WILMINGTON TRUST

MEMBER OF THE M&T FAMILY

Year-End Estate and Tax Planning: More Important than Ever in 2020

With an election looming and the potential for change, be sure you're well positioned to optimize your plan for today and for the year ahead.

Key points:

- Year end is always a good time to review and adjust your estate and tax planning strategies
- The strategies you consider may have different implications and timelines depending on the results of the November election
- Reviewing your plan with your advisors can help you determine the right course of action for your situation, this year and beyond

2020 has been a year of uncertainty, in large part due to the global COVID-19 pandemic. Additionally, because 2020 is an election year, election outcomes may result in significant tax law changes. As the year draws to a close, now is a good time to review, reflect on, and augment estate and tax planning strategies. Outlined below are some year-end strategies for your consideration, to help optimally position you and your family for changes that may come.

Maximize pre-tax contributions

Tax-advantaged accounts, such as employer-sponsored 401(k) plans, health savings accounts (HSAs) and traditional individual retirement accounts (IRAs) present opportunities to set aside pre-tax money and allow for income-tax-free growth within these types of accounts. Each are subject to different contribution limits, and in the case of traditional IRAs, income limits as well.

Continued

 ©2020 M&T Bank Corporation and its subsidiaries. All rights reserved.

While changes to tax laws in 2017 restricted many itemized deductions, rules around charitable giving became more favorable for high-net-worth taxpayers.

Pre-tax contributions to employer-sponsored 401(k) plans in 2020 are limited to $19,500 per individual annually (with an additional $6,500 "catch-up" contribution allowed for taxpayers over age 50).

Annual contributions to a traditional (deductible) IRA in 2020 are limited to $6,000 ($7,000 if over age 50). The deductibility of an IRA contribution is limited if you are covered by an employer-sponsored retirement plan and is phased out altogether if your income is $75,000 per year ($124,000 if married filing jointly).

Distributions from 401(k) and traditional IRA accounts are taxed as ordinary income in the year received, and required minimum distributions (RMDs) must begin at age 72, but may occur beginning at age 59½. Note that the starting age to take RMDs was increased from age 70½ as a result of the SECURE (Setting Every Community Up for Retirement Enhancement) Act of 2019. Additionally, the CARES (Coronavirus Aid, Relief and Economic Security) Act of 2020 enables any taxpayer with an RMD due in 2020 from a defined contribution retirement plan, including a 401(k) or 403(b) plan or an IRA, to skip those RMDs this year.

HSAs are available to taxpayers with high-deductible health insurance plans (defined in 2020 as $1,400 deductible per individual or $2,800 for a family) and allow for the contribution of pre-tax dollars to fund anticipated future health care expenses. Expenses do not need to be incurred in the same year as contributions. Account balances may be invested in an array of options depending on the plan sponsor, and earnings on HSAs grow tax-free. For 2020, contributions are limited to $3,550 per year for an individual and $7,100 for a family. Again, there is a catch up contribution of $1,000 per year allowable for individuals over age 50. Withdrawals from HSAs are also tax-free if used for qualifying expenses. Thus, HSAs have a triple tax advantage.

Effectively plan charitable contributions

While changes to tax laws in 2017 restricted many itemized deductions, rules around charitable giving became more favorable for high-net-worth taxpayers, allowing for deductions ranging from 20%–60% of adjusted gross income (AGI) depending on the type of asset gifted and whether the gift is made to a public charity or private foundation, with the limit of up to 60% for cash gifts to public charities.

Charitable gifts do not need to be made in cash, and may include other assets such as appreciated securities held for more than one year. Gifts of appreciated securities can be especially beneficial for the donor, as the charitable deduction is based on the fair market value when transferred. Additionally, transfers of appreciated securities avoid recognition of capital gains by the donor, which would have been taxable had the asset been sold and the sale proceeds donated to charity. Likewise, appreciated real estate may also be an appropriate gift to charity, although there are more complex rules around appraisals, and a donation of debt-burdened real estate may have adverse tax consequences to the donor.

Continued

©2020 M&T Bank Corporation and its subsidiaries. All rights reserved.

The timing of income and deductions can sometimes result in a higher or lower tax bracket for a particular year, and it may be possible to defer or accelerate some income from year to year in order to be taxed in a lower tax bracket.

The 2017 Tax Cuts and Jobs Act also brought with it a higher standard deduction (now $12,400 for single filers and $24,800 for married couples filing jointly), which resulted in more taxpayers falling into the standard deduction, losing the ability to itemize. If this applies to you, you may wish to consider making a more substantial charitable gift, equivalent to what you would normally make over several years, which would be large enough to allow you to itemize. If this is something you decide to do, have a discussion with the charity to let them know not to rely on a similar size gift every year. Alternatively, larger gifts may be made to a donor advised fund, and parceled out to charities over several years, while still receiving the charitable deduction this year.

More complex gifts may also be structured through entities such as private foundations, charitable trusts, or charitable split-interest trusts.

