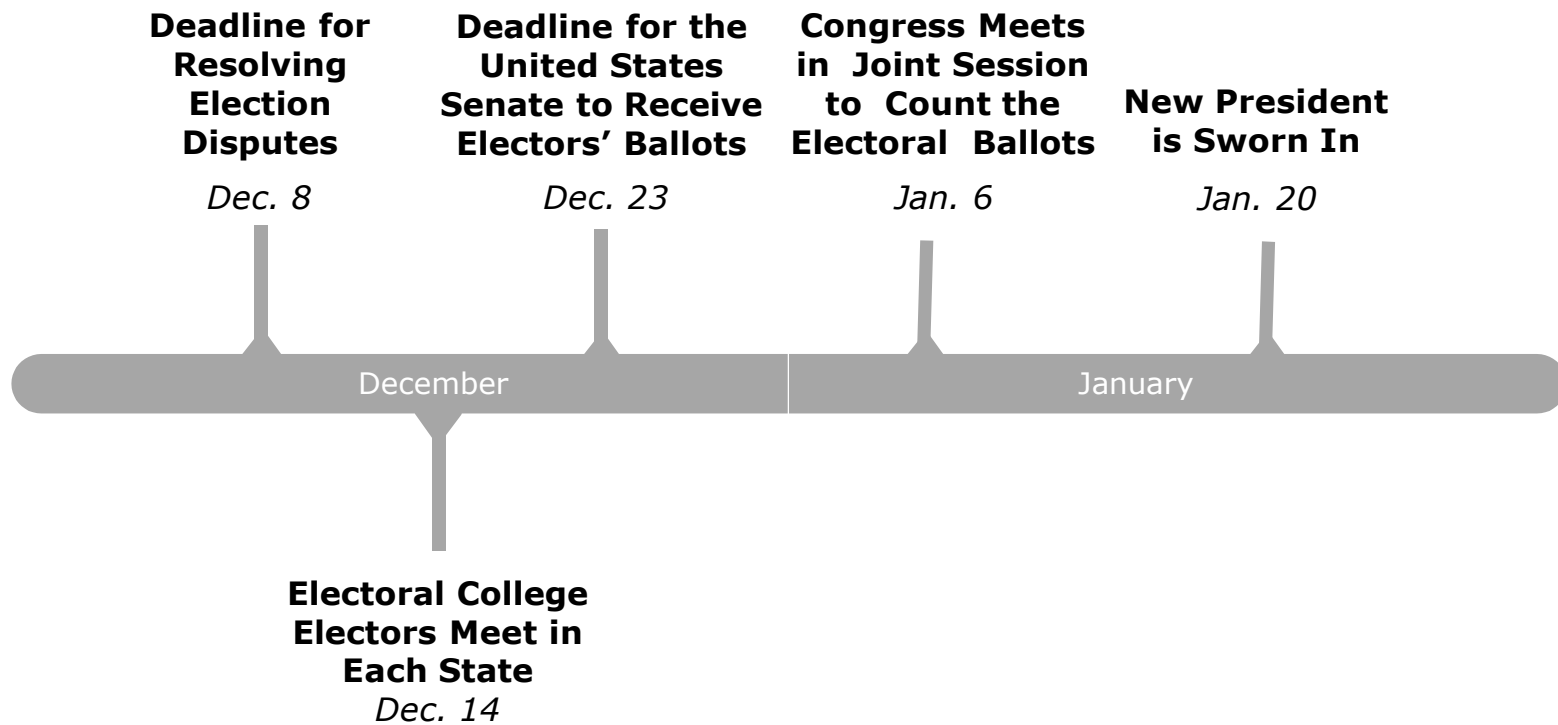
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<https://www.270twin.com/electoral-college-tie-combinations/>

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# Process and Timing to Determine the Winner in the Electoral College Voting

