GBQuarterly: Year-End Individual Tax Update

December 7, 2021

Note

1. This presentation is intended to make participants aware of tax issues that may apply to this audience.

2. Information presented herein is not intended to be tax advice.

3. Please consult with a qualified practitioner for tax advice related to specific transactions.

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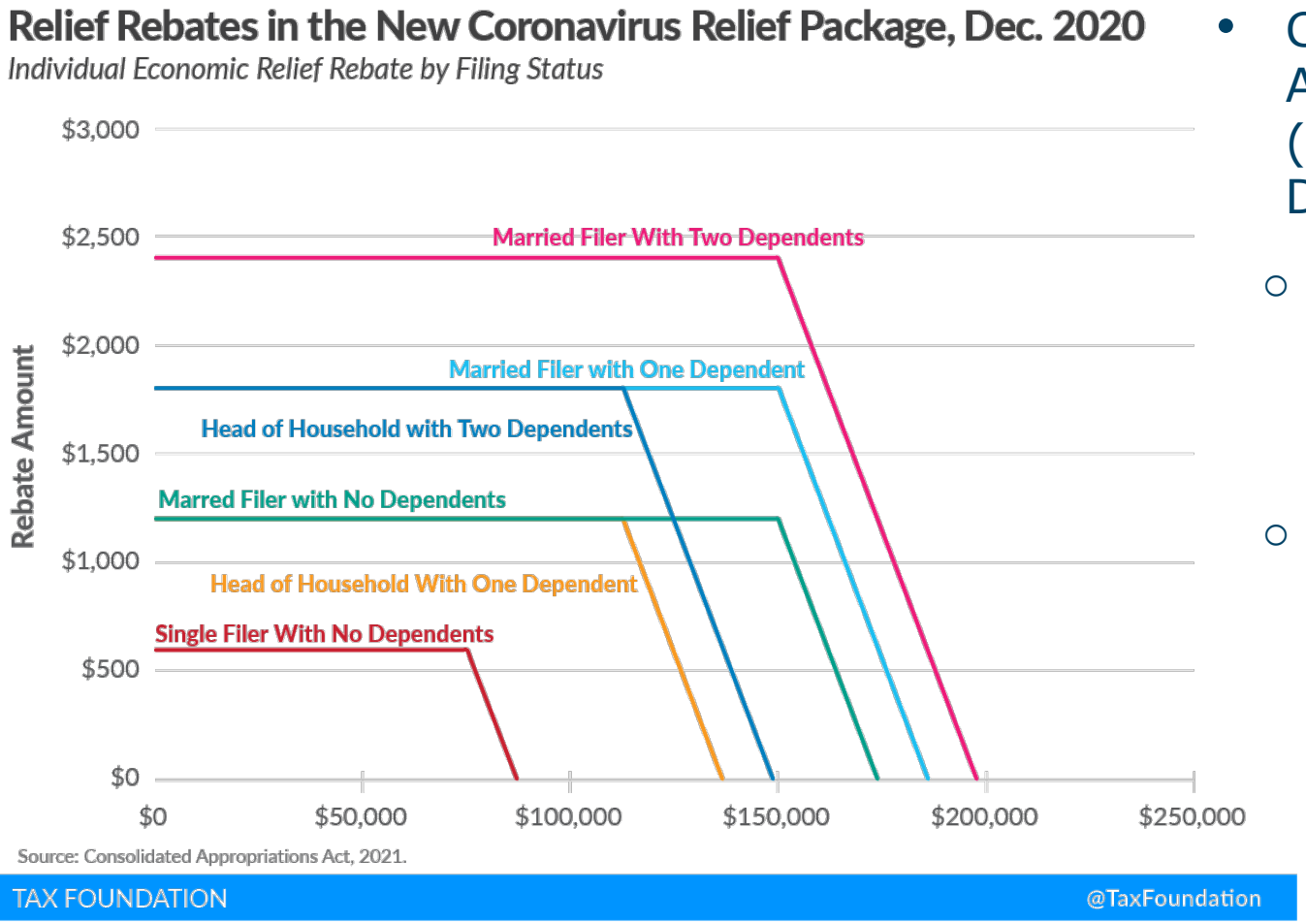
Agenda

