2021 YE Tax Planning in an Era of Tax Changes and Rumored Changes

Stancil CPAs • Advisors | December 1, 2021

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Agenda

I. North Carolina Budget Bill

II. Build Back Better Act – Current Status:
- What is NOT Included
- What is Included

III. FAQ's – Common Misunderstandings

IV. Top Tax Strategies for 2021

North Carolina Budget Bill

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North Carolina Budget Bill

North Carolina Budget Bill – Tax Highlights

- Deduction allowed for expenses paid via PPP loan proceeds thru 2022.
  - This will require amending 2020 NC tax returns.
- The exclusion of up to $10,200 unemployment compensation as permitted for federal tax is NOT allowed for NC.
- The NC personal income tax rate decreases to 4.99% in 2022, 4.75% in 2023, 4.6% in 2024, 4.5% in 2025, 4.25% in 2026, and 3.99% in 2026.

North Carolina Budget Bill

North Carolina Budget Bill – Tax Highlights

- The standard deduction increases to match the federal amount beginning in 2022.
- The Child deduction increases from $2,500 to $3,000 beginning in 2022.
- The current 2.5% corporate tax rate is gradually reduced until it is eliminated in 2030.
- Certain S Corps and Partnerships are permitted to pay the state income tax of their owners as a "SALT Cap Workaround" beginning in 2022.

Build Back Better Act – Current Status – What is NOT included

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Build Back Better Act – Current Status:

Build Back Better – what is NOT included?

- The top ordinary income rate is NOT increased to 39.6%
- The capital gain and qualified dividends rate is NOT increased.
- The Qualified Business Income (QBI) deduction will NOT be phased out for incomes greater than $400,000.
- Social Security and self-employment tax is NOT expanded to incomes greater than $400,000.

Build Back Better Act – Current Status:

Build Back Better – what is NOT included?

- The phase-out of itemized deductions for taxpayers with income greater than $400,000 is NOT re-instated.
- The estate tax exemption is NOT reduced from its current $11.7 million (note it is still schedule to drop to $5.0M in 2026 under provisions of the 2026 tax act)
- The step-up in basis at death is NOT eliminated.

Build Back Better Act – Current Status:

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Build Back Better Act – Current Status:

Personal Income Tax Consequences

- Per the bill -- "*Nothing in this subsection is intended to increased taxes on any taxpayer with taxable income below $400,000*".

Build Back Better Act – Current Status:

Tax Consequences of Build Back Better Tax bill

- Currently approved by House
- 2 Democrat Senators want to make some changes so expect these rules to change a little

Build Back Better Act – Current Status:

It's Back and Just in Time for 2021!

- The State and Local Tax Deduction limitation is increased from $10k to $80k for MFJ / S / HOH
  - ($40k for MFS, Estates & Trusts)

Build Back Better Act – Current Status:

Child Tax Credit has been extended through 2022.

Current rule:

- $3600 credit for children 0-5
- $3600 credit for children 6-17 (used to be to 16)
- Fully refundable with no Minimum Income required
- Phase out for the additional credit:

MFJ	$150,000	($400k for regular credit)
S / MFS	$75,000	($200k for regular credit)
HOH	$112,500	($200k for regular credit)

*Reduced $50 for every additional $1000 of Gross Income

Advance Payments are still in effect. If you want to opt out, each parent must opt out through IRS website. https://www.irs.gov/credits-deductions/child-tax-credit-update-portal

Build Back Better Act – Current Status:

Other Items Extended:

- Earned Income Credit current amounts extended through 2022.
  - Current Rule -- Increased amount by 3 times from 2020 to 2021 and increased income limits for applicability.
- Premium Tax Credit rules extended through 2025.
  - Current Rule -- Lowered cost of Premiums & capped the cost to 8.5% of Household income. This allows Taxpayers with household income over 400% of poverty level to receive a credit to extent premium costs exceed 8.5% of income.

