William Blair

Maximizing the impact of your capital

10 Year-End Strategies for 2019

Tax Reform Continues to Shape Year-End Planning in 2019

10 YEAR-END STRATEGIES TO CONSIDER IN 2019

- Maximize your deductions
- (Re)consider a Roth conversion
- Don't overlook an HSA
- Understand the laws for establishing residency in a low-tax state
- Take full advantage of lifetime giving opportunities
- Review your estate plan in light of major changes
- Review and update your beneficiary designations
- Maximize the after-tax value of your business equity
- Look into opportunity zones
- Check your withholding

Every year, there are steps that high-net-worth individuals, families, and business owners can take before December 31 to strengthen their wealth management strategies and lower their tax bills—and 2019 is no different.

Even though the Tax Cuts and Jobs Act has been in effect for more than a year now, the landmark tax reform law continues to create opportunities to reduce your tax exposure and maximize the impact of your capital.

Our 2019 year-end planning guide highlights 10 tax and wealth management strategies that high-net-worth investors should consider as they look for opportunities to strengthen their financial lives.

To learn more about these and other strategies, we encourage you to schedule a time to talk with your William Blair advisor or contact us at pwm@williamblair.com.

Sincerely,

Ryan DeVore, Partner
Head of Private Wealth Management

Maximize the Value of Your Deductions

The Tax Cuts and Jobs Act made a host of changes to the deductions that many high-income taxpayers claimed in the past.

The net result is that significantly fewer taxpayers will itemize their deductions, and will instead take the standard deduction. But there still are many year-end planning opportunities related to deductions that high-income individuals and families should consider, particularly when it comes to charitable giving.

WHAT YOU NEED TO KNOW ABOUT CHANGES TO TAX RATES AND DEDUCTIONS THAT WENT INTO EFFECT IN 2018

- Top marginal tax rate decreases to 37%, and tax rates decrease at all income levels
- State and local tax (SALT) deductions are limited to $10,000
- Standard deduction doubles and personal exemption is eliminated
- Making charitable gifts directly from your IRA is still an option
- The income threshold for cash gifts to public charities has increased
- Mortgage interest deductions are more limited
- Pease limitations are eliminated
- AMT remains, but its impact is muted

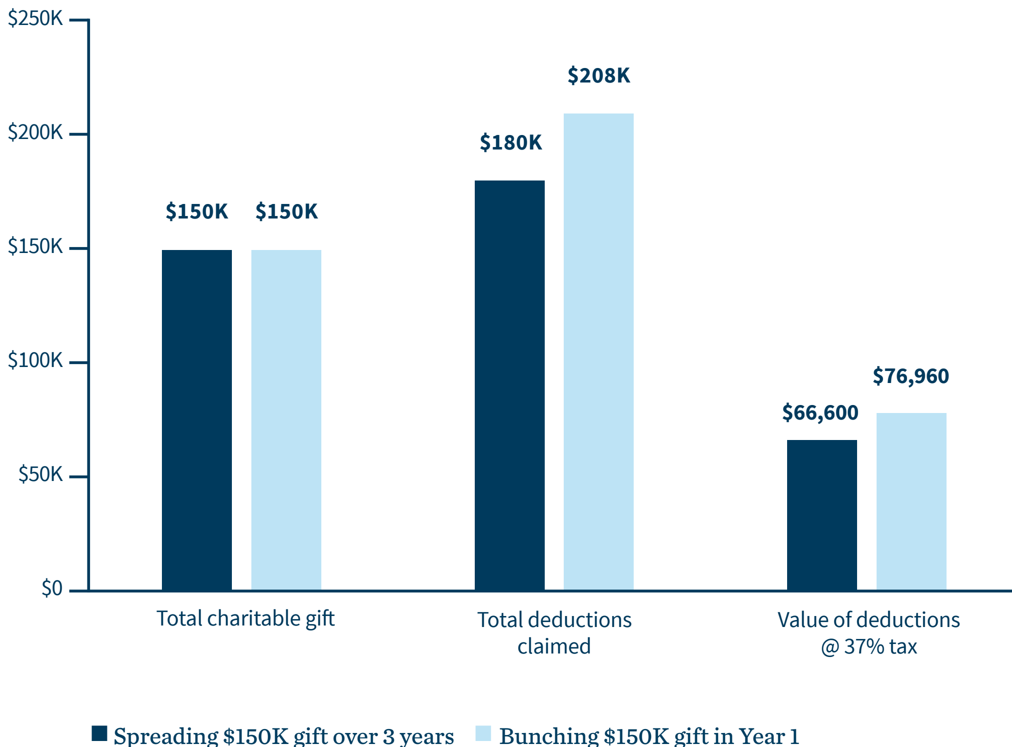
Bunching Charitable Gifts Can Maximize Tax Savings