- Overview of Known Changes for Tax Year 2021
- Potential Tax Changes in President Biden's Build Back Better Framework
- Estate & Gift Tax Update
- Other Tax Planning & Year-End Charitable Giving Strategies

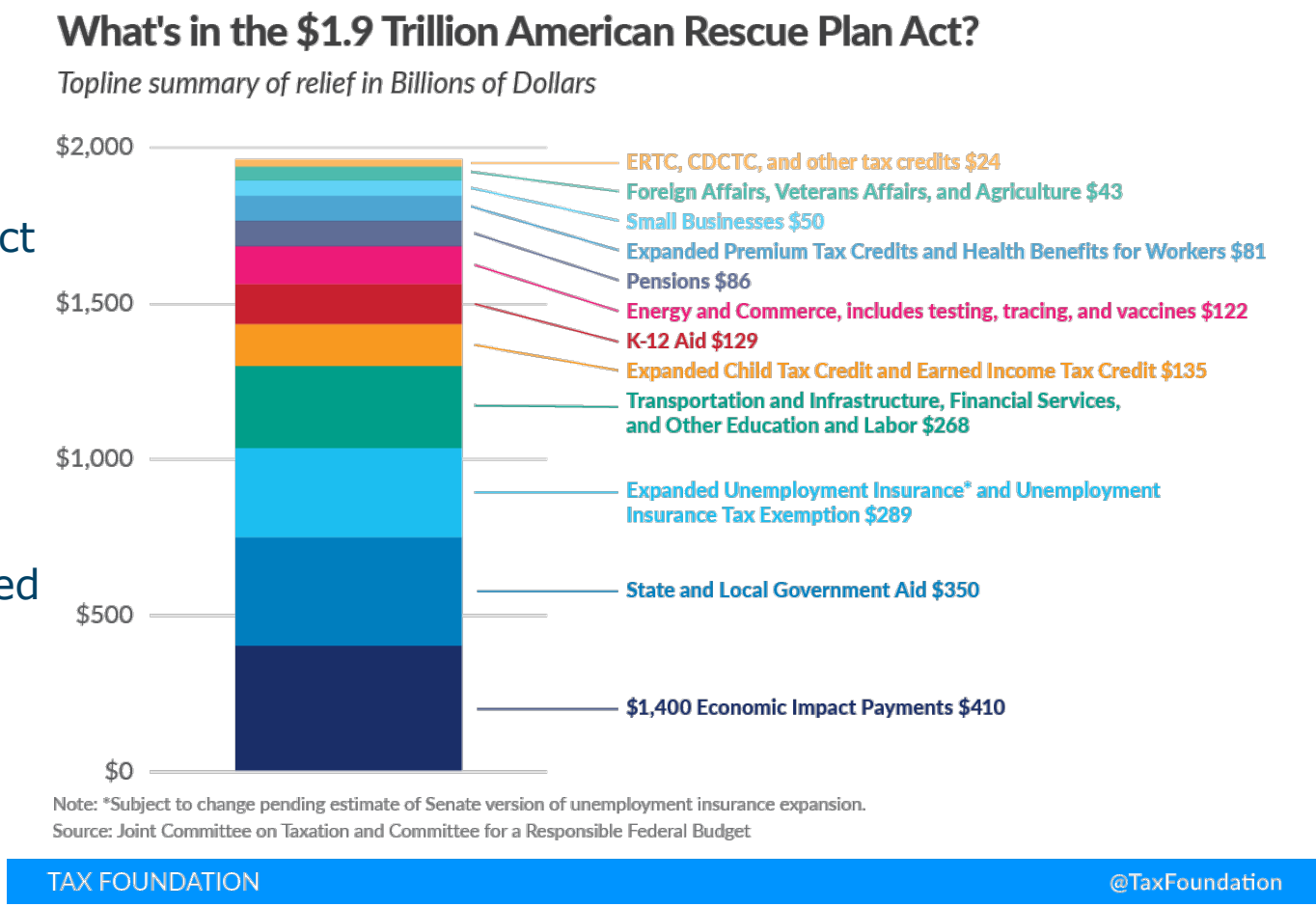
2021 Known Changes



- Consolidated Appropriations Act (CAA) passed in late December 2020
  - Economic Impact Payments (reconciled on 2020 tax return)
  - Increased Above-the-Line Charitable Contribution Deduction

