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Year-End Estate and Tax Planning 2021: A time to consider both conventional and situational strategies

First and foremost, wealth planning is a process. It can include routine tasks to maintain or improve upon a strong financial position, which are generally rules of thumb that tend to apply regardless of your current situation. However, there are also situational strategies that you may consider given our current environment of potentially changing taxes, legislation, markets, the economy, and more. As we approach the end of 2021, it's as important as ever to fine-tune your year-end planning to make sure you consider both routine and situational strategies, helping to best position yourself not only for this year, but for those to come.

Key points:

- Routine year-end planning typically includes income tax, capital gains, annual exclusion gifting, and estate planning considerations
- Supplementing your routine strategies with situational strategies can help further enhance your financial and tax positions
- A well-coordinated plan is key to utilizing this year's opportunities and being prepared for what the future may bring

Routine year-end planning

Considering income taxes

Conventional wisdom for year-end income tax planning generally points toward minimizing taxation by deferring income and maximizing deductions. With this in mind, maximizing contributions to tax-deferred retirement accounts should generally be part of your annual routine. Contributions to tax-advantaged retirement plans,

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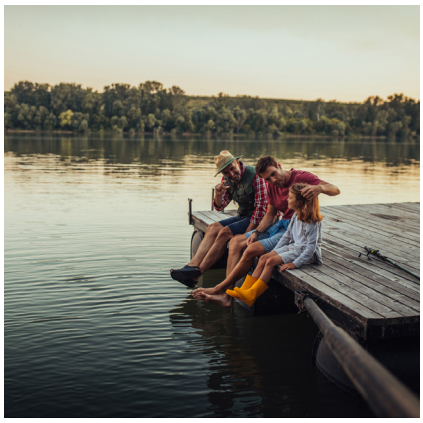

Every individual may make tax-free, annual exclusion gifts of up to $15,000 to as many people as desired, without counting toward the lifetime exemption from estate and gift tax.

such as 401(k)s and IRAs, offer the double advantage of reducing current year taxable income, as well as providing tax-deferred growth while the assets remain in the account. Contributing to health savings accounts provide similar tax benefits and may offer the added benefit of tax-free distributions for qualified medical expenses. As these are significant tax advantages, contributions to these accounts are limited on an annual basis. To take advantage of the current and future tax advantages these accounts provide, it's important to maximize your contributions to the extent allowed. Ending the year with unused contributions is essentially a missed opportunity to improve your current and future financial position. Regardless of your income tax situation or potential legislative changes, it is generally sound planning to defer income in tax-advantaged accounts.

Reducing capital gains

To the extent that you have sold appreciated assets throughout the year, you will generally seek losses that can offset the taxable gain. Commonly known as tax-loss harvesting, realizing capital losses can eliminate or reduce the impact of capital gains. It is important to note that wash sale rules prevent the repurchase of a "substantially identical" security within the 30-day period before or after a security is sold. For this reason, it may be helpful to work with your advisor to maintain a sound investment strategy while simultaneously seeking tax benefits.

Taking advantage of annual exclusion gifting

Every individual may make tax-free, annual exclusion gifts of up to $15,000 ($30,000 for a married couple) to as many people as desired, without counting toward the lifetime exemption from estate and gift tax. An annual exclusion gifting strategy to consider is establishing (or contributing to established) 529 education savings plans for children or grandchildren. A special option exists with 529 plans, allowing you to front-load five years' worth of annual exclusions in one year, which can be beneficial if you are looking to rapidly accumulate assets for education and shift additional appreciation out of your estate this year. This "superfunding" technique allows for a $75,000 transfer, per individual, without counting as a taxable gift.

Reviewing your estate plan

Year end is a great time to be sure your estate plan is complete, your beneficiary designations are current, and that your plan still meets your wishes for eventual distribution. A complete plan includes a will, trust, and key legal documents—such as powers of attorney for financial and health care matters. You may also want to review whom you have named to serve as your fiduciaries, agents, executor, and trustee in your various documents. This review is important, to be sure that the individuals named can fulfill the requirements of the roles. A complete plan requires advance thought and guidance from your trusted advisors.

