Financial Planning Association of Northeast Ohio

Tax Update: Hot Topics for 2022

January 20, 2022

Cohen & Co®

SS1

Cohen & Co

Recent Tax Law Changes

- TCJA – Tax Cuts and Jobs Act of 2017
- SECURE Act – Setting Every Community Up for Retirement Enhancement Act of 2019
- CARES Act – Coronavirus Aid, Relief, and Economic Security Act of 2020
- Emergency Coronavirus Relief Act of 2020 (CRA)
- American Rescue Plan Act of 2021
- Infrastructure Investment & Jobs Act of 2021

Comparison of Biden and Ways & Means

Biden	Build Back Better (November Framework)	Comment
Raise corp. rate to 28%	15% minimum tax on Book Income, 1% surtax on corp. buybacks	**Changes earnings on ~1,000 companies, changes buyback**
Raise top indiv. rate to 39.6%	Appears to retain current rules	**Status quo**
State and Local Tax (SALT)	Raise deduction cap to $80,000 until 2030	**Goodbye to the tax return "postcard"**
Tax Cap Gains as ordinary income 39.6% (+ NIIT). Carryover basis	Appears to be replaced by surtax , no change to carryover basis	**CG rate and step-up retained**
No high income surtax	5% on AGI over $10M, 3% over $25M	**New wealth tax**
Raise Global Intangible Low-Tax Income Rate (GILTI)	15% GILTI enforces BEAT SHIELD	**Affects about 120 of the S&P 500**
Phase out Pass-through >$400K	Add 3.8% NIIT/Limit Excess Loss Limitation	**Affects pass-thorough income & trusts**
No estate or gift tax changes	Appears to leave estate tax alone	**Status quo for now**

Income Tax Planning

Cohen & Co®

Income Tax Planning Opportunities

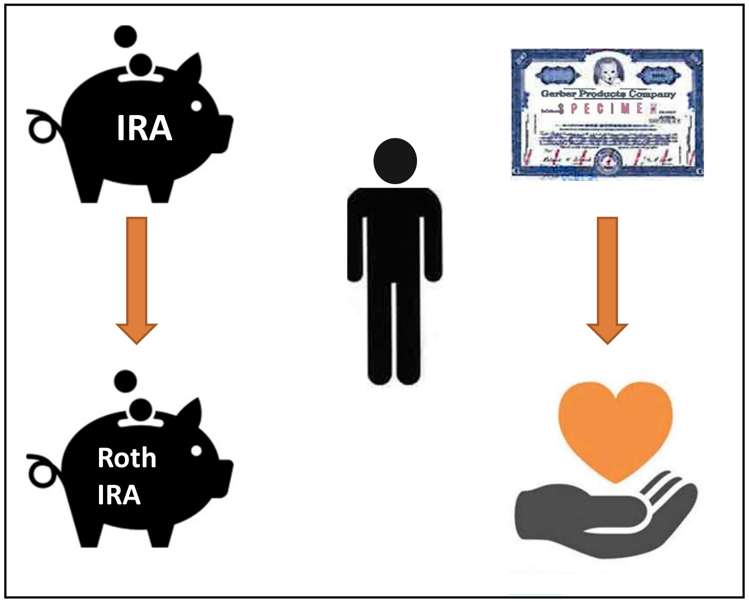
- Qualified Opportunity Zones –
  - Defers capital gain tax when gain dollars are invested in QO Funds until 2026
  - Reduce gain by 10% if invested by 12/31/21 and held for 5 years - EXPIRED
  - Other 90% taxed in 2026
  - Appreciation after QO investment is made **never taxed** if held for 10 years
- Qualified Business Income Deduction (QBID)
  - 20% deduction of business income for flow through entity owners or sole proprietorships
  - Limitations apply once taxable income exceeds $170,050 ($340,100 joint)
- Harvesting capital gains or losses
  - Utilize capital loss carryovers or shelter gain realized during the year

