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Dear Client:

With year-end approaching, it is time to start thinking about moves that may help lower your income tax bill for this year and next. This year's planning is more challenging than usual due to the uncertainty surrounding pending legislation that could, among other things, increase top rates on both ordinary income and capital gains 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 continue to produce the best results for all but the highest income taxpayers, as will the bunching of deductible expenses into this year or next to avoid restrictions and maximize deductions.

If proposed tax increases do pass, however, the highest income taxpayers may find that the opposite strategies produce better results: Pulling 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.

We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all of them will apply to you, but you (or a family member) may benefit from many of them. We can narrow down specific actions when we meet to tailor a particular plan for you. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves might be beneficial:

- 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).

- 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 to the 3.8% net investment income tax (NIIT) proposed to be effective after this 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.

- The 0.9% additional Medicare tax also may require higher-income earners to take year-end action. It applies to individuals whose employment wages and self-employment income total more than an amount equal to the NIIT thresholds, above. Employers must withhold the additional Medicare tax from wages in excess of $200,000 regardless of filing status or other income. Self-employed persons must take it into account in figuring estimated tax. There could be situations where an employee may need to have more withheld toward the end of the year to cover the tax. This would be the case, for example, if an employee earns less than $200,000 from multiple employers but more than that amount in total. Such an employee would owe the additional Medicare tax, but nothing would have been withheld by any employer.

- Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15%, or 20% depending on the taxpayer's taxable income. If you hold long-term appreciated-in-value assets, consider selling enough of them to generate long-term capital gains that can be sheltered by the 0% rate. 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 the maximum zero rate amount (e.g., $80,800 for a married couple, estimated to be $83,350 in 2022). If, say, $5,000 of long-term capital gains you took earlier this year qualifies for the zero rate then try not to sell assets yielding a capital loss before year-end, because the first $5,000 of those losses will offset $5,000 of capital gain that is already tax-free.

- Postpone income until 2022 and accelerate deductions into 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 include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may actually pay to accelerate income into 2021. For example, that may be the case for a person who will have a more favorable filing status this year than next (e.g., head of household versus individual filing status), or who expects to be in a higher tax bracket next year. That's especially a consideration for high- income taxpayers who may be subject to higher rates next year under proposed legislation.

- If you believe a Roth IRA is better for you than a traditional IRA, consider converting traditional-IRA money invested in any beaten-down stocks (or mutual funds) into a Roth IRA in 2021 if eligible to do so. Keep in mind that the conversion will increase your income for 2021, possibly reducing tax breaks subject to phaseout at higher AGI levels. This may be desirable, however, for those potentially subject to higher tax rates under pending legislation.

- It may be advantageous to try to arrange with your employer to defer, until early 2022, a bonus that may be coming your way. This might cut as well as defer your tax. Again, considerations may be different for the highest income individuals.

- Many taxpayers won't want to itemize because of the high basic 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. You can still itemize medical expenses that exceed 7.5% of your AGI, state and local taxes up to $10,000, your charitable contributions, plus mortgage interest deductions on a restricted amount of debt, but these deductions won't save taxes unless they total more than your standard deduction. 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 able to work around these deduction restrictions by applying a bunching strategy to pull or push discretionary medical expenses and charitable contributions into the year where they will do some tax good. For example, a taxpayer who will be able to itemize deductions this year but not next 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.

- Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2021 deductions even if you don't pay your credit card bill until after the end of the year.

- If you expect to owe state and local income taxes when you file your return next year and you will be itemizing in 2021, consider asking your employer to increase withholding of state and local taxes (or make estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2021. But this strategy is not good to the extent it causes your 2021 state and local tax payments to exceed $10,000.

- 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 2020 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.

- If you are age 70 ½ 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 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 entire standard deduction. (The qualified charitable distribution amount is reduced by any deductible contributions to an IRA made for any year in which you were age 70 ½ or older, unless it reduced a previous qualified charitable distribution exclusion.)

- Take an eligible rollover distribution from a qualified retirement plan before the end of 2021 if you are facing a penalty for underpayment of estimated tax and increasing your wage withholding won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2021. You can then timely roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2021, but the withheld tax will be applied pro rata over the full 2021 tax year to reduce previous underpayments of estimated tax.

- Consider increasing the amount you set aside for next year in your employer's Flexible Spending Account (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.

- Make 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.

- If you were in federally declared disaster area, and you suffered uninsured or unreimbursed disaster- related losses, keep in mind you can choose to claim them either on the return for the year the loss occurred (in this instance, the 2021 return normally filed next year), or on the return for the prior year (2020), generating a quicker refund.

- If you were in a federally declared disaster area, you may want to settle an insurance or damage claim in 2021 to maximize your casualty loss deduction this year.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Sincerely yours,

Gregory Montagna

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