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PREPARING FOR HIGHER TAXES

In his recent address to a joint session of Congress, President Joe Biden outlined a number of proposed spending initiatives intended to improve the nation's infrastructure, access to education, and health care. The president will advocate that funding for these projects come, at least in part, from tax increases focused on wealthier Americans. While the maximum marginal rate was scheduled to increase in 2026 under the current law, an accelerated increase could be effective as soon as this year, as could the adoption of proposed higher long-term capital gains taxes, an increased corporate tax rate, and significant changes to estate tax laws.

While we are closely observing developments in Congress, we encourage clients to bear in mind that months of negotiation are likely to pass before a final version of any legislation comes to a vote. Without taking drastic action in response to uncertain changes, there are a number of strategies investors might begin to consider in anticipation of potentially higher rates ahead:

1. **Build Tax Diversification.** Our most often repeated tip for clients is to build as much tax diversification into a portfolio as possible. Saving into a combination of taxable, tax-deferred, and tax-exempt accounts provides the flexibility necessary to navigate an ever-changing tax code over time. Take advantage of opportunities to save or move money into Roth IRAs, in particular.

2. **Choose Tax-Advantaged Investments.** Municipal bonds can offer tax-advantaged interest, making them an attractive alternative to corporate bonds for tax-sensitive investors. For equities, choosing exchange traded funds (ETFs) or individual stocks can potentially provide an investor more control over the timing of capital gains and losses than some other investments.

3. **Place Investments Advantageously.** When constructing a portfolio, consider holding higher turnover stock investments or high-yield corporate bonds inside of retirement accounts where income and gains are tax-deferred. Consider using taxable accounts to house municipal bond investments, low turnover stock holdings, and tax-advantaged insurance products.

4. **Give Strategically.** Lumping charitable gifts into a higher income year rather than giving equal amounts over several years can lead to more valuable itemized deductions. A charitable Donor-Advised Fund can be used to earmark funds for future charitable gifts while creating an immediate tax deduction. The benefits are compounded by funding these gifts with appreciated securities rather than cash, as the capital gains on the donated stock can be avoided altogether.

5. **Accelerate or Delay Income.** Retired clients or those with stock options or self-employment income may be able to better control the timing of income and its source. For some, accelerating a stock option exercise or Roth IRA conversion before tax rates increase may be advantageous, whereas others might benefit from spreading a capital gain over multiple years or deferring consulting income through a customized self-employed retirement plan. Work with your tax advisor to determine the optimal timing of certain income items in your situation.

Tax planning in the face of ongoing legislative changes can be a complex challenge. An investor's best approach begins with creating flexibility and working with a thoughtful, informed team of advisors to navigate each year's challenges and opportunities.

Contact us to discuss how these concepts may relate to your personal situation.

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