Build Back Better Act – Current Status:

Surcharge Tax on for High Income starting in 2022. There will be an additional tax for income that exceeds the following:

Tax Rate	Estate / Trust	MFS	MFJ / S / HOH
5%	200,001 - 500,000	5,000,001 - 12,500,000	10,000,001 - 25,000,000
8%	Over $500,000	Over $12,500,000	Over $25,000,000

Build Back Better Act – Current Status:

Additional Net Investment Tax on Nonpassive Income when MAGI exceeds certain thresholds (**starting in 2022**).

- Current Rules -- 3.8% additional tax on Passive income to extent income exceeds the following:

MFJ	$250,000
MFS	$125,000
S / HOH	$200,000

- Passive income includes Interest, Dividends, Annuities, Royalties, Passive Rental income, Income from Pass Through Entities that are Passive
- New Rules -- 3.8% additional tax on **Nonpassive** income that is not subject to Self-Employment tax from Rental activities or Pass Through Entities to the extent MAGI exceeds the following:

MFJ	$500,000
MFS	$250,000
S / HOH	$400,000

Build Back Better Act – Current Status:

Energy Credits are a Focus starting in 2022:

- Home Energy credit is revamped from a $500 lifetime credit to $1,200 annual limitation.
- Electric Vehicle credit is revamped and meant to help those with non-expensive vehicles:
  - Increased minimum credit from $2,500 to $4,000. Maximum is $12,500 (limited to 50% of cost of vehicle)
    - You get an additional $4,500 if the final assembly is at a U.S. plant that has a union.
  - NO credit if MSRP is over:

$80,000	SUV's, Pickups, Vans
$55,000	Other Vehicles

  - Credit phases out if AGI if over:

MFJ	$500,000
MFS / S	$250,000
HOH	$375,000

Build Back Better Act – Current Status:

2 Other New Vehicle Credits:

- Credit for Used Electric Vehicles
  - $2,000 to $4,000 if Vehicle is less than $25,000
  - Credit phases out for income over the following:

MFJ	$150,000
MFS / S	$75,000
HOH	$112,500

- New Credit for Depreciable Commercial Vehicles
  - 30% of cost if 100% electric
  - 15% of cost if hybrid

Build Back Better Act – Current Status:

The Exclusion for Section 1202 Stock Gain is Reduced for Those with AGI over $400,000

- No longer allowed to get 75% or 100% exclusion
- May get 50% exclusion though
- **Starts 9/13/2021**

Build Back Better Act – Current Status:

The Taxation of Retirement Plans Continues

- Starting in 2022, **NO** more backdoor Roth IRA conversions.
- Starting in 2031, **NO** more Roth conversions at all if taxable income is > $450,000

Build Back Better Act – Current Status:

But it doesn't stop there, the Bill limits the amount of tax deferred wealth that you may have. The following limitations start in 2029 and only apply if your Taxable Income exceeds the following:

MFJ	$450,000
MFS / S	$400,000
HOH	$425,000

- Note - these rules do not apply to Defined Benefit Plans. They apply to Defined Contribution Plans (401k, 403b, 457) & IRA's (Roth and Traditional)

Build Back Better Act – Current Status:

Limitation #1:

- If the Aggregate value of your Retirement Plans exceed $10,000,000 at end of prior year:
  - No contribution allowed to **ANY** IRA account
  - Must take a Required Minimum Distribution of 50% of the amount that exceeds $10,000,000
    - No age requirement, so applies to people of all ages
    - No 10% penalty

Build Back Better Act – Current Status:

Limitation #2:

- If the Aggregate value of your Retirement Plans exceed $20,000,000 at the end of the prior year:
  - To the extent the value is in excess of $20,000,000, ALL Roth related accounts must be distributed until get to limitation
  - After this is done, then apply limitation #1

Corporate Tax Provisions

2 Major Tax Provisions:

- Starting in 2023 - 15% minimum tax if the prior 3 year average of Financial Statement net income exceeds $1,000,000,000
- Starting in 2022 - 1% surcharge tax on repurchase of $1,000,000 or more of stock
  - Applied to Domestic Corporation that has its stock traded on an established securities market

FAQ's – Common Misunderstandings

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FAQ's – Common Misunderstandings

Frequently Asked Questions .. Surprising Answers

1. I just received an inheritance. How much tax do I pay on this?
   - Other than IRA's & 401K's, the answer is usually "none"
2. Is the annual limit for gifts that I can receive without paying tax still $15,000?
   - There is no limit.
3. Is the annual limit for gifts that I can give without paying tax still $15,000?
   - $15,000 is the threshold for having to file an informational gift tax return. The threshold for paying taxes is $11.7 million. This is a lifetime threshold.

