Tax Planning

2021 Financial Planning Guide

TAX REFORM?

A Biden administration coupled with Democratic control of both houses of Congress increases the chances for broader tax reform, although centrist Democrats in the Senate could act to moderate current tax proposals. While tax changes could potentially be implemented on a retroactive basis, many tax practitioners think tax reform, if enacted, likely would not become effective until 2022.

	Current	Biden Tax Proposal
Top Individual Federal Income Tax Rate	Currently 37%	Restore the top rate to the pre-TCJA level of 39.6% for taxable incomes above $400,000
Social Security Payroll Tax	Social Security's Old-Age, Survivors, and Disability Insurance (OASDI) tax (6.2%) is not collected on earnings above $142,800 (2021 earnings limit)	Collect additional OASDI tax on earnings above $400,000; this would effectively create a “donut hole” for the OASDI tax
Long-Term Capital Gains & Qualified Dividends	Top federal tax rate of 20%, plus 3.8% Net Investment Income Tax (NIIT)	Tax at the top (proposed) ordinary income rate of 39.6% for taxpayers with incomes > $1 million
Itemized Deductions	Itemized deductions generally provide a tax benefit equivalent to a taxpayer’s income tax bracket	Limit the tax benefit of itemized deductions to 28% for taxpayers earning more than $400,000 Restore the Pease limitation on itemized deductions for taxpayers earning more than $400,000
Estate & Gift Tax Exemption	$11.58 million per person for 2020 $11.70 million per person for 2021	Reduce the estate exemption to “historical norms” – unclear whether the target amount might be $3.5 million or $5 million + per person Increase the top federal estate tax rate from 40% to 45%
Corporate Income Tax Rate	21%	Raise to 28%

2021 FEDERAL TAX PROVISIONS

Federal Income Tax Brackets

Marginal Tax Rate	Single Filers	Head of Household	Married Filing Jointly	Trusts and Estates
10%	0 - 9,950	0 - 14,200	0 - 19,900	0 - 2,650
12%	9,951 - 40,525	14,201 - 54,200	19,901 - 81,050	
22%	40,526 - 86,375	54,201 - 86,350	81,051 - 172,750	
24%	86,376 - 164,925	86,351 - 164,900	172,751 - 329,850	2,651 - 9,550
32%	164,926 - 209,425	164,901 - 209,400	329,851 - 418,850	
35%	209,426 - 523,600	209,401 - 523,600	418,851 - 628,300	9,551 - 13,050
37%	523,601 +	523,601 +	628,301 +	13,051 +

Source: Tax Foundation. October 2020

Alternative Minimum Tax (AMT)

	AMT Exemption	AMT Exemption Phaseout
Single and Head of Household	$73,600	$523,600
Married Filing Jointly	$114,600	$1,047,200

The AMT exemption is reduced by $0.25 for each dollar that a taxpayer's Alternative Minimum Taxable Income (AMTI) exceeds the phase-out threshold

Long-Term Capital Gains Tax Rates

	Taxable Income:	
0%	<	$40,400 Single $54,100 Head of Household $80,800 Married Filing Jointly
15%	*between*	$40,401 - 445,850 Single $54,101 - 473,750 Head of Household $80,801 - 501,600 Married Filing Jointly
20%	>	$445,850 Single $473,750 Head of Household $501,600 Married Filing Jointly

2021 FEDERAL TAX PROVISIONS

Standard Deduction vs. Itemized Deductions

Taxpayers may take the greater of the standard deduction or total itemized deductions

Standard Deduction

- $12,550 Single
- $18,800 Head of Household
- $25,100 Married Filing Jointly

Itemized Deductions

- Medical expenses greater than 7.5 percent of adjusted gross income are deductible
- SALT Deduction capped at $10,000 for *the sum of*: 1) property taxes *and* 2) *greater of* state and local income taxes *or* sales taxes
- Home mortgage interest on mortgages up to $750,000. (*Note: Mortgages before12/15/2017 up to $1 million grandfathered.)*
- Charitable contributions (subject to AGI limits based on contributed property & receiving charity)

"Must Know" Healthcare Taxes

Net Investment Income Tax (NIIT):

3.8%

On the *lesser of* net investment income *or* Modified AGI above threshold:

$200,000 for Single/Head of Household
$250,000 for Married Filing Jointly

Note: These threshold amounts are not indexed for inflation.

