SC&H GROUP

WEBINAR

2021 Year-End Tax Planning Forum

How to Maximize Outcomes, Identify Possible Deductions, and Navigate the Evolving Tax Landscape

Presented on December 2, 2021

Personal Tax Planning

Presented by Andrew Thompson, Managing Director | SC&H Financial Advisors

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Our Presenters

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What's In Your Investment Portfolio?

- Impact of Year-End Capital Gain Distributions
- Mitigation strategies

Year-End Capital Gain Distribution

ABC Mutual Fund

↓

Taxable capital gain of $5/share or 15% of NAV

↓

Shareowner

Year-End Capital Gain Distribution – Gross vs Net

ABC Mutual Fund 10% pretax return

↓

15% of NAV capital gain distribution realized by shareowner

↓

Shareowner’s NET return = 5%

Mitigation Strategies

- Know what you're buying **BEFORE** you buy it
- Weight trade-offs of selling it prior to distribution date
- Sell any positions with unrealized losses to offset gain distributions (buy back similarly sold position after sale to maintain exposure)
- Asset location: Own tax inefficient investments in tax sheltered accounts
- Consider buying tax efficient mutual funds, ETFs or index mutual funds
- Gift highly appreciated shares to charity…

Effective Charitable Giving

- Current law's impact on giving
- Donor Advised Fund
- Effective strategies for giving

Donor Advised Fund (DAF)

Highly Appreciated Securities

Fidelity Charitable DAF

*(Deduction up to 30% AGI)

Qualified 501(c)(3)

Qualified Charitable Distribution (QCD)

Retirement Account

↓

2021 IRA RMD

*(up to $100,000)

↓

Qualified 501(c)(3)

***($0 recognized as taxable income)**

Individual Tax & Financial Planning

Presented by Amanda Wilhelm, Principal | SC&H Group

Our Presenter

Amanda Wilhelm

PRINCIPAL | WEALTH MANAGEMENT

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Proposed Tax Legislation

Build Back Better Act – House Proposal

- $1.75M bill includes individual tax provisions which could be impactful to tax planning for retirement accounts:
  - Prohibition on further contributions to Roth and/or traditional IRAs if contributions cause total value of all retirement accounts to exceed $10 million. ($400,000/$450,000 income limitations). Would be effective for tax years beginning after **12/31/28**.
  - Elimination of "back-door Roth" strategy in both IRAs and employer-sponsored plans. Would be effective for tax years beginning after **12/31/21**.
  - Elimination of Roth conversions for both IRAs and employer-sponsored plans ($400,000/$450,000 income limitations). Would be effective for tax years beginning after **12/31/31**.

Retirement Planning Opportunities

Facts

- **Elimination of IRA Age Limitation.** As long as you have earned income, you can make IRA contributions courtesy of the 2020 SECURE Act.

- **Required Minimum Distributions**. The age where you <u>must</u> begin taking Required Minimum Distributions remains at age 72. Let the funds grow and continue to defer the tax. Possibly consider converting some of that tax-deferred money to a tax-free Roth IRA.

Retirement Planning Opportunities with Employer Plans

Employer Retirement Plans

- **Max out your employer retirement account contributions**
    - Employer plan contributions (401k, 403b) - **$19,500 ($26,000 for age 50+)**. Must fund through payroll before 12/31/2021.
    - SIMPLE IRA - **$13,500 ($16,500 for age 50+)**. Can fund on or before the filing of the 2021 tax return.
    - SEP IRA – For self-employed business owner, funding is approximately **20% of net business income.** Can fund on or before the filing of the 2021 tax return. For plans with employees, 25% of compensation or $58,000 (employer-contributions only).
- **If you can't max it, contribute enough to get the employer match, if one is available.**

Retirement Planning Opportunities with Individual Accounts

Individual Retirement Accounts

- **Max out your individual retirement account contributions** Individual Retirement Account (Traditional IRA and Roth IRA) - $6,000 ($7,000 for age 50+). Can fund on or before the filing of the 2021 tax return.
  - IRA Income Limitations:
    - Traditional IRA – No limit if not covered by an employer plan. If covered, limits are Single $66K to $76K phaseout. MFJ $105K to $125K phaseout
    - Nondeductible IRA – No income limitation.
    - Roth IRA – Single $125K to $140K phaseout. MFJ $198K to $208K phaseout.

