



## YEAR-END TAX PLANNING 2021

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DECEMBER 8, 2021

Last year at this time we were faced with uncertainty regarding potential tax-related changes, preparing for potentially massive changes to the income and estate tax rules. The proposed tax changes ultimately became part of a bill called The Build Back Better Act ("BBBA"). Throughout the summer and into fall of this year, it looked like many of these changes were still in play. However, on November 19th, the House of Representatives passed a stripped-down version of the bill, removing many of the originally proposed tax changes. The bill now heads to the Senate, where it will likely be tweaked, but it is unlikely that any of the major tax increases not incorporated in the BBBA will be reintroduced.

In most cases, our mantra of deferring income and accelerating deductions continues to hold true today, but there are a few potential changes in the BBBA that, if passed, could encourage taxpayers to act before year end. Let's take a look at some of the most impactful provisions currently in the bill.

### Certain considerations as we approach year-end

- ▶ **For high earners:** The BBBA proposes a new five percent tax on individuals and married couples with modified adjusted gross income in excess of \$10 million. There is an additional three percent tax on modified adjusted gross income over \$25 million. Taxpayers who are selling their businesses or otherwise generating large amounts of income may want to finalize their transactions before year-end to avoid getting hit with the surtax. One quirk of the new surtax is that because it is based on modified adjusted gross income, itemized deductions like charitable contributions will not reduce the tax.
- ▶ **For business owners:** Since coming into effect in 2013, the net investment income tax rules have exempted passthrough income, even when not subject to self-employment taxes, from the 3.8 percent tax when the owners materially participated in the business. Most commonly, this applied to S-corporation shareholders. The BBBA would expand the 3.8 percent tax to include these S-corporation shareholders, as well as limited partners and LLC members, whose income exceeds \$500,000 if filing jointly (\$400,000 for single filers) to the extent the income is not already subject to SE tax. It may make sense for some business owners to accelerate income into 2021 and defer expenses until 2022 to take advantage of the current law and minimize the impact of the forthcoming additional tax.
- ▶ **For qualified small business stock (QSBS) holders:** The BBBA would eliminate the 75% and 100% exclusion of gain from the sale of stock for taxpayers with adjusted gross income over \$400,000. In the current bill, this change is scheduled to be retroactive to September 13, 2021. QSBS owners who have met all of the holding-period requirements should track the bill's progress in the Senate. If the effective date is pushed back, it may make sense to realize QSBS gains before the end of the year.
- ▶ **For those considering purchasing a car:** The BBBA would extend and expand the credit for plug-in vehicles. The base credit for qualifying cars would increase to \$12,500, and the current limit on the number of qualifying vehicles produced by a specific manufacturer would be lifted. A new credit of up to \$2,500 would be introduced for the purchase of a pre-owned electric vehicle. Taxpayers thinking about buying an electric vehicle should be on the alert to see if this credit survives any Senate changes.
- ▶ **For those owning cryptocurrencies:** The BBBA would enact significant changes to the current wash sale rules. The BBBA would expand the wash sale rules to include foreign currencies, commodities, and digital assets, including cryptocurrencies. Taxpayers who own cryptocurrency, such as bitcoin, should speak with their advisors to understand their options before year-end.

## Deductions still matter, and soon they may matter more

The Tax Cuts and Jobs Act lowered income tax rates and significantly increased the standard deduction, but one change many taxpayers are still salty about is the change to the state and local income tax (SALT) deduction. Currently, the SALT deduction is limited to \$10,000, meaning many taxpayers get little or no tax benefit for their real estate, excise, and other state taxes paid. The SALT cap in combination with the increased standard deduction means most taxpayers are no longer itemizing unless they have substantial mortgage interest or charitable contributions.

The BBBA proposes increasing the SALT cap from \$10,000 up to \$80,000 retroactive to 2021. This means that many taxpayers would be able to itemize once again. Taxpayers who are considering making charitable contributions should examine whether or not they expect to itemize. If it is likely that they will take the standard deduction, it would be better to bunch multiple years' worth of contributions into one year. Setting up and funding a donor advised fund is a great way to bunch several years of charitable contributions while still controlling the timing of the donations to charities. Keep in mind that there was an "above the line" charitable donation deduction of \$300 available, which has doubled in 2021 to \$600 for non-itemizing taxpayers who are married filing jointly.

While it is unclear whether the SALT cap increase will ultimately be passed, many states have enacted new laws in an attempt to circumvent the current \$10,000 limit. Traditionally, passthrough entities like S-corporations and partnerships have passed all their income and deductions directly through to their owners. This means there is no tax due at the entity level. Some states, including California, Massachusetts, and New York, have created elections whereby passthroughs can opt into paying entity-level taxes. By having a tax at the entity level, the tax can be taken as a business deduction rather than as an itemized deduction limited to \$10,000. These laws are brand new, and each state is unique. Given the complexity of these new rules, if you are the owner of a passthrough entity we recommend that you discuss your situation with your advisor.