For taxpayers who are looking to make large gifts, it may be beneficial to concentrate the donations in a single year, as opposed to spreading them over multiple years.

A family that is looking to contribute a total of $150,000 could spread those gifts evenly over three years and claim itemized deductions totaling $180,000 over that span (3 years x $50,000 annual gift + $10,000 in annual SALT deductions). Or they could make the full $150,000 gift in year 1 and then take the standard deduction in years 2 and 3, resulting in total deductions of $208,000 over those three years.

One vehicle to consider when bunching charitable contributions is a donor advised fund (DAF). In one year, you can consolidate your desired charitable contributions to the DAF, take the full deduction for that gift in the year of contribution and then use the DAF to support charitable organizations over a number of years.

Spreading a Donation Across 3 Years vs. Bunching Into 1 Year



(Re)consider a Roth Conversion

If you've thought about converting a traditional IRA to a Roth IRA in the past but haven't pulled the trigger, now might be a good time to look at the strategy again.

Lower Tax Rates = Lower Barriers

Now that the top marginal tax rate has decreased from 39.6% to 37%, the cost of a Roth conversion—which involves paying ordinary income tax on any pretax funds in your IRA in exchange for a Roth's tax-free growth and lack of required minimum distributions—has gone down.

No More Recharacterizations

But the news isn't all good in terms of how the Tax Cuts and Jobs Act affects Roth conversions. The tax-reform law also eliminated the opportunity to recharacterize a Roth conversion, something you could do before 2018 if the value of your account fell after you did the conversion. The elimination of the recharacterization option increases the risks related to market timing.

WHAT YOU NEED TO KNOW ABOUT CHANGES TO TAX RATES AND DEDUCTIONS

- **Can you pay the tax on the conversion by using funds from outside the IRA?** If you don't have to tap into the IRA to pay the conversion tax, this increases the potential benefit of a Roth conversion.
- **Will you need the IRA to fund your retirement expenses?** Roth IRAs can be powerful wealth-transfer tools thanks to their tax-free growth and lack of required minimum distributions.
- **Will you be in a higher tax bracket in retirement?** It's impossible to predict what Congress will do with tax rates down the road, but we know that the current top marginal tax rate of 37% is relatively low by historical standards.
- **Are you planning to make any large charitable gifts?** You may want to consider bunching your charitable gifts in the same year as a Roth conversion to help offset the conversion tax.

Measuring the Value of a Roth Conversion

If you're considering a Roth conversion, you need to think about where the cash will come from to pay for the tax bill generated by the conversion.