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Source: *Ballotpedia*

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# Agenda

**Risk of Higher Taxes**

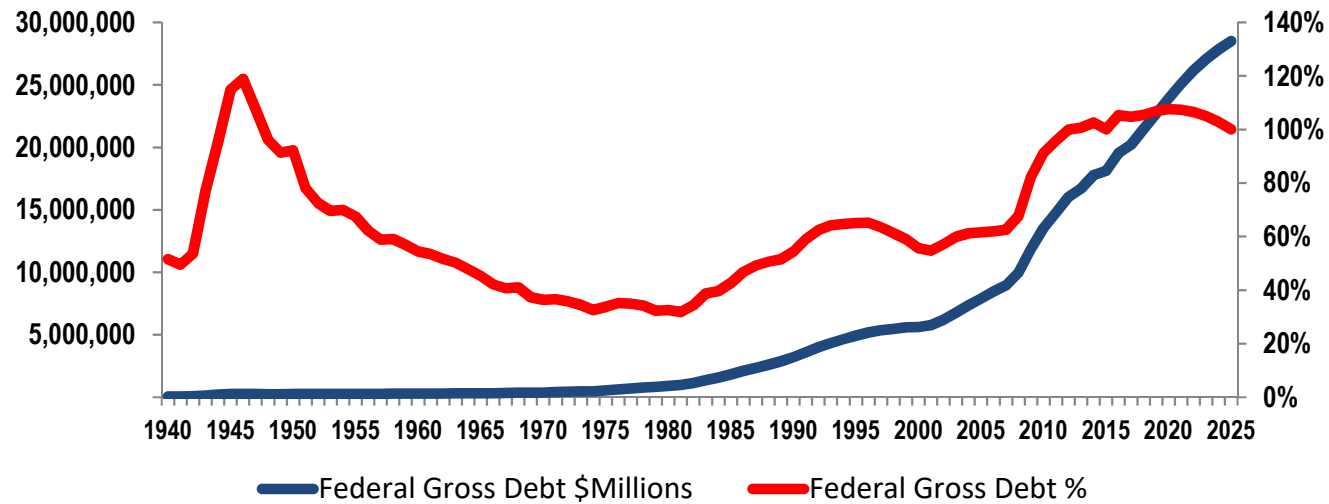
**Importance of Tax Efficient Investing**

**Planning Implications and Opportunities**

\* The final bill as passed by Congress is not officially called the *Tax Cuts and Jobs Act* and is now known only by its formal title: *“An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018”* or as “Pub. L. 115-97”. For this presentation, we will continue to use the more popular “Tax Cuts and Jobs Act” or “TCJA”

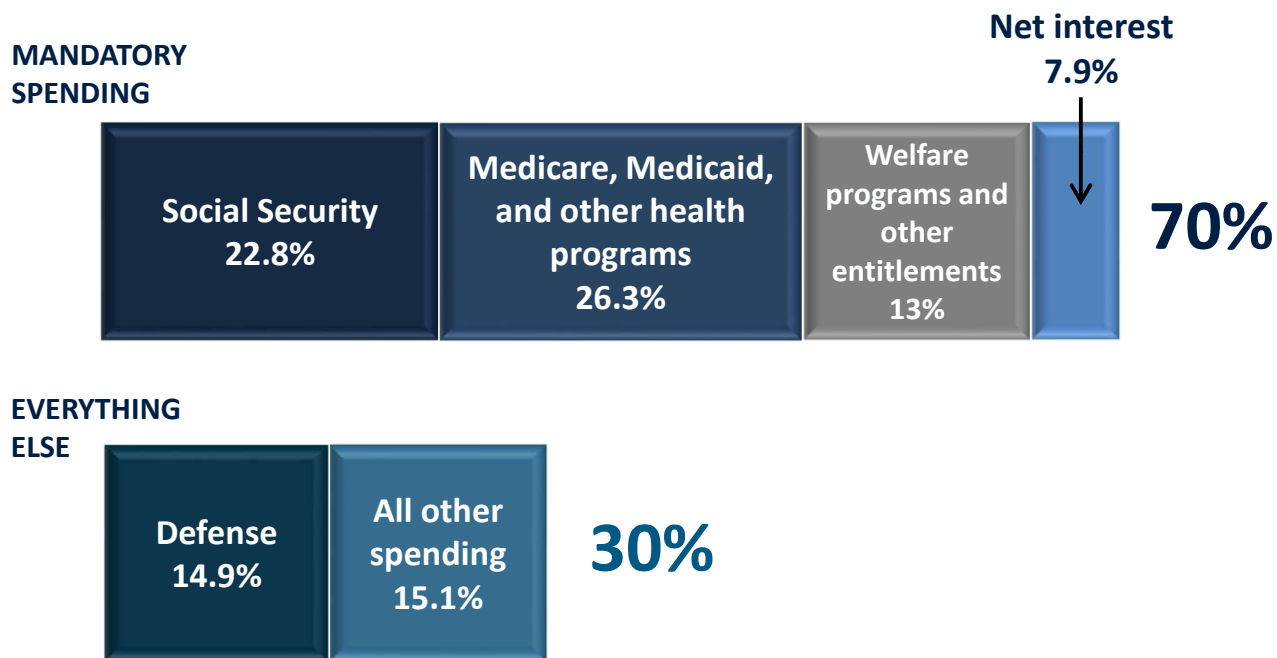
# U.S. Debt

Legislation has not been sufficient to reduce national debt



Source: Budget of the United States Government, FY 2021, Historical Tables (Table 7.1—FEDERAL DEBT AT THE END OF YEAR: 1940–2025)

