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Wealth Management

Moves to Consider in Conjunction With Year-End

December 2021

Year-end planning could prove more challenging in 2021, given continued uncertainty over tax reform. The social safety net and climate bill known as the "Build Back Better Act" (BBBA) has been tied up in negotiations for months, given competing priorities on when to pass the infrastructure bill versus the spending bill. While the infrastructure bill passed and has since been signed into law by President Biden, the outlook for BBBA remains in question, albeit with some recent traction.

Each taxpayer's planning opportunities are specific to their individual circumstances and should be reviewed in conjunction with the November 3, 2021 proposed tax legislation included in the Build Back Better Act. This proposal does not change the current federal income or long-term capital gain rates but would impose a 5% surcharge on modified adjusted gross income that exceeds $10 million for most individuals, $200,000 for estates and trusts and $5 million for married individuals filing separately. An additional 3% surcharge would be imposed on modified adjusted gross income in excess of $25 million for most individuals, $500,000 for estates and trusts and $12.5 million for married individuals filing separately.

The proposal would be effective for taxable years beginning after December 31, 2021. The long-standing strategies of deferring income and/or accelerating deductions to lower taxes will continue to be effective for many taxpayers; however, at times, accelerating income or deferring deductions may allow a taxpayer to maximize the benefit of a lower tax bracket. This process can be helpful in managing annuity and retirement income to minimize taxes over time. Also consider harvesting long-term capital gains if you can benefit from the 0% or 15% capital gain rates and/or stay below your NIIT threshold.

With the possibility that tax reform could be passed just prior to year-end (although likely in early 2022), taxpayers should engage their team of trusted advisors to determine whether planning strategies (such as those outlined below) might yield meaningful tax savings. Please do not hesitate to contact us with questions or for further discussion.

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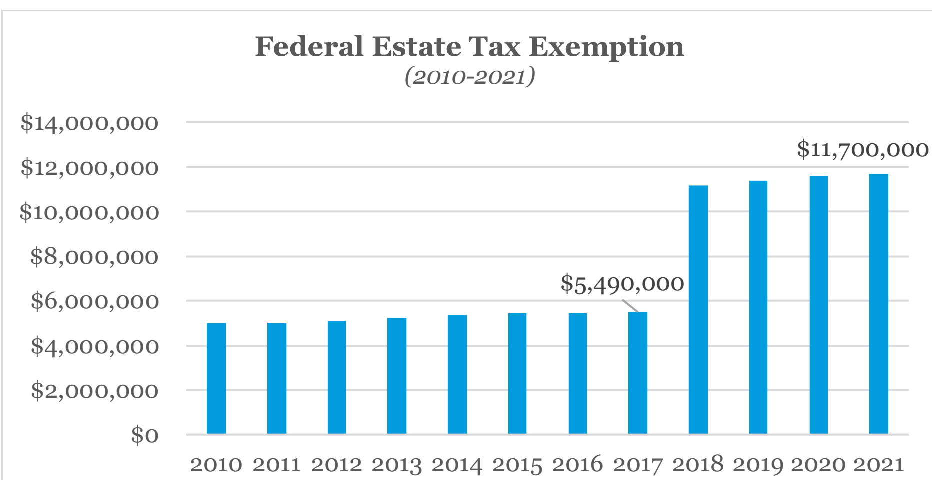
Utilize the Lifetime Gift Tax Exemption

The Tax Cuts and Jobs Act (TCJA), which passed in December 2017, approximately doubled the estate exemption – from $5.49 million per person in 2017 to $11.18 million per person in 2018. For 2021, the lifetime gifting exemption currently stands at $11.70 million per person, with a top federal estate tax rate of 40 percent. The increased exemption amounts, under TCJA, are scheduled to run through 2025, after which the basic exclusion amount (BEA) is set to revert to the 2017 level of $5 million per person, plus inflation adjustments.

President Biden previously expressed a desire to return the estate exemption to 'historic norms,' which led tax experts to assume a decrease in the per-person exemption to $3.5 million or $5 million, plus inflation adjustments. In September, the House Ways and Means Committee released its initial draft of legislation, which would have reduced the exemption to $5 million per person, plus inflation adjustments, beginning as of 2022.

The House's recently passed version of BBBA ***did not*** pursue changes to the estate exemption or to existing grantor trust rules. The Senate could choose to address these items in its draft, though that seems unlikely given the even divide in the Senate and earlier pushback from Senator Sinema on tax increases for individual taxpayers.

While the elevated exemption might remain in place through 2025, high net worth individuals should not lose perspective of the unique planning opportunity to get additional assets out of one's taxable estate.