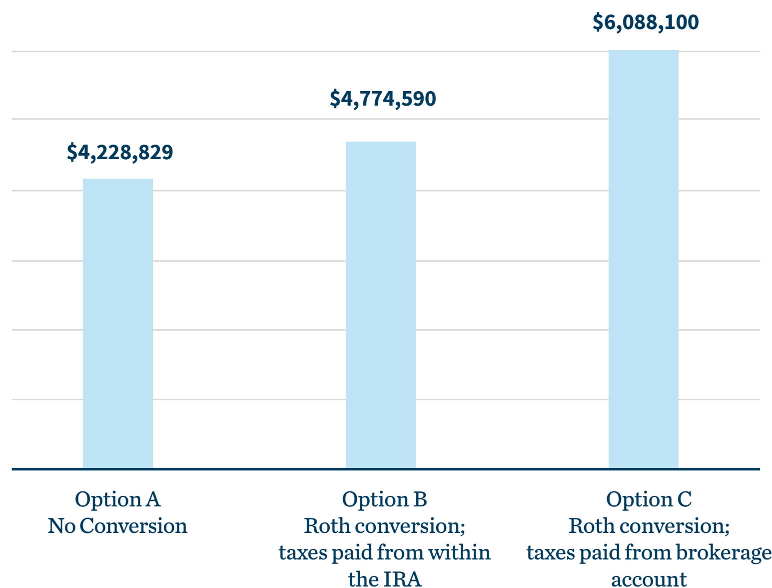
If you can pay the tax with funds outside the IRA, it will significantly increase the chances that the conversion will provide a net benefit. Conversely, if you have to liquidate assets in the IRA to pay the conversion tax, that will significantly eat into the potential benefits of a conversion.

To see how the math works, consider the example of a 65-year-old investor who has $1 million in a traditional IRA and $370,000 in a taxable brokerage account and is in the top tax bracket (37%).

The investor has three options:

• Keep the retirement account as a traditional IRA
• Convert the traditional IRA to a Roth and use funds from the IRA to pay the conversion tax
• Convert the traditional IRA to a Roth and use funds from the brokerage account to pay the conversion tax

Portfolio Value After 30 Years



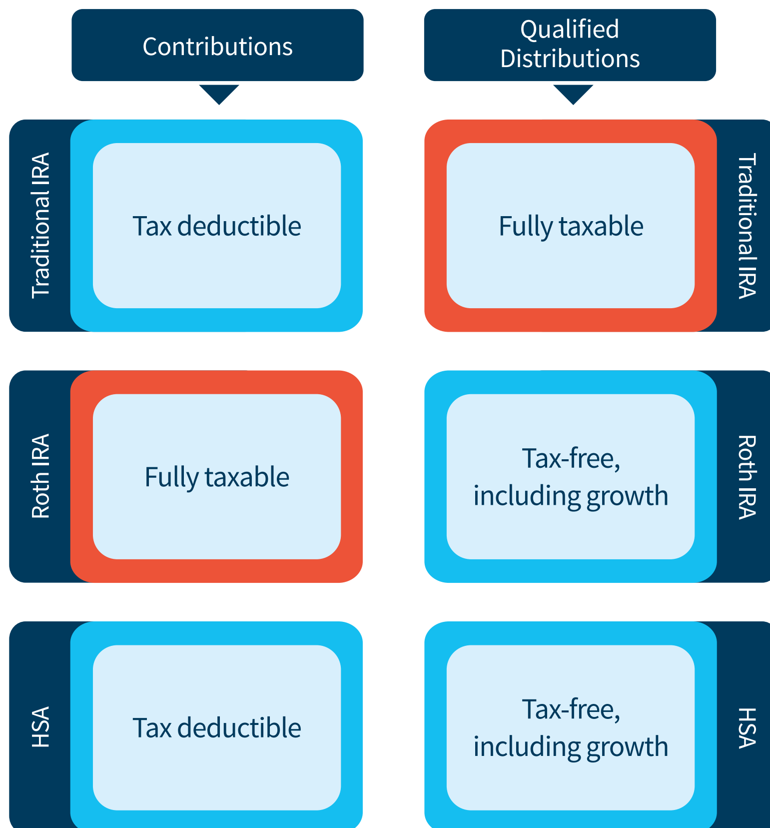
Assumes that the accounts generate annual investment returns of 6% and that, under Option A, the individual invests the after-tax proceeds from the traditional IRA's required minimum distributions into the brokerage account.

