2021 Top 10 Year-end Tax Planning Ideas for Individuals

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The Key Wealth Institute is comprised of a team of highly experienced professionals from across wealth management, dedicated to delivering commentary and financial advice. From strategies to manage your wealth to the latest political and industry news, the Key Wealth Institute provides proactive insights to help grow your wealth.

Year-end tax planning for 2021 brings new challenges as we consider flexibility in changing the tax planning course if the new administration is able to pass legislation before the end of 2021. The big question then would be the effective date of any changes – upon enactment, retroactive to January 1, 2021, prospective beginning January 1, 2022, or some later date. As of the writing of this article, we are still governed by the Trump era Tax Cuts and Jobs Act of 2017 ("2017 Act").

Broadly speaking, some of the proposals aim to raise the tax rate on upper-income earners (generally defined as those earning more than $400,000/year) in a variety of ways. Without going into detail on these potential changes, we highlight some strategies to consider with the mindset of remaining nimble in case of change.

As a reminder, below is the current individual tax landscape:

- For the wealthiest taxpayers, personal income is subject to a top ordinary rate of 37% and a potential high-wage earners Medicare tax of .9%.
- Special maximum tax rates generally apply to long-term capital gains and qualified dividends (0%, 15%, or 20%).
- There is still a 3.8% Medicare surtax on Net Investment Income.
- Fewer taxpayers are affected by Alternative Minimum Tax (AMT).
- Many more taxpayers are using the increased standard deduction.
- Many itemized deductions have been repealed or significantly reduced. State and local tax deductions are capped at $10,000, qualified home interest deduction rules have changed, the Pease limitation is no longer in place, and some prior miscellaneous itemized deductions are gone.
- And there is the qualified business income deduction for pass-through income.

Here are 10 wealth planning ideas to consider for 2021:

1. Tax Bracket Management – Accelerate income and defer deductions

With the potential for an increase in tax rates, those with income above $400,000 might want to consider accelerating income into 2021. Roth conversions, harvesting gains and deferring loss harvesting, exercising stock options, accelerating bonuses, accelerating the installment sale gain, or moving up the closing date of a sale are just a few strategies to consider. Defer deductions that can be used to offset future income that could be taxed at higher rates.

2. Itemized Deduction Timing – Accelerating or Deferring deductions

Many more taxpayers are using the standard deduction. Therefore, to maximize itemized deductions in certain years, consider the tactic of "bunching" expenses into this year or next year to help get around deduction restrictions imposed by the Tax Cuts & Jobs Act. Again, this applies to deductions such as charitable, state and local taxes (up to $10,000), mortgage interest, and miscellaneous itemized deductions. If tax rates are higher in the future, consider deferring itemized deductions, as previously mentioned. If itemized deductions are capped in the future, or the 3% Pease limitation is restored in the future, rather than deferring deductions, consider accelerating them into 2021 to avoid additional itemized deduction limits.

3. Gain/loss Harvesting – Make the most of the reduced capital gain tax rates

Long-term capital gains are taxed at a rate of 0%, 15%, or 20%. And, the 3.8% surtax on net investment income may apply. If these preferential rates are eliminated for those over $1,000,000 (or some other threshold), long-term capital gains could be subject to a higher rate. You may consider accelerating sales of capital assets into 2021. For those capital assets with gains, they can be sold now and repurchased with a higher basis so that future sales will have less capital gain that could be taxed at higher rates. Whether the preferential rates stay the same or increase, always work with your tax advisor and portfolio strategist near year-end for strategies to match capital gains and capital losses. Remember that for individuals, capital losses can't be carried back, but can be carried forward indefinitely.

Taxpayers wanting to realize paper losses on stocks while still retaining the same investment position can sell shares and buy shares in the same company or another company, just avoid the wash-sale rules which disallow the loss if substantially the same shares are acquired within the 61-day period beginning 30 days before and ending 30 days after the sale.

