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## Potential tax law changes hang over year-end tax planning for individuals

As if another year of the COVID-19 pandemic wasn't enough to produce an unusual landscape for year-end tax planning, Congress continues to negotiate the budget reconciliation bill. The proposed Build Back Better Act (BBBA) is certain to include some significant tax provisions, but much uncertainty remains about their impact. While we wait to see which tax provisions are ultimately included in the BBBA, here are some year-end tax planning strategies to consider to reduce your 2021 tax liability.



### Accelerate and defer with care

One of the most reliable year-end tactics for reducing taxes has long been to accelerate your deductible expenses and defer your income. For example, self-employed individuals who use cash-basis accounting can delay invoices until late December and move up the planned purchase of equipment or the payment of estimated state income taxes from early next year to this year.

This technique has always carried the caveat that you generally shouldn't pursue it if you expect to be in a higher tax bracket the following year. Potential provisions in the BBBA also may make it advisable for certain taxpayers to reverse the strategy for 2021 — that is, accelerate income and defer deductible expenses.

The current version of the BBBA would impose a new "surtax" of 5% on modified adjusted gross income (MAGI) that exceeds \$10 million, with an additional 3% on income of more than \$25 million. As a result, the highest earners could pay a 45% federal marginal income tax on wages and business income (the current 37% income tax rate plus 8%). It could be even higher when combined with the net investment income tax, which might be expanded to include active business income for pass-through entities.

In addition, there's a proposal to temporarily increase the \$10,000 cap on the state and local tax deduction to \$80,000. Individuals in high-tax states should consider whether there may be an advantage to accelerating a 2022 property or estimated state income tax payment into 2021, or whether the deduction might be more valuable next year, particularly if they'll face a higher effective tax rate.

### Leverage your losses

Taxpayers with substantial capital gains in 2021 could benefit from "harvesting" their losses before year-end. Capital losses can be used to offset capital gains, and up to \$3,000 (\$1,500 for married persons filing separately) of excess losses (those that exceed the amount of gains for the year) can be applied against ordinary income. Any remaining losses can be carried forward indefinitely.

## Leverage your losses (continued)

Beware, however, of the wash-sale rule. Generally, the rule prohibits the deduction of a loss if you acquire “substantially identical” investments within 30 days, before or after, of the date of the sale.

Taxpayers who itemize their deductions could compound their tax benefits by donating the proceeds from the sale of a depreciated investment to a charity. They can both offset realized gains and claim a charitable contribution deduction for the donation.

## Satisfy your charitable inclinations

For 2021, charitable contributions can reduce taxes for both itemizers and non-itemizers. Taxpayers who take the standard deduction can claim an above-the-line deduction of \$300 (\$600 for married couples filing jointly) for cash contributions to qualified charitable organizations.

The adjusted gross income limit for cash donations is 100% for 2021; it’s scheduled to return to 60% for 2022. That means you could offset all of your taxable income with charitable contributions this year. (Donations to donor advised funds and private foundations don’t qualify, though.)

Taxpayers who don’t generally itemize can benefit by “bunching” their charitable contributions. In other words, delaying or accelerating contributions into a tax year to exceed the standard deduction and claim itemized deductions. For example, if you usually make your donations at the end of the year, you could bunch donations in alternative years — say, donate in January and December of 2022 and January and December of 2024.

Retired taxpayers who are age 70½ and older can reduce their taxable income by making qualified charitable contributions of up to \$100,000 from their non-Roth IRAs. Retired or not, individuals age 72 and older can use such contributions to satisfy their annual required minimum distributions (RMDs). Note that RMDs were suspended for 2020 but are effective for 2021.

So long as the assets would be considered long-term if they were sold, donations of appreciated assets offer a double-barreled tax benefit. You avoid the capital gains tax on the appreciation and can deduct the asset’s fair market value as of the date of the gift.

## Convert traditional IRAs to Roth IRAs

As in 2020, when many taxpayers saw lower than typical income, 2021 could be a smart time to convert funds in traditional pre-tax IRAs to an after-tax Roth IRA. Roth IRAs have no RMDs, and distributions are tax-free.

You’ll have to pay income tax on the converted funds, but it’s better to do so while subject to lower tax rates. Similarly, if you convert securities that have dropped in value, your tax may well be lower now than down the road — and any subsequent appreciation while in the Roth IRA will be tax-free.

It’s worth noting that President Biden had proposed including a provision in the BBBA that would limit the ability of wealthy individuals to engage in Roth conversions. There was a lot of back-and-forth with respect to these provisions, and the latest version of the House bill includes certain restrictions. Whether these provisions will make it past any Senate amendments remains to be seen, but the proposal could be a harbinger of future proposed restrictions.

## Proceed with caution

The strategies outlined above always come with pros and cons, but perhaps never more so than now, when potentially significant tax legislation that would take effect next year is under negotiation. We can help you chart the best course in light of any developments. [Contact us](#) if you have questions.

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