Investment income includes, but is not limited to:

- Interest
- Dividends
- Capital Gains
- Rental/Royalty Income
- Non-Qualified Annuities
- Business involved with Financial Trading
- Passive Activities

Medicare Surtax:

0.9%

On *earned* income above:
$200,000 for Single
$250,000 for Married Filing Jointly

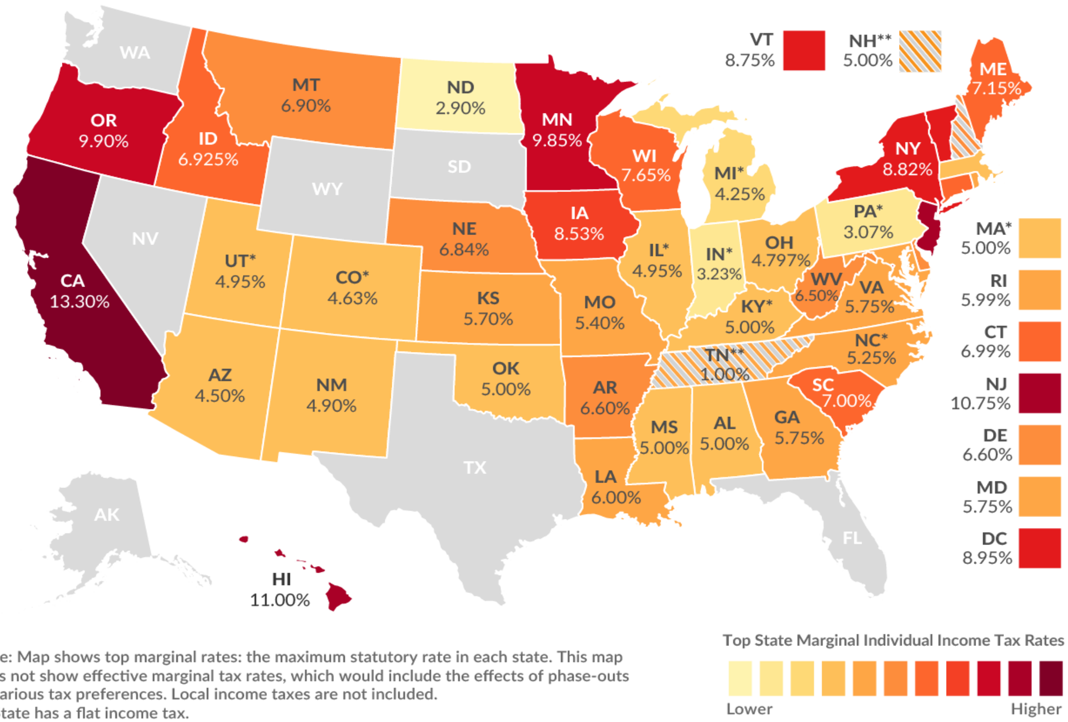
Note: These threshold amounts are not indexed for inflation.

STATE TAX PROVISIONS

41 States with individual income taxes

2 States that only tax dividends and interest (New Hampshire, Tennessee)

7 States with no individual income tax (Alaska, Florida, Nevada, South Dakota, Texas, Washington, Wyoming)



Note: Map shows top marginal rates: the maximum statutory rate in each state. This map does not show effective marginal tax rates, which would include the effects of phase-outs of various tax preferences. Local income taxes are not included.
(*) State has a flat income tax.
(**) State only taxes interest and dividends income.

Sources: Tax Foundation; state tax statutes, forms, and instructions; Bloomberg BNA.

