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2021 year-end tax planning

The National Wealth Strategies team, part of the Chief Investment Office, is pleased to present the 2021 Year-End Tax Planning Guide. This summary addresses common year-end federal tax issues for high-net-worth individuals, but only at a general level. Your particular situation should only be evaluated by your tax advisor, who knows the details of your situation.

TABLE OF CONTENTS

The tax changes continue

Each year we prepare this planning guide to help our clients navigate common tax-planning issues that arise at year's end. For some of these year-end planning issues, you need to compare the tax benefits/burdens under the current year's tax regime with the tax benefits/burdens under next year's tax regime.

Tax legislation was enacted on December 22, 2017, which made significant changes to the income tax and transfer tax laws for 2018 and thereafter (with many of those changes scheduled to expire after 2025). This legislation is often referred to as the "Tax Cuts and Jobs Act" (the "TCJA"). This guide will factor in those changes as we summarize these year-end planning issues.

In addition, there have been some new developments in 2019 and 2020. In particular, this guide includes a discussion of (i) how the IRS has thwarted attempts by some states to circumvent the $10,000 cap on the deduction for state and local taxes; (ii) 2020 year-end deadlines for certain investments in Qualified Opportunity Funds; (iii) the Setting Every Community Up for Retirement Enhancement Act of 2019, known by its acronym "SECURE," passed December 20, 2019; and (iv) the Coronavirus Aid, Relief and Economic Security Act ("CARES" Act) that was passed on March 27, 2020, to provide assistance to individuals and businesses in response to the coronavirus pandemic.

This guide is updated each year to provide information on what steps taxpayers might take to plan at year's end. As of mid-December, there is a pending bill in Congress: the Build Back Better Act (BBB). While the fate of this bill is subject to political uncertainties, it contains significant tax changes targeted to large corporations and high-income taxpayers. Many of the proposed tax changes would have limited effect on taxpayers with income below $10 million. Some of the proposals would take effect as early as 2022, while others have an effective date as far out as 2032. To the extent relevant, we briefly mention some of the proposed changes.

Taxpayers should keep an eye on this pending legislation and stay in contact with their tax and wealth advisors for the most up to date information and how any changes could affect their year-end planning. For information regarding recently proposed changes in tax laws, readers are encouraged to refer to our *Tax Alert 2021-16: Democrats release details of tax plan to pay for social spending expansion* and *Tax Alert 2021-17: Proposed Tax Changes — Build Back Better Framework*. (Note: A more in-depth discussion of estate tax planning can be found in our Wealth Strategy Report: *Estate Planning for a Declining Estate Tax Exemption* and a more in-depth discussion of income tax planning for a range of possible future changes can be found in our *Tax Alert 2020-13: Beyond First Blushes and Gut Reactions — Planning for the Coming Tax Increases?*)

Basic tax planning

Quarterly estimated taxes

Although estimated tax payments are not always a year-end matter, there are a few planning tips that are related to the year's end.

Federal (and most state) estimated tax payments are due quarterly on April 15, June 15, September 15 and January 15 (except if the 15th falls on a Saturday, Sunday or legal holiday). To the extent withholdings from your salary do not satisfy the amount due, you may have to make additional payments to the IRS by these quarterly due dates in order to avoid an underpayment penalty.

There are three ways to calculate your federal quarterly estimated tax payments; you can choose the method that requires the smallest payment. (Your state might have different rules for calculating your state estimated tax payment.)

Method #1: 90% Rule

Each quarter, pay 25% of 90% of the current year's tax. This requires that you predict the current year's tax.

Method #2: 100/110% Rule

- If your adjusted gross income (AGI) on last year's return was $150,000 or less and you filed singly or jointly ($75,000 for married filing separately), then your quarterly payment under this method must be 25% of 100% of last year's tax, reduced by certain credits. This requires no prediction.
- If your AGI was more than these amounts, then your quarterly payment must be 25% of 110% of last year's tax (which is mathematically equivalent to 27.5% of 100% of last year's tax).

Method #3: Annualization

Each quarter, based on the year-to-date pace of your income, you predict what would be 90% of the current year's tax. You pay 25% of that for the first quarter. For the second quarter, you would pay whatever additional amount would make your year-to-date estimated tax payments total 50% (of 90% of the predicted tax), etc. This annualized method can be favorable if your income is not earned evenly throughout the year.

Planning tip. Taxes that are withheld from wages are deemed to have been withheld equally on the estimated tax payment dates throughout the year. This can be beneficial if at year's end you find that you have underpaid prior quarters' estimated taxes. If you file an updated form W-4, your employer will withhold more tax, and a portion of that amount will be deemed to have been retroactively and evenly paid in prior quarters during that year, possibly mitigating an estimated tax underpayment penalty. The IRS launched a new internet-based tax withholding estimator in 2020. The results can help with more accurate withholding or estimated tax payments. The estimator can be found at: https://www.irs.gov/individuals/tax-withholding-estimator

Similar withholding rules apply to distributions from IRAs. If it is advantageous, you can withdraw from your IRA and have tax withheld at a higher rate than the default withholding rate. The taxes that are withheld are deemed to have been withheld equally on the estimated tax payment dates throughout the year.

Because you would incur income tax on withdrawn amounts, this can make the most sense if you are over 72 and must withdraw the required minimum distributions. In that case, you would not be incurring additional income tax since you must withdraw from your IRA; rather you would just be having more tax withheld from your required minimum distributions.

Similar rules apply to Social Security retirement benefits. If you are receiving Social Security retirement benefits and want to have income tax withheld, that is accomplished by filing a Form W-4V, Request for Voluntary Withholding. If you file that form, income tax will be withheld until you file another Form W-4V directing otherwise. Any withheld amounts are deemed to have been withheld on the four estimated tax due dates.

Estimated taxes must include 3.8% Medicare surtax and 0.9% Medicare tax. Traditionally, the estimated taxes discussed above have encompassed income taxes, self-employment taxes and alternative minimum taxes. Beginning in 2014, however, taxes due under the 3.8% Medicare surtax also must be included in estimated tax calculations. Similarly, the additional 0.9% Medicare tax imposed on wages and self-employment income above certain thresholds must be included in estimated tax calculations.

Timing deductions

Income tax deductions are subject to many limitations that can have different effects each year. As a result, it can sometimes be beneficial to time the payment of deductible amounts, either accelerating payment into the current year or delaying payment into the next year.

In prior years, there were two significant limitations that might apply in the current or next year and which therefore could influence this type of timing. One limitation involved so-called “miscellaneous itemized deductions,” which were deductible only to the extent they exceeded 2% of AGI. The TCJA made all such deductions nondeductible for tax years 2018 through 2025. Another limitation was the so-called “Pease limitation,” which phased out certain itemized deductions once your AGI exceeded certain thresholds that depended on your filing status. Similar to the 2% miscellaneous itemized deductions, the TCJA removed the Pease limitation for tax years 2018 through 2025.

Nevertheless, there are other limitations to take into account, including the following:

Deduction for state and local taxes. Under the TCJA, for tax years 2018 through 2025, the deduction for state and local income, sales and property taxes is limited to $10,000 in the aggregate ($5,000 for married filing separately). There is no limitation on state and local property taxes paid or accrued in carrying on a trade or business, or for the production of income.

Note: The BBB Bill proposes to increase the cap on state and local taxes for 2021 and several additional years. The deduction could be means tested, but it appears it will not be unlimited.

