**Year-End Planning**
By John Mlynczyk, *Partner*

Year-end tax planning is more challenging than usual this year due to the uncertainty surrounding pending tax legislation that could, among other things, increase top rates ordinary income, capital gains and net investment income tax starting next year.

Whether or not tax increases become effective next year, the standard year-end approach of deferring income and accelerating deductions to minimize taxes will likely continue to produce the best results for all but the highest income taxpayers.

If proposed tax increases do pass, however, the highest income taxpayers may find that the opposite strategies produce better results. Thereby accelerating income into 2021 to be taxed at currently lower rates, and deferring deductible expenses until 2022, when they can be taken to offset what would be higher-taxed income. This will require careful evaluation of all relevant factors.

**Net Investment Income Tax**
*Current Law*
Higher-income individuals must be wary of the 3.8% surtax on certain unearned income. The surtax is 3.8% of the lesser of: (1) net investment income (NII), or (2) the excess of Modified Adjusted Gross Income (MAGI) over a threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case). For purposes of NII, the term Modified Adjusted Gross Income is generally defined as Adjusted Gross Income (AGI) for regular tax purposes increased by the foreign earned income exclusion. Thus, for most taxpayers MAGI generally equals AGI.

*Planning Considerations*
As year-end nears, the approach taken to minimize or eliminate the 3.8% surtax will depend on the taxpayer’s estimated MAGI and NII for the year. Some taxpayers should consider ways to minimize (e.g., through deferral) additional NII for the balance of the year, others should try to reduce MAGI other than NII, and some individuals will need to consider ways to minimize both NII and other types of MAGI. An important exception is that NII does not include distributions from IRAs or most other retirement plans.

*Pending Legislative Changes*
Pending legislative changes to the 3.8% net investment income tax (NIIT) proposed **beginning with the 2022 tax year** would subject high income (e.g., phased-in starting at $500,000 on a joint return; $400,000 for most others) S shareholders, limited partners, and LLC members to NIIT on their pass-through income and gain that is not subject to payroll tax. Accelerating some of this type of income into 2021 could help avoid NIIT on it under the potential 2022 rules, but would also increase 2021 MAGI, potentially exposing other 2021 investment income to the tax.

**Long-Term Capital Gains**
*Current Law*
Long-term capital gain from sales of assets held for over one year is federally taxed at 0%, 15% or 20%, depending on the taxpayer's taxable income. If you hold long-term appreciated-in-value assets, The 0% rate

generally applies to net long-term capital gain to the extent that, when added to regular taxable income, it is not more than $80,800 for a married couple.

*Planning Considerations*
If possible, consider maximizing the zero percent long-term capital gains bracket. For example, if you recognized $5,000 of long-term capital gains earlier this year and you expect to be in the zero percent capital gains bracket, then you may want to avoid recognizing capital loss before year-end, because the $5,000 of capital gain that is already tax-free (federal).

Consider deferring capital gains income until 2022 and recognizing capital losses "i.e., tax loss harvesting" in 2021 if doing so will enable you to claim larger deductions, credits, and other tax breaks for 2021 that are phased out over varying levels of AGI. These may include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest.

Consider accelerating capital gains into 2021 if current year income is lower than "normal" or other capital losses are available of to offset capital gains.

**Roth IRA Conversion**
Consider converting some portion of your traditional-IRA to a Roth IRA if:
1) The value of the IRA investments has declined during the year; or
2) Your 2021 taxable income is expected to be lower than "normal".

Keep in mind that the conversion will increase your income for 2021, possibly reducing tax breaks subject to phaseout at higher AGI levels. However, this may be desirable for those potentially subject to higher tax rates under pending legislation.

**Itemized Deductions**
*Current Law*
Many taxpayers won't be eligible to itemize deductions (federally) because of the high standard deduction amounts that apply for 2021 ($25,100 for joint filers, $12,550 for singles and for marrieds filing separately, $18,800 for heads of household), and because many itemized deductions have been reduced or abolished, including the $10,000 limit on state and local taxes; miscellaneous itemized deductions; and non-disaster related personal casualty losses.

*Planning Considerations*
You may still itemize medical expenses that exceed 7.5% of your AGI, state and
local taxes up to $10,000, charitable contributions, and home mortgage interest (limited in some cases). In addition to the standard deduction, you can claim a $300 deduction ($600 on a joint return) for cash charitable contributions.

Some taxpayers may be benefit from a "bunching" strategy by pulling or pushing discretionary medical expenses and charitable contributions into the year where they will receive a maximum tax benefit. For example, a taxpayer who will be able to itemize deductions this year but not next year will benefit by making two years' worth of charitable contributions this year. The COVID-related increase for 2021 in the income-based charitable deduction limit for cash contributions from 60% to 100% of MAGI assists in this bunching strategy.

*Pending Legislation*
Pending legislation may temporarily increase the State and Local Tax (SALT) deduction cap beginning in 2021. Current draft legislation may lift the SALT cap to approximately $80,000 per year but stay tuned as the legislation is still not final.

**Required Minimum Distributions**
*Current Law*
Required minimum distributions RMDs from an IRA or 401(k) plan (or other employer-sponsored retirement plan) have not been waived for 2021, as they were for 2020. If you were 72 or older in 2021 you must take an RMD during 2021. Those who turn 72 this year have until April 1 of 2022 to take their first RMD but may want to take it by the end of 2021 to avoid having to double up on RMDs next year.

*Planning Considerations*
If you are age 70½ or older by the end of 2021, and especially if you are unable to itemize your deductions, consider making 2021 charitable donations via qualified charitable distributions (QCDs) from your traditional IRAs. These distributions are made directly to charities from your IRAs, and the amount of the contribution is neither included in your gross income nor deductible on Schedule A, Form 1040. However, you are still entitled to claim the full standard deduction.

**Various Planning Ideas**
Consider increasing the amount you set aside for next year in your employer's FSA if you set aside too little for this year and anticipate similar medical costs next year.

If you become eligible in December of 2021 to make HSA contributions, you can make a full year's worth of deductible HSA contributions for 2021.

Consider making gifts sheltered by the annual gift tax exclusion before the end of the year if doing so may save gift and estate taxes. The exclusion applies to gifts of up to $15,000 made in 2021 to each of an unlimited number of individuals. You can't carry over unused exclusions to another year. These transfers may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

**Summary**
In summary, deferring income may be desirable for taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. However, in some cases, taxpayers may benefit by accelerating income into 2021. Moreover, pending tax legislation makes it increasingly difficult to navigate the best strategy.

Your year-end tax plan is unique. We welcome a year-end planning discussion that considers your personal and business circumstances. Please feel free to reach out to your tax professional at Kernutt Stokes to tailor a plan that is customized to you.