2021 Known Changes

- American Rescue Plan Act (ARPA) passed March 2021
  - Economic Impact Payments (Reconciled on 2021 return)
  - Expanded Child Tax Credit
  - Expanded Earned Income Tax Credit (EITC)
  - Enhanced Child and Dependent Care Credit



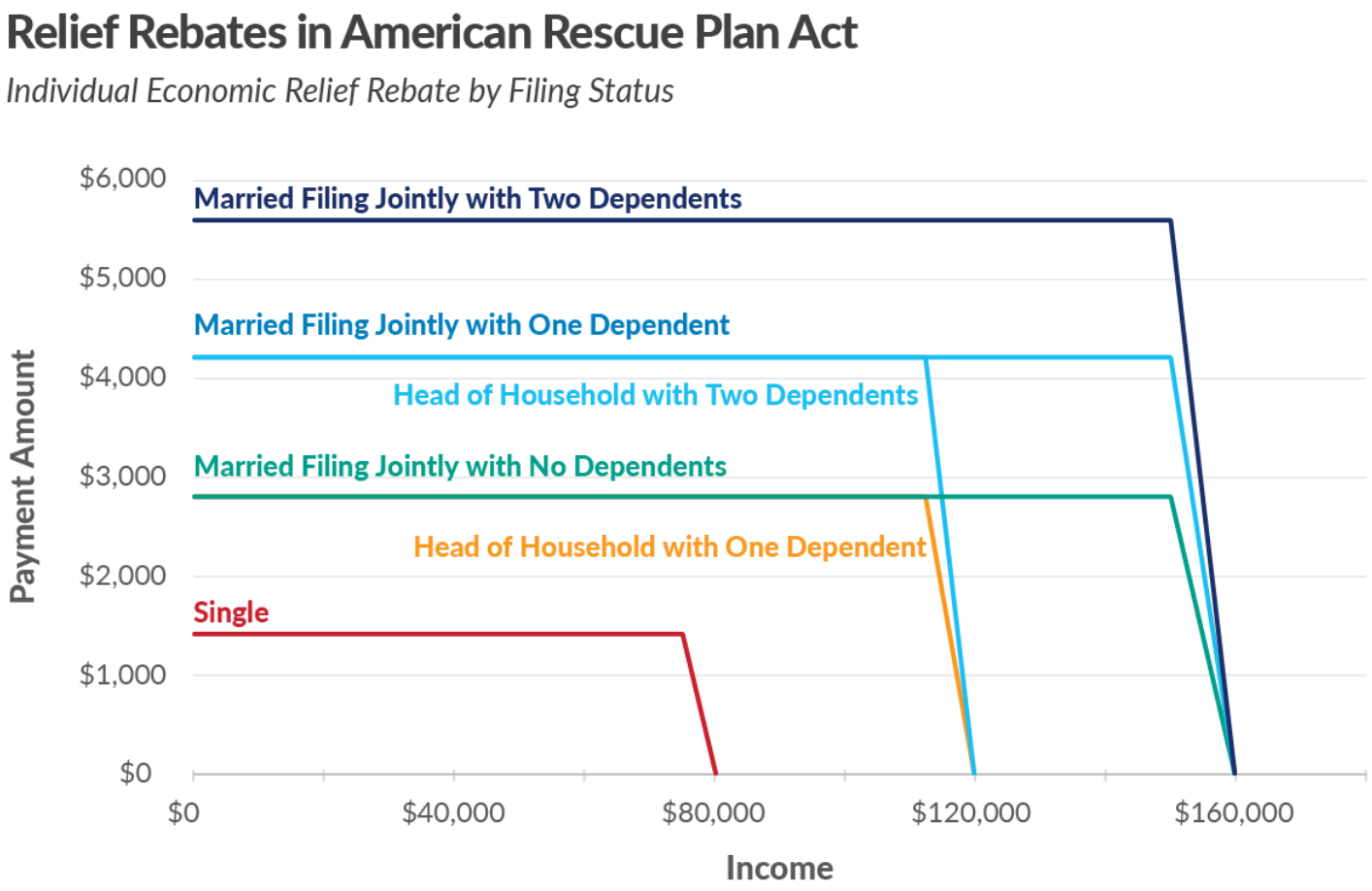
Additional Economic Impact Payment in 2021