In 2021, numerous states enacted so-called Pass-Through Entity Tax regimes. A Pass-Through Entity Tax is generally an optional tax that can be paid by a pass-through entity such as a partnership, multi-member LLC or an S-corporation, in lieu of paying taxes on such income allocable to the entities’ partner, member or shareholder. The IRS has sanctioned such an approach as a way of indirectly obtaining a deduction for state and local taxes attributable to the entity’s income.

Note: This $10,000 cap does not affect “investment interest,” which remains deductible as an itemized deduction, to the extent of net investment income.

Deduction for medical expenses. In 2018, 2019 and 2020, medical expenses were an itemized deduction, subject to a “floor” of 7.5% of AGI. That is, medical expenses were deductible only to the extent they exceeded 7.5% of AGI. In 2021, the floor increased to 10% of AGI. The Consolidated Appropriations Act, 2021, signed on December 27, 2020, made the 7.5% medical expense deduction floor permanent, rather than reverting to a 10% floor beginning in 2021. If you will have significant medical expenses and you will be itemizing, and if you can control the timing of these deductible payments, two planning ideas are as follows:

- If your threshold is lower in one year than another (which will depend on your AGI), making a deductible medical expenditure in that year could allow you a larger tax deduction.
- If your medical expenditures don’t exceed the threshold when paid each year, then “bunching” them together in one year might allow you to exceed the threshold in one year.

Increased standard deduction. The standard deduction for 2018 increased significantly to $24,000 ($12,000 if single), and enhanced for elderly and blind. Those amounts are indexed for inflation. The standard deduction for 2021 is $25,100 ($12,550 if single) and for 2022 will be $25,900 ($12,950 if single). There continues to be an additional deduction for those who are 65 or older or blind. Because of this increase, you might find that taking the standard deduction provides a greater deduction than itemizing, in effect rendering your itemized deductions useless. In that case, bunching your itemized deductions might provide a benefit. For example, let’s say that in addition to $10,000 of state taxes, you also have $13,000 of charitable deductions in each of 2021 and 2022. Your itemized deductions would total $23,000 and so you would instead use the standard deduction of $25,100 in 2021 and $25,900 in 2022 (assuming married filing jointly).

If instead you could bunch all of the charitable deductions into 2021, you would have itemized deductions of $36,000 in 2021 and you would still have the $25,900 standard deduction in 2022.

20% deduction for qualified business income. The TCJA enacted a new deduction of up to 20% of the business income that you report on your individual tax return from a pass-through entity. We discuss the workings of this new deduction in our *Wealth Strategy Report: Business Income From Pass-Through Entities: The New 20% Deduction.*

The availability of this new deduction might depend on your taxable income. For example, assume you have business income from a service business. Whether a particular service business will allow you to qualify for this deduction can depend on your level of taxable income, and lowering your taxable income (by timing other deductions) could affect the amount of your deduction.

Alternative minimum tax (AMT) planning

When calculating AMT, each taxpayer is entitled to an AMT exemption. However, that exemption is phased out as AMT income increases. The TCJA significantly increased both the amount of the exemption and the levels at which the exemption is phased out. The following charts summarize the actual exemptions for 2021 and 2022.

AMT Exemption	2021	2022
Married filing jointly	$114,600	$118,000
Married filing separately	$57,300	$59,050
Single	$73,600	$75,900

Exemption Phase Out		2021	2022
Married filing jointly	From	$1,047,200	$1,079,800
	To	$1,505,600	$1,552,200
Married filing separately	From	$523,600	$539,900
	To	$752,800	$776,100
Single	From	$523,600	$539,900
	To	$818,000	$843,500

As a result of these changes, fewer taxpayers will now face the AMT.

If you are subject to AMT, your marginal federal income tax rate is 26% or 28%,[1] compared with a top marginal bracket of 37% for regular tax purposes.[2] Thus, once you are subject to AMT, it can actually be beneficial to recognize income while in that tax bracket. Conversely, some deductions (such as charitable contributions and mortgage interest) are more valuable if your income tax rate is 37% than if your income tax rate is 28%. Other deductions (such as state income taxes) are not deductible for AMT purposes and therefore are "wasted" if incurred in a year you are subject to AMT.

Alternative Minimum Tax issues. If you will be paying AMT in 2021 but do not expect to do so in 2022, you might consider accelerating ordinary income into 2021 so that it is taxed at 28% rather than 37% or higher. For example, if you are considering exercising nonqualified stock options, exercising a portion in 2021 might reduce taxes overall if that income would be taxed at the marginal AMT rate of 28% in 2021 rather than, say, 37% in 2022. (You need to be careful not to exercise so many options that it causes you to no longer be subject to AMT.)

If you will be paying AMT in 2021 but not 2022, deferring certain deductions can also be beneficial. For example, it is common to pay estimated state income taxes in December, rather than January, in order to accelerate the deduction. If you are subject to AMT in 2021, state taxes paid in December 2021 will not be deductible, and so paying those taxes in December would provide no tax benefit. Consider deferring payment until 2022 if that would provide more of a benefit. Remember, however, that in general the deduction for state and local income, sales and property taxes is limited to $10,000 in the aggregate ($5,000 for married filing separately). As a result, it might be the case that much of your state income tax will not be deductible regardless of which year you pay it.

If you will not be paying AMT in 2021 but expect to do so in 2022. If you will not be subject to AMT in 2021 but expect to be in 2022, the suggestions in the previous paragraphs should be reversed — consider accelerating deductions into 2021 and deferring income into 2022.

The AMT is a moving target. For example, if you shift income or expenses from 2021 to 2022 (or vice versa), that can affect your AMT status for both years. You should always quantify the benefit and have your tax advisor run "before and after" tax projections prior to implementing a strategy.

1 Long-term capital gains retain their favorable rates (15% or 20%) under AMT.

2 For income subject to the 3.8% Medicare surtax, the top federal rate is 40.8%.

Capital transactions

How short- and long-term gains/losses are netted[3]

Capital gains and losses are subject to a series of "netting rules" that govern how capital gains are offset by capital losses. These netting rules are applied at year's end to the entire year's capital gains and losses. The steps involved in this netting process are as follows:

1. Short-term losses are netted against short-term gains.
2. Long-term losses are netted against long-term gains.
3. If one of the preceding two steps is a net gain and the other a net loss, you net those.
4. Any resulting short-term gains are taxed at ordinary income rates. Any resulting long-term gains are taxed at the appropriate long-term capital gain rates, which are as follows for 2021 (maximum rates):[4]
   - 15% for securities (for long-term capital gains). If your taxable income exceeds certain thresholds, the maximum rate applicable to long-term capital gains is 20%. These thresholds are discussed in the next section.
   - 25% for certain real estate depreciation recapture.
   - 28% for collectibles (such as art) and the portion of gain from the sale of "qualified small business" stock that is taxable.[5]

3.8% Medicare surtax alert

Each of these rates is increased by an additional 3.8% if the gain is subject to the 3.8% Medicare surtax.

5. If there is an overall capital loss, up to $3,000 can be deducted against ordinary income. This $3,000 comes first from short-term capital losses, if any, and then long-term capital losses.
6. After applying the foregoing rules, any remaining excess capital loss is carried forward to future years indefinitely (until death), retaining its character as short- or long-term capital loss.