Don’t Overlook an HSA

Health savings accounts (HSAs) are among the most powerful—and most frequently overlooked—tax-savings vehicles.

If you have a high-deductible health insurance plan, you’re eligible to contribute to an HSA, which is the rare vehicle that receives a triple tax benefit—contributions are pretax, the income earned is tax-free, and withdrawals are tax-free if used for qualified medical expenses. There’s no deadline for using HSA funds, so these accounts can be an effective supplement to your retirement-savings strategy.

Taxation of Traditional IRA, Roth IRA, and HSA



HSAs – Numbers to Know for 2019

$2,700

Minimum deductible needed to qualify as a high-deductible health insurance family plan ($1,350 for individual plans)

$285,000

Average amount of after-tax dollars needed by a couple to pay for medical expenses during retirement, according to Fidelity*

$7,000

HSA contribution limits for family plans ($3,500 for individual plans); plus $1,000 catch-up contributions if you're age 55 or older

4.15.2020

Deadline for making HSA contributions that are deductible from 2019 taxes

0%

Percentage of HSA funds that expire if you don't use them by the end of the year; unlike Flexible Spending Accounts, HSAs aren't a use-it-or-lose-it proposition

* Source: Fidelity Retiree Health Care Cost Estimate, 2019

Understand the Rules for Establishing Residency in a Low-Tax State

Establishing residency in a new state isn't nearly as simple as it may seem. If you're considering moving to a state with lower tax rates, here are four things to keep in mind about residency and domicile rules.

New SALT limits change the math

Since 2018, tax payers have been limited to $10,000 in deductions for their state and local taxes (SALTs), which includes income, sales, and property tax.

Because of these limits, taxpayers will now feel the impact of their state and local taxes more acutely.

Residency rules vary by state

Residency determinations usually involve looking at taxpayers' domicile, which is their permanent home. Beyond that, residency rules vary, often significantly, across the states.

Trusts and estates have separate residency rules

Just because an individual has established residency in a state doesn't mean that his or her estate and trusts will automatically be taxed under that state's laws.

States are aggressively challenging residency

States have ramped up the frequency and severity of their residency audits and are requesting more information to corroborate residency claims, including personal calendars, telephone records, and travel itineraries.

Top Income Tax Rates by State

As the disparity in income tax rates and estate taxes has grown across states, high-net-worth individuals are increasingly looking to establish residency in states with more favorable tax environments, such as Florida and Texas.

New Hampshire and Tennessee tax only dividends and interest; they don't tax ordinary income.

Take Full Advantage of Lifetime Giving Opportunities

While estate planning gets most of the attention, lifetime gifts to loved ones have always been among the most powerful—and under-used—wealth-transfer tools.

Annual exclusion increased to $15,000

The amount that an individual can give someone each year without any gift- or estate-tax implications increased from $14,000 in 2017 to $15,000 in 2018 and 2019. This can be used for gifts to an unlimited number of recipients, and spouses can combine their exclusions.

529 plans can now be used for K-12 tuition*

Previously, 529 plans could only be used to fund college and graduate-level education expenses. But since 2018, up to $10,000 a year from these tax-advantaged accounts can be used to pay for qualified K-12 tuition.

** Varies by state*

Direct gifts to educational or medical institutions don't count against the exclusion

One way to support loved ones beyond the $15,000 annual exclusion is to pay for their tuition or medical expenses. Payments made directly to an educational or medical institution don't count against the annual exclusion.

