2021
Year-End Tax Planning

"It's like déjá vu all over again."

– New York Yankee great, Yogi Berra

As hard as it is to believe, another round of tax changes appear to be coming. And as Congress debates possible tax changes, taxpayers are left wondering what should I be expecting and what should I be doing? Without a crystal ball, it is difficult to know for sure. However, to help, we have put together this piece to highlight strategies that are worth considering.

CHANGES ARE COMING?

The House has laid out its proposal, the Senate is discussing modifications, the President appears ready to sign; however, will anything actually get done? It is anyone's guess. Here are some of the items that have been discussed and that we are keeping our eye on:

- Increased individual top income tax rate from 37% to 39.6%
- Increased top capital gains tax rate from 20% to 25%
- Expansion of the Net Investment Income Tax (3.8% surtax) to include income from trades and businesses
- 3.8% surtax on individual taxpayers with adjusted gross income exceeding $10,000,000
- Reduction of estate and gift tax exemptions to $5,000,000 (plus inflation)
- Changes to grantor trust tax rules
- Elimination or modification of gift and estate tax valuation discounts
- Increased Corporate tax rate from 21% to 26.5% for businesses with income exceeding $5,000,000
- Modifications to IRA distriubtion rules including required distributions from "Mega IRAs"

INCOME TAX CONSIDERATIONS

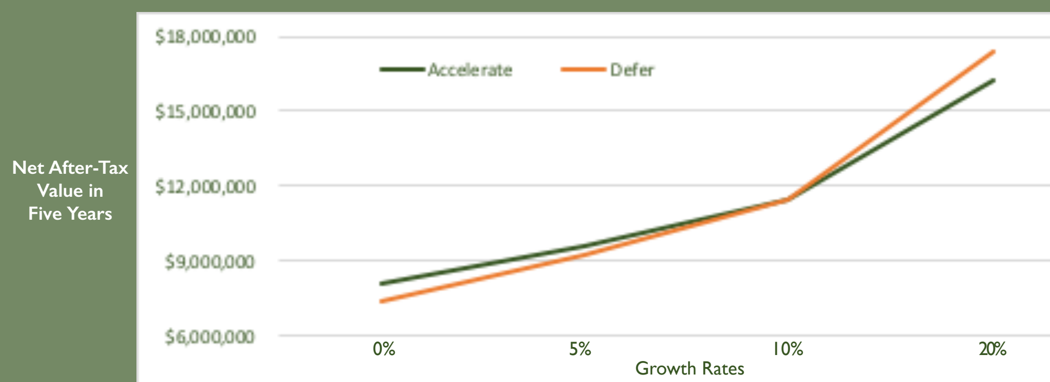
Accelerating Income/Deferring Deductions

Under current proposals, high-income taxpayers would face increased taxes (see "Changes are coming?"). Effectively, assuming all the proposed changes go through, a taxpayer would end up with top marginal rates of 47.2% on ordinary income and 32.6% on capital gains. Combined with state tax rates, a taxpayer in a high tax state, like California or New York, could end up facing marginal ordinary rates above 58% and marginal capital gains rates above 43%. This raises the question, should I accelerate income into 2021?

A common strategy in tax planning is deferring, where possible and permissible, events that will generate taxes. There are times when the opposite makes sense. The decision, which hinges on individual circumstances, is now also dependent on difficult-to-predict factors including the magnitude of any legislation passing and if changes pass when will they be effective. Two such decisions, accelerating capital gains and converting IRAs, fall into this category.

DOES ACCELERATING INCOME REALLY PAY OFF?

When combining proposed ordinary and capital gains rate changes, along with other surtaxes and expansion of the net investment income tax, top ordinary rates could increase by more than 10% and capital gains rates by more than 8%. Do these rate changes really dictate that taxpayers should accelerate income into 2021? The answer is possibly, but analysis suggests maybe not.



Assumptions: stock with fair market value of $10,000,000, basis of $2,000,000, current capital gains rate of 23.8% and future rate of 32.6% .

In addition to accelerating income, another consideration is delaying payment of items that might be treated as a deduction until 2022. This would include charitable contributions, taxes and other items treated as miscellaneous itemized deductions. If the tax proposals go into effect as currently designed, such deductions might be more valuable in 2022.

THE RETURN OF THE STATE AND LOCAL TAX DEDUCTION?

One item in The Tax Cuts and Jobs Act of 2017 that significantly affected high-income taxpayers, and especially those in high-tax states, was the implementation of a $10,000 state and local tax deduction cap for federal income tax purposes. In response, a number of states have looked for workarounds to provide taxpayers with relief. The most popular has been the so called "pass-through" entities tax workaround that is currently effective in nineteen states. Generally, under these laws, it is possible to structure certain income derived from LLCs, partnerships and other passthroughs, so that the state taxes associated with it becomes fully deductible by the owner. The laws among the states providing for this are not uniform and have varying effective dates.