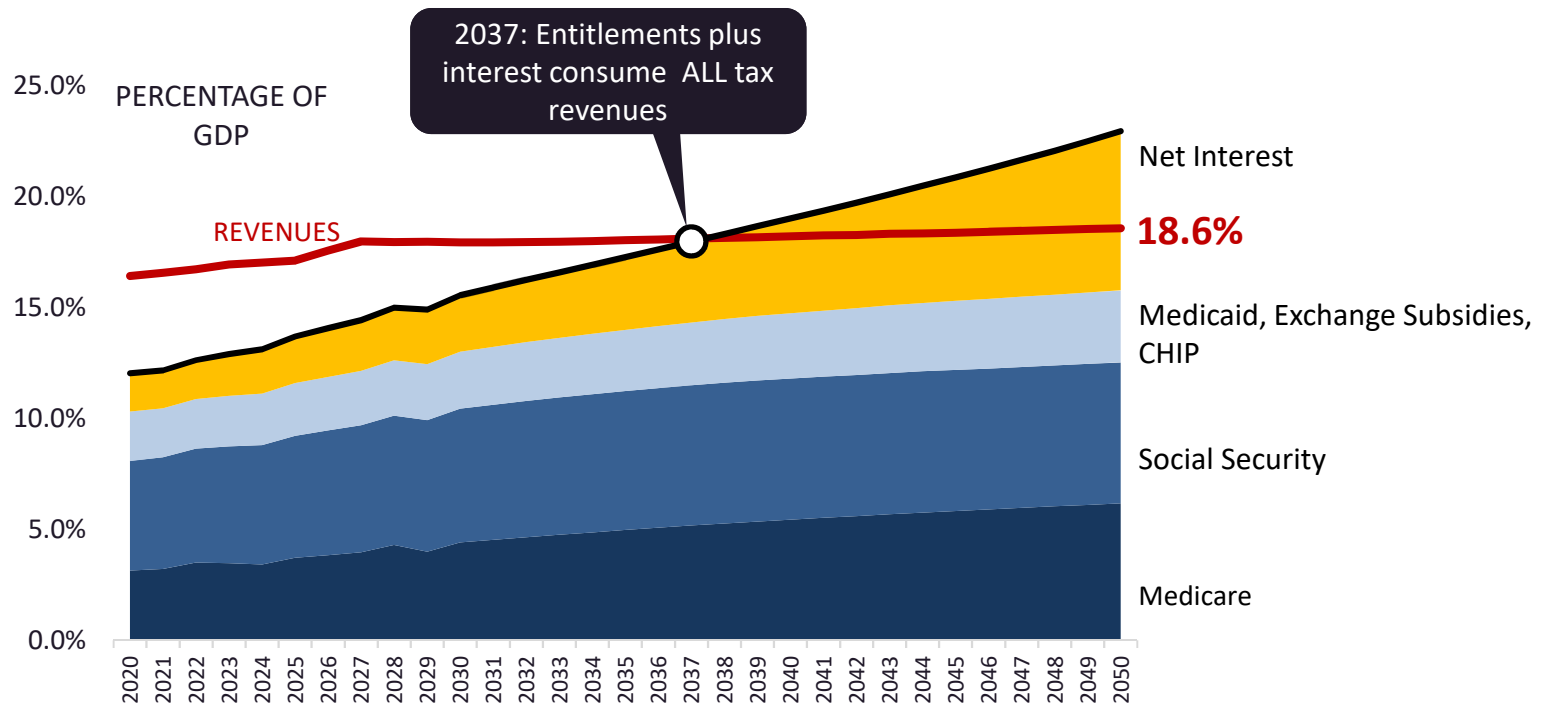
# In 2020 70 Percent of All Federal Spending Was Mandatory



Source: Budget of the United States Government, FY 2020, Historical Tables. Table 8.5 "Outlays for Mandatory and Related Programs, 1962-2025"; Table 8.7 "Outlays for Discretionary Programs, 1962-2025"



# All Tax Revenue Will Go Toward Entitlements and Net Interest by 2037



Source: The Congressional Budget Office; Budget and Economic Data; Long-Term Budget Projections, Supplemental Table 2: Summary Data for CBO's Extended Baseline; March 2020; Accessed August 2020

