Hello, I must be going

Advisors and clients will see a flurry of coveted tax breaks come and go in the next three years. Here's how to keep track.

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- By Mark Schoeff Jr.

With less than six weeks before Americans run out of time to file their 2022 taxes, financial advisors and their clients seem fixated on what may or may not happen several tax seasons ahead.

Their worry centers on the fate of the estate tax exemption. For the moment, it is set at $12.9 million per individual in 2023. That level is double what it was before the Tax Cuts and Jobs Act became law in 2017.

Under that measure, the estate tax exemption will reset to half its current level at the end of 2025.

It's just one looming change in tax rules that has captured imaginations. The SECURE 2.0 legislation Congress approved late last year will usher in what are likely to be some popular tax policy changes — such as converting assets in 529 college savings plans to Roth individual retirement accounts — in 2024 and beyond.

“Tax season gives us a great opportunity to address the SECURE 2.0 changes,” said Joanne Burke, owner of Birch Street Financial Advisors. “After filing season, that’s our springboard into digging deeper into those provisions that are unique to [clients].”

Although SECURE 2.0 offers potential new tax strategies, it’s the looming expiration of the elevated estate tax exemption that is top of mind for advisors and their clients. One reason is that they’ve seen this movie before.

In late 2012, Congress wrestled with a raft of temporary tax cuts. They expired on Jan. 1, 2013, when the country technically went over the so-called fiscal cliff. Later that day, the Senate and House passed a bill that contained many tax and budget provisions, including one that raised the estate tax relative to the 2012 level.

This time around, advisors don’t want to be caught by surprise if a coveted exemption expires.

“Some of it is a little PTSD from 2012,” said Leslie Geller, wealth strategist at Capital Group. “That end of the year was an absolute nightmare.”

It’s not just the estate tax exemption that will snap back at the end of 2025. Other expiring tax breaks include a reset of the standard deduction, which doubled under the TCJA, the reinstatement of the unlimited state and local tax deduction, which was capped at $10,000, and the return of the top income tax rate to 39.7% from the current 37%.

“If nothing happens, then everything happens,” said Tim Steffen, director of advanced planning at Robert W. Baird & Co.

POLITICAL HOT POTATO

But it won’t be clear for years whether the 2017 tax breaks will be extended. Much depends on the political environment, which currently consists of a Democratic White House and Senate and a Republican House. Each party maintains a narrow majority in the congressional chamber it controls.

That’s not a playing field on which many tax touchdowns will be scored.

“The odds of anybody addressing this sunset under the current administration are almost zero,” Steffen said. “I don’t mean to put all that on [President] Biden. It’s also a function of the makeup of Congress. We need to wait until the next election cycle to get a real sense of what might happen.”

Even when the political dust settles after the 2024 election, the new Congress may not get around to addressing tax cuts that expire at the end of 2025 until the end of 2025. Advisors know from sometimes painful experience that the one certainty about tax policy is uncertainty.

“Everything tends to happen at the last minute,” said Jonathan Duggan, director of financial planning at Procyon Partners.

What’s occurring early is the concern about how to deal with the possibility that in a couple of years, the estate tax exemption will go back down to approximately $6 million for individuals.

“The question has come up over and over again,” Geller said.

The query can serve as a catalyst for delving into a client’s financial game plan.

“That has been a great way for advisors to connect with clients, especially the boomers and Silent Generation,” Geller said. “It’s a way to get the client interested in larger financial planning conversations.”

One topic that’s likely to come up is gifting. High-net-worth clients may want to make gifts before the end of 2025 to take advantage of the higher estate tax exemption. Beginning to parcel out an estate that way creates an opportunity for an advisor to help the client think through how to prepare the client’s children for a larger inheritance they’ll receive one day.

“You can start educating them by giving them smaller amounts,” said Jon Ekoniak, managing partner at Bordeaux Wealth Advisors. “It’s not a lot of time to change spending habits, but it’s enough time to get them started on it. We really have to understand the family dynamics.”

Aaron Hodari, managing director at Schechter Investment Advisors, said gifting is at the top of the agenda lately when he talks to clients.

“We’re being very proactive about having conversations around gifting for families with large estates,” he said.

Another popular topic that transcends tax years is the advantage of using a Roth IRA. Unlike traditional IRAs, which give retirement savers a tax deferral for putting money into the account, a Roth contribution is made with after-tax money. Those funds can grow and be withdrawn in retirement tax-free, while withdrawals from traditional IRAs are taxed.

RAISING ROTH’S PROFILE

“If you have excess cash that you would be putting into your investment account and not using for the next few years, this is a no-brainer,” Ekoniak said. “We’re educating our clients about the benefits of the after-tax contributions and mega Roth. They are embracing it.”

Burke preaches a similar gospel to her clients. “My theme is Rothification,” she said.

That’s also a theme for Congress because the Roth approach allows the government to collect revenue from retirement savings upfront rather than waiting to get tax payments when the funds are withdrawn in retirement.

Congress likes Roth “because of the positive impact on the current budget,” Burke said.

Lawmakers tapped Roths in SECURE 2.0. Under the new law, catch-up retirement contributions for people 50 and older will have to be made to Roth accounts for individuals earning more than $145,000 beginning in 2024.

Another Roth boost SECURE 2.0 introduced for 2024 is allowing the transfer to Roths of unused money in 529 college education savings plans. That policy change is adding to the popularity of 529s among high-net-worth clients.

The decision on where clients put their money always should include some thought about whether it’s a taxable or nontaxable account, said Andy Watts, vice president of planning and growth solutions at Avantax.

“What we’ve been encouraging our advisors to be thoughtful about is accumulation diversity,” Watts said. “Begin with the end in mind. When you don’t apply the lens of tax, you’re ignoring one of life’s biggest expenses other than a mortgage.”

TAX TIME, ALL THE TIME

Hodari also stresses asset location. That applies beyond retirement accounts. For instance, it affects the decision on whether to invest in municipal bonds, whose income is tax-free and good for those in a high bracket, or in taxable bonds, which are better for people in lower brackets.

“People should focus on being tax-efficient all year long,” Hodari said. “If all you’re doing is looking at investments and not discussing financial planning topics, then you’re missing the opportunity to assist your clients in a holistic fashion.”

Another thing to keep an eye on is the client’s “location” within a tax bracket, which is paramount in making strategic tax decisions, Duggan said. There are an array of tax credits and deductions that phase in and out at various levels of adjusted income.

“If you find yourself within one of these phaseouts, any contributions you make that reduce your income will not only provide you with tax savings equal to your marginal bracket but will also provide a ‘bonus’ effect due to phasing in more of those credits and deductions,” Duggan said.

It’s always a good time for tax strategizing because it’s likely that tax rates are as low today as they ever will be, especially if the 2017 breaks expire. Burke’s clients “think the tax rates almost certainly will go up,” she said. “The tax brackets are on sale, as Ed Slott would say.”

It pays for advisors to always be thinking about their clients’ tax situation, not just during tax season. For instance, several advisors said they do tax-loss harvesting whenever market volatility presents an opportunity.

“For us, tax strategies and tax advice span all year,” Ekoniak said. “We don’t want taxes to drive [an investment] decision, but we want to understand the tax implications before making a recommendation.”