Source: The Tax Foundation

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The lifetime gifting exemption is $11.7 million per person in 2021 and increases to $12.06 million per person (with a top federal estate tax rate of 40 percent), the increased exemption in 2022 would allow a married couple to an additional $720,000 if they had already reached the 2021 maximum. The Treasury Department and IRS issued final regulations in November 2019 clarifying that taxpayers taking advantage of the increased exemption amounts would not be subject to a claw back, should the exemption amount decrease from current levels.

High net worth individuals should evaluate current assets and assess how much might be needed for their remaining lifetime, with consideration to gift 'excess assets' to loved ones. Depending on the size of an outright gift, estate planning which incorporates making gifts to trusts may be advisable to provide parameters or safeguards for the intended beneficiaries.

Individuals who are likely to one day have a taxable estate should also consider direct payments (to the educational/medical provider) for tuition and medical expenses, which do not constitute gifts, as well as annual exclusion gifts ($15,000 for 2021 increasing to $16,000 for 2022 to each donee). Such gifts can be an effective strategy for further reducing the size of a taxable estate.

Keep in mind that any gifts in excess of the annual gift tax exclusion per donee should be properly recorded on a gift tax return.

Accelerate Charitable Donations

Charitably inclined individuals who might reasonably expect to be in a lower tax bracket next year should consider accelerating charitable gifts prior to year-end. A common example of this might be an individual who retired earlier this year and who will, consequently, have much lower taxable income next year. Another example would be an individual who had a much higher-than-normal income year. In such instances, it may be beneficial to group multiple years' worth of gifting into a single tax year while income is subject to a higher tax bracket.

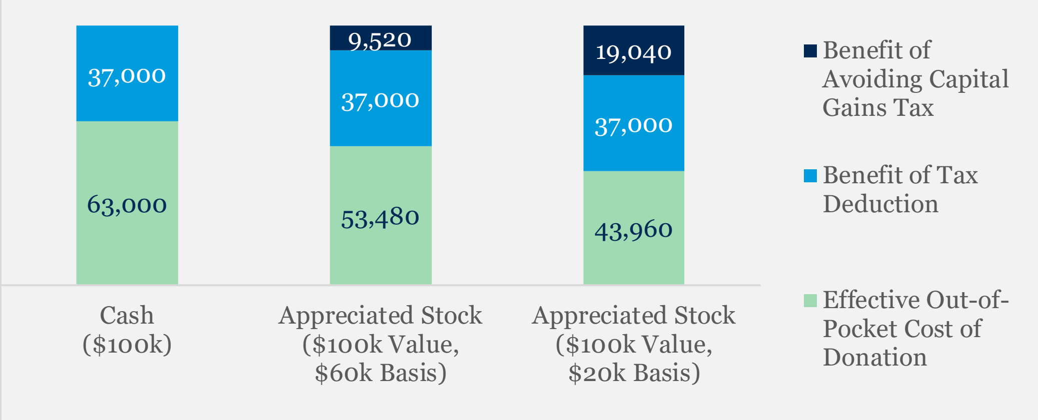
Also, many provisions of the CARES Act (from 2020) were extended to 2021. Among the special provisions, individuals may deduct up to 100 percent of AGI for 2021 charitable gifts for cash donations made directly to a public charity (not to a donor-advised fund).

This enhanced deduction (versus the typical 60 percent deduction for cash donations) may provide an additional planning opportunity.

Gifting Long-Term Appreciated Securities Rather than Cash

With equity markets near all-time highs, investors with taxable accounts may hold highly appreciated equity positions. From a tax planning standpoint, gifting long-term appreciated securities is a very efficient charitable-giving strategy as the charity receives the same economic benefit as a cash donation, while the taxpayer receives a tax deduction for the full market value of the gift and avoids paying capital gains taxes on the gifted security.

Advantage of Gifting Appreciated Securities vs. Cash



This is a hypothetical example for illustrative purposes only. Analysis assumes taxpayer subject to highest federal tax bracket (37 percent) and capital gains subject to 23.8 percent federal tax rate. Analysis assumes charitable gifts are made to qualified public charities.

Investors who have a portfolio overweight to equities may use charitable gifting to rebalance back to target weights. In doing so, an investor can achieve philanthropic goals while avoiding having to sell appreciated equities to return to a desired target allocation.

Keep in mind that gifts of long-term appreciated securities to qualified public charities (including donor-advised funds) are limited to 30 percent of adjusted gross income (AGI) while similar gifts to a private foundation are limited to 20 percent of AGI. Charitable gifts in excess of the AGI limits result in a charitable carryforward which can be used over the next 5 years.