Charitable Contributions

Charitable contributions made during the year might provide an income tax deduction useable in the current year or carriable forward for use in future years. The value of the deduction and the amount that can be taken is dependent on several factors including the type of asset contributed and the status of the recipient charity. In addition, a taxpayer's Adjusted Gross Income ("AGI")—basically income one receives/earns modified by certain tax adjustments – is relevant in determining the availability of a charitable deduction.

CHARITABLE CONTRIBUTIONS + AGI
A symbiotic relationship!

An example of how the AGI limitation works may provide some clarity:

Tony Taxpayer contributes $1,500,000 of cash to a public charity when his AGI is $3,000,000. As a gift of cash to a public charity, Tony can deduct the contribution up to 100% of his AGI, allowing him to deduct the entire amount in 2021. Now, assume the same facts except Tony's contribution was to his private, non-operating foundation. Tony is limited to a deduction equal to 30% of his AGI, or $900,000, with $600,000 of the contribution not deductible in 2021 and instead carried forward up to five years to be deducted in future years.

The following tables summarize the rules that apply to charitable contributions (special rules for items such as tangible personal property and closely held stock might apply):

Contributions to Public Charities (includes donor advised funds and private operating foundations)

Type of Property	Deductible Amount	AGI Limit
Cash	Amount of cash	100%/60%
Short-term capital gain and ordinary income property	Basis	50%
Long-term capital gain property	Fair Market Value	30%
Tangible property used by the charity in its exempt function	Fair Market Value	30%
Tangible property NOT used by the charity in its exempt function	Basis	50%

Contributions to Non-Public Charities (i.e., private non-operating foundations)

Type of Property	Deductible Amount	AGI Limit
Cash	Amount of cash	30%
Short-term capital gain and ordinary income property	Basis	20%
Long-term capital gain property	Basis unless publicly traded stock, then Fair Market Value	30%
Tangible property used by the charity in its exempt function	Basis	20%
Tangible property NOT used by the charity in its exempt function	Basis	20%

If a current year charitable deduction is desired, it is important to make sure certain timing requirements are met. In general, charitable contributions will be recognized the day the charity physically receives the donation. The most significant exception is when a contribution is mailed. In that case, the contribution will generally be treated as contributed at the time of postmark. Note: if sent via a private carrier (e.g., FedEx or UPS) instead of the United States Postal Service, it is the date of delivery and not the date of postmark that dictates when the contribution is treated as completed for deduction purposes.

Another way to fund charitable giving is to use IRA assets. IRA owners can distribute up to $100,000 annually from an IRA directly to a qualifying charity. The amount distributed counts towards the current year's required minimum distribution ("RMD"). The donated amount will not be included in the income of the IRA owner, and therefore the gift from the IRA will not be considered a taxable distribution.

Harvesting Losses

December is typically when portfolios are reviewed to determine what positions might generate tax losses if sold. Although a loss itself is not good, harvesting losses to offset gains elsewhere in a portfolio might be beneficial. There are a couple of rules to keep in mind when harvesting losses:

Netting rules: Netting rules ensure that the character of a gain (i.e., long-term or short-term) is generally matched with the character of a loss. Short-term is when an asset is held for less than one year, long-term is when an asset is held for one year or more. The rules work as follows:

- Short-term losses are first applied against short-term gains.
- Long-term losses are first applied against long-term gains.
- If, after netting short-term losses and gains and long-term losses and gains, excess losses and gains remain, you apply the losses against remaining gains regardless of character, and you can net against short-term gains first.
- If an excess loss still exists, $3,000 of the loss can be taken against ordinary income with any remaining loss carried forward indefinitely to be used in subsequent years.

Wash sale rule: If a security is sold at a loss and then a "substantially identical security" is acquired either within 30 days before or 30 days after the sale, the loss will be disallowed. The disallowed loss is added to the basis of the acquired security and can be taken upon the subsequent sale as long as the wash sale rule is not again violated. Many transactions may cause the wash sale rule to apply; including exercising an option to acquire a stock, sale/purchase in an IRA, sale/purchase in a grantor trust, or short sales.

CRYPTOCURRENCY

The IRS knows what it is!

The rise of cryptocurrency in the media, in use and in investments has been explosive. Such has not escaped the attention of the IRS. Since 2019 taxpayers have been required to report all dispositions of virtual assets. In addition, the recent tax proposals contain several cryptocurrency provisions including the application of the wash sale rules to cryptocurrency transactions.

With the possibility of higher tax rates in 2022, taxpayers may want to consider harvesting losses in 2022 rather than 2021, depending on personal circumstances.