Retirement Planning Opportunities with Individual Accounts

Individual Retirement Accounts

- **Max out your retirement account contributions (cont.)**
  - Back-door Roth IRA Contribution. Strategy to get around Roth IRA income limitation. First contribute to nondeductible IRA, then convert to a Roth IRA. Be careful of the IRS's pro rata rules surrounding Roth Conversions. THIS TOOL COULD GO AWAY AFTER 2021!
  - Roth Conversion. Take your traditional IRA, pay the tax on it, and convert it to a Roth IRA. Managing your tax bracket is key. THIS TOOL COULD DISAPPEAR AFTER 2031!

Retirement Planning Opportunities with Individual Accounts

2021 Individual Income Tax Brackets

2021 Tax Brackets and Rates for Single Filers, Married Couples Filing Jointly, and Heads of Households			
2021 Tax Rate	**For Single Filers**	**For Married Individuals Filing Joint Returns**	**For Heads of Households**
10%	Up to $9,950	Up to $19,900	Up to $14,200
12%	$9,951 to $40,525	$19,901 to $81,050	$14,201 to $54,200
22%	$40,526 to $86,375	$81,051 to $172,750	$54,201 to $86,350
24%	$86,376 to $164,925	$172,751 to $329,850	$86,351 to $164,900
32%	$164,926 to $209,425	$329,851 to $418,850	$164,901 to $209,400
35%	$209,426 to $523,600	$418,851 to $628,300	$209,401 to $523,600
37%	$523,601 or more	$628,301 or more	$523,601 or more
Source: Internal Revenue Service			

Retirement Planning Opportunities with Individual Accounts

Roth IRAs for Children

- Children need earned income. Can contribute lessor of $6,000 or amount of earned income.

- Tremendous opportunity for business owners to put children on payroll and shift tax-free wealth to the child/children.
  - Business gets a tax deduction for payroll reducing owner's taxable income.
  - Child can get the money and pay no income tax due to the standard deduction.
  - Child contributes to a Roth and the money grows tax-free for 60 to 90 years.
  - Children can use the Roth for College or Retirement.

Income Planning

- Tax rate considerations and optimization
    - Reconsider "deferring income and accelerating deductions" – effective tax rates and value of deductions could mean more in future years
    - Tax rates for qualified dividends and capital gains could rise dramatically
    - Planning considerations
        - Convert investment income taxable at regular rates into qualifying dividend income
        - Accomplish multi-year planning by considering future tax rates and filling low-rate income buckets
        - Capturing capital gains (focus on 0%/15% rate, below NII threshold)
        - Review of current filing status (MFJ v MFS) and current reduced impact of marriage penalty

Income Planning

- Business and/or Self-employed
  - Ensure best position to take advantage of the Qualified Business Income (QBI) deduction
    - Keep taxable income below the 2021 limits of $164,900/$329,800 for those with a SSTB
    - Make sure adequate wages or assets are in place to qualify for deduction or consider entity conversion
    - Confirm use of most advantageous retirement plan and maximize contributions
- Tried but True
  - Arrange with employer to defer bonus until 2022
  - Dispose of passive activities to release suspended losses
  - Increase withholding to eliminate or reduce estimated tax penalty

