Tax Planning Guide

2021 / 2022

2021 Year-End Tax Planning Letter for Individuals

By Lucy Luo, CPA

Time is ticking on year-end tax planning as 2021 draws to a close. 2020 was a tumultuous year due to Covid-19. Challenges remain at the end of 2021 as the country is still recovering from the pandemic and the fate of the Build Back Better Act (BBB) is uncertain. The following includes several tax planning opportunities for you to consider before year-end.

Projected Income and Filing Status

For individuals, year-end tax planning commonly involves methods for increasing and decreasing adjusted gross income (AGI). You should review your income projection and filing status for 2021 to determine which method you shall take. Generally, taxpayers will aim to decrease AGI to reduce their overall tax liability. But there are some instances when it will make sense for the taxpayer to increase AGI in a particular year. For example, you may be in a higher tax bracket next year, your head-of-household or surviving spouse status may end after this year, or you were unemployed for part or all of 2021 because of the pandemic and expect to find a new job in 2022. Conversely, if your tax rate will instead be lower next year, you should consider deferring income recognition.

AGI also has numerous impacts on tax benefits subject to specified thresholds, such as deductible IRA contributions, child tax credits, education credits, and the 3.8% net investment income tax (NIIT).

Investment Account Analysis

As year-end approaches, income, gains, and losses for the year become more certain. Recognizing long-term capital gains may be beneficial if you will be subject to a higher rate in the future. Alternatively, if you expect your rate to go up, harvest some losses to offset some gains to reduce current year AGI and the NIIT. Be cautious of the

Build Back Better Act Tax Proposals: Where Do We Stand?

By Ryan McDonell, CPA

Back in March and April of this year, President Biden released a framework for traditional and "human" infrastructure provisions of the administration's Build Back Better agenda. Traditional infrastructure provisions were included in the Infrastructure Investment and Jobs Act, which passed the Senate and House on a bipartisan basis and was signed into law by President Biden. In September, the remaining framework was put into writing as part of the House's $3.5 trillion first draft of the Build Back Better Act (BBB).

Democrats intend to pass the BBB across party lines using reconciliation. Reconciliation is a special process that allows for legislation to pass the Senate with a simple majority (51 votes) instead of the typical 60 votes. Limits on how long reconciliation bills may be debated also make the process filibuster-proof. Lawmakers are limited in how often they may use reconciliation each year, and the proposals must generally be related to budgetary or revenue-related policies subject to the advice of a nonpartisan Senate parliamentarian. Reconciliation is often used by the party in power to advance an administration's policy goals. For example, the Trump administration used reconciliation to pass the Tax Cuts and Jobs Act tax reform towards the end of 2017.

Democrats hold a slim 221-213 majority in the House and an even tighter margin in the Senate split 50-50 with Vice President Harris serving as the tiebreaker in Democrats' favor. If all Democrats in the House and Senate agree on BBB, it can move through Congress without Republican opposition. However, over the last few months, differences between progressives and moderates within the Democrat party have delayed and reshaped the reconciliation bill to such

»

an extent that many question "if" the bill will pass instead of "when." To make concessions for party moderates, the latest version of BBB from early November is nearly half the size of the original $3.5T proposal coming in around $1.75T and leaves behind almost all the tax rate increase proposals.

Proponents of the bill are hoping for a passing vote by Thanksgiving in the House and before the end of the year in the Senate. It is unknown whether the reconciliation bill will survive the back-and-forth between party groups. In the meantime, taxpayers may plan around the latest draft of the legislation but should keep in mind that the proposals are likely to change before becoming law, if at all.

