

Financial Planning Association of Northeast Ohio

# Tax Update: Hot Topics for 2021

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Cohen & Co<sup>®</sup>



## Presenter:



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# 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)

# Income Tax Planning

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# Income Tax Planning Opportunities

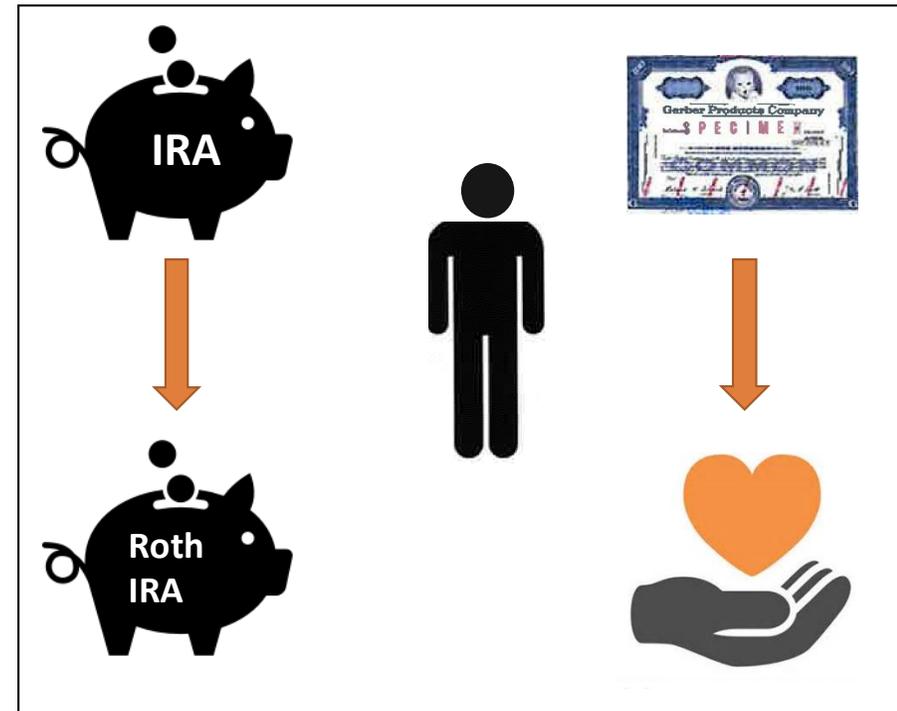
- Qualified Opportunity Zones –
  - › Defers capital gain tax when gain dollars are invested in QO Funds
  - › Reduce gain by 10% if invest by 12/31/21 and hold for 5 years
  - › Other 90% taxed in 2026
  - › Appreciation after QO investment is made never taxed if hold for 10 years
- Qualified Business Income Deduction (QBID)
  - › 20% deduction of business income for flow through entity owners or sole proprietorships
  - › Limitations apply once taxable income exceeds \$164,900 (\$329,800 joint)
- Harvesting capital gains or losses
  - › Utilize capital loss carryovers or shelter gain realized during the year

# Charitable Contributions

- 2020 limitation on cash charitable contributions was increased to 100% of AGI from 60%. CRA extended the 100% deduction through 2021.
  - › Any contributions over 100% of AGI will carryforward
- 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
- Fund contributions directly from IRA if age 70 ½ or older
- \$300 “above-the-line” charitable deduction in 2020 if not itemizing, up to \$600 in 2021 for married couple.