FAQ's – Common Misunderstandings

Frequently Asked Questions .. Surprising Answers

4. Should I gift property to my children now to avoid tax when I die?
   - Maybe yes, maybe no. Let's talk.
5. I am thinking about selling my house soon. How much tax will I pay on the gain?
   - Quite likely none, but let's talk.
6. How much will it hurt me on taxes if I pay off my mortgage?
   - If you are one of the 88% of taxpayers who take the standard deduction, your mortgage has no impact on your taxes.

Top Tax Strategies for 2021

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Top Tax Strategies for 2021

In Advance of College Football Playoffs, we have our Top 4 Seeds on Planning Items

Top Tax Strategies for 2021

#1 Seed - In light of the Build Back Better bill, do your Back Door Roth Conversions before year end. This goes away in 2022.

#2 Seed - Also related to the Build Back Better bill, make your 4^{th} quarter State tax estimate payment by December 31^{st}. The new limitation is expected to be $80,000.

Top Tax Strategies for 2021

#3 Seed - Thanks to the Build Back Better bill, more people are likely to itemize thanks to the additional State tax deduction. Due to this, think of doing the following:

- Use a Donor Advised Fund to make large Donations that you want to pay out later to a charity
- Donate appreciated property - Stocks, Land, etc.
- Bunch Medical Costs

Top Tax Strategies for 2021

#4 Seed - Know your Marginal tax rate. Here are the tax rates for 2021:

Tax Rate	S / MFS	MFJ	HOH
10%	$0 - $9,950	$0 - $19,900	$0 - $14,200
12%	$9,951 - $40,425	$19,901 - $81,050	$14,201 - $54,200
22%	$40,426 - $86,375	$81,051 - $172,750	$54,201 - $86,350
24%	$86,376 - 164,925	$172,751 - $329,850	$86,351 - $164,900
32%	$164,926 - $209,425	$329,851 - 418,850	$164,901 - $209,400
35%	$209,426 - $523,600	$418,851 - $628,300	$209,401 - $523,600
37%	$523,601 +	$628,300 +	$523,601 +

Top Tax Strategies for 2021

Planning options based on your marginal tax rate:

- If taxable income is <$80k MFJ ($40k S/MFS) ($54k HOH), take advantage of 0% LT Capital Gain rates
- If taxable income is in 24% or less tax bracket, consider a Roth Conversion
- If taxable rate is over 24%, accelerate NECESSARY expenses to this year
- If taxable rate is over 24%, defer year end billing so collections are pushed to next year (if on cash basis)
- Consider your Retirement contribution to your 401k, IRA or SEP IRA
    - If tax rate is 24% or less consider Roth versus Deductible

Top Tax Strategies for 2021

Let's not forget our perennial powerhouse as well as a couple overlooked dark horses.

- **a) Retirement Plan Strategies**
- **b) Capital Gain Strategies**
- **c) Qualified Charitable Distributions (QCD's)**
- **d) "Phase-out Awareness" Strategies**

Tax Strategies for 2021

I. Retirement Plan Strategies

A. Traditional vs. Roth

1. Key Factor: Which is higher **– current tax savings** for contribution to a Traditional IRA/401K **or future tax cost** for withdrawals from Traditional IRA/401K?
2. If current tax savings are not clearly greater than future tax cost, then a Roth IRA/401K is favorable.