Charitable Contributions

- Limitation on cash charitable contributions was increased to 100% of AGI from 60% for 2020 and 2021. Back to 60% for 2022
- Use of donor advised funds to bunch contributions / match high income years
  - Ease of funding with appreciated stocks
  - 30% of AGI limitations for LTCG positions
  - Be sure to use only LTCG positions
- Fund contributions directly from IRA if age 70 ½ or older
- $300 / $600 "above-the-line" charitable deduction is not back for 2022

Roth Charity Offset

- Concept: Use a charitable contribution to offset a Roth conversion
- Convert $100K Traditional to Roth, creating $100K of income, then fund charitable contributions
- 2022 limit on cash gifts is 60% of AGI, or 30% on LTCG positions
- Will need other income to get the full deduction



Net Operating Losses: The Hidden Stimulus

- 5-year carryback reinstated for 2018, 2019 and 2020 under Cares Act
- 80% TJCA limitation removed
- Arbitrage with pre-TCJA tax rates
  - Corp 35% v. 21%
  - Pass through 39.6% v. 37%

Cohen & Co

Repeal of Business Loss Limitations - Expired

- Excess Business Loss Limitation
  - Retroactively delayed implementation of the TCJA "excess business loss limitation" for tax years 2018, 2019, and 2020
  - It was not delayed further so it's back for 2021 filings and 2022
  - Limits the amount of non-business income (wages, investment income, etc.) that could be offset by business losses to $262,000/$524,000 for 2021 (single/married filing jointly)

Cohen & Co

Other Tax Matters to Consider:

- Employee Retention Credit under CARES Act ended at 10/1/21, but could still be applied for
- Business meal expenses are fully deductible from now through January 1, 2023
- Kiddie Tax
  - SECURE Act shifted the kiddie tax back to the old rules prior to TCJA.
    - Children with unearned income of more than $2,200 taxed at parents' marginal tax rates
    - Parents can elect to include on parents' return if only interest and dividend income of $11,000 or less
- Expanded Tax Reporting – Cryptocurrency & online sales activity
- IRS is extremely backed up and difficult to work with
- City income tax refund claims will continue to be an issue in Ohio

Retirement Planning Strategies

Cohen & Co®

Retirement Planning: 2022 Contribution Limits

- Maximize pre-tax contributions to lower your overall taxable income
  - 401(k) 2022 annual plan contribution limits
    - $20,500 if under age 50
    - $27,000 if 50 or over
  - Traditional and ROTH IRA contribution limits (be aware of income limitation)
    - $6,000 if under age 50
    - $7,000 if 50 or over
  - Self-employed persons can contribute up to $61,000 to a solo 401(k) / SEP, max of $67,500 with catch up contribution

Rethinking Retirement Planning:

- Tax law changes from SECURE Act to consider:
  - RMD not required until age 72 if you reached age 70 on July 1, 2019 or later
    - New RMD math shifts distributions higher and creates bracket creep
    - Larger RMD's can leave surviving spouse in higher income tax bracket
    - No special RMD provisions remain for 2021
  - 10-year distribution limit imposed on inherited IRAs (deaths after 12/31/19)
    - Tax efficient distribution of taxable IRA's to beneficiaries becomes very complicated
    - Roth allows 10 years of tax-free accumulation and tax-free distribution to beneficiaries
- Roth IRA's now more attractive for estate planning
- Consider Roth 401(k)'s, "back-door" Roth contributions, and Roth Conversions

Cohen & Co

Rethinking Retirement Planning:

- Investing in Health Savings Accounts:
  - Have become more popular over time
  - Can fund up to $7,300 for a family in 2022 ($3,650 single)
  - $1,000 catch up also available over age 50
  - Must be a “High Deductible Health Plan”
    - Minimum deductible - $2,800 Family / $1,400 individual
    - Maximum “Out-of-pocket” limited to $14,100 / $7,050
  - Strategy: Fund the max every year and invest for the long-term
    - After age 65 withdrawals are tax free for medical expenses
    - Taxable if not for qualified medical expenses, so another source of deferral