TAX FOUNDATION @TaxFoundation

ASSET LOCATION

Planning Tip

- The taxation of portfolio income varies by asset class. Taxable bond and REIT income is taxed unfavorably at ordinary income rates, while equity dividends are taxed favorably at lower qualified dividend rates.
- An investor who has a combination of taxable accounts, Traditional 401(k)/IRAs and Roth 401(k)/Roth IRAs can optimize a portfolio's allocation to minimize tax drag, thereby enhancing long-term after-tax returns.

Tax efficiency	Asset class	Tax treatment
More Tax-Efficient	**Municipal Bonds**	Income is federally tax-exempt and may be state tax-exempt
	Energy-Infrastructure MLPs	Higher yields but mixture of return of principal & qualified dividends
	Equities, Low-Turnover	Qualified dividends with limited capital gains
	Equities, High-Turnover	Qualified dividends but may produce higher capital gains
	Taxable Bonds, Low Yields *(TIPS, Int'l Bonds, Core US Bonds)*	Lower yields but taxed as ordinary income
	REITs	Non-qualified dividends with capital gains
Less Tax-Efficient	**Taxable Bonds, High Yields** *(High Yield & EM Bonds)*	Higher yields and taxed as ordinary income

ACCELERATED CHARITABLE GIVING

Planning Tip

The charitable giving landscape changed substantially in 2018, as the Tax Cut and Jobs Act nearly doubled the standard deduction but capped the state and local tax (SALT) deduction at $10,000 and eliminated "miscellaneous two percent itemized deductions." Due to the new changes, taxpayers should evaluate if a portion of charitable giving would not produce a tax benefit.

Taxpayers might benefit from **accelerating ("bunching") charitable gifts** to maximize itemized deductions in a single tax year while taking the standard deduction in other years. This planning strategy can be particularly effective for charitably-inclined taxpayers without deductible medical expenses (> 7.5 percent of AGI) and with no/minimal mortgage interest.

Scenario #1: Married Filing Jointly, Level Annual Charitable Giving

	2021 - 2024	2021 – 2024 TOTAL
Mortgage Interest	$9,000	**$36,000**
State & Local Tax (SALT)	$10,000	**$40,000**
Charitable Gifts	$30,000	**$120,000**
Itemized Deduction Total	**$49,000**	**$196,000**
***Greater of:* Itemized Deductions *or* $25,100 Standard Deduction**	**$49,000**	**$196,000**

Scenario #2: Married Filing Jointly, Accelerated Charitable Giving

	2021	2022 - 2024	2021 – 2024 TOTAL
Mortgage Interest	$9,000	$9,000	**$36,000**
State & Local Tax (SALT)	$10,000	$10,000	**$40,000**
Charitable Gifts	**$120,000**	$0	**$120,000**
Itemized Deduction Total	**$139,000**	**$19,000**	**$196,000**
***Greater of:* Itemized Deductions *or* $25,100 Standard Deduction**	**$139,000**	**$25,100**	**$214,300**

In the above example, the couple's itemized deductions before charitable gifts total $19,000 (mortgage interest + SALT). Since the MFJ standard deduction is $25,100, the first $6,100 of charitables will not produce a tax benefit.

In Scenario #2, the couple accelerates charitable giving into a single year (2021) to maximize itemized deductions and takes the standard deduction in subsequent years (2022-2024). ***The composition of itemized deductions is the same under both scenarios, yet Scenario #2 produces a greater tax deduction of $18,300 over the four-year period.***

CHARITABLE GIVING VEHICLES

Planning Tip: Donor-Advised Funds vs. Private Foundations

There are numerous considerations to evaluate whether a donor-advised fund or a private foundation (or a combination) might be an effective charitable giving vehicle. The table below provides an abbreviated comparison.