ESTABLISHING RETIREMENT PLANS

Retirement plans, such as IRAs and 401(k)s, can provide significant tax benefits. Certain rules apply regarding when such plans must be established and funded. The following table summarizes the important dates for plan establishment and funding for the most common plans:

Type of Plan	Establishment Deadline	Funding Deadline
401K	12/31 of current year	12/31 of current year
IRA	4/15 of next year	4/15 of next year
Roth IRA	4/15 of next year	4/15 of next year
SEP IRA	4/15 of next year	4/15 of next year

Retirement Plan Distributions

In 2020 there was a "RMD holiday" where the required distributions were waived for all taxpayers. However, that waiver did not extend into 2021 and instead all taxpayers 72 years old and older, subject to some exceptions, must take distributions from qualified plans including IRAs and 401(k)s. In addition, custodians of plans are required to provide a calculation of what the RMD is for the year. There are several nuances to the rules that you should be aware of:

- RMDs can be taken in either the year the participant becomes 72, or by April 1 of the next calendar year.
- If the participant is still working and has a 401(k) with his/her current employer, distributions from that 401(k) do not need to begin until they retire, even if they have already turned 72.
- RMDs do not apply to Roth IRAs unless they are inherited (see below).

New life expectancy calculations coming.

The IRS will issue a new table for 2022 increasing the life expectancy factors used to determine RMD amounts. The result for taxpayers will be smaller RMD requirements going forward.

Rules applying to inherited IRAs

For the inheritor of an IRA, the distribution rules are different and dependent on (a) the age of the decedent participant and (b) the "type" of beneficiary (i.e. the inheritor of the plan).

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- ***Spousal beneficiary:*** a spousal beneficiary has the option either to roll the deceased spouse's IRA into his or her own IRA or transfer the assets into an Inherited IRA. If rolled over into the beneficiary's IRA, distributions must begin under the rules for that spouse's (the beneficiary's) IRA. If rolled into an inherited IRA, distributions must begin when the decedent would have attained age 72 and are based on the age of the beneficiary spouse.

- ***Non-spouse beneficiary:*** IRAs inherited by non-spouses must be fully distributed, subject to some exceptions, within a 10-year period following the death of the participant. The 10-year rule applies to individuals and trust beneficiaries, as well as where no beneficiary is named.

Roth IRAs

There are no required distributions from Roth IRAs for participants when a distribution is taken; they are income tax-free. However, like traditional IRAs inherited by non-spouses, inherited Roth IRAs are subject to the same 10-year rule. Basically, subject to minor exceptions, the entire Roth must be distributed within 10-years of the death of the participant.

OPPORTUNITY ZONE INVESTMENTS

A diminished opportunity?

One of the main benefits of Opportunity Zone investments was the permament elimination of 15% of the rollover gain. After 2021, this reduction, which had previously been reduced to 5%, will not longer be available. Two of the other benefits do remain intact: deferral of rollover capital gains and permanent elimination of tax on any post-investment gain. However, overall, benefits are diminished.

ESTATE PLANNING CONSIDERATIONS

Utilize Lifetime Exemption

Every taxpayer has exemptions from gift, estate, and generation skipping transfer taxes. For 2021 these exemptions are $11,700,000 and are scheduled to stay at this level, plus inflation adjustments, until January 1, 2026. Under some current proposals, these exemptions would be decreased to $5,000,000, or possibly lower. There is discussion that the reduction will be effective sometime in 2021, but more likely as of January 1, 2022. Therefore, for taxpayers who are considering making major gifts to heirs, consideration should be given to do so by December 31, 2021.

Annual Exclusion Gifts

Every taxpayer has an annual exclusion from gift taxes that enables them to make gifts of up to $15,000 to as many individuals (or qualifying trusts) as they want. This is an annual exclusion and any amount unused in a particular year is "lost" (cannot be carried over to future years). For a gift to be treated as made in 2021, it must be completed in 2021:

- If writing a check, the gift is not complete until the check clears.
- A cashier's check, like cash, is complete upon delivery.
- Gifts of stock are complete when the stock is registered in the recipient's name or in the case of an endorsed stock certificate, once physically received by the recipient.

Review Estate Plans

As part of an annual financial review it is prudent to revisit your estate plans. Review the decision-makers (e.g., executors, trustees, guardians, health care decision-makers, powers of attorney, etc.), beneficiaries, and distribution provisions. This might be particularly relevant with possible upcoming changes to the estate tax.

Refinance Intra-Family Loans

The use of loans between family members, trusts, and family entities is very common and can be very beneficial. These loans need to be set at the applicable federal rate ("AFR") which is "leading rate" set by the IRS. This rate continues to be at historical lows creating an opportunity to review such outstanding loans and consider refinancing them.

Don't forget...

As a child, we all heard the continual "don't forget" statements by our mothers (don't forget to wash your hands, don't forget to use your manners, etc.). We would be well served to apply our mother's advice to insurance. Don't forget about it and make sure it is proactively managed. As such, we recommend that taxpayers work with their advisors to review all their insurance including life insurance, property, casualty and liability insurance at least annually.

Tax planning, while always complicated, is even more so with the uncertainty as to what lies ahead. This makes it even more important for taxpayers to be constantly reviewing their situation and work with advisors that can proactively assist them.

Planning Advisory Services, LLC
Santa Barbara, California ~ Naples, Florida ~ New York, New York
alexander.popovich@planning-advisory-services.com