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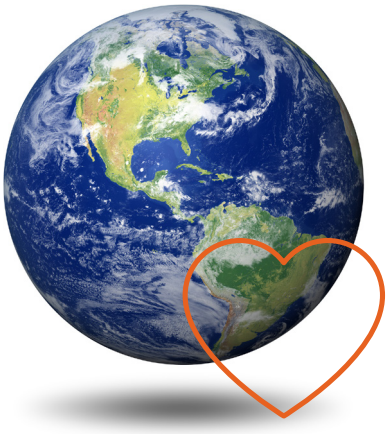

If you are charitably inclined and gift on an annual basis, you may want to consider bunching charitable donations to maximize deductions in a high tax year.

Situational year-end planning: playing offense or defense?

Supplementing your routine strategies with situational strategies can help further enhance your financial and tax positions. As the end of the tax year approaches, it is a good time to ask yourself if you are playing offense or defense with regard to your tax planning in 2021. Simply, if this year has been a high tax year, you will likely be looking to defend against immediate taxation by employing additional tax reduction and deferral strategies that will help reduce your 2021 tax bill. Alternatively, if the year has resulted in relatively low taxable income, or you expect higher rates in the future, there may be an opportunity to play offense and be proactive with strategies that can help improve your long-term tax position. In 2021, situational planning is even more relevant given the proposed changes to tax legislation. With potential rate increases and restrictions on the horizon, carefully consider how your personal short- and long-term situation may be impacted.

Defensive strategies to help further reduce the 2021 tax impact

If, after your routine strategies have been executed, you still find yourself in a high tax year, there may be additional strategies to consider that may provide tax relief for those in certain circumstances.

Charitable gifting: If you are charitably inclined and gift on an annual basis, you may want to consider bunching charitable donations to maximize deductions in a high tax year. This is particularly useful if your combined itemized deductions do not currently exceed the standard deduction. Bunching several years of charitable donations into one year may increase itemized deductions and reduce taxable income beyond what the standard deduction provides.

In addition, charitable contributions for gifts of cash to public charities may be deducted up to 100% of a donor's adjusted gross income for 2021. This extended benefit is available to donors who itemize deductions. It may be useful to consider utilizing this enhanced deduction if you sold a business or a substantial block of appreciated stock this year. Additionally, if you do not itemize your deductions, a married couple filing jointly may take an increased deduction up to $600 for gifts of cash to public charities. This benefit is available in 2021 and will no longer be available next year.

Contributing to 529 plans: If you are preparing for future education expenses, contributing to a 529 plan may provide additional deductions on a state income tax basis. Each state varies in the availability and amount of 529 plan deductions, so be sure that the strategy will have the intended impact for you.

Accelerating deductible expenses: If you are anticipating deductible expenses in upcoming years, there may be an option to accelerate deductible expenses by making payments in the current tax year. Medical expenses and certain interest expenses may fall into this category.

Offsetting ordinary income: If realized capital losses exceed realized capital gains, you can offset ordinary income with up to $3,000 in capital losses in any given year.

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While higher earners will phase out of being able to make direct contributions to a Roth account, Roth conversions are currently available at any income or wealth level.

Capital losses that exceed the $3,000 limit may be carried over to offset capital gains in future years. As noted earlier, any liquidation decision should be considered with your investment strategy in mind—not simply tax mitigation.

Offensive strategies to help reduce future tax impacts, while taking advantage of a lower tax year

These strategies counter conventional tax planning and the typical benefits sought through deferral and decrease of taxation in the current year. Situationally, however, there may be opportunities to utilize these strategies to improve your long-term tax position.

Retirement account considerations: While contributing pre-tax dollars to tax-deferred accounts should generally be part of your planning routine, those in a relatively low tax year may seek long-term benefits from a Roth account. Instead of providing tax deferral, Roth accounts are funded with after-tax dollars, which grow and distribute on a tax-free basis. While higher earners will phase out of being able to make direct contributions to a Roth account, Roth conversions are currently available at any income or wealth level. The converted amount will be taxable at the time of conversion, so the strategy should be carefully considered. However, if you are in a low tax year, or otherwise expect to pay higher effective rates in the future, the tax-free benefits could be substantial. If you are considering a Roth conversion, please note that an earlier legislative proposal may prohibit conversions of after-tax dollars held in retirement plans beginning in 2022, and prohibit conversions for high earners beginning in 2032. At the time of this writing, that legislation does not appear to have much momentum, but the situation is fluid and care should be taken to consider all options.