The potential future change in preferential rates also applies to qualified dividend income. This could affect your investment strategy of shifting investments out of holdings that generate income taxed at ordinary rates (e.g., bonds) and into dividend-paying stocks to achieve tax savings. Dividend-paying stock may not be as advantageous. You may consider tax-exempt bonds for additional tax savings. If this future change is more likely to occur, review your investment allocation and adjust accordingly.

4. Roth conversions

With the potential for future higher tax rates, many more individuals are considering a Roth conversion and paying the tax on the conversion now at the lower rates. As you get closer to year end, determining your 2021 marginal tax bracket and projected investment income can be done with more certainty. If you are trying to convert your traditional IRA to a Roth IRA to fill up a tax bracket, start those conversations now. Roth conversions can also offset unused charitable contributions carryovers or other tax carryovers that may be "wasted." Traditional IRA to Roth IRA conversions can reduce future required minimum distributions and create a potential tax-free inheritance for children. Under present law, there are no required distributions by the participant from the Roth IRA in future years. There are, however, required minimum distributions for the beneficiaries of a Roth IRA (generally within 10 years of the original Roth IRA owner's death for non-eligible designated beneficiaries.) But, you could still get 10 years of post-mortem tax-free growth before final distribution to the non-eligible designated beneficiary. If your beneficiaries are in lower tax rates than yourself, then conversion may not be the right strategy.

Higher earning taxpayers who cannot contribute directly to a Roth IRA may be able to contribute to a non-deductible IRA that might later be converted to a Roth IRA. Alternatively, for those unable to contribute to a Roth IRA, if their company retirement plan allows after-tax contributions and in-service distributions, you can convert the after-tax amount to a Roth IRA or do an in-plan Roth conversion to a Roth 401(k) account. New legislation could change the availability of this strategy in future years. Just be mindful that you can no longer recharacterize Roth conversion contributions as a result of the TCJA.

5. Charitable planning

This year, in particular, presents some opportunities with maximizing the deductibility of charitable contributions. Donors can deduct cash donations to public charities (excluding Donor Advised funds and supporting organizations) up to 100% of adjusted gross income (AGI) for 2021. The limit will revert back to 60% of AGI after 2021 unless this provision is extended further by new legislation. With a potential for increased capital gains tax rates, consider gifting appreciated assets to charity in order to avoid having to recognize gain.

There is still some benefit to considering the Charitable IRA Rollover which allows an individual age 70½ or older to make a qualified charitable distribution (QCD) from their IRA directly to a charity (the age for QCDs is still 70½ despite that the beginning RMD age is now 72) and exclude the distribution from gross income (up to $100,000 per year). QCDs may be good strategies for those that file their taxes using the standard deduction. Those who itemize may want to weigh other options for their 2021 charitable gifting using cash or appreciated stock.

6. Review your estate plan

With the federal estate and gift exemption amount doubled now to almost $11.7 million per person, those with taxable estates should make use of the increased exemptions with the use of lifetime gifts. Remember, the estate tax exemption reverts to the old levels (those that existed prior to the Tax Cuts and Jobs Act) at the end of 2025 (if not sooner by an act of Congress). It is a “use-it-or-lose-it” opportunity.

For transfers that could potentially be subject to the generation skipping tax, take advantage of the increased Generation Skipping Transfer (GST) tax exemption as well by making current gifts to skip persons or making late allocations of GST exemption to trusts that previously were non exempt.

When reviewing your estate plan, consider the possibility that a reference to the exemption amount in an estate planning document that was drafted before the enactment of the Tax Cuts and Jobs Act could create an undesirable result.

There are a number of trusts that allow you to shift wealth to children or grandchildren while still maintaining access to funds if needed.