	Donor-Advised Fund	Private Foundation
Start-up Time	Immediate	May take several weeks or months
Start-up Costs	None	Legal and other fees
Initial Contribution/ Minimum	Varies by sponsor, but often as low as $5,000 - $10,000	No minimum, though due to start-up and ongoing administrative expenses, a larger starting balance (several million dollars) is generally advisable
Minimum Grant to Charity	Varies by sponsor, but often as low as $50-$100	No minimum
Ability to Give Anonymously	Yes, donor can choose whether to give publicly or anonymously	No, IRS Form 990 must report gifts
Ongoing Administrative Expenses	Varies by sponsor, but typically starts ~0.60%	Various tax & other expenses
Underlying Investment Expenses	Varies by sponsor, with some investment options as low as 0.03%	Varies based on investments chosen & advisor
Tax Deduction for Gifts	Up to 60% of AGI for cash gifts Up to 30% of AGI for long-term securities	Up to 30% of AGI for cash gifts Up to 20% of AGI for long-term securities
Annual Distribution Requirement	None	IRS requires minimum 5% annual distribution based on prior year’s net average assets
Tax Reporting	Handled by the sponsor; donors do not report charitable grant activity	Responsible for tax filings and must annually file IRS Form 990
Excise Taxes	None	1.39% of net investment income

QUALIFIED CHARITABLE DISTRIBUTIONS

Planning Tip

The Qualified Charitable Distribution (QCD) provision may be beneficial for individuals who are charitably inclined and who would receive a greater tax benefit from the standard deduction rather than itemized deductions.

- Taxpayers can gift up to $100,000 from an IRA directly to 501(c)(3) charities
    - Donor-advised funds, private foundations and supporting organizations are *not* eligible recipients under the QCD rules
- Taxpayers must be over age 70½ at the time of the QCD
- The distribution does *not* count as income and does *not* count as a charitable deduction
- The distribution counts towards satisfying the RMD for that tax year
- This strategy may have the added benefit of reducing Adjusted Gross Income (AGI) which may result in lower Medicare premiums, depending on the taxpayer's income

- *Note: The IRA custodian will provide a 1099-R noting the amount of the distribution; however, the amount of the QCD will not be clearly identified. Total IRA distributions (QCD and non-QCD) should be reported on line 4a of the Form 1040 tax return, while the taxable amount of total IRA distributions (line 4b) should exclude the value of any QCD. The IRS advises to write "QCD" next to line 4b, if applicable. Be sure to communicate to your tax advisor if a QCD was made.*

Note: While the SECURE Act pushed back the beginning RMD age to 72 (for those turning age 70½ after 2019), ***the QCD rules were not impacted by the SECURE Act.***

CONCENTRATED STOCK POSITIONS

Taxable investors holding highly appreciated, concentrated stock positions might consider various strategies to reduce single stock risk exposure.

Available Choices	Pros & Cons
Continue to Hold Position	High-risk / potentially high reward; position is potentially subject to extreme swings
Sell a Portion/All of the Position	Reduces concentration risk, but may result in significant capital gains taxes
Hedge Exposure with Options	Requires rolling options contracts over time; may be very costly and options on the stock may be thinly traded
Gift to Family Member or Friend	May be some benefit if family member/friend is in a lower tax bracket, but cost basis carries over; may require using a portion of lifetime gifting exemption
Gift to Charity	Efficient way to reduce risk but tax deduction effectively provides only a $0.37 federal benefit for each $1.00 gifted; best suited for investors who are already charitably inclined
Exchange Fund	Provides a means to diversify risk exposure without triggering a taxable event

Exchange Fund – Mechanics & Details:

- Exchange fund provider states the fund’s objective and chooses which securities to accept to track chosen benchmark
- Exchange fund must invest at least 20 percent of fund in “qualifying assets” (typically real estate, real estate partnerships, commodities)
- Investor must be both accredited investor and qualified purchaser with more than $5,000,000 of investments
- Investor contributes appreciated security to exchange fund and receives an interest in the diversified pool, based on the amount of the contributed stock; investor retains the cost basis associated with the contributed position
- Investors may have limited redemption provisions (varies based on the exchange fund) and should consider the fund’s expenses, which may include redemption fees if investment interest is withdrawn in the first several years
- Investors who stay invested in the exchange fund for more than seven years can withdraw a diversified basket of stocks; investors exiting the exchange fund prior to seven years are returned the originally contributed stock