Tax Strategies for 2021

I. **Retirement Plan Strategies** (cont.)

A. Traditional vs. Roth

	Tax Rate	Traditional	Roth
Current year balance - Traditional IRA	25.00%	100,000	
Convert to Roth			
Tax cost			(25,000)
Net Remaining in IRA		100,000	75,000
Growth while inside IRA	100.00%	100,000	75,000
Value at Withdrawal		200,000	150,000
Tax Cost	25.00%	(50,000)	
Net after Tax Value		150,000	150,000

Tax Strategies for 2021

I. **Retirement Plan Strategies** (cont.)

A. Traditional vs. Roth

3. **Advantages** of a Roth Retirement Account.
   - Tax-free income!
   - **Principal is always accessible without tax or penalty**.
   - No Required Minimum Distributions at age 72.
   - Tax-free income to heirs.

Tax Strategies for 2021

I. **Retirement Plan Strategies** (cont.)

A. Traditional vs. Roth

4. **Short-term Opportunity for Roth Conversion.**
   - Current rates are schedules to revert back to pre 2018 brackets after 2025.
   - 12% bracket increases to 15%, 22% increases to 25%. 24% increases to 28%.
   - **Almost always a good idea** in an amount that does not cause one to exceed the **12% tax bracket**.
   - **Worth considering** to the extent that one is in the **22% or 24% bracket … and maybe even higher.**

Tax Strategies for 2021

I. **Retirement Plan Strategies** (cont.)

A. Traditional vs. Roth

4. **Short-term Opportunity for Roth Conversion.**
   - Need to have **funds available to pay the tax**.
   - One can convert **any amount** of your current traditional IRA.
   - No requirement to sell current investments inside your IRA.
   - Beware! Can **impact other things** (e.g. Medicare premiums, capital gain tax bracket).

Tax Strategies for 2021

I. **Retirement Plan Strategies** (cont.)

A. Traditional vs. Roth

4. **Short-term Opportunity for Roth Conversion – Run the numbers first!**

<u>Example:</u>

Molly and Travis have taxable income of $80,000, which includes long term capital gains of $18,000 and qualified dividends of $12,000. Molly and Travis are in the 0% tax bracket for the long-term capital gains and qualified dividends. Suppose Molly converted $30,000 of her traditional IRA to a Roth. Molly expects to pay federal tax of 12% on the $30,000 conversion. **Molly later discovers she paid a federal tax rate of 27% on the conversion as it caused the tax rate on the capital gains and dividends to increase from 0% to 15%.**

Tax Strategies for 2021

I. **Retirement Plan Strategies** (cont.)

A. Traditional vs. Roth

5. Other considerations for Traditional IRA / 401k.

<u>Example</u>:

Ava is a self-employed, single taxpayer in a "Specified Service Trade or Business"(SSTB) with net business income of $210,000. She also has $25,000 of other income. Ava makes a $30,000 contribution into an SEP IRA. Ava's federal tax is reduced by **$15,214, or 50.7%,** of the SEP contribution. If Ava's business income is instead $160,000, then her federal tax is reduced by only **$5,852 or 19.5%** of the SEP contribution.

Tax Strategies for 2021

II. Capital Gain Strategies

A. Timing Strategies

1. Accelerate gain if in **0% federal tax bracket** ($80,800 for married taxpayers, $40,400 if single).
   - For gains, there is no "wash sale" rule to prevent you from immediately repurchasing the investment.

     Example:

     Kyle & Anna are married taxpayers age 65 with gross income of $60,000 and taxable income of $32,600. They realize **$50,000 capital gain**. The capital gain **increases their federal tax by only $390**. This is because $47,400 of the capital gain is in the 0% capital gain bracket.

Tax Strategies for 2021

II. Capital Gain Strategies (cont.)

A. Timing Strategies

2. Beware of thresholds for higher capital gains rates.
   - **Net Investment Income tax adds 3.8%** to most capital gains once gross income is greater than $250,000 ($200,000 for single taxpayers).
   - Capital gain rate increases from 15% to 20% at taxable income of **$501,600 ($445,850** for singles).
   - Utilizing the **"installment sale method"** is one way of spreading a large capital gain from a property sale over two tax years to avoid reaching the higher capital gain brackets.