Cohen & Co

Bracket-Topping

- Applies to spousal IRAs as well as other beneficiaries
- Taxable income is focus for planning, not AGI
- Take IRA distributions up to the edge of a target bracket
- Convert to Roth
- Spend or reinvest outside of IRA
- Spousal planning in year of death – deeper MFJ brackets

2022 Income Tax Bracket Thresholds

	Single	Married Filing Jointly	Married Filing Separate	Head of Household
10%	$0	$0	$0	$0
12%	$10,275	$20,550	$10,275	$14,650
22%	$41,775	$83,550	$44,775	$55,900
24%	$89,075	$178,150	$89,075	$89,050
32%	$170,050	$340,100	$170,050	$170,050
35%	$215,950	$431,900	$215,950	$215,950
37%	$539,900	$647,850	$323,925	$539,900

Bracket Topping: RMD to Fund Roth Conversion

- Spouse, over 72, at top of 22% bracket
- Doesn't like or need RMD
- Usually takes RMD and saves it
- Use RMD to pay taxes on Roth conversion
- Roth Conversion to the edge of the next bracket
- Example: RMD is $25,000
  - Withhold 100% for fed tax
  - In 24% bracket, withholding pays for RMD tax and $79,000 of Roth conversion
  - Used up full 24% bracket

Cohen & Co

Charitable Considerations:

General Strategy for Taxable Retirement Accounts

- Goal is to maximize the use of the 10-year stretch
- Execute bracket topping in years 1 through 9
- In year 10, distribute the remaining IRA balance
- Execute charitable gift in year 10 with a goal of minimizing income taxed in the highest brackets
- Could be done with public charities, donor-advised funds, or private foundations

Cohen & Co

Roth Strategies: Mom Roth

- Older parent in lower tax bracket
- Taxable IRA
- RMD not needed
- Someone has funds to pay for conversion
- Bracket-top to the edge of next tax bracket

Roth Strategies: What To Do

Individual situation will determine strategy

Age 72+:
Use QCD, take RMD then bracket top & convert to Roth

Age 70½ - 72:
Delay RMD, bracket top to convert to Roth

Ages 60-70:
Optimum bracket topping Roth conversion period

Ages 50-60:
Roth IRA, back-door Roth, Roth 401(k)

Ages 40-50:
Roth IRA, back-door Roth, Roth 401(k)

Ages 30-40:
Roth IRA, Roth 401(k)

Ages 20-30:
Roth IRA, Roth 401(k)

Estate Tax Planning Strategies

Cohen & Co®

Quick Refresher – Gift & Estate Tax

- 2022 Annual Exclusion - $16,000 – Finally!
- Estate & Gift Exemption - $12,060,000 for 2022
- Current Exemption sunsets at 12/31/25, likely dropping to about $6,000,000 for 2026
- Gift splitting is available for spouses
- For individuals under the exemption amounts, **focus on income tax basis planning**
- Have a dialogue with clients about estate planning documents

Give It Away

- Business and real estate values are still depressed in some cases due to the pandemic
- Gifting ownership is a simple approach
  - Outright
  - Irrevocable trust
    - Spousal Lifetime Access Trusts (SLATs)
    - Intentionally Defective grantor trusts (IDGTs)
- Valuation & gift tax return filing required
- Carryover basis

Spousal Lifetime Access Trusts (SLATs)