Maximum capital gain rate

The maximum tax rate imposed on most[6] long-term capital gain is 20%. The maximum rate on "qualified dividends" is also 20%. This maximum rate begins at certain thresholds based on filing status, summarized in the following chart. These thresholds are indexed for inflation and change annually. For 2021 and 2022 they are:

Filing Status	Taxable Income Threshold for the 20% Rate for Long-term Capital Gain and Qualified Dividends	
	2021	2022
Married filing jointly	$501,600	$517,200
Head of household	$473,750	$488,500
Single	$445,850	$459,750
Married filing separately	$250,800	$258,600
Trusts and estates	$13,250	$13,700

Note: The BBB Bill proposes a new tax surcharge on individuals and trusts in a two tier structure. First tier — a surcharge of 5% would apply to individuals with modified adjusted gross income in excess of $10 million. This threshold is the same for married couples filing jointly and single taxpayers. If a married couple files separate tax returns, the threshold drops to $5 million for each of them. For a non-grantor trust, the threshold drops to $200,000. This low threshold is further confirmation of Congress' suspicion of trusts. Second tier — an additional surcharge of 3% would apply to individuals with modified adjusted gross income in excess of $25 million. This threshold is the same for married couples filing jointly and single taxpayers. However, if a married couple files separate tax returns, the threshold drops to $12.5 million for each of them. For a non-grantor trust or an estate, the threshold drops to only $500,000. The surcharge is determined and applied to all income (i.e., wages, dividends and gains) in excess of the modified adjusted gross income thresholds (modified adjusted gross income is essentially, gross income, reduced by investment interest expense). For individuals, it is important to note that charitable deductions (and other itemized expenses) do not reduce the income potentially subject to the surcharge.

3 "Long-term" gain/loss is gain/loss from the sale of a capital asset owned more than one year. "Short-term" gain/loss is gain/loss from the sale of a capital asset owned one year or less.

4 Each of these rates is increased by an additional 3.8% if the gain is subject to the 3.8% Medicare surtax.

5 The portion of gain from the sale of "qualified small business" stock that is taxable can vary due to several legislative amendments. We have a separate Wealth Strategy Report: *Qualified Small Business Stock*.

6 As listed above, certain types of gain, such as recapture and gain from collectibles, can be taxed at higher rates.

Examples

(i) You want to raise $50,000 in cash and can do that by selling one of two stocks. One will generate $10,000 of long-term capital gain; the other will generate $10,000 of short-term capital gain. Which is better?[7]

You might assume it is better to incur the long-term capital gain because it is more favorably taxed at 15%/20%, but that's true only with respect to the entire year's net long-term gains. For a particular transaction, long-term is not necessarily better.

Consider if we add the assumption that you have previously recognized $10,000 of capital losses during this tax year. Under the netting rules described above, assuming no other gains or losses, this $10,000 capital loss will offset either of the $10,000 gains being considered, whether it be the short- or long-term gain. Given that, which $10,000 gain would you rather leave behind, so to speak — (i) the short-term gain potentially taxed at 37% or (ii) the long-term gain taxed at 15%/20%? It would probably be better to incur the $10,000 of short-term capital gain now, knowing it will be fully offset by the already-existing loss, and leave for later the $10,000 long-term gain, which already qualifies for the favorable 15%/20% rate.

Thus, although generally long-term capital gains are to be preferred when viewing the entire year's capital gains, for this particular transaction it could be more beneficial to recognize short-term capital gain.

(ii) You have $10,000 of short-term capital gain for the year so far, and you want to "harvest" a $10,000 capital loss. You can generate a $10,000 loss by selling either of two stocks. One will generate a $10,000 long-term capital loss; the other will generate a $10,000 short-term capital loss. Which is better? It might seem better to harvest the short-term capital loss, but that's not necessarily true.

Under the netting rules discussed previously, either loss will fully offset the $10,000 short-term capital gain. Think of the short-term capital loss as normally offsetting 37% income and the long-term capital loss as normally offsetting 15%/20% income. Under this particular fact pattern, incurring the long-term capital loss will actually allow it to offset 37% income. Therefore, it might be better to incur the long-term capital loss and save the short-term capital loss (though it will eventually "mature" into a long-term capital loss).

Planning with the capital gain netting rules

Long-term capital gains are often viewed as "better" than short-term gains because of the lower tax rate applicable to long-term gains. Similarly, short-term losses are often viewed as more valuable than long-term losses because under the netting rules they offset 37% gain, whereas long-term losses offset 15%/20% gain. However, the capital gain netting rules described above apply to the entire year's cumulative capital gains and losses. There is no universal rule that your next capital transaction is better being short-term or long-term. Rather, it depends on how it would affect the entire year's capital gains and losses.

Capital gains

There is no universal rule that your next capital transaction is better being short-term or long-term. Rather, it depends on how it would affect the entire year's capital gains and losses.

On the next page are two examples illustrating that (i) a long-term capital gain is not necessarily better than a short-term capital gain and (ii) a short-term capital loss is not necessarily better than a long-term capital loss. In each case, it depends on how it would affect the entire year's capital gains and losses.

Will the gain/loss on securities be in 2021 or 2022?

Depending on your tax situation, you might prefer to have a year-end gain taxed in 2021 or 2022. Similarly, with a loss, you might prefer to recognize the loss sooner in 2021 or later in 2022. In general, you can achieve whatever result you want if you follow the tax rules summarized below.

Most of the rules summarized below depend on the "trade date," which is when your order to buy or sell is entered. One rule, however, depends on the "settlement date," which is normally two or three business days after the trade date. (This can differ depending on the particular type of security involved.) The rules below assume that stock is sold on an exchange. In a private transaction, state commercial law governs when the transaction is closed and a gain or loss is recognized. In order to get the tax result you want, it is important to understand which rule applies to your transaction.

[7] These examples assume that the sale of either stock — and therefore the retention of either stock — is consistent with your investment strategy. Always remember that it is risky to make investment decisions based solely on tax consequences.

Gains. For gains, there is one rule that covers both long and short positions[8] — the gain is recognized for federal income tax purposes on the trade date.

- *Long positions.* A "long" position means you purchased stock, you own it and you will profit if the stock's price increases. If you sell stock that you own for a gain, the gain is recognized for tax purposes as of the trade date. So, if you want to defer the gain until 2022, your trade date must be in 2022.
- *Short positions.* A "short" position means you borrowed stock to immediately sell it; you do not own it but rather must repay it to the lender, and you will profit if the stock's price decreases (because you can then repurchase the stock at a lower price to repay your debt). If you shorted stock and now want to close out that short to take a gain, the gain will be taxed as of the trade date. So, if there is a gain in the short position, then closing with a trade date of December 31, 2021, and a settlement date of January 4, 2022 (two business days later), will trigger the gain in 2021. If you want to defer the gain until 2022, your trade date must be in 2022.

Deferring gain

If you sell stock that you own for a gain, the gain is recognized for tax purposes as of the trade date. So, if you want to defer the gain until 2022, your trade date must be in 2022.

Losses. For losses, there's one rule for long positions, another for short positions.

- *Long positions.* If you own stock and want to sell it for a loss, the loss is incurred as of the trade date (same rule as for gains on long positions). So, if you want to be able to take the loss on your 2021 tax return, make sure your trade date for the sale is on or before December 31, even if that sale settles in January 2022.
- *Short positions.* If you shorted stock and now want to close out that short to take a loss, the loss is recognized for tax purposes on the settlement date when the shares are delivered to close the short. So, if you want to be able to take the loss on your 2021 tax return, make sure your trade date will be early enough so that the settlement date will also be in 2021.