Tax Strategies for 2021

II. Capital Gain Strategies (cont.)

A. Timing Strategies

3. Defer gain if future year will have lower tax rate.

Example:

Josie is a single taxpayer with an annual income of $150,000. Josie sells property that produces a $600,000 capital gain. Josie's federal income tax on the gain is **$134,016, which includes 20% capital gain, NIIT and AMT**. Josie negotiates an installment sale with the buyer such that she receives half of the income in Year 1 and half in Year 2. Her total federal tax on the capital gain drops to **$109,000**.

Tax Strategies for 2021

II. Capital Gain Strategies (cont.)

A. Timing Strategies

4. "Harvest" capital losses in investment account to offset realized capital gains.

- Check with financial advisor or broker to see if you have available unrealized losses where you can realize the capital loss by selling before year-end.
- **Investment strategy offsets tax strategy.**
- Beware of 30-day **"wash sale" rule**.

Tax Strategies for 2021

II. Capital Gain Strategies (cont.)

A. Timing Strategies

4. "Harvest" capital losses in investment account to offset realized capital gains.

Example:

Leland sold property with a $50,000 gain. He checks with his financial advisor and finds that he has an unrealized loss in an investment equal to $20,000. He sells this investment so that his net capital gains for the year are only $30,000. He must wait at least 31 days to repurchase this stock to avoid the "wash sale" rule.

Tax Strategies for 2021

III. Qualified Charitable Deduction (QCD)

1. Charitable contributions paid directly by one's IRA.
   - Available to taxpayers **age 70 ½** or older.
   - Available for up to $100,000 per year.
   - Counts as **part of one's RMD** (Required Minimum Distribution).
2. QCDs are not included in income and are not deductible as charitable contributions.

Tax Strategies for 2021

III. Charitable Contribution Strategies (cont.)

D. Qualified Charitable Deduction (QCD)

3. QCDs are especially effective for taxpayers taking the standard deduction.
   - Reduce RMDs that otherwise would count as taxable income. No reduction in standard deduction.
   - QCD's effectively create a charitable deduction even when one is taking the standard deduction.

Tax Strategies for 2021

III. Charitable Contribution Strategies (cont.)

E. Qualified Charitable Deduction (QCD)

<u>Example</u>:

Emily and Michael are age 72. They have RMDs totaling $50,000. They **typically make $15,000/year in charitable contributions**. However, because they have no mortgage deduction, **they do not have enough deductions to itemize.** Therefore, <u>they normally receive no tax benefit from making charitable contributions</u>. Upon learning of the QCD strategy, they begin making their charitable contributions from their IRAs rather than their regular accounts. **This strategy reduces their taxable income by $15,000.**

Tax Strategies for 2021

IV. "Phase-Out Awareness" Strategies

A. "Artificial" Tax Brackets: Examples.

1. **Qualified Business Income** deduction: For "Specified Service Businesses", this 20% deduction phases between **taxable income** of **$163,300 - $213,300** for single taxpayers, and **$326,600 - $426,600** for married taxpayers. It has the impact of increasing the marginal tax rate of married taxpayers by over 7%, and single taxpayers by over 14%.

Refer to earlier example under Retirement Plan Strategies.

Tax Strategies for 2021

IV. "Phase-out Awareness" Strategies (cont.)

2. **Active Rental Losses:**

   Example: Taxpayers with rental losses from properties they actively participate in can deduct up to $25,000 in rental losses each year. That deduction is phased out as gross income increases from $100,000 to $150,000.

Tax Strategies for 2021

IV. "Phase-out Awareness Strategies (cont.)

2. **Active Rental Losses:**

   Example: Harper has $100,000 W-2 income and no other income. She has a rental property that she actively manages. It has a $25,000 loss. Harper is allowed to deduct the loss in full. Suppose Harper has a capital gain of $50,000. **Not only is she taxed on the additional capital gain, but she now can no longer deduct the rental loss**.

Tax Strategies for 2021

IV. "Phase-Out Awareness" Strategies (cont.)

3. **Social Security Benefits:** Depending on one's total income, none of your Social Security benefits might be taxable, or up to 85% may be taxable. It's complicated. First determine one's "provisional income", which is ½ of Social Security income plus all other income, including tax-exempt income.

