Autumn Tax Planning Ideas for Individuals

As we approach the last quarter of 2019**,** it's a good time to brainstorm tax planning strategies. Some ideas will help cut your tax bill for the current year; others may allow you to minimize future taxes. Here are various short- and long-term strategies to consider. They factor in changes included in the Tax Cuts and Jobs Act (TCJA).

Perform an Estate Planning Tune-Up

Starting in 2018, the TCJA doubled the unified federal estate and gift tax exemption per individual from $5 million to $10 million, with annual indexing for inflation. For 2019, the inflation-indexed exemption is $11.4 million, or effectively $22.8 million for a married couple.

However, these generous exemptions are scheduled to expire after 2025. For 2026 and thereafter, they will revert to pre-2018 levels, unless Congress takes further action.

These sizable exemptions may mean your estate wouldn't be exposed to federal estate tax if you were to die tomorrow. However, your estate plan may need updating to reflect the current tax rules.

In addition, we don't know how long the historically generous unified federal estate and gift tax exemption will last. Under current law, the pre-TCJA exemption amounts are scheduled to return in 2026. Plus, the exemption amounts and estate tax rates could be changed sooner, depending on political developments and resulting tax legislation.

The current federal estate tax rate is 40%, but it was 55% a few years ago. That's why making big gifts now, under today's favorable tax rules, could be a smart tax move. (See "How to Avoid the Estate Tax Clawback" immediately below)

How to Avoid the Estate Tax Clawback

Regulations proposed in 2018 (but not yet finalized) stipulate that individuals who make large gifts in 2018 through 2025 and benefit from the historically generous unified federal estate and gift tax exemptions for those years will *not* be penalized if the exemptions revert to the pre-TCJA amounts after 2025.

Under the proposal, a decedent's federal estate tax exemption would be the greater of:

- The TCJA exemption amount that was used to shelter earlier gifts, or
- The exemption amount that's allowed in the post-TCJA year of death.

For example, let's suppose that in 2019, when the unified federal estate and gift tax exemption is $11.4 million, Andy makes $9 million of taxable gifts. (These gifts are in excess of the $15,000 per donee annual gift tax exclusion for 2019.)

When Andy passes away in 2026, assume the unified exemption is only $6 million, and he leaves a $4 million estate. What federal estate tax liability does Andy leave behind?

To calculate the tax liability for Andy's estate, the $9 million of taxable gifts made in 2019 is added back to his $4 million date-of-death estate, resulting in a gross estate of $13 million.

According to the proposed regulations, the estate tax liability would be calculated using a $9 million unified exemption. His estate would owe federal estate tax on $4 million ($13 million - $9 million). So, the $9 million of taxable gifts made while the $11.4 million unified exemption was in place under the TCJA wouldn't increase the 2026 federal estate tax liability of the estate.

What would have happened if Andy had given away $11.4 million in 2019 instead? Under this scenario, his remaining estate in 2026 would be only $1.6 million ($13 million - $11.4 million).

To calculate the 2026 federal estate tax liability for the estate, the $11.4 million of taxable gifts made in 2019 is added back to Andy's $1.6 million date-of-death estate, resulting in a gross estate of $13 million.

According to the proposed regulations, the estate tax liability would be calculated using an $11.4 million unified exemption. His estate would owe federal estate tax on $1.6 million ($13 million - $11.4 million). So, the $11.4 million of taxable gifts made while the $11.4 million unified exemption was in place wouldn't increase the 2026 federal estate tax liability of the estate.

The first situation is good news for high-net-worth individuals. But the second scenario produces even better results for Andy's estate.

Keep an Eye on Taxable Investment Accounts

If you hold investments in taxable brokerage firm accounts, consider the tax advantage of selling appreciated securities that have been held for over 12 months. The federal income tax rate on long-term capital gains recognized in 2019 is only 15% for most taxpayers. However, the maximum rate of 20% plus the 3.8% net investment income tax (NIIT) can apply at higher income levels.

To the extent you have capital losses that were recognized earlier this year or capital loss carryovers from pre-2019 years, selling appreciated shares this year won't result in any tax hit. In particular, sheltering net short-term capital gains with capital losses is a smart tax move, because net short-term gains would otherwise be taxed at higher ordinary-income rates.