	Long Position	Short Position
Gain is triggered on	Trade date	Trade date
Loss is triggered on	Trade date	Settlement date

The Wash Sale Rule

Although the Wash Sale Rule can be triggered at any time and so is not limited to year-end planning, it often comes into play when you "harvest" a loss, which often occurs at year's end.

The rationale behind the Wash Sale Rule is to disallow a current tax loss if you haven't changed your economic position due to a quick sale/repurchase. So, if you sell stock at a loss and reacquire "substantially identical securities" within 30 days before or after the loss[9] (total of 61 days), that is a "wash sale" and the result is:

- The loss is disallowed currently.
- The disallowed loss is added to the basis of the reacquired securities, in effect deferring the loss until you sell those reacquired securities (there is an important exception, noted in the paragraph below labeled "Beware repurchasing in an IRA").
- The holding period of the "old" securities carries over to the holding period of the reacquired securities.

The result is approximately the same as if you had not sold/reacquired the shares. IRS Publication 550 states that the Wash Sale Rule is also triggered if the reacquisition is by your spouse or your controlled corporation.

The Wash Sale Rule can also apply to short sales. For example, assume that you short stock and the stock price appreciates, which means you have a built-in loss. Assume you close the short position to incur the loss and, within 30 days, you short the same stock again. The Wash Sale Rule would apply and the loss would be disallowed.

Be aware that with multiple investment managers and separate investment accounts, the Wash Sale Rule can be inadvertently triggered. There is no requirement that it be triggered intentionally. For example, assume fund manager A of your separately managed account sells shares of ABC stock to harvest a loss, while fund manager B buys ABC stock within 30 days. That is a wash sale.

The Wash Sale Rule can apply partially. For example, if you sell 100 shares at a loss but reacquire only 60 shares of the same stock, the Wash Sale Rule would apply to 60 shares. For the other 40 shares that were sold at a loss, the loss would be allowed.

Beware repurchasing in an IRA. The Wash Sale Rule will apply even if the loss is incurred in a taxable account and the repurchase occurs in an IRA (traditional or Roth). In a 2008 Revenue Ruling, the IRS stated that, assuming the conditions of the Wash Sale Rule are met, the loss would be disallowed, but the disallowed loss would not be added back to the basis of the security repurchased inside the IRA. This is a worse result

[8] This assumes the short position is not a "short against the box."

[9] It is irrelevant whether the year's end is straddled. A loss incurred in December followed by a repurchase in January still triggers the Wash Sale Rule if the requirements are met.

than if the repurchase had occurred in a taxable account, in which case the disallowed loss would have been added to the basis.

Note: The BBB Bill proposes to modify and expand wash sale rules. The Bill would expand the scope of wash sales to include sales, dispositions, or terminations of specified assets. “Specified assets” would include an expanded scope of assets, including crypto-currencies (any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Treasury Secretary), foreign currency, and certain commodities. The proposal would also expand the wash sale rules so that they apply if the taxpayer or a related party acquires substantially identical specified assets. The effective date for the proposed expanded wash sale rules would apply to sales, dispositions and terminations after December 31, 2021.

Planning with the Wash Sale Rule

Each of the following constitutes a reacquisition under the Wash Sale Rule. That means if you recognized a loss 30 days before or after any of these transactions in the same or “substantially identical” stock, the loss is disallowed. Although some of these reacquisitions might be beyond your control, that just means you need to control when you incur the loss.

- Buying the same stock on the market (including via a dividend reinvestment program).
- Receiving the same stock as a compensatory stock bonus.[10]
- Being granted a compensatory stock option (the Wash Sale Rule can be triggered by the acquisition of an option to purchase the security, as well as by the reacquisition of the security itself).[11]
- Exercising a compensatory stock option (unless the grant of the option previously triggered the Wash Sale Rule; an option can trigger the Wash Sale Rule only once).
- Buying a listed option on the stock on an exchange.
- Acquiring certain convertible preferred stock, convertible into the security that was sold for a loss.
- Selling “deep in the money” puts (the theory being that if you sell deep in the money puts, as a practical matter you are going to end up with the stock again because the put option will likely be exercised).

There are straightforward ways to avoid the Wash Sale Rule.

- You could incur a loss and then wait 30 days before reacquisition. Remember, the loss is incurred on the trade date if you are selling long stock, while the loss is incurred on the settlement date if you are closing a short position for a loss.
- An approach similar to the preceding idea is to first purchase more of the stock that you intend to sell (called “doubling up”), and then wait 30 days before selling the stock for a loss. (You would need to be sure to properly identify the stock being sold for the loss. How to do that is discussed in the next section.) The main difference between this approach and the approach described in the preceding paragraph is that you would be “in” the market during the 30-day waiting period.
- You could make sure that what is reacquired is not “substantially identical securities.”
  - For stocks, a different issuer/company is not “substantially identical.” Therefore, you could sell your stock and reacquire shares of a different company that is in the same sector as the stock you sold.
  - For bonds, you could purchase the bonds of a different issuer. It is possible to stay with the same issuer, but the terms of the bond would have to be sufficiently different.
  - For mutual funds, former IRS Publication 564 stated the following: “In determining whether the shares are substantially identical, you must consider all the facts and circumstances. Ordinarily, shares issued by one mutual fund are not considered to be substantially identical to shares issued by another mutual fund.” Prior years’ versions of Publication 550 have stated that it incorporates Publication 564, although current versions of Publication 550 no longer say that explicitly. Unfortunately, Publication 550 does not address mutual funds (or ETFs) in the context of the Wash Sale Rule.
- If you have triggered the Wash Sale Rule and the triggering repurchase has not occurred within an IRA, then the disallowed loss has been deferred by adding the disallowed loss to your basis in the replacement shares. If you sell those replacement shares and do not reacquire “substantially identical” securities for 30 days, then the Wash Sale Rule would not apply to that later sale.

[10] There is no clear guidance whether a restricted (i.e., non-vested) stock grant constitutes a reacquisition.
[11] There is also no clear guidance whether a non-vested stock option grant constitutes a reacquisition.

Identifying which shares are sold

Like the Wash Sale Rule, this issue can arise at any time and is not limited to year-end planning. However, because year-end planning often includes recognizing gains or losses for tax purposes, it is important to be sure that the tax lots sold will generate the desired gain or loss.

To understand why this issue can be important, consider the following example.

Example. Assume your account holds two lots of ABC shares. One lot consists of 1,000 shares purchased at $100/share on January 5 for $100,000. The second lot consists of 1,000 shares purchased at $75/share on March 16 for $75,000. You want to sell 1,000 shares. Which lot should be sold?

Answer: It depends on your situation. The first lot has a higher basis and will generate less capital gain, which is normally preferred. However, if you have tax losses that can offset the gains, it might make sense to sell the second lot.

There are rules for determining which lots are considered sold for tax purposes. If you know the rules and follow them properly, you can be treated as having sold whatever lot you choose. If you do not affirmatively address this, a result will be imposed on you via a default rule, which might or might not produce the best tax result.

For securities other than mutual funds:

You can identify which shares you want to sell, and those will be the shares you are considered to have sold. This process is known as “specific identification” and has two requirements:

1. When the trade is requested, you must communicate to your portfolio manager which shares are to be sold. This can be done orally or in writing.
2. You must receive written confirmation of your identification within a reasonable time.

If you do not follow the “specific identification” method described above (or you fail to meet both requirements), then the default rule applies, which is first in, first out (FIFO). In other words, the first shares you acquired in the account are deemed to be the first shares sold from the account.