# Roth Charity Offset

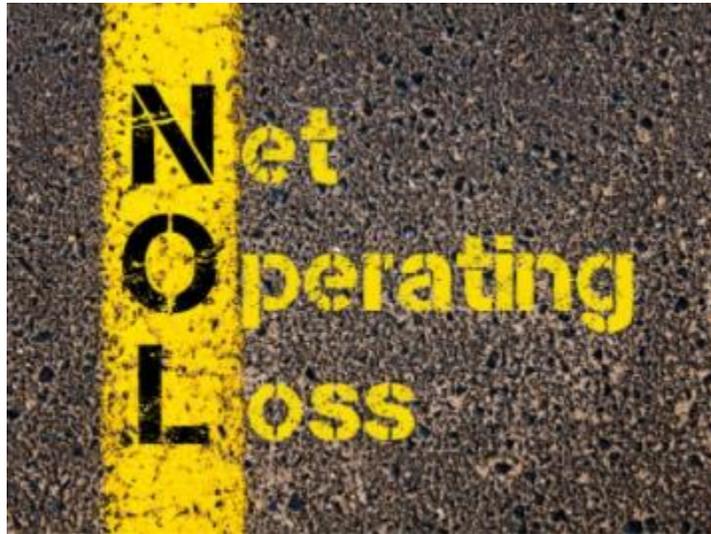
- ▶ **Concept:** Use a charitable contribution to offset a Roth conversion.
- ▶ Convert \$100K Traditional to Roth, creating \$100K of income, then fund charitable contributions
- ▶ 2021 limit on cash gifts is 100% of AGI, or 30% on LTCG positions
- ▶ Will need other income to get the full deduction in use LTCG property



# 2021 Tax Provisions to Consider:

- Paycheck Protection Program Loans
  - › CRA provides for deduction of expenses paid with loan proceeds, even if they are forgiven
  - › PPP Second Draw loan program should be up and running by 2<sup>nd</sup> or 3<sup>rd</sup> week of January
- Employee retention credit under Cares Act extended to 6/30/21 and expanded under CRA (increased from 50% to 70% of wages up to \$10,000 per employee, per quarter)
- Paid sick & family leave credits extended for wages paid through 3/31/21 per CRA
- 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
- [www.cohencpa.com/insights](http://www.cohencpa.com/insights) for the latest updates on the new legislation

# 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%

# CARES Act Temporarily Repeals Business Loss Limitations

- Excess Business Loss Limitation
  - › Retroactively delayed implementation of the TJCA “excess business loss limitation” for tax years 2018, 2019, and 2020.
  - › As of now, it’s back for 2021
  - › Limits the amount of non-business income (wages, investment income, etc.) that could be offset by business losses to \$250,000/\$500,000 (single/married filing jointly).

# Retirement Planning Strategies

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# Retirement Planning: 2021 Contribution Limits

- Maximize pre-tax contributions to lower your overall taxable income
  - › 401(k) 2021 annual plan contribution limits
    - \$19,500 if under age 50
    - \$26,000 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 \$58,000 to a solo 401(k) / SEP

# 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 often 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

# Roth Strategies: What To Do

Individual situation will determine strategy.

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**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)

# Roth Strategies: Bracket Topping

2021 Income Tax Bracket Thresholds				
Tax Rate	Single	Married Filing Jointly Surviving Spouse	Married Filing Separately	Head of Household
10%	\$0	\$0	\$0	\$0
12%	\$9,950	\$19,900	\$9,950	\$14,200
22%	\$40,525	\$81,050	\$40,525	\$54,200
24%	\$86,375	\$172,750	\$86,375	\$86,350
32%	\$164,925	\$329,850	\$164,925	\$164,900
35%	\$209,425	\$418,850	\$209,425	\$209,400
37%	\$523,600	\$628,300	\$314,150	\$523,600

- Take IRA distributions up to the edge of the bracket
- Convert to Roth, spend, or invest in taxable account

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Source: <https://www.kiplinger.com/taxes/tax-brackets/601635/irs-releases-income-tax-brackets-for-2021>



## 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: Kid Roth

- 16-year-old earns over \$6,000 a year.
- Until age 25, Mom or Dad (or maybe Grandma or Grandpa) deposit \$6,000 in a Roth, putting it in an index fund as a gift.
- Deposit at the beginning of the year, 6% annual return.
- Age 25, the Roth would contain about \$79,000.
- Don't disturb until age, 65, the Roth would be worth over \$813,000, tax-free, all from ten \$6,000 contributions.
- Kids (or donor) continues to make contributions; the kid would have \$1,637,000 at 65.
- Withdraw 4%, \$65,510 a year tax-free during his/her retirement years.