Another strategic charitable gift for high-income earners is an IRA charitable rollover. The IRS allows individuals over age 70½ to transfer up to $100,000 directly from an IRA to a qualified charity without recognizing income, and the amount transferred to charity counts to satisfy all or part of the required annual distribution. This charitable rollover may be helpful to taxpayers who do not itemize deductions or have already maximized their permitted charitable contribution deductions, or could otherwise benefit from a lower amount of AGI, such as to avoid the 3.8% Medicare surtax on net investment income (which applies to AGI of $200,000 for unmarried taxpayers, $125,000 for married filing separately, or $250,000 for married couples filing jointly).

The use of IRA assets for charitable donations may also be a smart estate planning strategy. IRAs do not receive a step-up in basis upon the owner's death. Consequently, when recipients of an inherited IRA take out their required annual distributions, the distributions are taxed as ordinary income. Alternatively, non-IRA assets currently receive a step-up in basis to fair market value at death, meaning that heirs will be taxed on the capital gains only attributed to the future appreciation of the assets. Distributing IRA assets to charities during your lifetime not only helps save on current income taxes, but also reserves more tax-advantaged assets to pass to heirs upon death.

Be sure to allow enough time for any charitable gift to be completed prior to December 31, 2020 in order to take advantage of deductibility in this tax year. While gifts of cash via a check or credit card may be processed quickly, other asset transfers will likely require more time.

Optimize the timing of income recognition and deductions

For individuals, income is taxable in the year received, and expenses are deductible in the year paid. The timing of income and deductions can sometimes result in a higher or lower tax bracket for a particular year, and it may be possible to defer or accelerate some income from year to year in order to be taxed in a lower tax bracket.

Continued

 ©2020 M&T Bank Corporation and its subsidiaries. All rights reserved.

The amount exempt from federal gift and esate tax in 2020 is $11.58 million per person, which is slated to sunset on December 31, 2025 and revert to $5 million per person, barring any intervening legislation.

Income deferral. One way to defer income is to wait until January to take discretionary IRA distributions. Unless required, delaying a distribution into next year may reduce income tax liability this year. Additionally, if you anticipate selling certain securities, consider delaying the sale until January rather than selling in 2020. Gains from the sale will be in the 2021 tax year (of course, the purchase or sale of a security should primarily be based on whether the timing is right from an investment perspective).

Acceleration of expenses. Deduction timing is an important component of year-end planning. In addition to the charitable deductions discussed above, in high-income tax rate years it may be advantageous to pay deductible expenses that may not come due until the following year. This may include medical expenses or certain interest expenses. Conversely, if you anticipate that your income tax rate may be higher next year, consider paying those expenses early next year.

Tax-loss harvesting. A year-end review of your portfolio is a good time to take advantage of any losses that should be harvested to offset capital gains incurred throughout the year. The goal of this strategy is to reduce overall tax liability by selling underperforming assets at a loss to offset realized investment gains. For taxpayers with large capital gains in 2020, tax-loss harvesting may result in a significant reduction in tax liability. Realized losses that exceed realized gains in a particular year may be applied against ordinary income, up to $3,000, with the remaining loss carried forward to offset future gains. Again, the sale of any security should be based on whether timing is right from an investment perspective.

Make the most of generous lifetime gifting limits: They may be abruptly reduced

Gift and estate tax exemption. For those whose assets are significant enough to have a taxable estate, year-end planning will have even more significance. One result of the comprehensive tax reform enacted in 2017 was a significant increase in the lifetime gifting exemption. Indexed for inflation, the amount exempt from federal gift and estate tax in 2020 is $11,580,000 per person ($23,160,000 for a married couple), which means that you may give this amount during your lifetime, free of gift tax, with any unused amount applied against federal estate taxes at your death.

Barring any intervening legislation, this inflation-indexed increase in the exemption amount is slated to sunset on December 31, 2025, and effective January 1, 2026, the exemption reverts to $5,000,000 per individual ($10,000,000 for a married couple) as indexed for inflation. However, there is a possibility that legislation may be enacted any time prior to 2026 that may abruptly, and potentially dramatically, reduce the exemption as early as 2021. This could be due to proposed tax policy changes and may be dependent on the outcome of the November election. Specifically, the Biden campaign has indicated an intent to revert to 2009 limits, which include a $1,000,000 lifetime gifting exemption and a $3,500,000 estate tax exemption and generation-skipping transfer (GST) tax exemption.

Continued

 ©2020 M&T Bank Corporation and its subsidiaries. All rights reserved.

A 529 plan allows for the tax-free growth of funds and tax-free withdrawals to pay for the plan beneficiary's qualifying educational expenses.

As recently as 2003, the exemption was $1,000,000 per person. Proposals that will change the current exemption, as well as implement potential new wealth taxes, are very real considerations. This is a good reason why it may be best to make larger gifts now, while the exemption remains high and there is some certainty about the taxation of such gifts, and the IRS has indicated that there will not be a "claw back" in the event of a future reduction in the exemption level.