For mutual fund shares and shares subject to a Dividend Reinvestment Plan (DRIP):

In 2012, the rules for determining which mutual fund shares (including DRIP shares) have been sold, and the basis in those shares, changed. The rules are complicated, and the rule that you will be subject to can depend on your investment manager’s default method. These rules are beyond the scope of this summary.

Which stock have you sold?

If you know the rules and follow them properly, you can be treated as having sold whatever lot you choose. If you do not affirmatively address this, a result will be imposed on you via a default rule, which might or might not produce the best tax result.

Worthless stock

The general rule is that if a stock (or any security) becomes worthless during the year, it is treated as if you sold it for $0 on December 31, resulting in a capital loss. You must be able to prove the stock is worthless. Bankruptcy might be such proof, but if the bankruptcy is a reorganization and the company might emerge as a continuing enterprise, then the stock is probably not worthless.

This rule is not optional. If the stock becomes worthless, you must deduct it in the year it first becomes worthless or not at all. This can lead to a sort of dilemma if you have an asset that might be worthless but it's not certain:

- If you deduct the stock as worthless before it actually becomes worthless, the IRS can disallow the loss. The stock must be totally worthless to get the write-off.
- If you wait too long to deduct the stock as worthless, the IRS can claim it was first worthless in a prior year. If the statute of limitations for that prior year has expired, it would be too late to go back and amend the prior year's return to claim the loss.

Because of this, some advisors suggest that it is better to claim worthlessness sooner rather than later. An alternative might be to sell the stock for pennies. A sale is much more easily identifiable as a transaction triggering a loss than is worthlessness.

Planning with a covered call at year's end

Selling a covered call is a common investment technique in which you receive a premium for selling a call option on stock that you already own (that is, your obligation under the call option, should it be exercised, is "covered"). This can present a year-end tax planning opportunity that may seem too good to be true — and it is. There is a special tax rule that addresses what otherwise could be a good tax planning opportunity.

Because the two positions (the owned stock and the sold option) are inversely related, at year's end one of them might have a built-in loss and the other a built-in gain. That loss and offsetting gain have a net economic value of $0, but for tax purposes you might be tempted to harvest the loss in late December and take the same amount of gain in early January. If the loss and gain are recognized within 30 days of each other, then the loss would be disallowed in the earlier year under the so-called "tax straddle" rules.

Qualified Opportunity Funds can have a year-end deadline

A tax provision enacted in December 2017 allows capital gain to be deferred, and possibly reduced, if the capital gain is timely reinvested into a Qualified Opportunity Fund ("QOF"). The Treasury issued final regulations on December 18, 2019 (and generally effective on March 13, 2020), which modified some of the proposed regulations and clarified many topics that were of concern to potential opportunity-zone investors and potential sponsors. We have a separate Wealth Strategy Report that discusses the rules governing QOFs: *Deferring Capital Gain: Qualified Opportunity Zones*. In addition, there are several timing issues contained in the statute and proposed regulations, some of which will be relevant for 2021 year-end planning. We have a separate Wealth Strategy Report addressing those: *Qualified Opportunity Funds: Timing Matters*.

In order to obtain the benefit of the 7-year basis increase before the deemed recognition on December 31, 2026, you would have had to invest in a QOF on or before December 31, 2019. In order to obtain the benefit of the 5-year basis increase before the deemed recognition on December 31, 2026, you would have to invest in a QOF on or before December 31, 2021.

When the investment in a QOF is made. Even if you know that you need to invest in a QOF by a certain date, it's not always easy to determine whether you have done so. When is an amount considered invested in a QOF? In the case of publicly-traded stock, the trade date is when stock is considered acquired. However, most QOFs will not be publicly-traded securities; they will be private investments, which makes it less clear.

For example, assume you subscribe to invest in a QOF, and there is a capital call due by Day 10. You wire the funds to the QOF on Day 3. Other investors wire funds on other days, all before Day 10. The funding closes on Day 10. Your ownership interest is entered on the books of the QOF on Day 12. Your certificate of ownership (it could be a limited partnership certificate, it could be a stock certificate) is mailed to you on Day 13 and you receive it on Day 16. On what day have you "invested in a qualified opportunity fund"? It would be best either (i) to know for certain what the rules are governing the transaction and the precise day on which you have "invested in a qualified opportunity fund", or (ii) to plan ahead to avoid the issue. For example, you might plan the transactions so that no matter which of several possible days is the precise day on which you are considered to have invested in the QOF, in all cases the QOF investment will be timely.

IRAs

Required minimum distributions

Generally, you must begin withdrawing required minimum distributions (RMDs) from your traditional IRA by April 1 of the year following the year you turn 72 (or age 70½ if you reached age 70½ on or before December 31, 2019). Failure to withdraw your annual RMD could expose you to an excise tax equal to 50% of the excess of (i) the amount you should have withdrawn, over (ii) the amount actually withdrawn. Therefore, you should be sure that you avoid an unnecessary 50% excise tax by timely withdrawal of your RMD.

If you were born before July 1, 1949, then you were subject to the RMD rules for tax year 2019 and later. If you were born on or after July 1, 1949 you will be subject to the RMD rules beginning in the year you turn 72 when you will be allowed to take your first RMD anytime from January 1 of that year through April 1 of the following year.

(For all future years, you can withdraw that year's RMD from January 1 to December 31 of that year.) However, this does not mean that you should necessarily wait until April 1 of the following year.

If you withdraw your first RMD in the year following the year you turned 72, you will still have to take your RMD for that year by December 31. That would mean two IRA distributions in the same year, which would "bunch" taxable income into one year and might not be best overall.

The CARES Act suspended the RMD rules for 2020. There has been no similar suspension adopted for tax year 2021.

We have two separate Wealth Strategy Reports: (i) *Required Minimum Distributions* and (ii) *Should You Take Your RMD Earlier or Later in the Year?*

Note: The BBB Bill proposes a new additional minimum required distribution for taxpayers with (1) high income (adjusted taxable income exceeding $450,000 for a married couple, $400,000 for a single taxpayer) and (2) large retirement account balances ($10 million). The proposed new additional distribution would take effect in 2029 and generally would require 50% of the excess over $10 million to be withdrawn and 100% of any Roth amount to be withdrawn if retirement balances exceed $20 million.

The end of "stretch" distributions from IRAs, 401(k)s, and 403(b)s

Upon the death of an IRA, 401(k) and 403(b) owner, it is common planning to leave the retirement assets to one's spouse. If there is no spouse, it is common planning to leave the retirement assets to one's child(ren) or grandchild(ren). Before the SECURE Act, the retirement assets could be distributed over the child's or grandchild's lifetime, often referred to as a "stretch" provision. This ability to stretch the retirement asset distributions allowed undistributed amounts inside the retirement accounts to continue to grow on a tax-deferred basis until distributed.

Moreover, the younger the beneficiary, the longer the life expectancy. The longer the life expectancy, the smaller the annual required distributions and the greater potential for deferring income taxes and growing the retirement account.

The SECURE Act changed this rule and severely limits the ability to stretch distributions from retirement assets in IRAs and qualified plans like 401(k)s. The legislation generally requires non-spouse beneficiaries to take complete distribution of the benefits by the end of the tenth calendar year following the account owner's death. This rule applies regardless of whether the account owner died before or after his or her required beginning date.