- Eligible individuals received payments of $1,400 per person plus $1,400 for each qualifying dependent.

- Differed from the first two rounds in a few key areas:
  - Income phase-out amounts changed
  - Payment amounts were different
  - Qualifying dependents expanded

- Additional "Plus-Up" Payments were sent out to people who
  - Were eligible based on their 2020 tax return.
  - Already received a third Economic Impact Payment based on 2019 tax return information.

Additional Economic Impact Payments in 2021



Source: American Rescue Act (Senate Version), Tax Foundation calculations.

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Charitable Contributions in 2021

- Taxpayers can claim a limited deduction on 2021 returns even if they don't itemize
  - Max deduction is $600 for married individuals filing joint returns and $300 for other filers (an increase from 2020 limit of $300 per return)
  - Qualifying contribution must be made in cash to a qualifying organization

- Cash contributions that are not deductible include those:
  - Made to a donor-advised fund
  - Carried forward from prior years
  - Made to most private foundations (non-operating)
  - Made to charitable remainder trusts

Charitable Contributions in 2021

- Individuals that itemize may elect to take advantage of an increased individual limit of up to 100% of AGI for qualified cash contributions.
  - Any excess is still carried forward as a charitable contribution for each of the following five years
  - Non-cash property does not qualify for an increased limit

Changes on Loss Deductions

- Net Operating Losses (NOL)
  - TCJA reduced the amount of taxable income that can be offset with NOL deductions from 100% to 80%, and prohibited NOL carrybacks but allowed unlimited NOL carryforward
  - CARES Act reversed the 80% limitation for NOLs carried forward into tax years beginning before 2021 and allowed 5-year carryback

- Excess Business Loss Limitation
  - Limit is $250k ($500k for MFJ) adjusted for inflation for current-year business losses available to offset income from other sources
  - Temporarily lifted with CARES Act for 2018-2020
  - 2021 limit is $262k ($524k for MFJ)

Retirement Plan Changes in 2021

- Required Minimum Distributions (RMD) requirement reestablished in 2021.
  - All individuals who reached age 70 ½ in 2019 will have to take a RMD by December 31, 2021
  - All individuals who reached age 72 in 2021 will have to take a RMD by April 1, 2022.
  - Individuals who reached age 72 in 2021 may elect to make the first withdrawal by December 31, 2021, if they wish to avoid taxation on two RMDs in the same tax year

Credits – Child Tax Credit Changes

- Changes to the Child Tax Credit (CTC) were signed into effect under the American Rescue Plan Act (ARPA)
- Three key revisions to the CTC include:
  - Makes the CTC fully refundable
  - Increases in the amount of CTC certain taxpayers may claim
  - Allows for part of the CTC to be "advanced" to taxpayers during the last six months of 2021

Credits– Child and Dependent Care Tax Credit Changes in 2021

- Key Revisions to the Child and Dependent Care Tax Credit include:
  - Fully refundable credit
  - Up to $8,000 of work-related expenses for one qualifying person and $16,000 of work-related expenses for two or more qualifying persons (up from 3k/6k respectively)
  - Maximum percentage of work-related expenses that can be claimed as a credit is 50% - Up from 35% (2020).
  - The 50% number phases down for taxpayers with AGI over $125,000, and taxpayers with AGI over $438,000 can only use 20% of expenses

