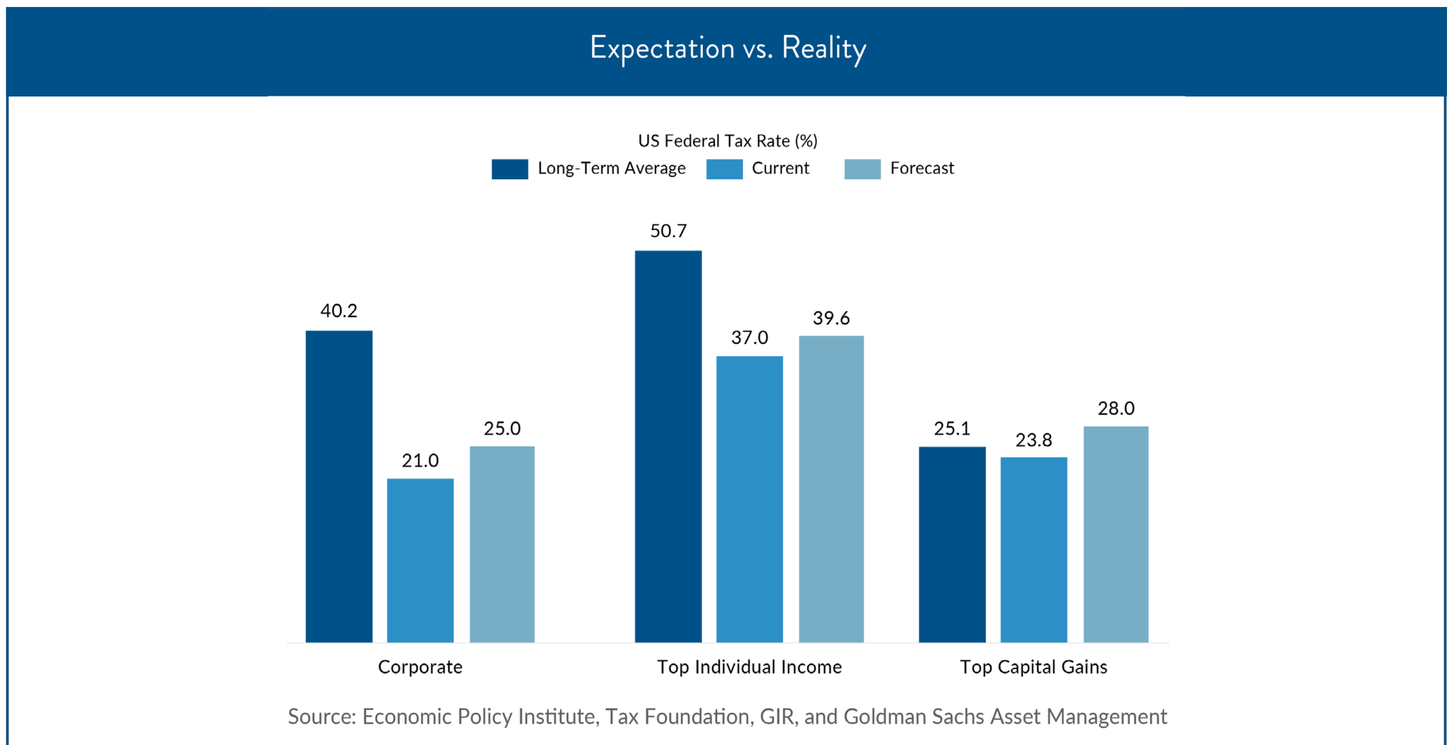
JSF FINANCIAL

PREPARING FOR CHANGE: TAX MOVES TO CONSIDER BEFORE 2022

We are all waiting to see what changes in the tax code as President Biden's tax proposals work their way through Congress. Potential tax hikes in the future do present us with additional uncertainty in year-end planning. But with current tax rates below long-term averages, it may be wise to go into 2022 expecting that tax rates could go higher.[1]



Fortunately, by planning and acting on the following tax moves now, you can stay ahead of the curve.

Realize Income and Capital Gains Early

Typically, when tax rates are expected to stay about the same or decline, deferring your income and investment gains can be a smart move. However, because proposed tax increases target higher earners, wealthier taxpayers and trust owners may want to consider realizing gains in 2021.

For instance, one current proposal adds a 5% surcharge on adjusted gross income over $10 million and 8% on income over $25 million.[2] Because adjusted gross income includes capital gains and dividends in addition to earned income, this move would effectively raise both capital gains and income taxes. Moreover, the proposal includes the same incentives for trust income but at a much lower threshold of 200k and 500k of total income.