Net Investment Income Tax

The Net Investment Income Tax (NIIT) is a 3.8% surtax on a portion of modified adjusted gross income over certain filing status-based thresholds:

- $250,000 for married filing jointly or qualifying widow(er)
- $125,000 for married filing separately and
- $200,000 in all other cases

Net investment income includes interest, dividends, capital gains, non-qualified annuity distributions, income from passive investment activities, etc. The most recent Build Back Better proposal calls for expanding the application of the NIIT to trade or business income for single taxpayers making over $400,000 and $500,000 for married taxpayers filing jointly.

Consider opportunities to accelerate trade or business income from pass through entities in 2021 that could be subject to NIIT in 2022 under the expanded definition.

Satisfy Required Minimum Distributions using the IRA Charitable Rollover

The SECURE Act raised the beginning age for required minimum distributions (RMDs) to 72, from age 70½ previously. However, it did not adjust the age 70½ requirement for taxpayer eligibility to make a Qualified Charitable Distribution (QCD).

Under this provision, a taxpayer may gift up to $100,000 each year from an IRA to qualified 501(c)(3) charitable organizations (donor-advised funds, private foundations and supporting organizations are excluded). A qualified charitable distribution neither counts as an itemized deduction nor as taxable income, though it does count towards satisfying the RMD for that year.

This strategy may be beneficial for charitably inclined individuals who receive a greater tax benefit from the increased standard deduction rather than itemized deductions.

Harvest Losses

Review unrealized gains and losses in taxable investment accounts and harvest losses where available. Realized losses can offset other realized gains. To the extent that realized losses exceed realized gains, net realized losses can offset up to $3,000 of ordinary income with any remainder resulting in a loss carryforward to be used in future years.

Beware of the “wash sale rule” which states that a loss cannot be realized for tax purposes if a *substantially identical* position was bought within 30 days before or after the sale. As a practical example, an investor could sell an actively managed equity fund and could redeploy the sales proceeds to an equity index fund. In doing so, the investor recognizes a tax loss while also keeping similar, but not identical, portfolio exposure to capture a subsequent market recovery.

Given notable market gains over the past several years, positions with notable unrealized losses may be limited, but your team at NEIRG will maximize losses where appropriate in your managed accounts.

Analyze Mutual Fund Year-End Capital Gain Distributions

Mutual funds are required to pass along capital gains to fund shareholders. Regardless of whether the fund shareholder benefited from the fund’s sale of underlying securities, the shareholder will receive the capital gain distribution if the mutual fund is held as of the dividend record date.

Mutual fund families typically provide estimates for year-end dividend distributions over the course of October and November, with such distributions most commonly paid in December.

Capital gain distributions can be either short-term or long-term. Short-term capital gain dividends are treated as *ordinary income* and thus *cannot* be offset by realized losses; in contrast, long-term capital gain dividends are treated as capital gains and can be offset by realized losses.

It is important to review unrealized gains and losses across mutual fund holdings in taxable accounts and to compare those figures against capital gain distribution estimates to determine if selling a mutual fund position before the year-end distribution would produce a tax savings.

NEIRG conducts regular review of mutual funds in client portfolios to ensure we are not buying ahead of large gain distributions and selling when appropriate ahead of distributions to avoid potential gains.

Consider a Roth Conversion

With income tax rates at historically favorable levels, individuals who believe their future tax rate might be higher than their current tax rate might consider converting a portion – or all – of existing Traditional IRA assets to a Roth IRA. Assuming the Traditional IRAs have no basis, the amount of the conversion is treated as taxable income. In exchange, the Roth IRA grows tax-free with qualified distributions also treated as tax-free.

This strategy can be particularly beneficial for individuals with a taxable estate, as the tax cost of the conversion effectively reduces the size of the estate, while the named beneficiaries one day receive a very tax-favorable asset, compared to inheriting a Traditional IRA. In some cases, high net worth individuals might pair a Roth conversion with accelerated charitable giving, as the charitable deduction will help to offset the effective tax cost of the conversion.

Individuals with notable assets but with lower-than-usual income in 2021 might also consider this strategy, as it allows the taxpayer to pay a reduced rate on the conversion while taxable income is low.

Note that there are several factors (time horizon, overall net worth, tax bracket, etc.) to evaluate to determine whether a Roth conversion might be beneficial.

You may be able to reduce your taxes by contributing as much as you can to IRAs and employee retirement plans. These contributions are subject to the following limits:

- IRA Contributions: The maximum you can contribute to all your traditional and Roth IRAs for 2021 is $6,000 ($7,000 if you are 50 or older). Remember, you can make contributions to your IRA until April 15, 2022, for the 2021 tax year. For 2022, these limits remain unchanged.
- 401(k) or 403(b) Contributions: The 2021 employee deferral limit on 401(k) or 403(b) contributions is $19,500 (plus an additional $6,500 if you are 50 or older). For 2022, these limits are $20,500 and $6,500, respectively.

