Year-End Planning Letter: Significant Tax Changes Likely

The 2020 elections resulted in a Democratic "sweep" of Congress and the White House, although with a very narrow majority in the House of Representatives and particularly the Senate. On September 13, the Chairman of the House Ways & Means Committee introduced a set of tax proposals as part of the House Democrats' "budget reconciliation" package, which could be passed with simple majorities in the House and Senate. The package proposes significant federal tax changes designed to raise revenue to offset spending elsewhere in the bill.

The Ways & Means reconciliation package is currently being considered in Congress and will be subject to negotiations. For that reason, predicting which tax changes will become law is a challenge due to the fluid current political dynamic in Washington, but it is fair to say that the Biden Administration and the Democratic leadership in both the House and Senate are committed to both the major federal programs set out in the reconciliation bill and the tax changes designed to fund them. Individuals should bear in mind these potential changes as they make end of the year tax considerations.

We discuss the most significant legislative proposals affecting individuals and possible end-of-year planning ideas below. Unless otherwise noted, the proposed tax changes would be effective no earlier than the 2022 tax year.

I. Legislative Proposals

A. Proposals in the House Ways & Means Committee Reconciliation Package

- ***Increase top ordinary income rate to 39.6 percent and add a 3 percent surtax for high earners.*** The 39.6 percent rate would apply to joint filers with taxable income over \$450,000 and unmarried individuals with taxable income over \$400,000. An additional "surcharge" of 3 percent would apply to taxpayers with adjusted gross income (minus any investment interest deduction) in excess of \$5 million.

- ***Increase the top tax rate for capital gains.*** Under current law, long-term capital gains and qualified dividends are taxed at a maximum rate of 23.8 percent. The Ways & Means Committee proposes to raise the capital gains tax rate to 28.8 percent for taxpayers whose taxable income exceeds \$450,000 (married filing jointly) or \$400,000 (individual). ***Unlike most of the other proposed changes, this change generally would be effective for gains realized on or after September 13, 2021.***

- ***Reduce the unified estate and gift tax exemption.*** Under current law, individuals may transfer up to \$11.7 million during their lifetimes or at death and be exempt from the

estate and gift tax. The proposed legislation restores the exemption to its 2010 level of $5 million for bequests and gifts made after December 31, 2021.

- ***Eliminate the estate tax benefits from certain grantor trusts.*** Under current law, taxpayers may use a trust that is disregarded for income tax purposes but not for estate tax purposes (a so-called "intentionally defective grantor trust") to allow assets' future appreciation to escape the estate tax. The proposed legislation eliminates this planning opportunity for contributions that occur on or after the enactment date

B. Additional legislative proposals

- ***Restrict the use of donor advised funds (DAFs)***. Under current law, taxpayers are allowed an immediate deduction for a contribution to a DAF. The contributed money may grow inside a DAF indefinitely until the taxpayer (or his/her designee) recommends the DAF grant the money to a charity. Senators Angus King (I-ME) and Charles Grassley (R-IA) have introduced a bill (S. 1981) that would significantly restrict the flexibility of DAFs, most notably by requiring DAFs to distribute the contributed funds within 15 years of contribution in order for the taxpayer to receive an up-front deduction. These changes generally would be effective for contributions that occur after the date the legislation is signed into law.

- ***Expansion of the universal charitable deduction for non-itemizers.*** Proposed legislation (S. 618 and H.R. 1704) seeks to expand the current universal charitable deduction enacted in the CARES Act, the COVID relief legislation passed in March 2020. The proposed legislation would allow a charitable deduction up to one-third of the standard deduction available to non-itemizers (about $4,000 for individual filers and $8,000 for married joint filers).

- ***Expansion of the IRA Charitable Rollover.*** Proposed legislation (S. 243) would expand the annual limit on IRA charitable rollovers to $130,000 (from its current level of $100,000) for direct transfers to charity, and permit transfers charitable remainder trusts and gift annuities of up to $400,000. A House proposal (H.R. 2954) would index the rollover amount to inflation and permit one-time transfers to charitable remainder trusts and gift annuities at a $50,000 level.