Itemized Deductions

- "Bunching" Strategy
  - Continue being an "occasional itemizer" due to substantially increased standard deduction ($12,550/$25,100 in 2021) by bunching itemized deductions in higher income years
    - Bunch charitable giving
      - Donate every other year (January and December of year 1, 3, 5, etc.)
      - Establish a donor advised fund (DAF) and fund with several years' worth of planned giving
    - Bunch medical expenses
      - Timing of elective surgeries, prescription eyewear, and payment of special education tuition
      - AGI hurdle set at 7.5% for now
- State and Local Taxes
  - Weigh the tax implications of deducting real estate and sales tax in order to reach $10,000 deduction limit to avoid the state addback

Itemized Deductions

- Charitable Giving
  - Maryland residents - CITC program still valid
- Mortgage Interest
  - Review current mortgage terms and balances to determine impact of new law
  - Accelerate payoff of all debt incurred that is not home acquisition debt
  - Consider payoff of home acquisition debt for non-itemizer due to higher after-tax cost
  - Consider refi due to low interest rates

Itemized Deductions

Miscellaneous Itemized Deductions

- Determine correct billing and allocation of professional fees (tax, legal)
- Negotiate employer payment of unreimbursed employee expenses
- Consider payment of advisory fees from IRA

Miscellaneous Tax Planning

- 529 College Savings Plan
  - Contributions to your state's plan are eligible for a state tax deduction
  - Earnings grow Federal tax-free and will not be taxed upon withdrawal to pay for qualified education expenses
- Fund HSA, FSA, and Dependent Care FSA
- **Utilize flexible spending accounts before year end.** Whether for health or dependent care, these are "use it or lose it" plans.
  - **Contribute to Health Savings Account.** $3,600 for single, $7,200 for family. $1,000 catch-up for age 55+. Must be high-deductible health plan. HSA's are triple-tax-free. Contributions are tax-deductible. Growth and earnings are tax-free. Distributions for medical expenses are tax-free.

State Tax – Maryland

- Maryland continues to follow the new federal tax law with the following modifications:
  - Personal exemptions still in place
  - 2021 standard deduction ($2,350/$4,650)
  - No allowance for QBI deduction
  - Decoupling from increased bonus and Sec 179 depreciation rules
  - Reduction of estate tax exemption to $5 million

Estate and Gift Tax Planning

Opportunities to Consider

- Outright gifts
  - Take advantage of current annual exclusion and exemptions by making direct gifts when prudent
- Gifting to various trusts
  - Intentionally Defective Grantor Trusts (IDGT) - provides benefit to family, provides asset protection and prevents inclusion in the beneficiaries' taxable estate. Grantor is responsible for income tax on trust income, thus another outlet to reduce their taxable estate and allows assets to remain in trust to grow tax-free
  - Grantor Retained Annuity Trust (GRAT) - effective for assets with anticipated value appreciation. Grantor transfers assets and receives right to an annuity payment from the trust. If GRAT is successful, both the asset and appreciation have been passed to the beneficiaries.
  - Charitable Lead Trust (CLT) - allows one to provide to a charity during their lifetime while leaving assets to their family with both gift and income tax savings.

Answering Your Questions

Business Tax Planning

Presented by Jim Wilhelm and James Eaton | SC&H Group

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Proposed Tax Legislation

Congress has the Build Back Better Act in Process

- $1.75M bill would impact individual and business taxes in many ways – though it appears much less impactful than we were reading about this summer
    - New tax surcharges on individuals with AGI over $10M and $25M
    - Raise the SALT Cap to $80,000 – this is funny
    - Eliminating the benefit of IRC 1202 for taxpayers with AGI over $400K
    - Make ALL business income subject to net investment income tax when AGI exceeds $400K
    - Changes to GILTI, FDII for corporations
    - A new 15% minimum tax on book income for corporations with $1B in net income