Other Notable Changes in 2021

- Standard Deduction Increases
  - Married Filing Joint - $25,100 – up from $24,800
  - Head of Household - $18,800 – up from $18,650
  - Single - $12,550 – up from $12,400

- Increase in contribution limit for pre-tax dependent care Flex Spending Accounts
  - $10,500 for 2021 compared to $5,000 for 2020

- Enhanced Earned Income Tax Credit for Childless Workers (EITC)
  - Expanded credit eligibility to more childless workers. Minimum age down to 19 from 25, maximum age has been eliminated.
  - Maximum credit available for Childless Workers increased.

Build Back Better Bill (as Passed by the House) – Individual Tax Provisions

- Final form and timing of the Senate bill are still unclear. Below are the proposed tax rate changes as passed by the House:

- 5% surcharge on modified AGI exceeding:
  - $200,000 for estates and trusts
  - $5 Million for Married Filing Separate taxpayers
  - $10 Million for all other individuals

- Additional 3% Surcharge on modified AGI in excess of:
  - $500,000 for estates and trusts
  - $12.5 Million for Married Filing Separate taxpayers
  - $25 Million for all other individuals

- Extends all of the 2021 changes to the Child Tax Credit through 2022
  - Makes CTC permanently refundable

Build Back Better Bill (as Passed by the House) – Individual Tax Provisions

- Net Investment Income Tax (NIIT) Revisions– Revised NIIT rules would broaden the types of income subject to the NIIT.

- NIIT would be applicable to the greater of "old" Net Investment Income or "Specified Net Income"
  - The definition of Specified Net Income has been broadened to include investment income even if it has been earned in the ordinary course of business.
    - Income from pass-through, even if the taxpayer is active in the business as long as that income has not been subjected to self-employment tax.

Build Back Better Bill (as Passed by the House) – Individual Tax Provisions

- "New" NIIT rules would apply to taxpayers with MAGI exceeding:
  - $500,000 - Married filing jointly
  - $250,000 – Married filing separately
  - $400,000 – All other individuals
  - $12,500 – Trusts

- "Old" NIIT rules would still apply to taxpayers with MAGI exceeding (no change):
  - $250,000 - Married filing jointly
  - $125,000 – Married filing separately
  - $200,000 – All other individuals
  - $12,500 – Trusts

Build Back Better Bill (as Passed by the House) – Individual Tax Provisions

- Changes treatment of losses disallowed by Excess Business Loss Limitation
  - Under current law, losses disallowed in a given year are converted to NOLs, which can be used the next year
  - Proposed changes would treat those disallowed losses as incurred by the taxpayer's business activities in the next year and subject to EBL rules in the next year.
- Reduces the exclusion for gains on qualified small business stock from 100% to 50%
  - Taxable half of gain would be a subject to special 28% rate
  - The portion of the gain excluded would be an AMT preference item
  - Effective tax rate on Section 1202 gain would be 16.88% (not including proposed surtaxes)
  - Applies to sales occurring after 9/13/2021

Build Back Better Bill (as Passed by the House) – Individual Tax Provisions

- Increases the SALT deduction cap from $10,000 to $80,000
  - Would apply to the tax year 2021
  - Extends increased cap through 2030
  - SALT deduction cap in 2031 would be $10,000

- Retirement Plan Changes
  - Elimination of the ability of all taxpayers to convert after-tax IRA contributions to a Roth account after 2021 ("Backdoor Roth")
  - High income taxpayers cannot contribute to retirement accounts if they have retirement accounts that total over $10 million
  - After 2028, requires taxpayers with large IRA balances to distribute amounts over $10 million
  - After 2031, no Roth conversions will be allowed for taxpayers with taxable income over $400,000

Build Back Better Bill (as Passed by the House) – Individual Tax Provisions

- What's out (for now)?
  - Increase in the "regular" top marginal individual income tax rate
  - Increase in the capital gains rate for certain high-income individuals
  - Limitation on the Section 199A deduction of qualified business income for certain high-income individuals
  - Modification of the rules for carried interests
  - Changes to treatment of irrevocable grantor trusts
  - Taxation of unrealized capital gains
  - Taxation of transfers to certain types of trusts
  - Elimination of basis step-up at death
  - Changes to rules regarding valuation discounts
  - Reduction in estate tax exemption