GRATs still provide attractive opportunities

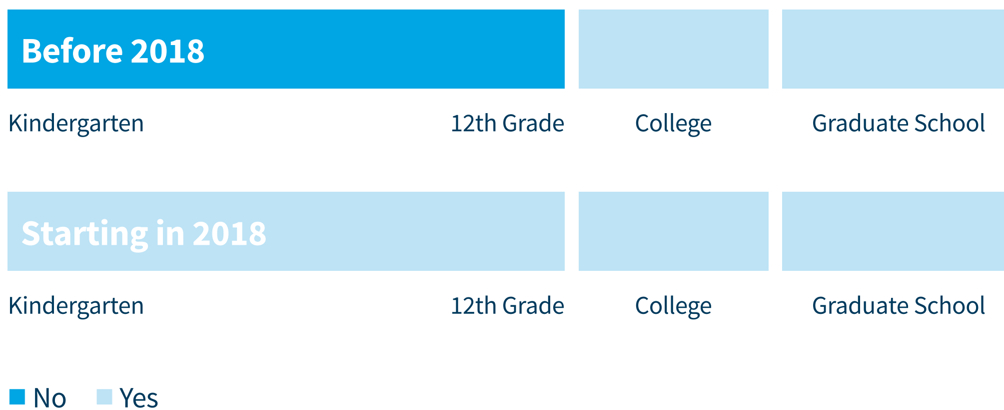
In the current low-interest-rate environment, grantor retained annuity trusts (GRATs) have become popular wealth-transfer techniques for taxpayers who want to gift future asset appreciation to heirs.

Using 529 Plans to Fund K-12 Tuition

Since 2018, up to $10,000 a year from 529 plans can be used to pay for K-12 tuition.

Previously, 529 plans could only be used to fund college and graduate-level education expenses. But since 2018, up to $10,000 a year from these tax-advantaged accounts can be used to pay for K-12 tuition. This varies by state. Also, you can front-load up to five years' worth of annual exclusions to fund a 529 plan, meaning you can contribute up to $75,000, or $150,000 if you are married, to a loved one's 529 plan in 2019. (But if you do this, you can't make additional tax-free gifts to that recipient until 2024.)

529 Plan Qualified Expenses



Review Your Estate Plan in Light of Recent Changes

In 2019, the federal estate tax exemption amount increases to $11.4 million per individual, or $22.8 million per married couple.

The slight increase in 2019 comes after the exemption amount nearly doubled in 2018. But that doesn't mean that estate planning should become an afterthought for high-net-worth families. Here are five reasons why it's important to review your estate plan in light of the recent tax-law changes:

Estate tax exemption amounts are constantly in flux

The new higher exemption amount "sunsets" after 2025 and returns to 2017 levels ($5.49 million, adjusted for inflation) in 2026.

You may still be subject to estate tax at the state level

About one-third of the states impose an estate or inheritance tax. In many states, the exemption amount and the rate do not mirror the federal levels.

Old language and structures may now be obsolete

Your wills and trusts may include language that references the amount that can be passed free of federal estate tax, which has changed drastically.