Removed…For Now

Arguably as important as what remains in the bill is which proposals have been removed. Just because these items have been taken out of the current draft of the BBB does not necessarily mean that they are gone for good. However, for the time being, several policies have been tabled to appease vocal congressmembers, including, for example:

- Increasing top capital gain tax rate from 20% to 25%
- Increasing individual income tax rate from 37% to 39.6%
- Increasing top C corporation tax rate from 21% to 26.5%
- Reducing the base estate/gift lifetime exclusion from $10M to $5M
- Including grantor trusts in estate, treating distributions as gifts, and transfers as sales
- Capping the QBI 20% deduction
- Taxing unrealized gains for high income taxpayers
- Reporting bank inflows and outflows to the IRS ($600 or $10,000 threshold)

Still In Play

Despite the omission of many flagship proposals, the current BBB draft still has several provisions that taxpayers should be aware of. Some notable items include the following:

Net Investment Income Tax 3.8% Expansion

The net investment income tax (NIIT) is a 3.8% tax imposed on investment income and passive activity income for married taxpayers with adjusted gross income in excess of $250,000 (or $200,000 for single filers). Income subject to this tax may include interest, dividends, stock sales, and income from K-1s if the owner does not meaningfully participate in business operations. Presently, income from nonpassive business interests is not subject to the 3.8%. This means that an owner who actively participates in business operations generally does not pay the NIIT on income from the related K-1 or on income derived from selling ownership in the business. The BBB proposal would expand the NIIT by including nonpassive income for married taxpayers with taxable income in excess of $500,000 (or $400,000 for single) starting in 2022. This could be a 3.8% tax increase on income that taxpayers receive from businesses they actively manage and from sales of said business interests.

New Surcharge Tax on High-Income

The BBB includes a proposal that would impose a 5% tax on modified adjusted gross income in excess of $10,000,000 and an additional 3% tax (totaling 8%) on MAGI in excess of $25,000,000 beginning in 2022.

State and Local Tax (SALT) Itemized Deduction Increase

Taxpayers are presently limited to deducting up to $10,000 of state and local taxes as an itemized deduction on their federal tax return. This $10,000 "cap" was introduced as part of the 2017 tax reform and is set to expire after 2025. The latest House BBB proposal would raise the cap to $80,000 in 2021 and extend the cap through 2031. Senate counterparts have already begun discussing alternatives to this proposal, such as retaining the $10,000 cap for taxpayers making more than $400,000.

Closing Backdoor Roth IRA Conversions

In order to contribute to a Roth IRA, taxpayers must meet certain adjusted gross income (AGI) levels. For 2021, contributions were limited if AGI exceeded $198,000 for a married couple (or $125,000 for single filers). As a workaround, taxpayers have been able to make contributions to nondeductible IRAs and then convert the nondeductible IRA to Roth, effectively creating a "backdoor" means of avoiding the Roth AGI contribution limits. The present BBB proposal would prohibit taxpayers from using this backdoor Roth conversion workaround beginning in 2022.

In conclusion, the size and contents of the BBB have changed drastically over the last couple months. Even now, about a week out from the Thanksgiving holiday, it's hard to pin down how much of an appetite there is for the current draft of the bill. Taxpayers should proceed with caution as we monitor for more changes to the BBB and see if the bill eventually becomes law.

"wash sale" rule - when substantially identical stock or securities are bought and sold within a 61-day period (30 days before or 30 days after the date of sale), the loss on disposition of stock is not allowed and is instead added back to the stock's basis.

Alternative Minimum Tax (AMT) Threat

The Tax Cuts and Jobs Act of 2017 (TCJA) substantially increased AMT exemptions so that fewer taxpayers must pay the AMT. However, in certain situations, incentive stock options (ISOs) can trigger significant AMT liability. High long-term capital gains, qualified dividend income, and tax-exempt interest on certain private-activity municipal bonds might trigger or increase AMT liability.

Net Operating Loss (NOL)

The TCJA reduced the NOL deduction from 100% to 80% of taxable income. After a temporary suspension of this rule under the CARES Act, the 80% of taxable income deduction limitation returns for NOLs arising in 2021 and after and the NOLs may not be carried back.