Review Estate Plans & Retirement Account Beneficiaries

The Setting Every Community Up for Retirement Enhancement (SECURE) Act, enacted on January 1, 2020, effectively eliminated what was known as "the stretch IRA." Under the SECURE Act, most non-spouse beneficiaries will be required to fully withdraw all inherited IRA assets by the end of the 10th year after the IRA holder died. Estate plans which previously incorporated this "stretch" strategy are now outdated and in need of updating.

"The Stretch IRA"

A beneficiary could stretch required minimum distributions (RMDs) for an inherited IRA over their lifetime. Example: John Smith, age 92, names his great grandson Billy, age 20, as the beneficiary of his $2 million Traditional IRA.

Periodically reviewing and updating estate plans is a recommended best practice in light of potentially changing estate planning rules and limits. Individuals who have recently experienced a significant life event (marriage, divorce, birth/adoption) may also need to make updates to existing estate plans and beneficiary designations.

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Federal Income tax rate brackets for 2021 and 2022 are as follows:

2021:

Rate	For Unmarried Individuals, Taxable Income	For Married Individuals Filing Joint Returns, Taxable Income	For Heads of Households, Taxable Income	For Married Individuals Filing Separate Returns, Taxable Income	For Estate and Trusts
10%	$0 - $9,950	$0 - $19,900	$0 - $14,200	$0 - $9,950	$0 - $2,650
12%	$9,951 - $40,525	$19,901 - $81,050	$14,201 - $54,200	$9,951 - $40,525	
22%	$40,526 - $86,375	$81,051 - $172,750	$54,201 - $86,350	$40,526 - $86,375	
24%	$86,376 - $164,925	$172,751 - $329,850	$86,351 - $164,900	$86,376 - $164,925	$2,651 - $9,550
32%	$164,926 - $209,425	$329,851 - $418,850	$164,901 - $209,400	$164,926 - $209,425	
35%	$209,426 - $523,600	$418,851 - $628,300	$209,401 - $523,600	$209,426 - $314,150	$9,551 - $13,050
37%	Over $523,600	Over $628,300	Over $523,600	Over $314,150	Over $13,050

2022:

Rate	For Unmarried Individuals, Taxable Income	For Married Individuals Filing Joint Returns, Taxable Income	For Heads of Households, Taxable Income	For Married Individuals Filing Separate Returns, Taxable Income	For Estate and Trusts
10%	$0 - $10,275	$0 - $20,550	$0 - $14,650	$0 - $10,275	$0 - $2,750
12%	$10,276 - $41,775	$20,551 - $83,550	$14,651 - $55,900	$10,276 - $41,775	
22%	$41,776 - $89,075	$83,551 - $178,150	$55,901 - $89,050	$41,776 - $89,075	
24%	$89,076 - $170,050	$178,151 - $340,100	$89,051 - $170,050	$89,076 - $170,050	$2751 - $9,850
32%	$170,051 - $215,950	$340,101 - $431,900	$170,051 - $215,950	$170,051 - $215,950	
35%	$215,951 - $539,900	$431,901 - $647,850	$215,951 - $539,900	$215,951 - $323.925	$9,851 - $13,450
37%	Over $539,900	Over $647,850	Over $539,500	Over $323,925	Over $13,450

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Long-Term Capital Gains Rate Brackets for 2021 and 2022:

2021:

Rate	Single Filers (taxable income)	Married Filing Jointly	Heads of Household	Married Filing Separately	Estates and Trusts
0%	$0 - $40,400	$0 - $80,800	$0 - $54,100	$0 - $40,400	Below $2,700
15%	$40,401 - $445,850	$80,801 - $501,600	$54,101 - $473,750	$40,401 - $250,800	$2,701 - $13,250
20%	Over $445,850	Over $501,600	Over $473,750	Over $250,800	Over $13,250

2022:

Rate	Single Filers (taxable income)	Married Filing Jointly	Heads of Household	Married Filing Separately	Estates and Trusts
0%	$0 - $41,675	$0 - $83,350	$0 - $55,800	$0 - $41,675	Below $2,800
15%	$41,676 - $459,750	$83,351 - $517,200	$55,801 - $488,500	$41,676 - $258,600	$2,801 - $13,700
20%	Over $459,750	Over $517,200	Over $488,500	Over $258,600	Over $13,700

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