## Roth Strategies: Biz Owner Conversion

- Business owner of pass-through entity (Sub-S, LLC, Sole Proprietorship)
- Generates losses in 2021, or NOL carryover from 2020
- May not be able to use the loss
- Convert to offset loss & low tax brackets
- Use Roth 401(k), contributory, conversions



# Estate Tax Planning Strategies

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# Quick Refresher – Gift & Estate Tax

- 2021 Annual Exclusion - \$15,000 for 2021
- Estate & Gift Exemption - \$11,700,000 for 2021
- 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

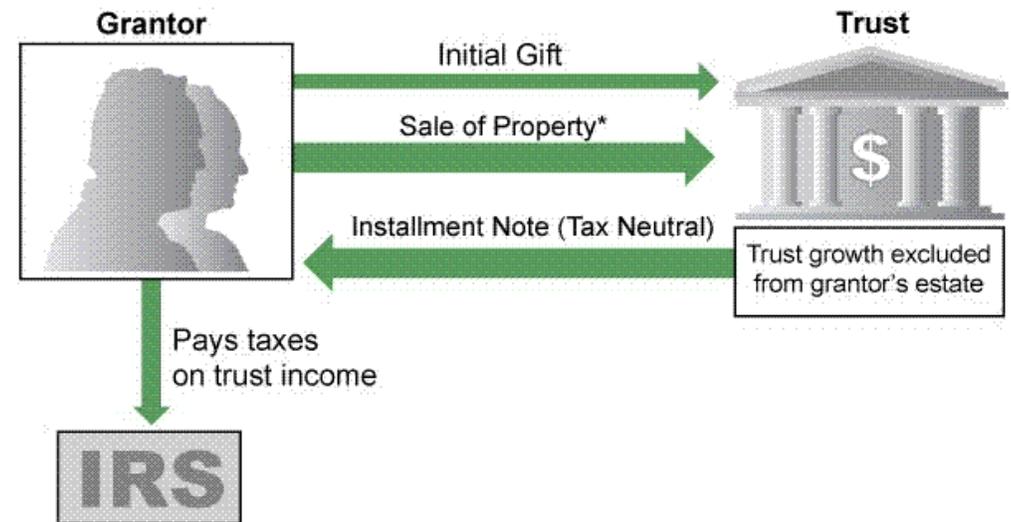
# Carryover Basis Proposed

- Biden tax plan proposes no more step-up at death
- Would drastically increase taxation to heirs (on top of the impact of the SECURE Act)
- Possible CG rates changed to ordinary income
- Tracking challenges across generations
- Could be in conjunction with decreased estate exemption



# 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

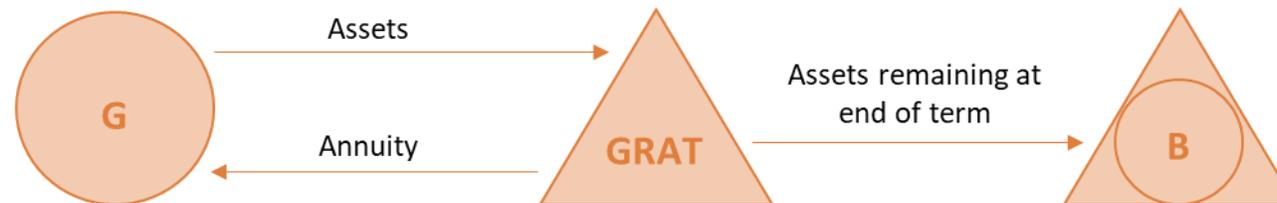
# IDGT Example

- \$13.3M FMV of asset pre-COVID-19
  - \$10M FMV of asset post-virus (25% drop)
  - 20% valuation discount (*15-35% range*)
  - \$8M discounted value
  - Assume annual cash flow = \$1,900,000 after return to normal (7 X multiple)
- \$800,000 seed gift to trust
  - \$7.2M sale to trust via 9-year note
  - Mid-term AFR 0.58%
  - \$823,379 annual P&I payments
    - Total interest \$210,410
    - Could instead use interest-only with a balloon payment
  - Net effect is transfer of \$13.3M of stock while using only \$800,000 of exemption

# Grantor Retained Annuity Trusts (GRATs)

- Transfer assets to trust for specified term in exchange for an annuity
- Annuity calculated at the IRC §7520 interest rate
- Excess appreciation goes to beneficiaries
- Minimum term of two years
- Estate tax inclusion if grantor dies during the term of the GRAT

