

Cherry Tree Wealth Management

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CHERRY TREE WEALTH INSIGHTS:

*Published by Keith Tuft, President of Cherry Tree Wealth Management, LLC,
with insights on investing and wealth management.*

INVESTING QUOTE OF THE MONTH:

"I have enough money to last me the rest of my life, unless I buy something." – Jackie Mason.



TAX PLANNING IN AN ELECTION YEAR

The two leading Presidential candidates (Trump and Biden) are polling very even with each other for the 2020 election, which is now just four months away. Due to the massive increases in our federal budget deficits and debt levels this year from the coronavirus recession, we believe it is likely that tax rates will increase over the next 1-6 years regardless of who is President. In addition, the Trump tax cuts from 2018 are set to expire at the end of 2025. Absent an act of Congress to extend them before then, we know that tax rates will go up at that time.

Biden and Trump have very different views when it comes to income taxes and estate taxes. What are the likely changes in the tax code if Joe Biden is the next President, when do Trump's tax cuts expire, and what are some things investors might consider in response?

Possible tax changes over the next 1-6 years:

- Higher income tax rates, especially for the rich. Biden has proposed a top income tax rate of 39.6%, reverting back to what the top tax rate was in 2017.
- Higher capital gains tax rates. Biden has proposed taxing capital gains at the same rate as ordinary income, with a top tax rate of 39.6% for those who earn over \$1 million. That compares with the current top capital gains tax rate of 20%.
- Elimination of the stepped-up cost basis rule on inherited assets. Currently people who inherit assets with capital gains get to continue owning the asset but using the value on the date of death of the grantor as the new cost basis (avoiding any tax on the capital gain). That could be changed to simply no stepped-up cost basis at death (but also no taxes owed on death). It could also change to a tax due at death based on the unrealized gain at transfer, as if the beneficiary had sold the asset. This would be a significant increase in estate taxes.
- The current (2020) large federal estate/gift tax exemption amounts of \$11.58 million per person, or \$23.16 million per couple, could be reduced. The current top estate tax rate of 40% could be increased. These large exemption amounts are set to expire at the end of 2025, when the exemption amount will be cut in half back to \$5 million (adjusted for inflation) from the current \$11.58 million.
- Mr. Biden has said that he will be primarily targeting the wealthy and corporations with his tax increases, and that he does not want to raise income taxes on anyone making less than \$400,000 per year.
- Most of Trump's individual tax cuts are set to expire at the end of 2025.



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What might wealthy people consider doing in response to possible higher future tax rates?

- Sell some assets this year (2020) that have large capital gains, especially those assets that you were thinking about selling in the next few years anyway. This is especially relevant to those people who own a company or real estate property with large capital gains. The top federal capital gains tax rate could nearly double (20% to 39.6%) over the next couple years. If you sold your company in 2020 and had a \$10 million gain, the difference is nearly \$2 million in tax savings.
- Shift some income into 2020 (from future years), to shield it from potentially higher tax rates in 2021 and beyond. An example might be selling your stock options or restricted stock this year rather than in the next couple years.
- Move to a tax-efficient investment strategy. If capital gains are going to cost you more in taxes in the future, you should focus even more on keeping the taxable capital gains to a minimum. Our buy and hold investment strategy uses very tax-efficient ETF funds and index-based mutual funds with low turnover. They typically pay out low or no year-end capital gains distributions. We are also very tax smart in how we manage and take capital gains throughout the year. Actively managed mutual funds, funds with high turnover, active trading, hedge funds, and market timing are much less tax efficient.
- Consider large gifts to your family and children this year. Individuals can gift up to \$11.58 million (couples up to \$23.16 million) without paying any gift/estate tax this year. This uses up (some or all of) your lifetime estate tax exemption but going forward these assets are out of your estate (for estate tax) and future growth is also out of your estate. These large estate/gift tax exemption amounts are especially generous now and could be reduced in the future.
- Move from a high tax state to a lower income tax state such as Florida, Arizona, Texas, South Dakota, Wyoming, Nevada, Washington, or North Dakota.

If the unfavorable estate tax law changes mentioned above (no cost basis step-up on death, lower exemption amounts, and/or higher estate tax rates) pass, there are a couple of things wealthy families might consider doing more of:

- Giving more of their estate to their family during their lifetime, rather than at death.
- Giving more to charity upon death rather than to their families. This is true because legacy gifts to charity avoid estate tax, income tax, and capital gains tax.
- Using life insurance more as an estate planning tool. Life insurance benefits are not taxable as income (or capital gains), and you can own it outside your estate to avoid estate taxes as well.

At this point it is very uncertain who will win the 2020 presidential election, who will control Congress, and what changes in the tax law are likely. We are getting questions about this topic, and many wealthy families are already planning moves based on likely higher tax rates in the future. Please talk to us (and your CPA) about how any likely tax changes in the future might affect you personally, and if there are any smart moves you can make now or in the future.

Cherry Tree Wealth Management, LLC (CTW) provides unique wealth management services for a select group of client families to help give them peace of mind. Author Keith Tufte, (President of CTW) has over 25 years of successful investment management experience as a Wall Street Analyst, Mutual Fund Portfolio Manager, Director of Equity Research for a major mutual fund firm, Hedge Fund Portfolio Manager, and Wealth Management Advisor. Please FORWARD this e-mail to friends/relatives/business associates that you think may have an interest. Please see our website at <http://www.cherrytree.com>.

CHERRY TREE WEALTH MANAGEMENT, LLC

Keith N Tufte, CFA, MBA • ktufte@cherrytree.com • Cell (952) 465-1785 • Office (952) 253-6006



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