# Risk of Higher Taxes? Candidate Positions



**President  
Donald Trump**

## **“Tax Cuts and Jobs Act” (TCJA)**

- Temporarily reduced income tax rate
- Preserved the step up in basis for capital assets
- Reduced corporate tax rates to 21%
- Temporarily raised the estate/gift/GST exemption amount (\$11.58MM per person 2020)
- Waive Social Security payroll tax for 2020



**Former Vice President  
Joe Biden**

- Increasing income taxes and payroll taxes on certain taxpayers with high incomes (\$400K +)
- Capping the value of itemized deductions at 28%
- Eliminating step up basis
- Tax capital gains ordinary income rate for those earning more than \$1 million
- Raise corporate tax rate to 28% and implement a 15% corporate minimum tax
- Reducing the estate/gift/GST Exemption to the 3.5MM to \$5MM range
- Expand Social Security taxable wage base to include income above \$400,000

# 2021 Income Tax (Proposed)

Filing Jointly/Married				Filing as Single			
TAXABLE Income 2020	2020 Tax Bracket	Biden's Proposal	TAXABLE Income 2020	TAXABLE Income 2020	2020 Tax Bracket	Biden's Proposal	TAXABLE Income 2020
\$635,585	37%	39.6%	\$470,700	\$529,683	37%	39.6%	\$470,700
	35%	35%			\$418,700	\$418,700	
\$423,589	32%	33%	\$333,647	\$211,844	32%	33%	\$168,824
\$333,647	24%	24%	\$174,790	\$168,824	24%	24%	\$87,395
\$174,790	22%	22%	\$81,946	\$87,395	22%	22%	\$40,973
\$81,946	12%	12%	\$20,136	\$40,973	12%	12%	\$10,068
\$20,136	10%	10%	\$0	\$10,068	10%	10%	\$0
\$0			\$0	\$0			\$0

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 Source: Rev. Proc. 201-9-44, Nov. 6, 2019

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# Capital Gains Tax

TCJA			Biden	
Single	Married Filing Jointly	Tax Bracket	Single	Married Filing Jointly
\$0 - \$40,000	\$0 - \$80,000	0%	\$0 - \$40,000	\$0 - \$80,000
\$40,000 - \$200,000	\$80,000 - \$250,000	15%	\$40,000 - \$200,000	\$80,000 - \$250,000
\$200,000 - \$441,450	\$250,000 - \$496,600	18.8%*	\$200,000 - \$441,450	\$250,000 - \$496,600
Over \$441,450	Over \$496,600	23.8%*	\$441,450 - \$1,000,000	\$496,600 - \$1,000,000
		43.4%*	Over \$1,000,000	Over \$1,000,000

\* Reflects addition of 3.8% Surtax on Investment Income, which is applied based on Adjusted Gross Income (AGI)

Sources: Rev. Proc. 2019-44 Nov. 6, 2019

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# 2020 Itemized Deductions

## Itemized Deductions under Trump's TCJA

Mortgage Interest	\$1MM on debt incurred before 12/15/17 (\$500k MFS)
	\$750k on debt incurred between 12/16/2017 to 12/31/2025 (\$375k MFS)
	\$0 for home equity indebtedness (expires 12/31/2025)
Charitable Giving	Fully Deductible
State/Local Income Taxes,	Deductible (Limit of \$10,000)
Medical Expenses	10% of AGI

## Itemized Deductions under Biden's Proposal

Cap itemized deductions at 28%,  
Reinstate PEASE limitations  
Eliminate SALT cap

Pub.L. 115-97, aka "H.R.1 " or the "Tax Cuts and Jobs Act"; December 22, 2017  
 "Understanding Joe Biden's 2020 Tax Plan", Committee for a Responsible Federal Budget, July 30, 2020  
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# Review Portfolio for Tax Efficiency

*“Most people don’t think about how taxes affect their long-term portfolio”* David Blanchett, Head of Retirement Research, Morningstar

- Turnover Ratio
- Average After-Tax Return
- Pass-Through Gains
- Holding Period of Investments
- Cost of Rebalancing
- Tax Cost Ratio
- Tax Drag

# Turnover Ratios

	Average
Equity Mutual Fund	61%
Taxable Bond Mutual Fund	124%

\*Source: Morningstar Direct, U.S. Open-End Funds; September 2020.

In practical terms, the resulting percentage loosely represents the percentage of the portfolio's holdings that have changed over the past year.

Mutual funds and annuities have different benefits and risks. Withdrawals or surrenders from annuities may be subject to contingent deferred sales charges. Withdrawals and distributions of taxable amounts from variable annuities are subject to ordinary income tax and, if made prior to age 59½, may be subject to an additional 10% federal income tax penalty, sometimes referred to as an additional income tax. Mutual fund fees may also be lower than total annuity fees and charges. Mutual funds are subject to capital gains taxes, which may be lower than ordinary income taxes. Distributions may also be subject to the 3.8% tax on investment income that applies to higher income taxpayers.