Such trusts include:

- **Spousal Lifetime Access Trust (SLAT)** which permits each spouse to be a beneficiary of the trust created by the reciprocal spouse.
- **Self-Settled Domestic Asset Protection Trusts (DAPTs)** which permit access by naming the grantor as a beneficiary.
- **Non-Self Settled Trusts (Hybrid DAPTs)** which permit access by giving someone a non-fiduciary power to add beneficiaries from a class that includes the grantor.
- **Special Power of Appointment Trusts (SPATs)** which permit access but avoid self-settled trust status.
- **Grantor Retained Annuity Trusts (GRATs)** which are valuable in a low-interest rate environment.

7. Low Interest Rate Environment

With interest rates still low and the prospect for higher rates in the future, the benefits of some estate planning strategies are enhanced. For those who expect a taxable estate, current conditions favor estate-freeze strategies like Grantor Retained Annuity Trusts (GRATs), which provide an annuity to the grantor for a period of time; Charitable Lead Annuity Trusts (CLATs) to benefit charity and provide for noncharitable beneficiaries in the future, with the added benefit of a charitable income tax deduction; and installment sales, to Intentionally Defective Grantor Trusts (IDGTs) all of which allow you to give away the upside appreciation potential of assets tax-free. There may only be a limited window of opportunity to implement a GRAT or a Sale to an IDGT under current rules. Proposed new legislation could impact GRATs and IDGTs after date of enactment.

8. Review your portfolio

With the potential for increase in the long-term capital gains rate, you may need to consider what this means for a concentrated stock position and how this can impact your diversification strategy. Review portfolios for low basis stock and consider implementing a capital gain realization strategy. If your portfolio consists of investments that currently pay qualified dividends currently taxed at preferred (lower) rates, you may need to consider how this impacts your portfolio.

9. Maximize the use of tax-advantaged savings vehicles

With the potential for future tax rate increase, maximizing tax-advantaged vehicles may be more important. Reduce taxable income by increasing pretax salary deferrals to employer-sponsored retirement plans (401(k), 403(b), 457, and SEP-IRA plans). If your plan allows after-tax Roth contributions, these should be considered because of the lack of an income-level phaseout for contributions and the potential for tax-free growth. Don't forget to consider contributions to IRAs for nonworking spouses as well. Also, maximize savings using tax-favored health plans such health savings accounts (HSAs). Remember that if you become eligible in December to make an HSA contribution, you can make a full year's worth of deductible HSA contributions for 2021. And parents and grandparents, don't forget to fund those 529 accounts for post-secondary (and now K-12) qualified education expenses.

10. Review beneficiary designations in light of the SECURE Act

With IRA planning, the Setting Community Up for Retirement Act (the SECURE Act) of 2019 basically eliminated the "stretch IRA," a concept for non-spousal and non-eligible designated beneficiaries. This concept previously allowed IRA or defined contribution plan beneficiaries to draw down the remaining plan benefits over the beneficiary's life expectancy. Inherited IRAs and inherited defined contribution plans must now be distributed within 10 years of the original owner's death. Review your beneficiary designations to see how the SECURE Act impacts the future distribution to those who inherit your retirement accounts. There are ways to simulate a stretch IRA using lifetime income strategies such as naming a Charitable Remainder Trust (CRT) or a Charitable Gift Annuity (CGA) as beneficiary of the account or using the RMD to purchase life insurance that will provide a tax-free benefit to heirs. Discuss any possible risk with these strategies with your advisors.

The end of 2021 is fast approaching. Review your tax situation with your advisor now and make adjustments before time runs out.

If you have any questions or need more information, please contact your advisor.

About the Author

In her role, Tina Myers is responsible for managing the Central Planning Team and overseeing the National Advisory Committee and any financial planning content distributed. She works with our Regional Planning Strategists to help facilitate our best thinking and advice delivery to clients.

Before joining Key, Tina worked in the public accounting industry, where she focused on taxes, specifically individual, trust, estate, and gift tax planning. She also held roles at a small public accounting firm, a regional firm, and the private client group of a large multi-national firm.

Tina earned a M.Tax from Virginia Commonwealth University and holds several industrystandard licensures. She received the Circle of Excellence Award for Key Private Bank in 2016 and 2018.

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