There are exceptions to this new 10-year rule for a designated beneficiary who is (i) the spouse, (ii) a minor child, (iii) a disabled or chronically ill person, or (iv) a person not more than 10 years younger than the account owner.

This change generally became effective for account owners dying after December 31, 2019.

Roth conversions, recharacterizations and reconversions

Since 2010, individuals can convert traditional IRAs and funds held in other tax-favored retirement vehicles to Roth IRAs regardless of income. (Prior to 2010, if you had "modified" adjusted gross income in excess of $100,000 or if your filing status was married filing separately, you were not allowed to convert.) As a result, many individuals have converted traditional IRAs to Roth IRAs.[12]

Prior to 2018, if your Roth IRA portfolio decreased after conversion, it was possible to "undo" the conversion, a process called "recharacterization." For tax years beginning after 2017, the TJCA changed the rule governing Roth IRA recharacterization; you can no longer recharacterize a Roth IRA conversion. Converting a traditional IRA to a Roth IRA is now a one-way street.

If you expect tax rates to increase in 2022, some commentators have suggested that 2021 might present a good opportunity to consider a Roth conversion, so that the income resulting from the conversion will be taxed at a maximum rate of 37% in 2021 instead of some higher rate in 2022 or later. We have a separate report, *Tax Alert 2020-13: Beyond First Blushes and Gut Reactions —Planning for the Coming Tax Increases?,* that covers this possibility as well as several other possible steps that taxpayers might consider in anticipation of possible tax changes.

Note: The BBB Bill proposes two separate rules for Roth conversions: one proposed to take effect in 2022 and the other in 2032.

No Back-Door Roth Conversions. For all taxpayers (regardless of income level), the BBB would prohibit amounts held in non-Roth accounts in (i) an employer sponsored retirement plan or (ii) a traditional IRA from being converted to a Roth IRA or a Roth 401k if any portion of the distribution that is being converted consists of after-tax contributions. This proposal would be effective for 2022, leaving 2021 the last year to make such a conversion.

Roth Conversions. Commencing in 2032, Roth conversions of tax deferred retirement assets for high-income taxpayers would be eliminated. In the case of a high-income taxpayer [same income limits mentioned in the proposed minimum distribution Note], (1) funds held in traditional IRAs may not be converted to a Roth IRA and (2) funds held in a 401(k) plan (non Roth portion), 403(b) plans, and governmental section 457(b) plans may not be converted into either a Roth 401k account or a Roth IRA.

[12] We have two separate Wealth Strategy Reports available upon request: *Fundamentals of Roth IRAs* and *Converting Traditional IRAs to Roth IRAs.*

Year-end charitable gifts

Charitable income tax deduction limitations

A gift to charity is normally deductible as an itemized deduction. However, you might not be able to deduct all of your charitable contributions. There are limitations, summarized in the following chart, based on (i) the type of property given and (ii) the type of charity.

Some common planning ideas from this chart are:

1. It is usually better to make a gift of appreciated long-term (held longer than one year) stock (or other asset) to a charity than to make a gift of appreciated short-term stock. A gift of appreciated long-term stock is deductible at its value; a gift of appreciated short-term stock is deductible only to the extent of basis. To put it another way, a gift of long-term appreciated stock entitles you to deduct the appreciation even though you have not been taxed on it.
2. In the case of a gift of appreciated long-term stock to a private foundation, a deduction for the fair market value is allowed only if the stock is "qualified appreciated stock." Generally that means publicly traded stock, but you should always consult your tax advisor.

If the amount you contributed to charities this year is more than you can deduct because of the AGI limitations summarized in the chart below, the excess can be carried forward for up to five years.

Due to multiple contributions, you might trigger several of these limitations. How these limitations interact with each other is a complicated matter beyond the scope of this summary, and you should consult your tax advisor.

Type of Property[1]	Public Charity (including Donor Advised Fund)		Private Foundation (non-operating)	
	Deductible Amount[2]	AGI Limitation[3]	Deductible Amount[2]	AGI Limitation[3]
Cash	Amount of cash	50%/60%/100%[4]	Amount of cash	30%
Short-term[5] capital gain property or ordinary income property	Tax cost/basis	50%	Tax cost/basis	20%
Long-term[5] capital gain property	Fair market value	30%	Tax cost/basis (Fair market value if publicly traded stock[6])	20%
Tangible personal property (e.g., art) — If it will be used by the charity in conducting its exempt functions	Fair market value	30%	Tax cost/basis	20%
Tangible personal property (e.g., art) — If it will NOT be used by the charity in conducting its exempt functions	Tax cost/basis	50%	Tax cost/basis	20%

1 Conservation easements are not discussed in this summary. We have a separate Wealth Strategy Report: *Conservation Easements*.

2 In all cases where the deduction is limited to tax cost/basis, if the fair market value is lower (i.e., the asset has depreciated), the deduction will be the lower fair market value.

3 Charitable contributions that are not deductible due to the AGI limitations can be carried forward for up to five years.

4 TJCA increased this limitation from 50% to 60% for years 2018 through 2025, if all gifts are made in cash. It is scheduled to "sunset" and return to 50% in 2026. For 2020 and 2021 this limit was increased to 100% for cash gifts to public charities (not including Donor Advised Funds).

5 Short-term property is property held one year or less. Long-term property is property held more than one year.

6 Gifts of publicly traded stock may be deducted at full fair market value, but the deduction for gifts of bonds (even publicly traded bonds) is limited to tax cost/basis.

Qualified Charitable Distributions (QCDs)

If you are over 70½ and have an IRA, you can also make charitable gifts by making a charitable distribution directly from your IRA.

- You must be age 70½ or older at the time of the distribution.
- You may distribute any amount up to $100,000 per tax year ($200,000 for a husband and wife, if both are over 70½ and each has an IRA with over $100,000), subject to reduction if you made tax-deductible contributions to a traditional IRA during the tax year.
- You may distribute from either a traditional IRA or a "rollover" IRA.
- Distributions may not be taken from an ongoing SEP, an ongoing SIMPLE 12 IRA, 403(b) plans, 401(k) plans or other similar retirement plans.

Charitable deductions for non-itemizers

The CARES Act allowed taxpayers who do not itemize deductions to deduct up to $300 for contributions made to certain qualifying charities (not including donor advised funds). This amount of $300 applied to individuals and married couples. The "Taxpayer Certainty and Disaster Tax Relief Act of 2020" enacted in December of 2020, extended this deduction for one more year (2021) and increased it to $600 for married couples filing jointly.

For 2020 tax year, the CARES Act also provided that taxpayers who do itemize deductions may elect to deduct cash contributions made to certain qualifying charities (not including donor advised funds), in an amount of up to 100% of their adjusted gross income for tax year 2020. The "Taxpayer Certainty and Disaster Tax Relief Act of 2020" extended this provision through tax year 2021 only.

Beware gifts of certain investments

The preceding section referred to a gift of publicly traded stock. Many investments do not fall neatly into that category and might not qualify for the favorable charitable income tax deduction rules just summarized. For example:

- Depending on how it is structured, a charitable gift of your interest in a gold exchange traded fund (ETF) can result in a deduction equal only to your basis in the investment, not the fair market value. The same might be true of a structured note.
- For a gift of a bond, the interest component might not qualify for a charitable deduction.
- Gifts of leveraged property raise complicated tax issues.

You should confirm with your tax advisor whether a charitable gift of a particular investment would allow you the full charitable income tax deduction.