Current Estate & Gift Tax Proposals

- Key Gift and Estate Tax Proposals discussed during Biden's first year:
  - Increasing the estate tax rate and lowering the exemption
  - Repeal of "step-up" in basis for inherited assets
  - Changes to grantor trusts
  - Limits on minority discounts
  - Limits on using "value in use"
  - Taxation of unrealized capital gains at death

Current Estate & Gift Tax Proposals

- No Gift and Estate Changes introduced with the latest Build Back Better Framework

- Estate & Gift Tax Exemption "Sunsets" 1/1/2026
    - Federal estate and gift tax exemptions would decrease from $11.7 million to $5 million (adjusted for inflation).
    - Effective January 1, 2026.

Planning Strategies - 2021

It's another unusual year for tax planning

- Accelerate any gifts or estate transfers
- Taxpayers may have significant losses in 2021

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Planning Strategies - Traditional

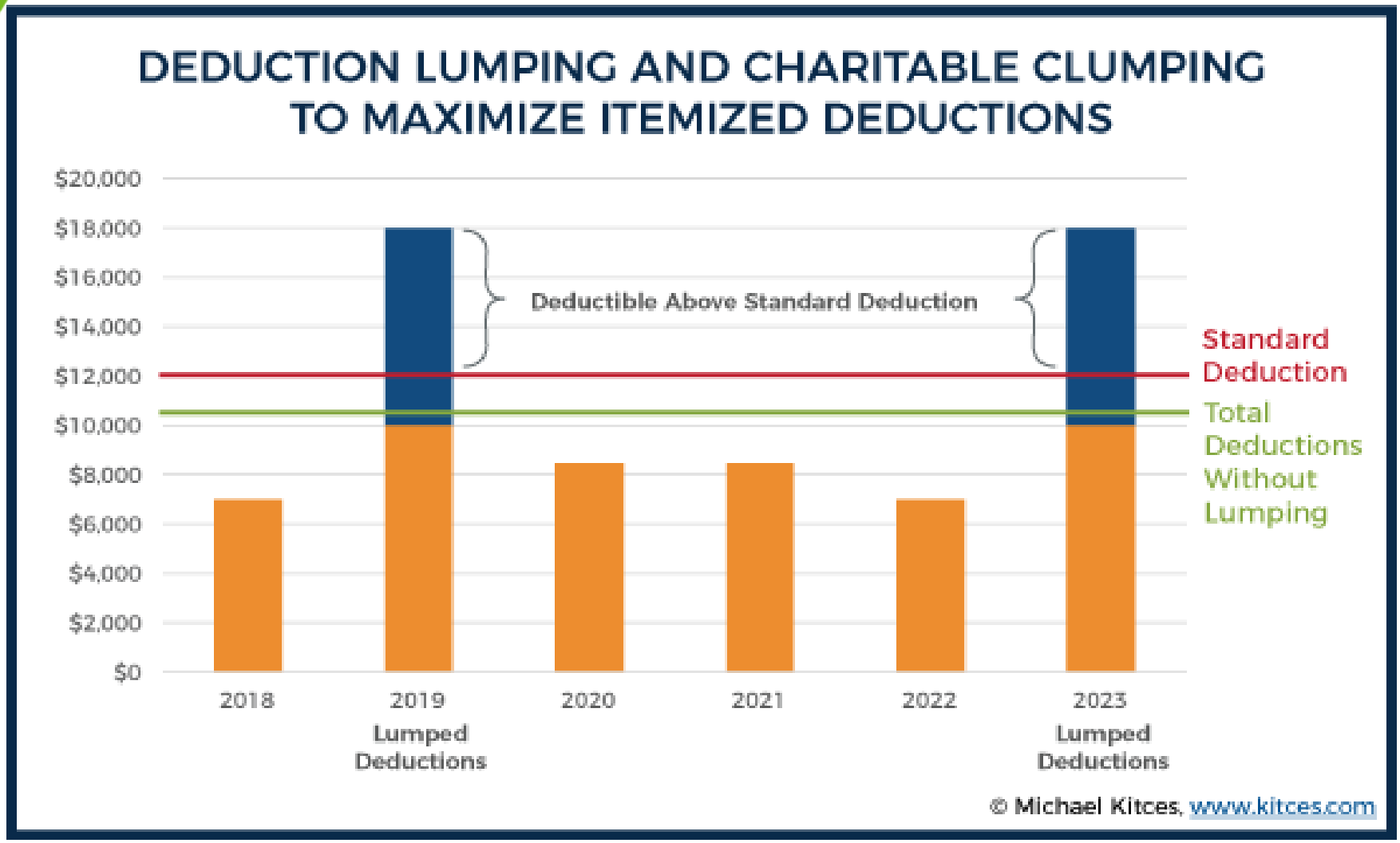
Defer Income:

- Postpone Roth conversions
- Minimize retirement distributions
- Hold appreciated assets
- Convert taxable interest to tax-exempt interest
- Defer receipt of year-end bonuses to the extent possible

Accelerate Deductions:

- Increase contributions to 401(k) plans, pension plans, SEP, etc.
- Maximize contributions to a health savings account (HSA)
- Recognize capital losses in 2021
- "Bunching" strategy for charitable contributions or medical expenses

"Bunching" Strategy for Itemized Deductions



Year-end Charitable Giving Strategies

- Consider changes in 2021 - 100% AGI limit for cash donations
- Accelerate planned gifts to 2021
- Qualified Charitable Distributions (QCD)
  - Donations out of IRA Required Minimum Distribution (RMD)
  - Especially powerful if taxpayers can't itemize
  - Direct transfer of funds from IRA payable to a qualified charity
- Use a Donor-Advised Fund (DAF)
- Timing of donations

Method of Charitable Giving	Effective Date of Contribution
Gifts by check	Date the check is mailed
Gifts by credit card	Date the charge is made to the card

Gifting Appreciated Securities

- Limited to 30% of AGI
- Allows for more dollars to be contributed to a charity and avoids capital gains taxes
- Must be stock held for more than one year to deduct FMV (if held for less than one year, limited to tax basis)

Example if stock sold first:

- 1,000 Shares of ABC Company Stock worth $100,000 (basis is $50,000)
- If sold, capital gains taxes owed of 28.8% (including Ohio) on a $50,000 gain or $14,400, leaving the remaining $85,600 to charity – a maximum tax savings of $31,672 (37%), a net savings of $17,272

Example of stock is donated to charity directly:

- 1,000 Shares of ABC Company Stock worth $100,000 (basis is $50,000)
- Income tax deduction of $100,000 – a tax savings of $37,000

Other Gifting Strategies

- Purchase a charitable gift annuity from a foundation
- Set up and fund a charitable lead or charitable remainder trust
- Both options provide for an income stream as well as a charitable deduction