Strategies for more significant wealth-transfer may be worth considering

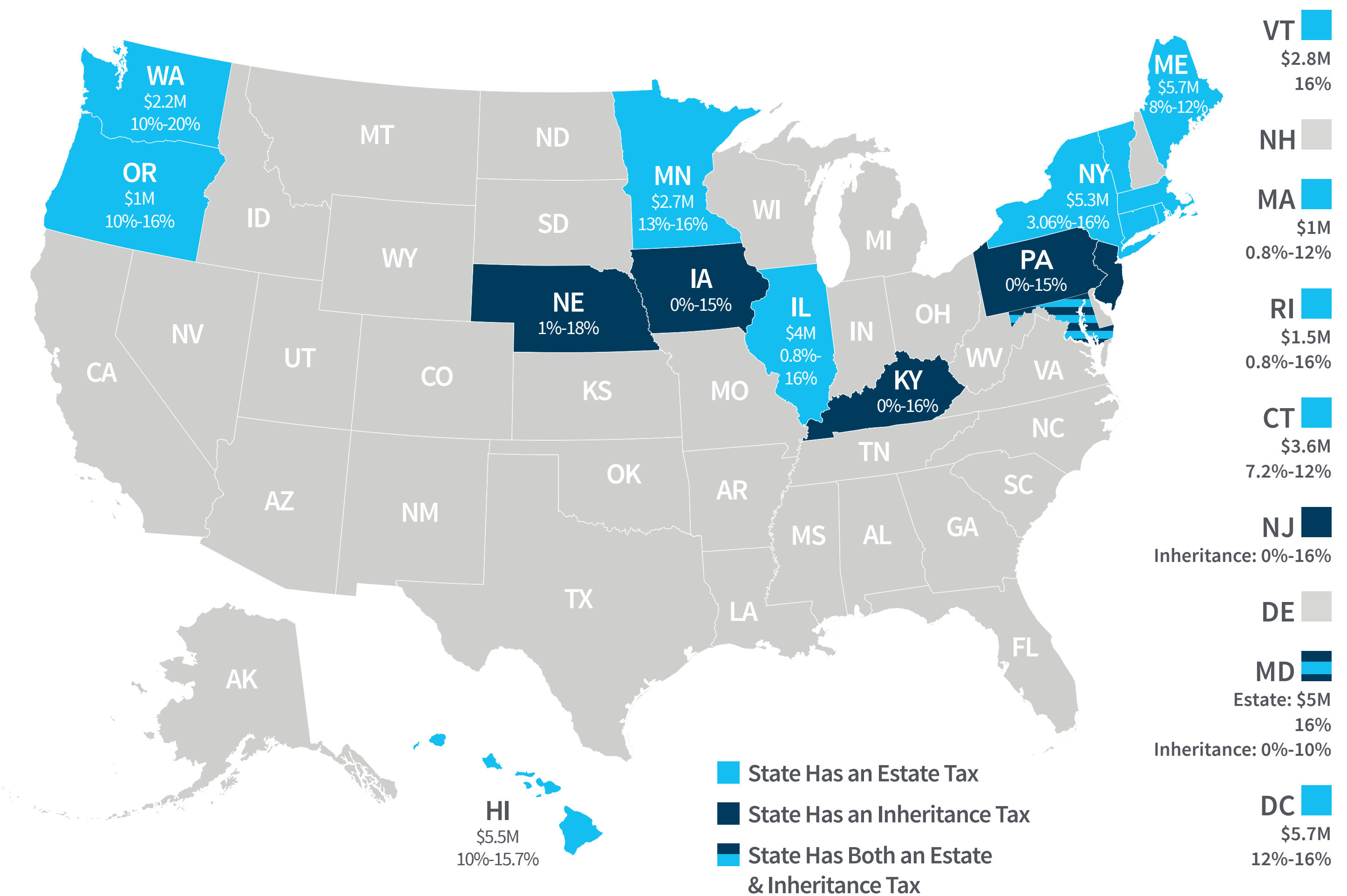
In the current market environment, families may want to consider additional wealth-transfer opportunities, including non-reciprocal spousal lifetime access trusts (SLATs) and dynasty trusts.

Estate planning is about more than just taxes

Other benefits of estate planning include protecting assets from creditors, disposing your assets in an orderly manner, planning for business succession, and planning for your incapacity.

Estate and Inheritance Taxes by State

Depending on the size of your estate and where you live, there's a chance that your estate wouldn't be taxed at the federal level but would be taxed at the state level.



Note: Exemption amounts are shown only for states with an estate tax.
Source: Tax Foundation

Review and Update Your Beneficiary Designations

The end of the year is a good time to review your beneficiary designations for your retirement plans and life insurance policies.

It's especially important to do this if you've experienced a major life event in 2019—such as getting married or divorced, having children, or losing a loved one.

In addition, if you've updated your estate plan in light of the Tax Cuts and Jobs Act or other changes to your wealth-transfer strategy, you want to make sure your beneficiary designations align with your goals for how you want your assets to be distributed upon your death.