C. Other upcoming tax changes

These changes will be effective for 2022 unless Congress acts by the end of this year.

- ***An end to the expanded charitable deduction for itemizers.*** COVID relief legislation passed in 2020 provided that charitable contributions made in cash to most charities (but not DAFs) were generally deductible to up to 100 percent of a taxpayer's gross income, rather than the usual 60 percent (with a carryover subject to certain limitations). This generous rule is set to expire at the end of 2021, and the Biden Administration has not proposed to extend it.

- ***Required minimum distributions (RMDs) are back.*** For 2020, the CARES Act suspended the requirement that those who are 70½ or older take an RMD from certain retirement savings accounts (including IRAs, 401(k)s, and Roth 401(k)s). This requirement is back for 2021 (though it applies beginning at age 72), and the Biden Administration has not proposed to suspend it again. RMDs from IRAs and 401(k)s are taxable income.

II. Key Considerations for Year-End Tax Planning

- ***Determine if (and how much) the ordinary income rate increase will affect you.*** If you have significant income in excess of the $450,000/$400,000 threshold, the proposed rate increase means it may be beneficial to defer deductions (including charitable deductions) to 2022 and beyond. This, however, is counter to the standard "tried and true" year-end tax planning mantra of deferring income and accelerating deductions to reduce the current year's bill, which can have significant time-value-of-money benefits.

- ***Use appreciated assets to make a charitable gift in 2021.*** As in previous years, gifts of appreciated assets (stock) remains a best practice. With the continued bull market and potential and the proposed retroactive increase in the capital gains tax rates, charitable donations of appreciated property are more valuable than ever, providing not only a deduction to the donor but also the potential to avoid the higher capital gains tax.

- ***Consider accelerating noncharitable gifts***. The proposed decrease to the unified estate/gift credit takes effect with respect to transfers that occur after December 31, so for taxpayers who are intent on making significant gifts (either during their lifetime or in the form of bequests), accelerating those gifts may provide a significant tax advantage.

- ***Consider donating to a DAF this year for maximum flexibility.*** If you are considering making a significant donation to charity over time but want a deduction today, this may be the last year to utilize the current flexibility provided by a DAF. It can be especially beneficial to donate appreciated property, because by doing so such property escapes capital gains taxation forever. Federations operate donor advised funds and would be happy to assist.

- ***Charitable donations of cash may be useful if offsetting a large portion of taxable income.*** 2021 likely will be the last year you can use a charitable donation of cash to offset more than 60 percent of your adjusted gross income. For taxpayers who are in a position to make a significant charitable gift, this may provide an opportunity. Note that contributions in excess of 60 percent of AGI cannot be made to a DAF, so careful planning is in order to balance DAF and non-DAF contributions.

- ***Consider if an intentionally defective grantor trust is right for you.*** If you have property that you expect to appreciate significantly in the future, 2021 may be your last chance to use an intentionally defective grantor trust to mitigate the estate tax that would otherwise apply when the property is passed to your descendants.

- ***Look into an IRA charitable rollover***. The IRA charitable rollover is an attractive option because it can satisfy the RMD requirement without incurring income tax, even if you don't itemize your deductions. Depending on whether proposed legislation expanding the rollover amount and allowing rollovers to charitable remainder trusts and gift annuities is enacted, this option could become even more attractive in future years.

As with any significant tax and charitable planning, it is always advisable to carefully consider potential changes in the context of your complete financial profile. We also recommend that you monitor the above legislative proposals as they will be considered by Congress later this year.

Disclaimer*: *JFNA and Federations do not provide tax advice. Please consult with your professional advisor before taking any action. If you have any questions, please contact Dirk Bird, Vice President of Planned Giving and Endowment at dirk.bird@jewishfederations.org or 303-669-5942