Beware charitable gifts of certain investments

Many investments do not fall neatly into the category of "publicly traded stock," and might not qualify for the favorable charitable income tax deduction rules.

Charitable gifts and the $10,000 deduction limit on state income taxes

The TCJA imposed a $10,000 limit ($5,000 for a married individual filing a separate return) on the amount of state and local taxes (known by the acronym "SALT") that an individual may take as an itemized deduction for federal income tax purposes, with no carryover of any excess amount. In the case of two individuals who are married and filing a joint return, the limit is still $10,000. This $10,000 limitation applies to state and local income taxes, sales taxes and property taxes. This $10,000 limitation does not apply to property taxes paid in connection with a trade or business. However, it does apply to income taxes, even if paid by an individual in connection with a trade or business.

In response to this $10,000 SALT limitation, a number of states enacted work-arounds, which attempted to allow federal charitable deductions for contributions to state-created charities, in return for which the donor would receive a credit against certain state and local taxes. Charitable deductions are not subject to the $10,000 cap (though charitable deductions are subject to other limitations, primarily tied to adjusted gross income, which have been in effect for some time). However, longstanding tax principles state that in order for a charitable contribution to be deductible, it must be made without the expectation of a *quid pro quo.*

In May 2018, the IRS issued Notice 2018-54, to inform taxpayers that it intended to propose regulations to address such work-arounds. On August 27, 2018, the IRS issued those proposed regulations. On June 11, 2019, the IRS issued final regulations (the "Final Regulations") that were virtually identical to the proposed regulations, as well as Notice 2019-12 stating that additional regulations will be issued to address some new matters. The Final Regulations apply to both new and preexisting state tax credit programs. Subject to some narrow exceptions, the Final Regulations reduce an individual's federal income tax charitable deduction, on a dollar-for-dollar basis, by any state tax credit allowed, treating the credit as a *quid pro quo* for the purported charitable gift.[13]

Our *Tax Bulletin 2019-03* summarizes the Final Regulations and new Notice 2019-12.

Several states have taken a different approach to a SALT work-around and have enacted what is referred to as a pass-through entity (PTE) tax for business income. These taxes vary somewhat in the details, but essentially, they are designed to assess and collect state income tax on PTEs at the entity level, instead of at the partner/member level. At least thus far, the IRS has been much less hostile to these structures (see IRS Notice 2020-75). We have four Tax Alerts dealing with some of these new state laws (*2021-7*-re: NY; *2021-12*-re: CA; *2021-13*-re: AZ; and *2021-14* re: IL). Several other states have enacted some sort of PTE tax. As of the date this guide was written, several other states have enacted some sort of PTE tax (AL, AR, AZ, CA, CT, CO, ID, GA, LA, MN, NJ, OK, OR, SC, WI). Other states are actively considering new laws, so do not think of this as list as exhaustive. These state laws vary in many respects. Some are applicable to only certain types of entities, some apply only to resident partners and others only to non-resident partners. Some of these state laws are elective at the entity level and others are elective at the partner/member level, so you should consult with your own tax advisor as to whether you might be able to take advantage of one of these state laws.

Making sure the deduction is in 2021

Gift of cash. You may want to make a year-end charitable gift of money in order to take the deduction in 2021. Depending on how you make the gift, there are different rules governing the determination of what year you can take the deduction.

- If you deliver cash or a check, the charity must receive it by December 31, 2021, in order for you to take the deduction in 2021.
- If you mail a check, it must be postmarked by December 31 or earlier, **and** it must be received by the charity in the ordinary course of mail deliveries. You can control when you have an envelope postmarked but probably cannot control if/when the envelope will be received, so this isn't the best approach.
- If you use a credit card, the gift occurs when the charge is made, regardless of when you pay your credit card bill.

Gift of stock. The date on which a gift of securities is completed depends on how the securities are delivered.

- *Securities held in street name (DTC).* These are considered transferred on the date the brokerage firm transfers title, a process that normally takes one or two business days. NOTE: The transfer is not made at the time that instructions to transfer the shares are given to your agent. Rather, it is the date the transfer is made on the books of the issuing corporation or transfer agent.
- *Physical certificates you hold.* If you have the physical stock certificate, your gift of those shares to charity is completed on the date you deliver an endorsed certificate to the charity. If you mail the certificate and endorsement (which should be mailed separately), the securities are considered gifted to the charity on the date of the mailing if they are received by the charity in the ordinary course of mail deliveries.
- *Physical certificates held elsewhere.* This would include securities held in a safe deposit box or trust department with your advisor/broker, but not in street name. If the advisor/broker is considered your agent, the transfer will not be considered complete until the date the transfer agent records the transfer, which can take several weeks. If the advisor/broker has stock powers on file, the securities can be converted to DTC, at which point the much quicker process described above for securities held in street name will apply.

[13] In December of 2019 the IRS issued Revenue Procedure 2019-12 to provide clarification and safe harbors for C corporations and certain pass-through entities that make charitable payments in exchange for state and local tax credits, to clarify when those payments may be treated as ordinary and necessary business expenses, and accordingly not subject to the SALT limitations.

Substantiating charitable gifts

In recent years, the documentation you need in order to claim a charitable deduction has become more stringent. Generally, for any monetary gift, you must have either a bank record (canceled check) or a written communication from the donee charity. In addition, if the gift is $250 or more, you must obtain a contemporaneous written acknowledgment from the charity containing certain required information. For a gift of property (such as a vehicle or art), certain additional valuation requirements apply. All of this must be in hand before you file your tax return.

You certainly do not want a charitable contribution deduction to be denied due to improper paperwork. You should consult with your tax advisor to make sure you comply with the ever-growing substantiation rules.

We have a separate Wealth Strategy Report: *Charitable Gifts — Recordkeeping Requirements.*

Charitable remainder trusts (CRTs) and 3.8% Medicare surtax planning

The 3.8% Medicare surtax is imposed on an individual's "net investment income" to the extent "modified adjusted gross income" exceeds certain thresholds. The surtax does not apply to a CRT itself; however, distributions from a CRT can have surtax consequences to the recipient/beneficiary. As a result, there is a year-end planning opportunity for CRTs: harvesting capital losses. Even for CRTs that have accumulated mostly long-term capital gains, harvesting losses can have a surtax benefit. The details of this planning are summarized in our Wealth Strategy Report: *Year-End Planning Opportunity for Charitable Remainder Trusts.*

Intra-family wealth transfers

General estate plan review

As has been mentioned for other planning ideas, reviewing your estate plan is not necessarily a year-end planning matter. However, there are several gift and estate tax planning matters that are addressed at the end of the year (discussed below), and therefore it can also be a good time to think about this important matter. As a general matter, we suggest you have your overall estate plan reviewed regularly by an estate planning professional. The reasons might not be obvious, so we list several here.

A useful working definition of "estate planning" is: (1) having your assets (2) go where you want them to go (3) in the manner you want (i.e., in trust or outright) (4) with minimum taxes or other expenses. Any one or more of these elements can change year to year.

Assets change. The value of your assets can change, causing the size of bequests to be very different from what you had in mind. Also, assets change locations, which can change which document governs that asset at your death. For example, funds inside an IRA will pass pursuant to your Beneficiary Designation, but once funds are distributed from your IRA to you they will be governed by your will.

Recipients change. Where you want your assets to go can change for many reasons. This could be due to a change in your family. Marriage can cause you to now engage in marital trust planning. Divorce can render marital planning inappropriate. The advent of children will require trust planning. The advent of grandchildren can require generation-skipping transfer tax planning. An unnatural order of deaths can change your estate desires.