LIFE EVENTS THAT MAY TRIGGER THE NEED TO UPDATE YOUR BENEFICIARY DESIGNATIONS

- Birth or adoption of a child
- Marriage or divorce
- Death of a loved one
- Change in health or financial status of a loved one
- Change in your health or financial status

Common Questions About Beneficiary Designations

Updating your beneficiary designations for retirement and life insurance policies is a free and relatively simple process that helps ensure that your assets are distributed efficiently and according to your wishes.

What types of accounts require beneficiary designations?

You're required to name a beneficiary for a life insurance policy and a qualified retirement account, such as an IRA, 401(k), or 403(b).

What are the advantages of naming a beneficiary?

Naming a beneficiary allows the proceeds of a retirement account or life insurance policy to pass directly to your beneficiary upon your death—thus avoiding probate, which can be a long, costly process.

Who can be a beneficiary?

For retirement plans, the beneficiary can be your spouse, a child, or anyone else you wish, as well as a charity, a trust, or your estate. For life insurance, anyone can be named as the beneficiary; you can also name a charity or a trust as the beneficiary.

Can you name more than one beneficiary?

You can name more than one person as your primary beneficiaries. If you do, your beneficiaries will receive equal shares unless you specify otherwise. You also can name a contingent beneficiary.

What is the process for updating a beneficiary designation?

Changing a beneficiary generally just involves filling out and signing a form provided by the company administering the account. Changing the beneficiary is free, and you can do it as many times as you like.

Maximize the After-Tax Value of Your Equity

Year-end tax planning is especially important for business owners and executives with equity compensation.

Opportunities to offset taxes related to monetizing equity—including selling a company, completing a dividend recapitalization, or exercising and selling stock options—can have a tremendous impact on your wealth planning.

TAX CONSIDERATIONS FOR LIQUIDITY EVENTS

- **Understand the tax character of your equity**
  One of the most important steps in planning for a liquidity event is to understand how the proceeds will be taxed. Namely, you want to know what percentage of the proceeds will be taxed as long-term capital gains (20% plus likely exposure to the 3.8% tax on investment income) vs. ordinary income (top rate of 37%).
- **Evaluate your eligibility for the QSBS exemption**
  Owners of companies whose stock qualifies for the qualified small business stock (QSBS) election can exclude up to $10 million (or up to 10 times the stock's adjusted basis, whichever is greater) of the gains on the sale.
- **Time your charitable gifts to offset gains**
  If you are philanthropically inclined, one of the best ways to reduce the tax impact of selling a business or monetizing your equity is to make charitable gifts in the same year as a liquidity event.

Business Entity Taxation: Understand the Impact of Tax Reform

In light of the numerous changes to how businesses are taxed, business owners may want to re-evaluate their entity choice.

When doing so, however, it's important to consider more than just the tax rate that applies to C corporations vs. pass-through entities. In addition to understanding the complex rules related to the pass-through deduction, you want to evaluate all of the costs and benefits of making a change from an accounting, legal, and operational perspective.

Overview of Business Tax Changes

	2017	2018-2025
C-corp tax rate	35%	21%
Pass-through entity tax rate	Taxed at owner's individual tax rate; no deduction	Taxed at owner's individual tax rate; 20% deduction for qualified businesses (generally excludes services businesses)
Interest deduction	100% deductible	Limited to 30% of EBITDA
Corporate AMT	In effect	Eliminated
Carried interest	One-year holding period	Three-year holding period

Tax Breaks for Investing in Struggling Communities

Opportunity zones offer significant tax breaks to individuals and companies that invest in these selected urban and rural areas that meet income or poverty thresholds.

Investing in areas designated as "opportunity zones" allows investors to potentially benefit from a triple tax benefit:

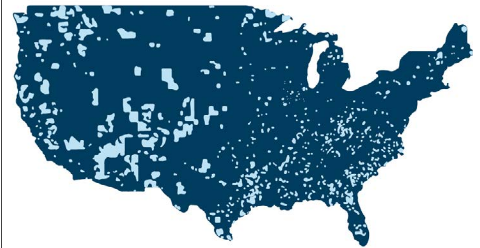
1. **A temporary deferral on capital gains:** Initially, taxpayers may defer taxation on their capital gains by reinvesting into an opportunity zone or fund within a defined period of time.