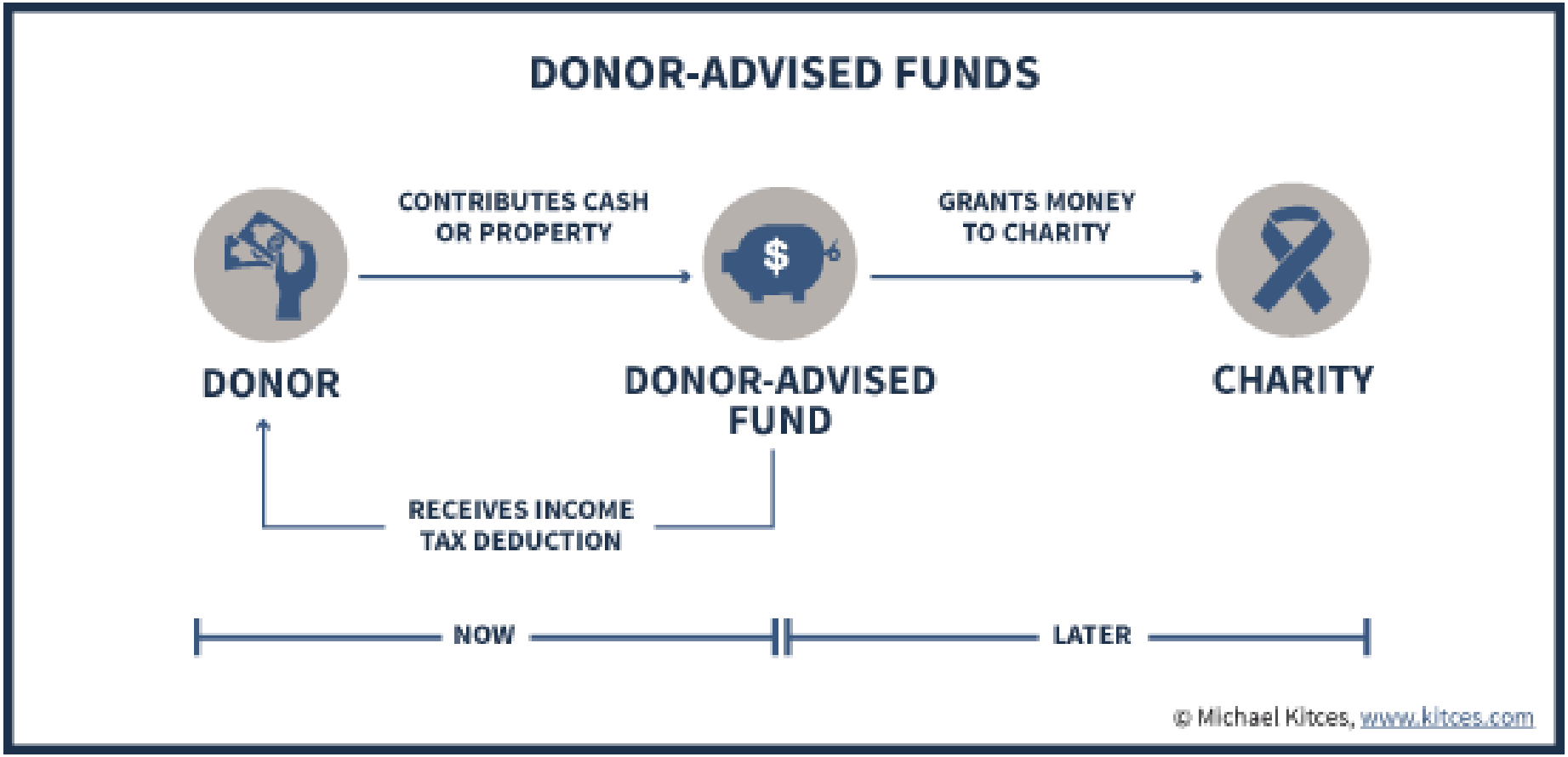
IRA Charitable Rollover

- Allows taxpayers over age 70½ to shift as much as $100,000 of their required minimum distributions (RMDs) to qualified public charities
- Acts as an "above the line" deduction, by diverting otherwise taxable income directly to a qualified charity
- Generally not available for donor-advised fund
- By excluding income, it may keep someone in a lower marginal tax bracket that also allows for Roth conversions, lower taxability of Social Security, etc.
- Provides state income tax benefit that would otherwise not be available for a charitable contribution

Donor-Advised Funds (DAF)

- A separately identified fund or account that is maintained and operated by a 501(c)(3) organization (i.e. The Columbus Foundation, The Catholic Foundation, Fidelity, Schwab, etc.)
- Each DAF is composed of contributions made by the separate donor
- Once the donor contributes, the sponsoring organization has legal control over it
- The donor retains advisory privileges concerning the distribution of funds and the investment of assets
- DAF provides a fairly affordable option to individuals to help them accomplish their charitable goals

Donor-Advised Funds



Questions

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