# Consider These Questions

- Are you currently subject to high tax rates?
- How tax-efficient are your investments?
- Are you invested in high-turnover mutual funds?
- Are you paying taxes when you rebalance your portfolio?
- Are you paying taxes on income you are not currently spending?

# Diversified Retirement Income Strategy

## Diversify Sources of Income to Manage Tax Liability in Retirement



- IRA
- SEP IRA
- SIMPLE IRA
- 401(k)
- 403(b)
- Annuities



- Mutual Funds
- Bonds
- Stocks
- Cash



- Muni Bonds
- Cash Value Life Insurance
- Roth

# Tax Benefits of Life Insurance

Section	BENEFIT
IRC §101(a)	This life insurance code section passes on death benefits <b>income tax-free</b> to the beneficiary
IRC §7702	Definition of life insurance for <b>tax-deferred growth</b>
IRC §7702A	Sets the maximum limit you can put into a life insurance policy and receive most favorable tax treatment
IRC §72	Allows for <b>tax-free policy withdrawals</b> to basis from a non-MEC policy
IRC §101(g)	Life insurance death benefit may be accelerated in the event of <b>chronic or terminal illness</b> , tax-free

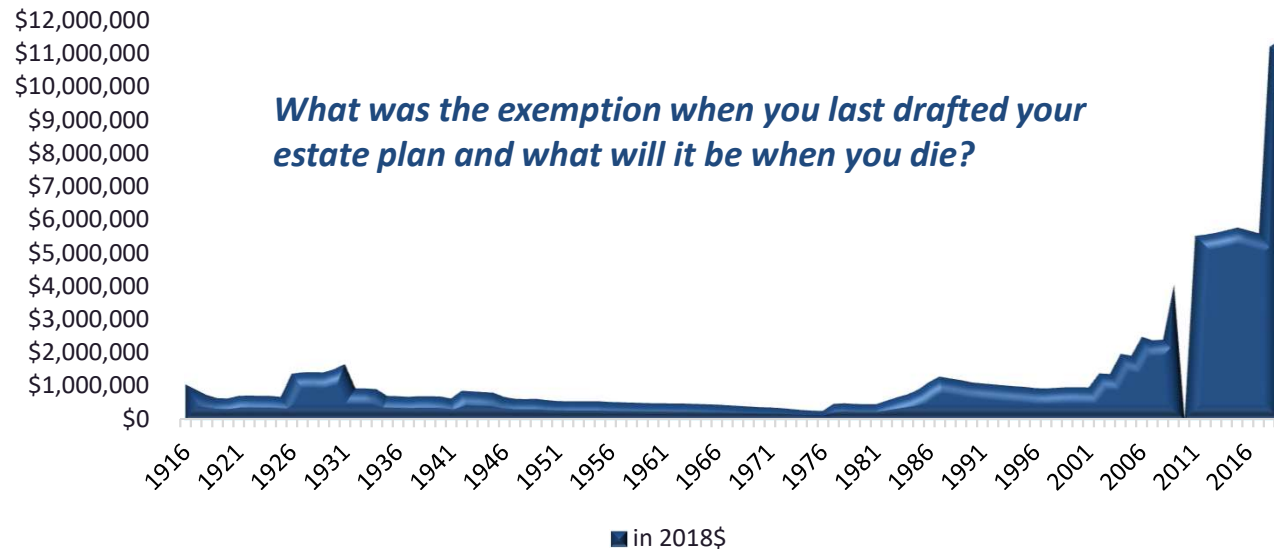
# Roth Conversions

## Benefits & Considerations

Benefits	Considerations
<ul style="list-style-type: none"><li>• Current Market Conditions</li><li>• Hedge Against Rising Taxes</li><li>• Tax Diversification</li><li>• No RMDs</li><li>• Tax Loss Harvesting</li><li>• Estate Planning Benefits</li></ul>	<ul style="list-style-type: none"><li>• Time Horizon</li><li>• Current Tax Bracket</li><li>• Tax Rates when Retired</li><li>• Paying the Conversion Tax Liability</li></ul>