After a year of strong market performance like 2021, there are situations where it can make sense to consider booking investment gains now, instead of waiting until next year.

Consider a Roth IRA conversion or "Backdoor Roth"

Contribution limits apply to Roth IRAs based on modified adjusted gross income, which start kicking in when single filers earn over $125,000 and married filers make over $198,000.[3]

However, you can convert a traditional IRA to a Roth IRA by paying current income tax rates on the amount converted.[4] Since this conversion can be done regardless of adjusted gross income, it is known as a "Backdoor Roth." The major perk of this strategy is that in the future, all withdrawals from your Roth (that meet the appropriate withdrawal requirements) are tax-free. By contrast, withdrawals from your traditional IRA are fully taxed as income.

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Revisit Your Estate Tax Exemptions—and Gifts

If you're on track to reach the lifetime $11.7 million per-person gift tax exemption in 2021,[5] now's a great time to use it. Even if Congress doesn't lower the limit next year, the exemption expires in 2025 anyway.

You can also transfer annual tax-free gifts to your loved ones. Typically, you can give up to $15,000 per person, per year with no tax consequences.[6] A married couple can gift their married adult child and spouse a combined $60,000 a year, tax free.[7] In addition, one can also pay tuition directly to a school/university as well as pay direct medical expenses, which are excluded from annual and lifetime gift thresholds.

Maximize Charitable Contributions

The IRS lets you claim a standard deduction or itemize deductions when filing your tax return. For 2021, the standard deduction for an individual is $12,550, and a married couple who files jointly can deduct $25,100.[8]

However, if your allowable deductions, including charitable giving, are greater than these limits, you can realize a greater tax benefit by itemizing deductions. A bump in your 2021 charitable donation could put you above the threshold to itemize and give you a bigger tax break.

An increasingly popular way to structure charitable donations is through a donor-advised fund.[9] This tool helps you take advantage of itemized deductions by structuring your donations in a way that puts you over the threshold to itemize. For example, you can make a single large contribution to your donor-advised fund, which is itemized for the relevant tax year. Then, you can donate that money over time to the causes most important to you.

Donating appreciated stock to a donor-advised fund can be particularly powerful. This strategy not only provides you with the benefits of the tax-deductible contribution, it also means you can avoid capital gains taxes on the appreciated amount.

Thanks to the CARES Act, this year there are two additional ways to lower your tax burden with charitable contributions.

Once in the donor-advised fund, your money grows tax-free, meaning that the contribution you make today can translate into an even larger one later on. Currently you can choose to use the funds in your donor-advised fund anytime you want—there are no limits on when you need to distribute funds to charities. However, some lawmakers have proposed putting limits on this feature in the future.

If you are interested in maximizing both your impact on charity and the tax benefits of philanthropy, a donor-advised fund is one strategy that could be useful. Please don't hesitate to reach out, as we'd be happy to walk through the different options with you.

Thanks to the CARES Act, this year there are two additional ways to lower your tax burden with charitable contributions. For 2021 you can deduct a cash gift of $300 for single filers or $600 for joint filers, even if you claim the standard deduction.[10] The other allows you to deduct up to 100% of your adjusted gross income in charitable contributions, compared to the previous maximum of 60%.[11]

Both of these benefits are set to expire this year, so now's the time to claim them![12]

Harvest Tax Losses on Cryptocurrencies

Given the extent of the market rally since the initial 2020 crash, you may be straining to find opportunities to harvest losses. It can be tempting to move in and out of positions, but the wash-sale rule doesn't permit you to write off losses if you sell and rebuy the same or similar security within 30 days.[13]

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However, there's one asset class that's not subject to the wash-sale rule: cryptocurrencies.

Congress is considering adding cryptos to the wash-sale rule sometime in 2022,[14] but for now you can claim up to $3,000 in cryptocurrency losses regardless of your trading frequency.[15]

You can use these losses to "mix and match" your losses between asset classes. And if you lose more than the $3,000 maximum, any losses you generate now can carry forward to future tax years.

It's important to work with your accountant to figure out the most appropriate tax planning strategies for you. We're here to help you quarterback that process!

Conclusion

The right year-end tax moves for 2021 vary widely based on your personal financial situation and any planning moves you've already executed throughout the year. Things are also a little more complicated right now with the possibility of new tax legislation in 2022.

These are just a few strategies that may be applicable to you—for specific ideas, it's important to work with us and your accountant to figure out the most appropriate way forward. We're here to help you quarterback that process and strategize specifics. While you're likely to have heard from us already about year-end planning, please don't hesitate to reach out if you have any outstanding questions about your tax situation. Thank you again for your ongoing support and trust throughout the year and we look forward to continuing to working closely together with you in 2022.

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