After being suspended for 2020, Required Minimum Distributions (RMDs) are back. The SECURE Act increased the RMD age from 70½ to 72. Anyone age 72 or older as of December 31, 2021 must take an RMD by year-end to avoid a 50% penalty. If it is your first RMD you can delay making the distribution until April 1, 2022. Taxpayers taking RMDs who are charitably inclined should consider making a Qualified Charitable Distribution. Up to \$100,000 can be distributed directly to a qualified charity. This distribution amount is excluded from taxable income while also satisfying the RMD requirement.

## Remember to plan for the future

While year-end tax planning is often focused on immediate savings, it is important to keep in mind the importance of long-term strategies. Heading into 2021, many were bracing for massive changes to the estate planning landscape. Some of the proposed changes were a reduction in the lifetime gift and estate exemption and the elimination of the basis step-up. The version of the BBBA that passed the House contained none of these major changes. For 2021, the lifetime federal estate and gift tax exemption is \$11,700,000 and is scheduled to jump to \$12,060,000 next year. By taking advantage of the portability rules, a married couple can shield over \$23 million from federal gift and estate taxes. Here are some other longer-term strategies to be aware of:

- ▶ **Give to future generations:** The annual gift exclusion amount remains at \$15,000 per person in 2021 and is set to increase to \$16,000 in 2022. A married couple can gift \$30,000 per year to as many individuals as they want without using any of their lifetime gift exclusion. Keep in mind that medical expenses and tuition payments made directly to an institution on behalf of family members do not eat into the lifetime exemption.
- ▶ **Plan for retirement:** The version of the BBBA that passed the House eliminates after-tax (i.e., backdoor and mega backdoor) Roth conversions beginning in 2022. Pre-tax savings in a traditional deductible IRA or 401(k) account can still be converted until 2032 when a future income limitation would apply. Converting a pre-tax retirement account into a Roth IRA means the converted amounts will be taxed now at ordinary rates, which may or may not make sense for a particular taxpayer. But if converted into a Roth IRA, the funds in question receive the double benefit of growing tax-free and not triggering taxes upon distribution at a later date.
- ▶ **Save money for education:** Contributing to a 529 plan is a good way to let your college savings grow tax free. If the funds are used for qualified education expenses there will be no tax when withdrawn. These plans are even more flexible now that \$10,000 per year can be used to pay for K-12 tuition. Be aware that not every state has conformed with the federal rules, so a K-12 distribution may still be taxable at the state level.

We will continue to monitor the progress of the BBBA in Washington. It is important to remember that each taxpayer's situation is different. You should contact your wealth or tax advisor to develop an appropriate plan tailored to your individual circumstances.

## 2021 Tax Rates

| Marginal Rate | Single               | Married Filing Joint |
|---------------|----------------------|----------------------|
| 10%           | \$0 - \$9,950        | \$0 - \$19,900       |
| 12%           | \$9,951 - \$40,525   | \$19,901-\$81,050    |
| 22%           | \$40,526 - \$86,375  | \$81,051-\$172,750   |
| 24%           | \$86,376 - \$164,925 | \$172,751-\$329,850  |
| 32%           | \$164,926-\$209,425  | \$329,851-\$418,850  |
| 35%           | \$209,426-\$523,600  | \$418,851-\$628,300  |
| 37%           | > \$523,600          | > \$628,300          |

## Retirement Contribution Limits

| Type of Account   | 2021 Contribution Limit                    | 2022 Contribution Limit                    |
|---|--|--|
| Individual Retirement Account (IRA)                             | \$6,000 + \$1,000 catch up if over age 50  | \$6,000 + \$1,000 catch up if over age 50  |
| Roth IRA  | \$6,000 + \$1,000 catch up if over age 50  | \$6,000 + \$1,000 catch up if over age 50  |
| 401(k), 403(b) and most 457 plans                               | \$19,500 + \$6,500 catch up if over age 50 | \$20,500 + \$6,500 catch up if over age 50 |
| SEP IRA and Solo 401(k)   | \$58,000 up to \$290K of comp              | \$61,000 up to \$305K of comp              |
| SIMPLE IRA  | \$13,500                                   | \$14,000                                   |
| Defined Benefit Plans   | Annual Benefit \$230,000                   | Annual Benefit \$245,000                   |
| Overall Qualified Plan Contribution Limit (Employer + Employee) | \$58,000                                   | \$61,000                                   |

SOURCES: <https://www.irs.gov/retirement-plans/cola-increases-for-dollar-limitations-on-benefits-and-contributions>  
<https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2021>

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