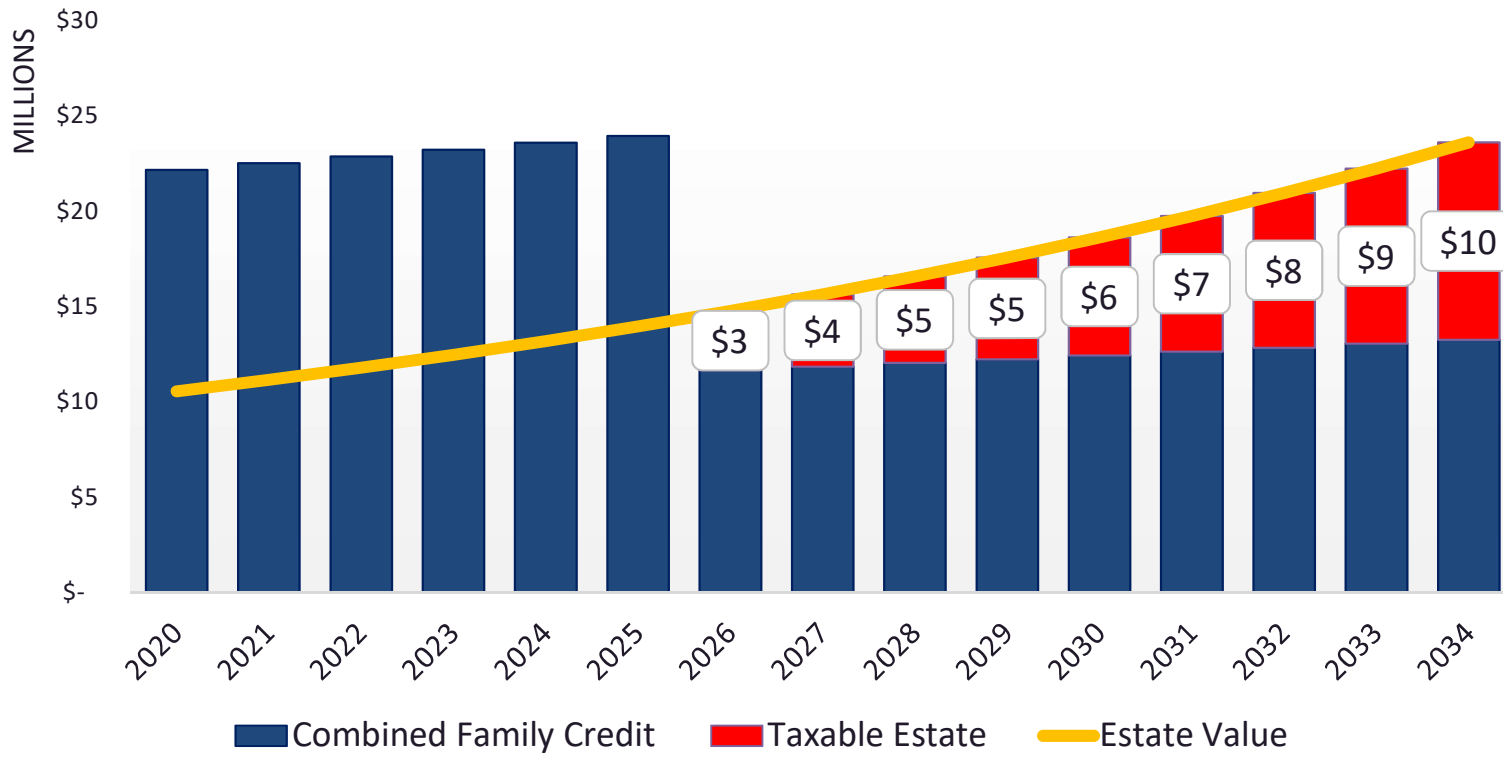
# Estate Planning in a Changing Tax Environment

## Historical Estate Tax Exemptions, 1916-2020 Inflation Adjusted



For years 1916 through 2017; adjusted by CPI-W as provided by Bureau of Labor Statistics: Inflation adjusted to 2018 dollars.  
Source: Internal Revenue Service; CCH Inc.; Julie Garber's "Annual Exclusion from Gift Taxes, 1997-2010," "Federal Estate, Gift and GST Tax Rates and Exemptions," McDermott Will and Emery; IRS Announcements 2011-2019

# Current Plan







# Addressing the “Clawback”

Tax Cuts and Jobs Act of 2017 will “sunset” a portion of the allowable lifetime exclusion in 2026

Concerns were raised regarding the possibility of lifetime gifts being taxed unfavorably at death

Treasury Department issued TD 9884 in November 2019

Allows the estate tax credit to be based on the greater of two credit amounts

- 1) The amount in effect in the year of death, or
- 2) The amount in effect in the year of the gift (not to exceed the amount of the gift)