QUALIFIED OPPORTUNITY ZONES

The Tax Cuts and Jobs Act (enacted in December 2017) contained a provision with special tax incentives for taxpayers making investments in economically distressed communities ("opportunity zones")

- A taxpayer may defer realized gains on appreciated property (typically a capital gain) by investing the "deferred gain amount" (DGA) in a qualified opportunity fund ("QOF")
- Among other requirements, a Qualified Opportunity Fund must hold at least 90 percent of its assets in property located within a Qualified Opportunity Zone (QOZ)
- Once the DGA has been invested in a QOF, the gain is deferred until *the earlier of:* the date the investor sells the QOF investment *or* December 31, 2026
  - A QOF investment must have been made by December 31, 2019 to receive the special seven-year holding tax benefits
  - A QOF investment must be made by December 31, 2021 to receive the special five-year holding tax benefits

Regulatory Update:
The IRS published finalized regulations, TD 9889, effective January 13, 2020, providing the following amendments:

- Allows a taxpayer to invest the entire gain amount from the sale of business property without regard to losses
- The beginning of the 180-day investment period is changed from the end of the year to the date of sale of each asset. Entities (partnership, S-Corp, Estates, and Trusts) have the option to start the 180-day investment period on the date the entity's tax return is due (not including extensions)

Qualified Opportunity Fund (QOF) Holding Period	Tax Benefits	
	Deferred Gain Amount (DGA)	Qualified Opportunity Fund (QOF)
Less than 5 Years	Deferral of gain	n/a
Between 5-7 Years	Deferral of gain, *plus* gain reduced by 10 percent of the deferred gain amount	n/a
More than 7 Years	Deferral of gain, *plus* gain reduced by 15 percent of the deferred gain amount	n/a
More than 10 Years	*Not applicable since the latest potential date for gain deferral is December 31, 2026*	Taxpayer can elect to fully exclude the QOF's gain

TAX PLANNING CHECKLIST

What we are doing to help clients

1. Tax-Aware Investing/Asset Placement
2. Tax-Efficient Securities and Active Management Considerations
3. Tax Loss Harvesting/Thoughtful Rebalancing
4. Tax-Aware Recognition of Capital Gains
5. Capital Gain Dividend Distribution Analysis

How your tax advisor can help

1. Recognition and Timing of Income
2. Timing and Target Amount for Charitable Gifts
3. Evaluating the Potential Benefits of a Roth Conversion
4. Review Estimated Tax Withholding
5. AMT Considerations
6. Manage State and Local Income Tax Deductions
7. Review Property Tax Deductions
8. Additional State Tax Considerations

Areas where we can offer perspective

1. **Evaluating and Minimizing Capital Gain Implications** amid a portfolio repositioning considering factors such as potential step-ups in cost basis, asset placement, etc.
2. **Evaluating Family Gifting Strategies** according to desired gifting goals and, once determined, coordinating the gifting transfers.
3. **Gifting Long-Term Appreciated Securities** rather than cash for charitable contributions, which avoids capital gains taxes on the appreciated securities.
4. **Charitably Gifting the Required Minimum Distribution of an IRA**, which avoids the IRA distribution being treated as taxable income.
5. **Weighing the Differences between a Lump Sum Option or Annuity** income stream for Defined Benefit Plan or Cash Balance Pensions.
6. **Evaluating Tax Bracket Breakpoints and Stock Volatility** when minimizing single stock concentrations.
7. **Reviewing Social Security** income options.

ADDITIONAL RESOURCES

Curious in learning more?

- **Complete 2021 Financial Planning Guide**
    - **Retirement Planning**
    - **Estate Planning**
- **Additional Zuckerman Group Resources**
- **Our Website**