By making larger gifts today, the more time the gift will have to grow outside of your estate, particularly if gifted to a trust rather than outright. In addition to benefits of a trust such as professional management, tax mitigation, and creditor protection, a trust structured as a grantor trust would effectively allow the trust assets to grow income-tax-free, as all income tax obligations would be paid by the grantor. The grantor trust structure also benefits the grantor in that all payments for taxes further reduce the taxable estate yet are not subject to gift tax. Other trust structures, particularly trusts with a Delaware trustee, may also serve to mitigate taxes attributable to the trust.

Annual exclusion gifts. In addition to the lifetime exemption, every individual may make tax-free, annual exclusion gifts of up to $15,000 ($30,000 for a married couple) to as many people as desired, without counting toward the lifetime exemption from estate and gift tax.

An annual exclusion gifting strategy to consider is establishing (or contributing to established) 529 education savings plans for children or grandchildren. A 529 plan allows for the tax-free growth of funds and tax-free withdrawals to pay for the plan beneficiary's qualifying educational expenses. Qualifying expenses now include up to $10,000 per year, per student for elementary or secondary school expenses. For college or university student beneficiaries, up to 100% of qualifying expenses may be paid with distributions from the 529 plan, including tuition, fees, housing, and books.

Although annual contributions to a 529 plan are limited to the $15,000 annual exclusion gift ($30,000 for a married couple), a special rule allows for a transfer of five times this amount, meaning that a married couple may make one gift of $150,000 per beneficiary (but no additional 529 gift for the next four years). Additionally, by timing an annual gift of $30,000 to a 529 plan at the end of the year, then making a $150,000 gift at the beginning of next year, it is possible to contribute up to $180,000 within a few months. The earlier in a child's life a plan is funded, the more time it may grow tax-free (and outside of your estate).

Continued

©2020 M&T Bank Corporation and its subsidiaries. All rights reserved.

This year end is unlike any other for many reasons. In terms of year-end tax planning, it is important to note that the above strategies may have different implications and timelines depending on the results of the November election. Year-end tax strategies that consider your view of the potential impact of election outcomes and any pending tax proposals may need to be modified. For further tax strategies related to the potential implications of the upcoming election, please see our earlier article on this topic, *Riding the Tax Law Wave: Planning Strategies in a Sea of Change*.

Lisa M. Ligas
Director of Wealth Strategies
Wilmington Trust, N.A.

310.300.3063
lligas@wilmingtontrust.com

As part of the Wilmington Trust and M&T Emerald Advisory Services® team, Lisa is responsible for the direction of wealth planning and strategic advice. In her role, she works closely with clients and their advisors to develop financial, tax, and estate planning strategies, helping clients meet their current needs and plan for their long-term objectives. Lisa received both her JD and MBA with honors, with a specialization in finance, from Loyola University Chicago, along with a bachelor's degree in communication and English from Pepperdine University. She is admitted to practice before the bar of New York, Illinois, and the United States Supreme Court.

This article is for informational purposes only and is not intended as an offer or solicitation for the sale of any financial product or service or as a determination that any investment strategy is suitable for a specific investor. Investors should seek financial advice regarding the suitability of any investment strategy based on their objectives, financial situations, and particular needs. This article is not designed or intended to provide financial, tax, legal, accounting, or other professional advice since such advice always requires consideration of individual circumstances. If professional advice is needed, the services of a professional advisor should be sought.

Wilmington Trust is not authorized to and does not provide legal, accounting, or tax advice. Our advice and recommendations provided to you are illustrative only and subject to the opinions and advice of your own attorney, tax advisor, or other professional advisor.

There is no assurance the any investment, financial, or estate planning strategy will be successful. These strategies require consideration for suitability of the individual, business, or investor.

The information in this article has been obtained from sources believed to be reliable, but its accuracy and completeness are not guaranteed.

Note that a few states, including Delaware, have special trust advantages that may not be available under the laws of your state of residence, including asset protection trusts and directed trusts.

Investing involves risks and you may incur a profit or a loss. Asset allocation/ diversification cannot guarantee a profit or protect against a loss.

Wilmington Trust and M&T Emerald Advisory Services are registered trademarks and refers to these services provided by Wilmington Trust, N.A., a member of the M&T family.

There is a flat fee to enroll in Wilmington Trust and M&T Emerald Advisory Services for a specified enrollment period ("Enrollment Period"). The fee is customized based on the Enrollment Period, your needs and circumstances and the complexity of the anticipated analysis. Our services terminate at the end of the Enrollment Period.

Wilmington Trust is a registered service mark used in connection with various fiduciary and non-fiduciary services offered by certain subsidiaries of M&T Bank Corporation including, but not limited to, Manufacturers & Traders Trust Company (M&T Bank), Wilmington Trust Company (WTC) operating in Delaware only, Wilmington Trust, N.A. (WTNA), Wilmington Trust Investment Advisors, Inc. (WTIA), Wilmington Funds Management Corporation (WFMC), and Wilmington Trust Investment Management, LLC (WTIM). Such services include trustee, custodial, agency, investment management, and other services. International corporate and institutional services are offered through M&T Bank Corporation's international subsidiaries. Loans, credit cards, retail and business deposits, and other business and personal banking services and products are offered by M&T Bank, member FDIC.

©2020 M&T Bank Corporation and its subsidiaries. All rights reserved. 48252 201002 VF