- “Zeroed-out” design can eliminate estate exemption usage
- Carryover basis
- Not eligible for annual exclusion (future interest)
- GSTT exemption not allocable until end of trust term

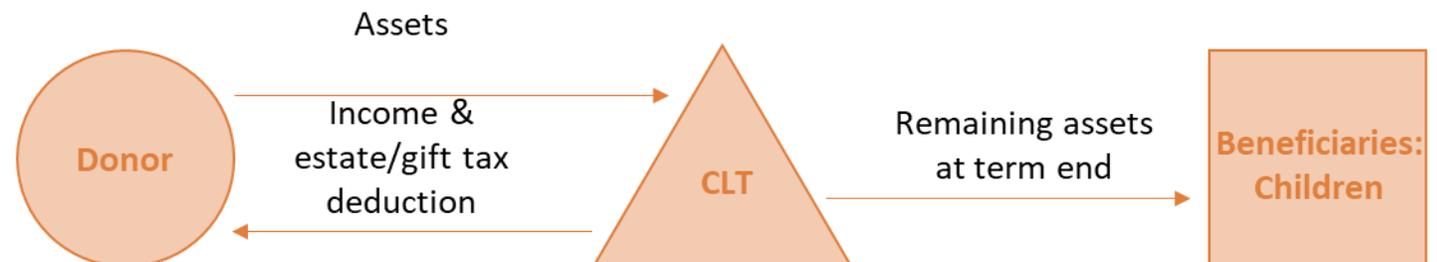


# GRAT Example

- Married couple
  - \$25M net worth
  - Real estate, investment assets, & family business
  - Transfers \$10M of family business to a GRAT
  - 20% discount (\$8M discounted value)
  - Annual growth in value of business is 8%
- 0.6% §7520 rate
    - › \$826,634 (~10.33%) annual annuity for 10 years
    - › \$5 PV remainder interest gift
    - › \$6,620,400 undiscounted value to heirs
  - Compare at 3% §7520 rate...
    - › \$4,606,600 value to heirs

# Charitable Lead Trusts (CLTs)

- Split interest charitable trust with gift tax deduction provided
- “Guaranteed” annual payments to charity, annuity valued using §7520 interest rate for current or prior 2 months (Lower rate = smaller taxable gift)
- Excess appreciation to heirs at the end of the trust term
- Charitable beneficiary options: Restrictions on family foundations
- Non-Grantor vs. Grantor
- Generally not used for GST transfers



## CLAT Example – “Zeroed Out”

- Transfer \$1M to 20-year CLAT
  - 5.213% (\$52,130) payout to charities for 20 years
  - 0.4% §7520 rate
  - \$1,000,000 PV of charitable benefit
  - \$0 PV remainder interest gift
  - \$1,289,503 transferred to heirs tax free in year 20 (6% annual growth rate)
  - Compared to \$734,400 transferred at 3% 7520 rate
- More aggressive variable annuity payment options are available
  - Build in 20% annual increase in annuity:
    - \$5,710 annuity in year 1
    - Increasing at 20% each year until \$182,360 in year 20
    - \$0 taxable gift, and \$1,774,883 transferred to heirs in year 20 (6% annual growth rate)

# Comparison of Transfer Strategies

	Outright Gift	IDGT	GRAT	CLAT
<b>Gift</b>	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'
<b>Tax Treatment</b>	Future income/sale proceeds taxed to beneficiary	Grantor trust	Grantor trust	Grantor or Non-grantor trust
<b>'Freeze' Asset Value</b>	Yes	Yes, when note is paid	Yes, once principal is paid and grantor survives	Yes
<b>Mortality Risk</b>	No	Yes, until note is repaid	Yes	Yes, for grantor CLATs
<b>GST Exemption</b>	Yes	Yes	No	Yes, subject to the adjusted GST exemption amount
<b>Carryover Basis</b>	Yes	Yes	Yes	Yes
<b>Gift Tax Issues</b>	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
<b>Valuation Rate</b>	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%)

# Questions?



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