Tax Strategies for 2021

IV. **"Marginal tax rate" Strategies** (cont.)

3. **Social Security Benefits:** If provisional income is less than $32,000 for a married couple or $25,000 for a single, Social Security is not taxable. From those income thresholds, the taxable percentage of Social Security increases until it eventually reaches 85%.

Tax Strategies for 2021

IV. **"Phase-out Awareness Strategies** (cont.)

	Married Couple		
Social Security Benefits	50,000	50,000	50,000
Interest & Dividend Income	10,000	10,000	10,000
Tax-exempt Interest income	1,000	1,000	1,000
Retirement income	20,000	20,000	20,000
Taxable Social Security	16,200	24,700	41,700
Additional income		10,000	30,000
Adjusted Gross Income	47,200	65,700	102,700
Standard Deduction	(27,800)	(27,800)	(27,800)
Taxable Income	19,400	37,900	74,900
Increase in taxable income		18,500	55,500

Tax Strategies for 2021

IV. "Phase-out Awareness" Strategies (cont.)

B. "Artificial" Tax Brackets:

	Single		
Social Security Benefits	30,000	30,000	30,000
Interest & Dividend Income	10,000	10,000	10,000
Tax-exempt Interest income	1,000	1,000	1,000
Retirement income	10,000	10,000	10,000
Taxable Social Security	6,200	14,700	23,200
Additional income		10,000	20,000
Adjusted Gross Income	27,200	45,700	64,200
Standard Deduction	(14,250)	(14,250)	(14,250)
Taxable Income	12,950	31,450	49,950
Increase in taxable income		18,500	37,000

Tax Strategies for 2021

IV. "Phase-out Awareness" Strategies (cont.)

4. **American Opportunity Tax Credit (AOTC):** This tax credit for undergraduate tuition of up to $2,500 per child phases out as gross income moves from $80,000 to $90,000 for single taxpayers, and $160,000 - $180,000 for married taxpayers.

Tax Strategies for 2021

IV. "Phase-out Awareness "Strategies (cont.)

4. American Opportunity Tax Credit:

Example:

Hailey has W-2 salary of $90,000. She also has two children who are college undergraduates, and after scholarships, she incurs $4,000 each in tuition expense. Because her income is over the threshold, she can claim no tax credits. Suppose she contributed $10,000 to her 401K. Not only would her federal tax be decreased by $2,200 for her 401K deduction, she would now be eligible for a $5,000 AOTC. **This means the 401K deferral of $10,000 decreased her federal tax by $7,200!**

Tax Strategies for 2021

IV. "Phase-out Awareness" Strategies (cont.)

B. "Artificial" Tax Brackets: Examples:

5. **Child Tax Credit:** This $2,000 per child tax credit begins phasing out for married taxpayers at $400,000, and at $200,000 for single taxpayers.
6. **Additional Child Credit:** The additional child credit of $1,600 for children 5 and under and $1,000 for children 6-17 begins phasing out at income of $75,000 for singles and $150,000 for marrieds.

Tax Strategies for 2021

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets: Examples:

7. **Medicare Premiums:** Medicare premiums begin increasing when gross income rises above certain levels.

	Married	Single
Monthly Medicare Premium = $144.60		
Monthly Medicare Premium = $202.40	$ 174,000	$ 87,000
Monthly Medicare Premium = $289.20	$ 218,000	$ 109,000
Monthly Medicare Premium = $376.00	$ 272,000	$ 136,000
Monthly Medicare Premium = $462.70	$ 326,000	$ 163,000
Monthly Medicare Premium = $491.60	$ 750,000	$ 500,000

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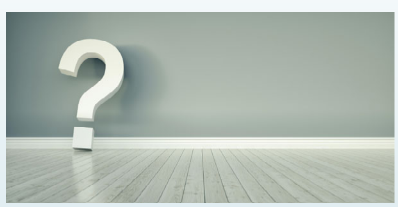
QUESTIONS???



Thank you for attending!

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