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After-Tax Advisor | Elections

Uncle Sam Can Provide Certainty in Uncertain Times

By: Eaton Vance | April 17, 2024

Is the uncertainty about tax reform resulting in tough conversations with existing and prospective clients? After-tax advisors can help clients navigate the uncertainty and provide clarity with a tax tenet: Uncle Sam can be a coach, not simply a referee.

While referees enforce the rules and penalize players who don't follow them, coaches instruct players on how to apply the rules to win the game. Seeing Uncle Sam's value as a coach requires recognizing the tax code for what it is: A set of rules designed to encourage some behaviors and discourage others.

In times of financial and political uncertainty, it's important to help clients focus on what's in their control. Let's explore three ways Uncle Sam can help clients take control of their tax bill, regardless of which political party is responsible for shaping the future of the tax code.

Income Avoidance

Avoiding taxable income is the easiest way for clients to lower their potential tax burden and can often be accomplished using a municipal bond strategy. Clients should evaluate yields on a tax-equivalent basis and account for the after-tax income that could be earned from a taxable bond.

Income Offsetting

Clients who itemize their deductions could also offset a portion of their income with charitable giving. Clients don't have to part with an asset completely to avail themselves of this strategy. Split interest giving vehicles, like charitable remainder trusts and pooled income funds, allow clients to retain an income stream for the contributed assets while receiving an upfront charitable deduction for the actuarial value of what will ultimately pass to charity.

Tax-loss harvesting—the process of harvesting losses to offset taxable gains—is another popular offsetting/deferral technique. Many clients think tax-loss harvesting is something they should only do in December to offset that year's gains. Remind them that they can harvest losses year round and carry unused losses forward into future tax years.

Income Deferral

Clients with large, concentrated positions who want to diversify yet also have large built-in capital gains may be able to use an exchange fund to diversify and defer their tax consequences. If certain conditions are met, such as minimum wealth requirements and acceptance of the stock by a private offering, they could exchange the concentrated position for shares of a broadly diversified portfolio in a non-taxable private partnership transaction. Basis step-up on death would defer taxes until a future sale or avoided altogether.

Another straightforward option is to delay income recognition. This could be as simple as choosing to delay a taxable event, like the sale of assets or the exercise of stock options.

Bottom Line: With concerns about tax reform growing as the election comes closer, inspire proactive decision making by reframing Uncle Sam as a coach and the tax code as a rule book to use to their benefit.

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