# Modification of “Stretch” IRAs

## Dramatic Planning Changes

- Replace the beneficiary stretch with a 10-year payout for most individual beneficiaries
- Exceptions (Eligible Designated Beneficiaries)
  - Surviving spouse (spousal rollover still available)
  - Beneficiary not more than 10 years younger
  - Disabled/chronically ill beneficiary
  - Minor child (not grandchild) of the owner – must switch to 10-year at age of majority
  - Generally, this change applies to deaths after 2019, with the exception of collectively bargained plans, government plans, and binding contracts

# Legacy Planning with Retirement Assets



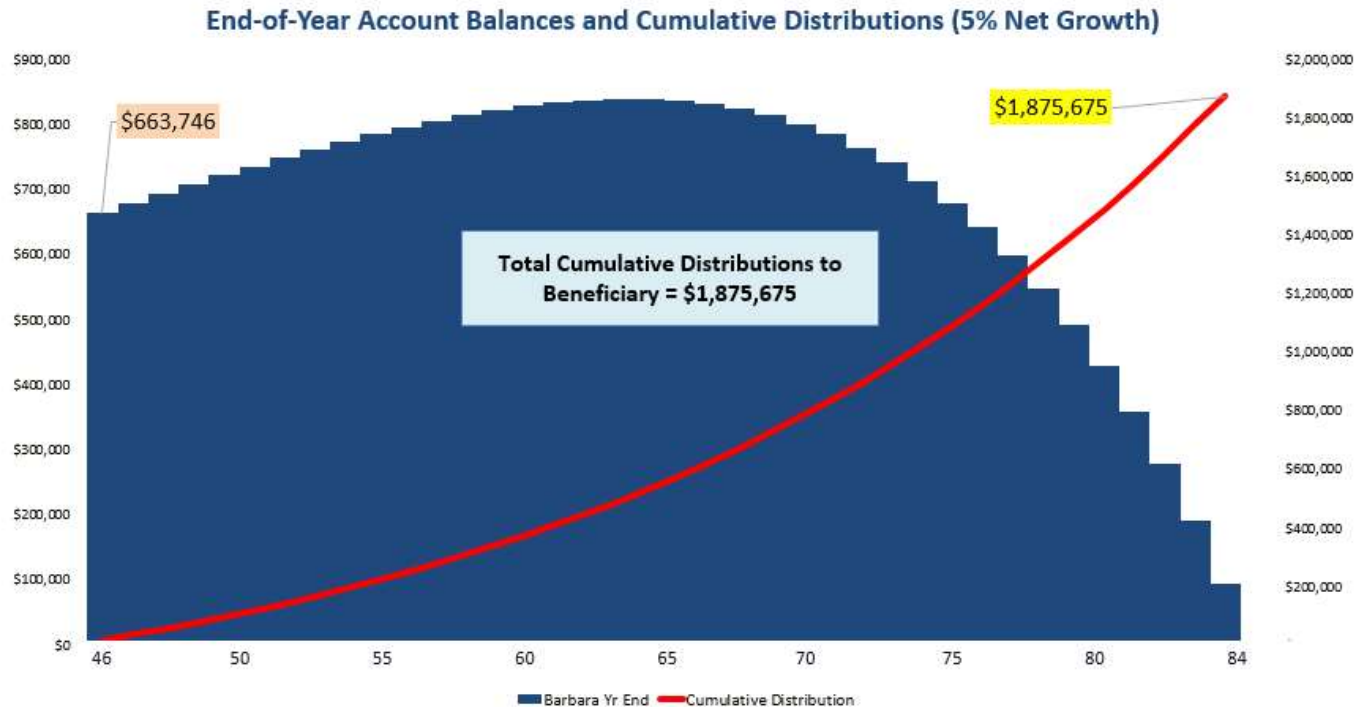
## Don and Kathy, both age 65

- One daughter Barbara (30)
- \$1,500,000 IRA
- \$1,000,000 investment assets
- Has income from a defined benefit pension plan and sufficient income from other assets to meet current and future income needs
- **\$500,000 of IRA assets earmarked as legacy money**

This hypothetical case study is for illustrative purposes only. Actual client results will vary.

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# Stretch Hypothetical Example – Old Rules



Assumes IRA value at 65 of \$500,000, death at 80, daughter (Barbara) as beneficiary at age 45. Assumes net 5% growth on assets.. Assumes death on 12/31.

The original IRA owner takes RMDs beginning at age 70, Distributions taken at beginning of year.

The Illustrations do not take into account the effects of inflation which will erode the purchasing power of investment.

The rate of return on the underlying investment(s) in the IRA is shown to be constant over the life of the account while in fact, account values are subject to market risks that cannot be predicted.