The need for trusts changes. You might have wanted a trust for a beneficiary's inheritance, but now a trust might not be needed either because the beneficiary is now older and mature, or perhaps because the dollars involved are now too little to merit a trust. The reverse could also be true — you might not have thought a trust was needed before, but now the beneficiary has proven to be a spendthrift. Or perhaps asset protection is more of a concern. For example, the beneficiary might now be in a profession prone to lawsuits.

Tax rules change. This has increased in importance in recent years because it must now be factored in that we cannot know what the tax rules will be when your estate plan gets "activated." In recent years there have been frequent changes to the various exemption amounts and tax rates governing wealth transfers, both at the federal level and at many state levels. This includes a doubling of the estate tax exemption made by the TCJA. In 2021 it is $11,700,000 per individual. The exemption for 2022 will be $12,060,000. After 2025 that exemption amount is scheduled to decrease 50% to its pre-TCJA amount (as indexed for inflation).

Because there is always the possibility that the tax rules are changed, there is always the possibility that your estate plan could become outdated without you doing anything. If you would like to discuss having your estate plan reviewed, please contact your advisor.

$15,000 annual exclusion gifts

Gift of money. If you would like to make a gift by check and have it qualify for the $15,000 annual gift tax exclusion for 2021, two requirements must be satisfied:

1. The donee must deposit the check in 2021.
2. It must clear in the ordinary course of business (which can happen in January).

A holiday gift of a check that doesn't get deposited until after New Year's Day is considered a gift in 2022. A cashier's check can avoid this, since a gift of a cashier's check, like cash, is complete upon delivery.

The annual exclusion will increase to $16,000 in 2022, up from $15,000 in 2021.

Gift of stock. The rules for completing a gift of stock to a family member are the same as the rules set out above for a year-end gift of securities to a charity, with one exception. If you mail a properly endorsed stock certificate to a family member, the gift is not completed until received.

Gifts to 529 plans

Paying for a grandchild's education can be a good way to transfer wealth and may be more appealing than just making gifts to a trust. A 529 savings plan (a "529 plan") offers a way to accelerate gifts and frontload a savings program. The TCJA expanded the use of 529 plans and allows up to $10,000 per year (per beneficiary) to be used for elementary and high school tuition.[14] It specifically allows funds to be used for private and religious schools. However, not all states follow this federal change.

529 plans allow you to make five years' worth of $15,000 annual exclusion gifts in 2021. This is as much as $75,000 from a single donor, or $150,000 from a couple. These gifts are treated as if they are made ratably over the current year and next four tax years.

Contributions between $15,000 and $75,000 made to a 529 plan in one year can be prorated over a five-year period without incurring gift taxes or reducing your lifetime federal estate or gift tax exemption. If you contribute less than the $75,000 maximum, additional contributions can be made in subsequent years without incurring federal gift taxes or reducing your lifetime federal estate or gift tax exemption, up to a prorated level of $15,000 per year. For contributions between $15,000 and $75,000 made in one year, if the account owner dies before the end of the five-year period, a prorated portion of the contribution is included in the taxable estate.

Be aware that such planning must be coordinated with all other gifting techniques, which might also affect how much of your $15,000 annual exclusion is available each year. If you make a gift of five years' worth of annual exclusion gifts to a 529 plan, no additional annual exclusion gifts can be made to the beneficiary within this five-year period (other than any additional increase in the annual exclusion amount during that five-year period).

If you are funding a 529 plan toward the end of 2021 and want to maximize the frontloading of the account, consider contributing only $15,000 ($30,000 for a couple) to the account this year. You could then frontload by contributing $80,000 ($160,000 for a couple) in January 2022. (This is based on next year's annual exclusion of $16,000.) This will allow you to contribute a total of $95,000 by January 2022 ($190,000 for a couple). In contrast, if you first contribute $75,000 ($150,000 for a couple) to the account in December 2021, you would not be able to contribute more for the next four years (other than an additional $1,000 per year per person if the annual exclusion increases to $16,000).

[14] Under the SECURE Act, 529 education savings accounts were expanded to cover costs associated with registered apprenticeships; homeschooling; and up to $10,000 of qualified student loan repayments (including those for siblings).

Beware the "kiddie tax"

Year-end planning can involve gifts to children. In general, making a gift of a financial asset to your children will cause them to be subject to income tax on the future earnings. However, under the "kiddie tax," a certain amount of your children's unearned income will be taxed at their parents top marginal income tax rate. The "kiddie tax" applies to children under 18 and to 18-year-olds if their earned income doesn't exceed one-half of the amount of their support.

It also applies to 19- to 23-year-olds if they are full-time students and their earned income doesn't exceed one-half of the amount of their support if at least one parent is living at the end of the tax year and the child is not filing a joint return for the tax year.

We have a separate Wealth Strategy Report: *The "Kiddie Tax."*

Income tax rates

The following tables may be helpful when trying to estimate what income tax bracket you are in, with the accompanying potential benefits.

Federal tax rates for 2021

Over	But not over	Pay this... *(rounded to the next dollar)*	Plus this %...	On excess over
Single				
$0	$9,950	$0	10%	$0
$9,950	$40,525	$995	12%	$9,950
$40,525	$86,375	$4,664	22%	$40,525
$86,375	$164,925	$14,751	24%	$86,375
$164,925	$209,425	$33,603	32%	$164,925
$209,425	$523,600	$47,843	35%	$209,425
$523,600		$157,804.25	37%	$523,600
Married filing jointly				
$0	$19,900	$0	10%	$0
$19,900	$81,050	$1,990	12%	$19,900
$81,050	$172,750	$9,328	22%	$81.050
$172,750	$329,850	$29,502	24%	$172,750
$329,850	$418,850	$67,206	32%	$329,850
$418,850	$628,300	$95,686	35%	$418,850
$628,300		$168,993.50	37%	$628,300
Non-grantor trusts				
$0	$2,650	$0	10%	$0
$2,650	$9,550	$265	24%	$2,650
$9,550	$13,050	$1,921	35%	$9,550
$13,050		$3,146	37%	$13,050

Federal tax rates for 2022

Over	But not over	Pay this... *(rounded to the next dollar)*	Plus this %...	On excess over
Single				
$0	$10,275	$0	10%	$0
$10,275	$41,775	$1,027.50	12%	$10,275
$41,775	$89,075	$4,807.50	22%	$41,775
$89,075	$170,050	$15,213.50	24%	$89,075
$170,050	$215,950	$34,647.50	32%	$170,050
$215,950	$539,900	$49,335.50	35%	$215,950
$539,900		$162,718	37%	$539,900
Married filing jointly				
$0	$20,550	$0	10%	$0
$20,550	$83,550	$2,055	12%	$20,550
$83,550	$178,159	$9,615	22%	$83,550
$178,159	$340,100	$30,427	24%	$178,159
$340,100	$431,900	$69,295	32%	$340,100
$431,900	$647,850	$98,671	35%	$431,900
$647,850		$174,253.50	37%	$647,850
Non-grantor trusts				
$0	$2,750	$0	10%	$0
$2,750	$9,850	$275	24%	$2,750
$9,850	$13,450	$1,979	35%	$9,850
$13,450		$3,239	37%	$13,450

Conclusion

This guide summarizes many different tax planning matters. We invite you to work with your advisor to navigate them. We also remind you to keep an eye on pending legislation which could affect your year-end tax planning.

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