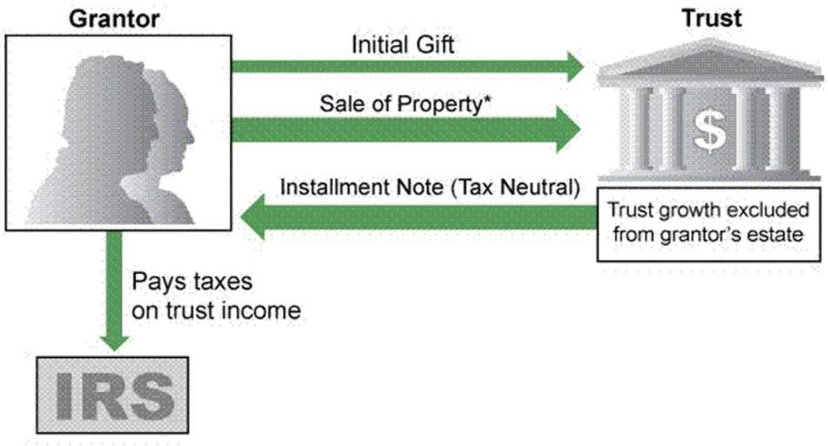
- A type of irrevocable gifting trust used by married couples
- One spouse (grantor) gifts assets to a trust for the benefit of:
  - Children
  - Future descendants – "Dynasty Trust"
  - Spouse while still living
- Typically, no mandatory distributions of income to anyone during spouse's lifetime
- Also typically set up as a "defective grantor trust" taxable to the grantor
- Spouse is often the trustee
- Advantages:
  - Can gift away the full $12,060,000 and spouse retains access to it if assets are ever needed
  - Assets grow tax free outside of taxable estate
  - Good option to use "Generation Skipping Tax" Exemption so assets are free of estate tax forever

Installment Sales

- Full purchase price financed by seller at the low AFR
- Buyers use business cash flow to fund note payments
- Income stream to seller from note repayment
- Buyers have basis equal to purchase price
- Taxable gain to seller
  - Minimized with discounted valuations
  - Spread out over the term of the sale

Installment Sales & Intentionally Defective Grantor Trust (IDGTs)

- Seed gift uses basic exclusion amount
  - › Lower valuation reduces this impact
- Remaining interest financed by seller with note at the AFR
- Eliminates taxable gain to seller
- Carryover basis for buyers
- Efficient GSTT planning vehicle

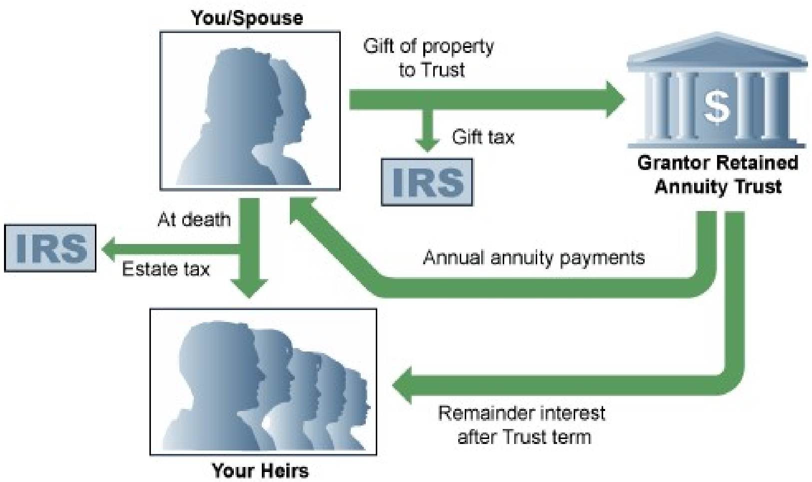


*The sale of property may be subject to a discount

IDGT Example

- $10M FMV
- 20% valuation discount (15-35% range)
- $8M discounted value
- Assume annual cash flow = $1,430,000 (7 X multiple)
- $800,000 seed gift to trust
- $7.2M sale to trust via 9-year note
- Mid-term AFR 1.08% (Nov 2021)
- $834,000 annual P&I payments
- Total interest $356,333
- Could instead use interest-only with a balloon payment
- Net effect is transfer of $10M of stock while using only $800,000 of exemption
- Trust assets at payoff = $15,364,000

Grantor Retained Annuity Trusts (GRATs)