What should you do with losing investments that you'd like to unload? Consider selling them and using the resulting capital losses to shelter capital gains, including high-taxed short-term gains, from other sales this year.

If your capital losses exceed your capital gains, the result would be a net capital loss for the year. A net capital loss can also be used to shelter up to $3,000 of 2019 ordinary income (or up to $1,500 if you use married-filing-separately status). Ordinary income includes such items as salaries, bonuses, self-employment income, interest income and royalties. Any excess net capital loss from 2019 can be carried forward to 2020 and beyond.

Having a capital loss carryover can give you extra investing flexibility in future years, because you don't have to hold appreciated securities for over a year to get a preferential tax rate. The top federal rates on net short-term capital gains recognized in 2020 through 2025 are 35% and 37% (plus the 3.8% NIIT if applicable). So, it's beneficial to have a capital loss carryover to shelter short-term gains recognized next year and beyond.

Gift Taxable Investments vs. Cash

Are you feeling generous? As you review your investment accounts for winners and losers, consider the optimal type of gifts to give your favorite relatives and/or charities.

***Gifts to relatives*.** Instead of making cash gifts, give your loved ones taxable investments that have appreciated in value. If your relatives are in lower federal tax brackets, they'll pay lower tax rates than you'd pay if you sold the same shares.

For example, relatives in the 0% federal income tax bracket for long-term capital gains and qualified dividends will pay a 0% federal tax rate on gains from shares that were held for over a year before being sold. (For purposes of meeting the more-than-one-year rule for gifted shares, you can count your ownership period plus the gift recipient's ownership period.)

Even if the appreciated shares have been held for a year or less before being sold, your relative will probably pay a much lower tax rate on the gain than you would.

For taxable investments that are currently worth *less* than what you paid for them, sell the shares and claim the resulting capital loss yourself. Then, you can give the cash proceeds to your relative.

***Gifts to charities*.** Similar principles apply to donations to IRS-approved charities. Donate shares that have appreciated in value, instead of giving away cash. Why? Donations of investments that you've owned over a year result in charitable deductions equal to the full current market value of the shares at the time of the gift (assuming you itemize deductions, rather than taking the standard deduction).

Plus, when you donate appreciated shares, you escape any built-in capital gains taxes. That's a double tax saver. First, you avoid capital gains taxes. Second, if you itemize deductions, you get a tax-saving charitable deduction. Meanwhile, the tax-exempt charitable organization can sell the donated shares without owing anything to the IRS.

For taxable investments that are currently worth *less* than what you paid for them, sell the shares and claim the resulting capital loss yourself. Then you can give the proceeds to your favorite charity and claim a resulting tax-saving charitable deduction (assuming you itemize deductions).

Consider an IRA Conversion

Should you convert a traditional IRA into a Roth IRA? This strategy makes sense if you expect that, during your retirement years, you'll be in your current tax bracket or a higher one. The current tax hit from a conversion done this year may turn out to be a relatively small price to pay for completely avoiding potentially higher future tax rates on the account's earnings.

There is no income limit imposed on Roth conversions. Even billionaires can do them! Your tax advisor can help you evaluate the wisdom of the Roth conversion idea.

Watch Out for AMT Pitfalls

The TCJA reduced the odds that you'll owe the alternative minimum tax (AMT) for 2018 through 2025. For those years, the law significantly increases the AMT exemption amounts and the income levels at which those exemptions are phased out. Even if you still owe the AMT, you'll probably owe considerably less than under prior law.

However, it's still critical to evaluate year-end tax planning strategies in light of the AMT rules. Because the AMT rules are complicated, you may want some assistance from a tax pro.

Ready, Set, Plan

These are just a few ideas for reducing future taxes and avoiding unpleasant surprises next spring. Act soon to benefit from these and other potential tax planning ideas. If you wait until the end of the year, it may be too late to take advantage of certain strategies.

The Law Office of Eugene Gorrin, LLC
17 Watchung Avenue, Suite 204
Chatham, NJ 07928
973.701.9300
egorrin@gorrinlaw.com
www.gorrinlaw.com