Income does not include the effect of taxes.

# Under the SECURE Act

<b>Immediate Lump Sum Distribution</b>	
<b>IRA value at death</b>	<b>\$663,746</b>
<b>Income tax* (effective tax rate of 31%)</b>	<b>(\$205,427)</b>
<b>Net to Beneficiary</b>	<b>\$458,319</b>

\* Assumes 2020 tax rates, single filer, standard deduction of \$12,400. Marginal tax bracket of 37%; effective tax bracket of 31%

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# Asset Repositioning

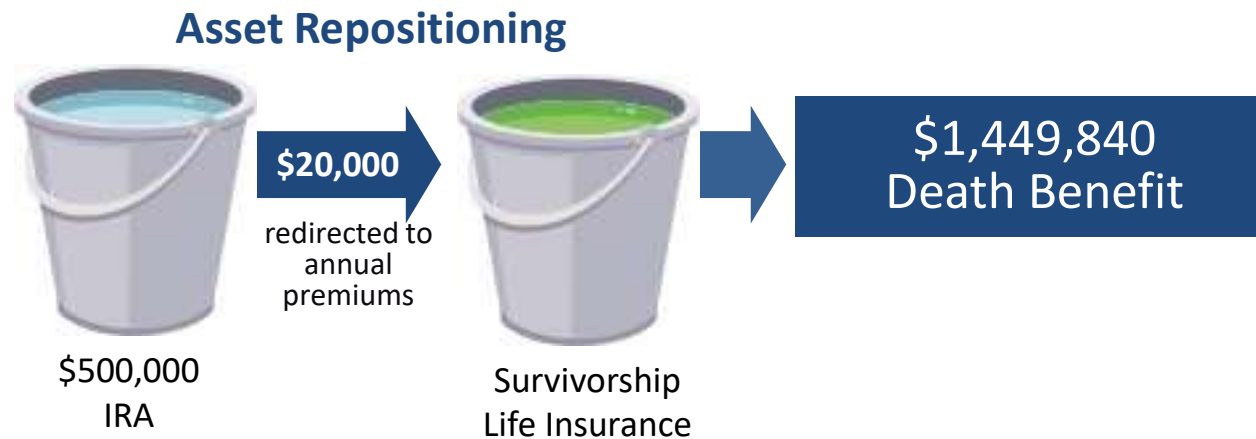
## Let's assume the following:

- Don lives to age 80
- Kathy lives to age 83, leaves IRA to Barbara
- Don and Kathy pay life insurance premiums with after-tax IRA withdrawals
- Barbara is the life insurance beneficiary

## Assumptions:

- 5% growth on IRA assets
- Don and Kathy, both age 65, preferred non-tobacco, PruLife<sup>®</sup> SUL Protector, \$20,000, no-lapse guarantee through age 105.

Hypothetical and for illustrative purposes only.



# Asset Repositioning with Life Insurance

	After SECURE Act	Asset Repositioning Strategy
IRA value at death	\$663,746	\$437,763 <sup>†</sup>
Income tax	(\$205,427)*	(\$123,674) <sup>‡</sup>
Tax-free death benefit		\$1,449,840
<b>Net to beneficiary</b>	<b>\$458,319</b>	<b>\$1,763,929</b>

**A difference of \$1,305,610**

\* Assumes 2020 tax rates, single filer, standard deduction of \$12,400. Marginal tax bracket of 37%; effective tax bracket of 31%

† Assumes \$500,000 IRA at age 65, growing at a net annual rate of 5%, distributions of \$26,315 per year at 24% marginal bracket, netting \$20,000 per year for life insurance premium, death at age 88

‡ Assumes 2020 tax rates, single filer, standard deduction of \$12,400. Marginal tax bracket of 35%; effective tax bracket of 28%  
This hypothetical example is for illustrative purposes only. Actual results will vary.



# Summary

- Investing in a challenging income tax environment
- Investment decisions can have tax consequences that are not normally considered
- Tax diversification and the use of tax-deferred vehicles can provide options and strategies for your clients

# Important Information

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Conversions to a Roth IRA are generally fully taxable. Before you convert to a Roth IRA, consider how your tax bracket will affect the overall benefit of the rollover. Conversion income may push you into a higher tax bracket. It is, however, possible to convert only part of your traditional IRA. This could enable you to remain in the same tax bracket you would be in without the conversion.

# Important Information

It is generally advisable to pay the taxes on the conversion with funds other than those in your traditional IRA. If you are under age 59½ when you do a conversion, any funds not deposited in the Roth IRA will be subject to the 10% federal income tax penalty (unless an exception applies).

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