Excess Business Loss (EBL)

The TCJA limits the deduction of business loss of non-corporate taxpayers to $500,000. The CARES Act temporarily lifted the EBL rule, but the limitation returns for 2021, with Congress looking to make this change permanent under the BBB.

Itemized Expenses

Consider bunching elective medical expenses and charitable contributions into alternative years if it would help you exceed applicable AGI floor limits. Also, the current state and local tax (SALT) cap limits individuals to $10,000 of SALT-itemized deductions. The BBB proposes to increase the cap to $80,000 retroactive to the start of 2021. At this point, it is uncertain whether this bill will be passed.

Retirement Accounts

The TCJA increased the required minimum distribution (RMD) age from 70½ to 72. The CARES Act waived RMD requirements for 2020 but not for 2021. As a reminder, if you do not comply with RMD rules, you can owe a penalty equal to 50% of the amount you should have withdrawn but did not. Taxpayers age 70½ or older can consider qualified charitable distributions (QCDs). QCDs allow direct contributions from a taxpayer's IRA to qualified charitable organizations, for up to $100,000 per tax year. And while a charitable deduction cannot be claimed for a QCD, the QCDs are not included in taxable income and can be used to satisfy an IRA owner's RMD.

Consider whether a Roth IRA conversion makes sense for you. If you have a traditional IRA, a partial or full conversion to a Roth IRA can allow you to turn tax-deferred future growth into tax-free growth. Keep in mind that both RMD and Roth conversion are included in your MAGI. This means that they could trigger or increase the NIIT or phase out some credits.

Setting up an IRA for teens can be ideal because they likely will have many years to let their accounts grow tax-deferred or tax-free.

Charitable Contribution

The charitable deduction for non-itemizers was extended to 2021. Thus, even if you take the standard deduction, you can claim a charitable deduction. Eligible contributions must be made in cash to a public charity. For 2021, one deduction is allowed per person, which allows married joint couples to deduct up to $600 or $300 for a single filer. Appreciated publicly traded securities held more than one year are long-term capital gains property, which often makes one of the best charitable gifts. You can deduct the current fair market value and avoid the capital gains tax you would pay if you sold the property. Do not donate stock that is worth less than your basis. Instead, sell the stock so you can deduct the loss and then donate the cash proceeds to charity.

Section 529

Plans Section 529 plans provide another tax-advantaged savings opportunity. Although contributions are not deductible for federal purposes, any growth is tax-deferred. You can also make tax-free rollovers to another qualifying family member.

Telecommuting Employee

The Covid emergency orders last year forced employers to have employees telework. For Massachusetts, starting March 10, 2020, a non-resident employee who worked remotely from a location other than usual work location because of the Covid pandemic had wages sourced based on where the employee worked prior to the state of emergency. This rule ceased starting September 13, 2021, and now wages will generally be sourced based on where the employee's work is actually performed. If you still work remotely from another state, you may have reporting requirements in multiple states.

Estimated Tax Payments and Withholding Status

Take a look if your estimated tax payments and withholding are enough to avoid underpayment penalties. You can increase your wage withholding or take an eligible rollover distribution and withhold from a qualified retirement plan before the end of 2021 if you are facing a penalty for underpayment of estimated tax. Withheld tax will be applied pro rata over the full 2021 tax year to reduce previous underpayments of estimated tax.

Gift and Estate

You can exclude certain gifts of up to $15,000 per recipient in 2021 without depleting any of your gift and estate tax exemption. You need to use your annual exclusion by December 31. The exclusion does not carry over from year to year. Medical bill payments made directly to medical providers for family members do not count against gift tax limits. Tuition payments made directly to educational organizations for family members do not count against gift tax limits. Without further legislation, the estate tax exemption will return to an inflation-adjusted $5 million by 2026. Review whether your current estate plan needs a tune-up.

Spend some time now getting your 2021 tax picture in order. Please feel free to contact us with any questions, we are happy to assist you. In the meantime, we will monitor the progress of the BBB proposals and provide you with periodic updates.