Overview – What Has (or Hasn't) Changed

- What hasn't changed much
  - Tax rates / highest tax brackets – no change
  - Capital gains tax rates – no change
  - Accelerated depreciation (Sec. 179 / Bonus depreciation) – no change
  - TCJA provisions (QBID, depreciation, loss & interest expense limits) – sunset 12/31/2025
  - PPP – Forgiveness process ongoing, no new funding on the horizon (@12/2/2021)
- New areas of interest
  - Employee Retention Tax Credit (ERTC)
    - Benefit = up to $7,000 / employee / quarter in 2021 (ex: 50 employees x 7,000 = $350,000 / quarter)
    - Safe harbor - 20% decrease in revenues (on your method of accounting for tax purposes)
    - More detailed methodologies to establish employees impacted by government shutdowns

Year-End Tax Planning Strategies

- Should "standard" year-end planning techniques be re-evaluated
  - Will tax rates be higher in 2022?
  - Will the QBI deduction be limited for high income taxpayers?

- Asset Acquisitions / Accelerated Depreciation
  - Assets acquired <u>and put into service</u> by year-end may be eligible for immediate expensing
    - Section 179 depreciation or Section 168 bonus depreciation
    - FYI: Many states "decouple" from these provisions, so benefits may only be at the federal level
  - Benefits are available even if acquisitions are financed, so this can be cashflow positive in the short / intermediate term

Year-End Tax Planning Strategies

- Cash basis taxpayers
  - Cash basis taxpayer can identify expenses to be accelerated at year end
    - Ex: Rent, utilities, salaries / bonuses, commissions
    - “Mailbox Rule”
  - Slow cash collections
    - Great idea in concept, tricky in practice
- Accrual basis taxpayers & deductible accruals
  - Recurring item Exemption - Some accrued expenses may be deductible if paid within 8 1/2 (or 2 ½) months
    - All Events test
    - Amount Certain
    - Economic Performance

Owner's Compensation

Year-end can be a great time to plan for next year too

- **Partnerships** – have shifted toward Profits Allocations rather than Guaranteed Payments
  - Must have significant economic effect
  - Cannot be "Guaranteed" / must be based on "profit"
- **S-Corporations** – Re-evaluation what represents "Reasonable Compensation" for owners
  - No hard and fast rules – What would you pay a third-party manager?
- Benefits
  - Limit payroll tax exposures
  - Maximize QBI deductions (effective tax rates on profits are < than Wages / Guaranteed Pmts)

M&A and Succession Planning

- We continue to see a hot M&A market
  - Continued low interest rates
  - Concerns from sellers about future tax rates
- EBITDA multiples continue to expand
  - Rising toward 5x – 8x range in some industries
  - Certain tech industries seeing much higher multiples
- Gifting and Succession planning - Uncertainty around the lifetime exemption
  - Spousal Limited Access Trusts (SLATs) popular again – party like it's 2010
  - Timing seen as beneficial for gifting / discounted sales to the next generation

Pass Through Entity Tax Election

- 22 states (including Maryland) have implemented workarounds to the TCJA SALT limitation
- What is the purpose?
  - No state tax benefit (states generally require the deduction to be added back to state income)
  - The IRS allows the deduction at the federal level
  - Ex:
    - $100K of profit x 8.5% tax rate = $8,500 deductible tax payment to state (remember, no state benefit)
    - $8,500 federal tax deduction (~30% – ~37%) = $2,500 - $3,000 federal tax benefit

Pass Through Entity Tax Election

- Payment must be made by 12/31/2021 even if an Accrual Basis
- Generally, does not apply to investment income or to corporate partners
- Nonresident owner complications
  - Not all states allow a state credit for taxes paid inside the entity
  - Some significant ambiguity in large states like CA and NY
  - Some states treat partnerships differently than S-Corporations
- Delays in MD filing - tax year 2021 to be more streamlined than tax year
  - 2020 Law was updated and clarified as late as spring 2021
  - The comptroller's office didn't release the 2020 forms until August / September 2021

Answering Your Questions

Corporate Tax Planning

Presented by Michael Bondi & Stephanie Johnson | SC&H Group

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Federal Corporate Tax Updates