For those who retain large tax-deferred accounts, a relatively low tax year could represent an opportunity to reduce the impact of required distributions in the future. Required minimum distributions (RMDs) from 401(k) and individual retirement accounts begin at age 72 and are taxed at ordinary income rates. Given the availability of other income sources, most will continue to defer until age 72. However, if you find yourself in lower marginal brackets currently, and anticipate that RMDs will push you into higher brackets in the future, it may be advantageous to distribute from 401(k)s and IRAs before required. This strategy may help flatten the long-term tax burden of distributing from tax-deferred accounts. Keep in mind that distributions prior to age 59½ may result in a 10% penalty. If you're interested in making a charitable donation, you can make a qualified charitable distribution (QCD) from your retirement account, which will count toward your RMD. Note this is not available for a QCD to a donor advised fund.

Harvesting capital gains: Should you have appreciated assets that exceed losses, you may wish to harvest capital gains as opposed to capital losses. Perhaps you are anticipating higher long-term capital gains rates in the future, based on legislative changes or simply because you are currently in a lower tax bracket. In this case, you may wish to realize gains in a lower tax environment rather than delay the sale into

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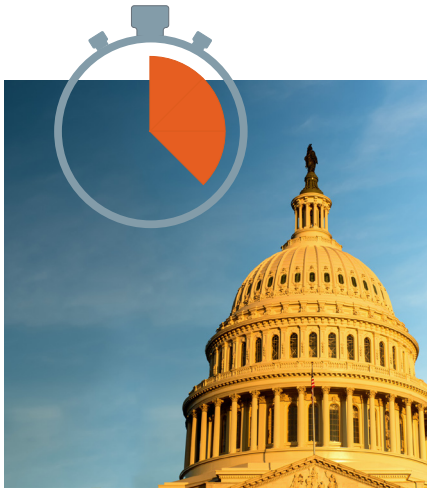

Legislation may be enacted earlier that may abruptly, and potentially dramatically, reduce the lifetime gift exemption. If you are considering making a substantial lifetime gift, now is the time.

a higher tax year. A potential increase in capital gains tax has been much discussed and proposed. Therefore, it is important to check with your advisor before acting on this strategy.

Deferring deductions: Instead of accelerating deductions as we discussed as a defensive strategy, you may wish to defer deductions this year. The same bunching strategy may apply, but instead of bunching this year, perhaps the charitable donations could be made in a future, higher tax year. Similarly, delaying deductible expenses as appropriate may have a bigger impact on reducing income in future years.

Utilizing the lifetime gifting exemption: For those whose assets are significant enough to have a taxable estate, year-end planning will have even more significance. With potential tax reform on the horizon, the possibility of a significant reduction to the lifetime gifting exemption is likely. For 2021, the amount exempt from federal gift and estate tax is $11.7 million per person ($23.4 million for a married couple), which means that you may give this amount during your lifetime, free of gift tax, with any unused amount applied against federal estate taxes at your death. Under current law this exemption amount is scheduled to sunset on December 31, 2025. However, there is a possibility that legislation may be enacted earlier that may abruptly, and potentially dramatically, reduce the exemption. Previous proposals have suggested the date may be as early as January 1, 2022. If you are considering making a substantial lifetime gift, now is the time.

By making larger gifts today, the more time the gift will have to grow outside of your estate, particularly if gifted to a trust rather than outright. In addition to the traditional benefits of a trust—such as professional management, tax mitigation, and creditor protection—you can also structure your trust as a grantor trust. Grantor trusts effectively allow the trust assets to grow income-tax-free, as all income tax obligations are paid by the grantor. The grantor trust structure also benefits the grantor in that all payments for taxes further reduce the taxable estate yet are not subject to gift tax. There have been numerous legislative proposals involving significant changes to this trust structure. It is an important time to speak with your advisors about the possibility of establishing a grantor trust.

Your year-end planning review is an important process, especially considering potential new tax legislation and an uncertain market and economic environment. It's important to consider your goals for your family and finances, and to meet with your advisors to discuss the strategies that are best for your situation. A well-coordinated plan is key to utilizing this year's opportunities and being prepared for what the future may bring.

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