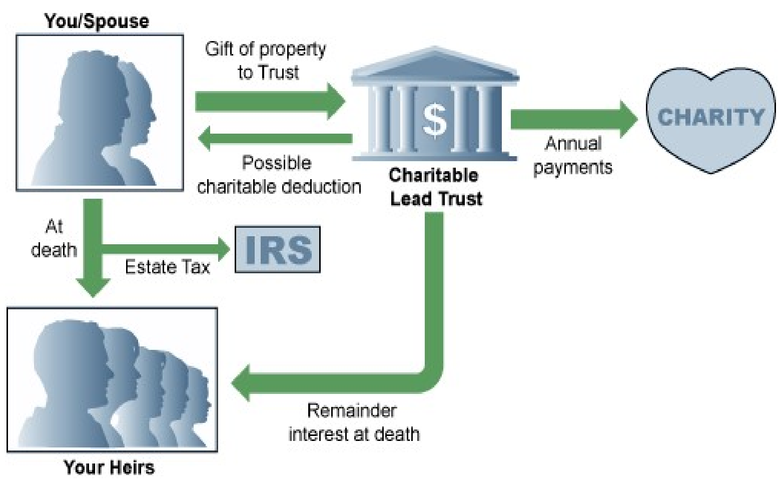
- Transfer assets in exchange for an annuity
- Annuity calculated at the §7520 rate
- Excess appreciation goes to beneficiaries
- Minimum term of two years
- "Zeroed-out" design can eliminate exemption usage
- Carryover basis
- GSTT exemption not allocable until end of trust term

GRAT Example

- Married couple
- $25M net worth
- Real estate, investment assets, & family business
- Business has 5% growth & 5% distributed income each year
- Transfers $10M of the business to a GRAT
- 20% discount ($8M discounted value)
- 1.6% §7520 rate for 1/2022
  - $872,077 (~10.90%) annual annuity for 10 years
  - $1 PV remainder interest gift
  - $7,000,000 to heirs at the end of 10 years at undiscounted value

Charitable Lead Annuity Trusts (CLATs)

- Split interest charitable trust with gift tax deduction provided
- Annual payments to charity with annuity based on the §7520 rate
- Excess appreciation to heirs at the end of the trust term
- Charitable beneficiary options
  - Restrictions on family foundations
- Non-Grantor vs. Grantor (Reversionary vs. Non-Reversionary)



CLAT Example

- Transfer $1M to 20-year CLAT
- 5.7673% ($57,673) payout to charities for 20 years
- 1.4% §7520 rate
- $1,000,000 PV of charitable benefit
- $0 PV remainder interest gift
- Compared to $142,000 taxable gift at 3% 7520 rate w/ same annuity
- If 6% total after-tax return, $1,085,595 transferred tax free in year 20

- More aggressive variable annuity payments
- If $10 annuity in year 1, increasing at 75% each year until $415,000 in year 20, $0 taxable gift, and $1,796,018 transferred tax free in year 20 with assumed 6% after tax return

Cohen & Co

Comparison of Transfer Strategies

	Outright Gift	IDGT	GRAT	CLAT
Gift	Yes, for full value of transfer	Yes, for seed funds	Yes, of PV, except ‘zeroed-out’ GRATs	Yes, for non-reversionary CLATs that are not ‘zeroed-out’
Tax Treatment	Future income/sale proceeds taxed to beneficiary	Grantor trust	Grantor trust	Grantor or Non-grantor trust
‘Freeze’ Asset Value	Yes	Yes, when note is paid	Yes, once principal is paid and grantor survives	Yes
Mortality Risk	No	Yes, until note is repaid	Yes	Yes, for grantor CLATs
GST Exemption	Yes	Yes	No	Yes, subject to the adjusted GST exemption amount
Carryover Basis	Yes	Yes	Yes	Yes
Gift Tax Issues	Yes, file 709 if value exceeds annual exclusion or gift is asset other than cash/publicly traded securities	Yes, file 709 for seed funds	Yes, file 709; recommended even if ‘zeroed-out’	Yes, file 709 for non-reversionary remainder interest
Valuation Rate	Fair market value	AFR (May 2020: mid-term 0.58%; long-term 1.15%)	§7520 rate (May 2020: 0.8%)	§7520 rate (May 2020: 0.8%)

Cohen & Co

Questions?

Scott Swain, CPA, CFA, CFP®, MT
Partner, Cohen & Company
sswain@cohencpa.com
216-774-1262