- NOLs
  - Generated in 2017 and prior
    - Offsets 100% of taxable income
    - Carryback 2 years, carryforward 20 years
  - Generated in 2018 and later
    - Offsets 80% of taxable income
    - No carryback, carryforward indefinitely
- Section 163(j) – Business Interest Expense Limitation
  - Starting in 2021, limited to 30% of ATI
  - Starting in 2022, cannot add-back depreciation, amortization, or depletion
- Depreciation – 100% Bonus Phase Out Beginning in 2023

Corporate Tax Planning 2021

- Cash Basis Taxpayers
  - Cash basis taxpayer can identify expenses to be accelerated at year-end
  - Slow cash collections
- Temporary 100% Business Meal Deduction
  - Qualified expenses incurred in 2021 and 2022
- R&D Deduction
  - Amortize expenses over 5 or 15 years, rather than immediately in year incurred
- Payroll Tax Deferral
  - First payment of 50% due December 31, 2021
  - Remainder due December 31, 2022

State Tax Considerations

Remote Employee Sourcing – Potential Nexus Trigger

- AR = After 1/1/21
- CA = After 6/11/21
- CO/CT/DE/IA/IL/KS/KY/MA = After 9/13/21
- MD/ME = After 6/30/21
- MN/MO/MT/NC/NE = After 7/30/21
- NJ/OR/SC = After 9/30/21
- VT/WI = After 12/31/21

Tax Rate Changes

- Florida – reduced from 4.458% to 3.535% for 2021, 5.5% in 2022
- Indiana – 5.25% until 7/1/21, 4.9% after 7/1/21
- Louisiana – graduated rate 4-8% 2021, 3.5%-7.5% 2022
- Oklahoma – reduced from 6% to 4% in 2022

PPP Loan Forgiveness Conformity

- Rhode Island – excluded up to $250,000; taxable above that
- Virginia – excluded up to $100,000; taxable above that

State Tax Considerations (*con't*)

Apportionment Changes

- Alabama – Single sales factor for 2021
- Maryland – Single sales factor beginning in 2022
- Montana – 3-factor with double-weighted sales for taxable years beginning after 6/30/21

Other

- California – NOL utilization suspended for tax years 2020-2022 for corporations with taxable income over $1 million
- Illinois – Illinois Income Tax Act
  - Disallows deductions for federal 100% foreign dividends received, GILTI, IRC section 243(e)
  - Decouples from 100% bonus beginning in 2022
  - NOL utilization limitation of $100,000 for 2022-2024
- North Carolina – 2021 Appropriations Act
  - Phase out income tax starting in 2025

Foreign – Derived Intangible Income (FDII)

- Deduction allowed under Section 250
- Equal to 37.5% of FDII
- Build Back Better Act
  - Current deduction of 37.5% decreased to 24.8%

Base Erosion and Anti-Abuse Tax (BEAT)

- IRC Section 59A
  - Alternative minimum tax on multinational U.S. corporate taxpayers
  - 10% of modified taxable income
  - If applicable, paid in addition to regular tax
- Build Back Better Act
  - Current rate of 10% increased to 12.5% in 2023, up to 18% in 2025
  - De minimis exception eliminated after 2024

Build Back Better Act

Proposed Corporate Tax Impact

- 15% minimum tax on corporations with financial reporting income greater than $1 billion
- 1% surcharge on stock repurchases
- 163(j) interest expense limited to 110% of net interest expense
- GILTI rate could increase from 10.5% to 15%
  - Computer on country-by-country basis, rather than worldwide
  - Reduce QBAI from 10% to 5%
  - Reduce Section 250 deduction from 50% to 28.5% of GILTI
- Foreign Tax Credit – Limitation applied on country-by-country basis
- Reduce FDII deduction from 37.5% to 24.8%

Answering Your Questions

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