2. **A step-up in basis:** After five years, there is a 10% exclusion of the initial capital gains tax obligation (i.e., a 10% basis step-up). After seven years, the 10% benefit adds another 5% (i.e., a total 15% basis step-up). And, if the investment is held until December 31, 2026, the deferred capital gains tax on the remaining 85% would be due by April 2027.

3. **Permanent exclusion:** After 10 years, there is no capital gains tax due on the investment's appreciation beyond the original reinvested capital into an opportunity zone area or a qualified opportunity fund (i.e., capital gains tax paid only on 85% of the initial reinvested gains). This is a rarity relative to typical private equity and real estate investing.

OPPORTUNITY ZONES

More than 8,700 opportunity zones have been designated across the country, primarily in urban areas. For example, in Illinois there are 327 zones, with more than 130 in Chicago, mostly in the south and west sides of the city.



Check Your Withholding to Avoid Unpleasant Surprises

If you haven't adjusted the amount of taxes that are withheld from your paycheck in the past two years, you may get a higher-than-expected tax bill in April.

The Tax Cuts and Jobs Act changed the withholding tables that employers use to determine how much in taxes to withhold from employees' paychecks.

As a result, many taxpayers—although paying less in taxes overall in 2018—received an unpleasant surprise in April 2019 in the form of a penalty and/or a tax bill that was larger than they expected. To avoid this fate for your 2019 taxes, work with your accountant to determine whether the withholding from your paycheck should be increased. Another option may be to make estimated quarterly tax payments.

IRS Resources: You can use the IRS's online Tax Withholding Estimator to see if you are having the proper amount withheld from your paycheck. The IRS warns that the Estimator works for most people, but if you have a more complex tax situation, you should use the instructions in Publication 505, Tax Withholding and Estimated Tax (PDF).

10 Year-End Strategies to Consider in 2019

In the final month of 2019, we recommend that you evaluate these 10 strategies to see if they present opportunities to reduce your tax bill in April 2020.

Itemized Deductions
Maximize your deductions under the new tax law

Retirement Savings
(Re)consider a Roth conversion

Healthcare
Don't overlook an HSA

Domicile Planning
Understand the laws for establishing residency in a low-tax state

Gifting
Take full advantage of lifetime giving opportunities

Estate Planning
Review your estate plan in light of major tax law changes

Life Events
Review and update your beneficiary designations

Business Ownership
Maximize the after-tax value of your business equity

Opportunity Zones
Learn about the potential triple tax benefit of investing in low-income areas

Tax Withholding
Revisit your paycheck withholding amount to avoid an unpleasant surprise in April

LEARN WHAT THESE STRATEGIES MEAN FOR YOU

To learn more about how to evaluate these year-end strategies in the context of your overall wealth plan:

- Schedule a time to talk with a William Blair advisor
- Visit **http://insight.williamblair.com/strategies-for-tax-planning**
- Contact us at **pwm@williamblair.com**

Potential Legislative Changes on the Horizon

The U.S. House of Representatives passed the Setting Every Community Up for Retirement Enhancement (SECURE) Act in May 2019 with near-unanimous support. If passed into law, the SECURE Act would make numerous changes to the rules governing retirement accounts, including:

- Expand access to 401(k) plans to more part-time workers and workers at small companies
- Eliminate the restriction on contributing to an IRA after age 70 ½
- Increase the age when required minimum distributions must begin from 70 ½ to 72
- Require funds in inherited IRAs to be withdrawn within 10 years, rather than over the beneficiary's lifetime

With 2020 being a presidential election year, it will be interesting to see what stances the candidates take on the SECURE Act and other legislation affecting retirement savings, as well as taxes more broadly.

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December 2019

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