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Year-End Tax Planning Tips: Start 2021 in the Best Wealth Shape

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By **Amy Neifeld Shkedy and Rebecca Rosenberger Smolen** | October 29, 2020

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It's that time of year again—pumpkins, hayrides and year-end tax planning. With the upcoming election, which, depending on the results, brings the possibility of a reduction in the federal estate and gift tax exemption, we are anticipating a particularly busy year-end. Therefore, it's a great idea to start thinking of year-end tax planning ahead of time, rather than wait until December when timing may be too tight to get things done in a well thought out way. Here are some items that we suggest you consider before the end of 2020 to enable you to start 2021 in the best wealth planning shape possible:

- **Annual Exclusion Gifts.** Each individual can make a cumulative annual gift tax exclusion gift of $15,000 per donee during 2020 and 2021 (or $30,000 for a married couple electing to split gifts),

without using any portion of his or her federal estate and gift tax exemption (discussed below). Annual exclusion gifts can be made outright, through 529 Plan benefits (education savings accounts), or in special qualifying trust structures. For those still considering such gifts, it may be worthwhile to plan for 2020 and 2021 at the same time, keeping in mind that gifts for 2021 can be made effective as of Jan. 1.

- **Use of Exemption.** For 2020, the federal and gift tax exemption amount is $11.58 million per individual (allowing a married couple to shield up to $23.16 million from federal estate and gift taxes), and is projected to increase for inflation in 2020 to $11.7 million per individual (or $23.4 million for a married couple). Of course, there is no guarantee that these exemption amounts will remain at such high levels. In fact, the exemptions are scheduled to decrease to about half of those amounts in the year 2026, and, depending on the outcoming of the upcoming election, there is currently widespread concern over speculation that new laws could be passed after the election to reduce these exemptions even earlier (possibly as early as January, 2021, and possibly to a lower amount than currently scheduled for 2026). As we explained in our last article, "Will It Be 2012 All Over Again, (https://www.law.com/thelegalintelligencer/2020/09/03/will-it-be-2012-all-over-again/)" many high net worth individuals are considering whether to make large gifts before year end in order to use their exemptions in case they might lose them next year. This type of planning needs to be carefully thought out and considered well in advance of year end, so that there is not a last minute rush into making irrevocable and potentially irreversible decisions. Moreover, estate planners will need ample time to properly guide clients and draft documents to get this done. There will also need to be enough time to open accounts at financial institutions in many instances.
- **Accelerate Deductions.** Prepay deductible expenses due in January (including state and local income tax estimated payments which may not be due until January). However, because of the $5,000 per person cap (i.e., $10,000 for a married couple) for deductions for all state and local taxes, it's important to ascertain whether the limit has been reached before accelerating a payment of such taxes which may be deferred until 2021.
- **Loss Harvesting.** Harvest tax deductible losses to offset taxable gains for 2020. However, be mindful of the 30-day wash sale rule of Internal Revenue Code Section 1091, which could disqualify a deduction of the capital loss if the same, or substantially identical, security is purchased within 30 days after selling at a loss.
- **Required Minimum Distributions.** Normally, those who have reached their required beginning date or who hold inherited IRA accounts would be required to take a required minimum distribution for 2020 from their IRAs or qualified plan accounts by Dec. 31, but, this year that requirement has been waived under the CARES Act.
- **Qualified Retirement Plan Establishment.** Business owners who are considering funding a new retirement plan have the opportunity to establish a qualified retirement plan by the end of the year but defer the decision about the funding amount (and the actual contribution) until later during 2021 (contributions can generally be delayed until at least Sept. 15). The limitation for tax deductible contributions for 2020 is $57,000 per participant for defined contribution plans (or up to $63,500 when including the $6,500 catch-up contribution for a participant who has reached the age of 50). Next year this cap is projected to be increased to $58,000 (or $64,500 when including the $6,500 catch-up for 2021).
- **Roth IRA Conversion.** Convert a traditional IRA to a Roth IRA to take advantage of lower brackets or absorb excess deductions. By converting a traditional IRA to a Roth IRA, any untaxed amounts that are rolled over to the Roth IRA are subject to income taxation. The conversion must take place by Dec. 31. Under current law, Roth IRA conversions can no longer be reversed. Before 2018, under prior law, you had until Oct. 15 of the year after conversion to reverse it by re-characterizing the conversion back to a traditional IRA to avoid the tax hit.
- **Basis Step-Up Planning.** For individuals who have funded "grantor" trusts for their families, year-end is a good time to consider swapping back low basis assets (e.g., appreciated stock) for high basis

assets (e.g., cash) to help make tax reporting after the swap cleaner (rather than switch tax identification numbers in the middle of a tax year). It's better to own the lower basis assets at death because of the opportunity for a basis step-up to fair market value under Internal Revenue Code Section 1014. (Note this is one of the items targeted for repeal, as a revenue raiser, under Biden's tax plan. So, stay tuned.)

- **Charitable Giving.** If you are in a high income year, consider "prepaying" future charitable contributions to generate current income tax deductions. This is also something to consider given the new higher standard deduction (for 2020, $12,400 for individuals and $24,800 for married couples) which might make bunching of charitable deductions worthwhile so you can benefit from the standard deduction in a year where your charitable deductions are reduced due to the prior year bunching/prepayment. This can be accomplished simply by increasing the contributions to your favorite charities, in general, or you can defer the receipt by the charitable organizations you wish to benefit (or even defer the decision as to which ones to benefit) by contributing to a donor advised fund, a private foundation, charitable lead trust or charitable remainder trust or purchasing a charitable gift annuity. Both the charitable gift annuity and charitable remainder trust options allow you to retain an income stream for life and defer the transfer of the remaining funds to the charity until after your death.
- **IRAs and HSAs.** While you technically have until April 15, 2021, to fund your Individual Retirement Account and Health Savings Account for 2020, it is always a good idea to start planning for such funding at year end. Consider helping your children (to the extent that they have earned income) to fund tax favored Roth IRAs if at all possible. The maximum contributions for IRAs for 2020 is $6,000 and is projected to stay the same in 2021 (plus an extra $1,000 catch up for those who have reached the age of 50). The maximum family contribution for an HSA in 2020 is $7,100 (or $3,550 for individuals), with an extra $1,000 available for those who have reached the age of 55. For 2021, the maximum family contribution for an HSA will increase to $7,200 (or $3,600 for individuals).
- **Trust Income Tax Planning.** While a trustee will generally have until 65 days after the end of the tax year to shift trust taxable income to a beneficiary, it's worthwhile to monitor the issue at year end to get a jump start on evaluating the issue. This is becoming a more consequential issue with the Medicare tax imposed at 3.8% and the extra 5% tax which is imposed on dividends and capital gains at the higher brackets (which are reached pretty quickly for a trust).
- **Estate Plan Review.** Last, but not least, although it's not necessarily year-end sensitive, the end of the year is a great time to review your estate plan (or make a resolution to review in 2021) to see if changes might be in order (whether because of changes in the tax law, your wealth, your chosen fiduciaries, or objects of your bounty). If you don't give this some thought at year-end, you might never get around to making desired changes before it's too late, since none of us can know if we will have any advance notice of the actual deadline. We have all most certainly learned over the last year (as well as in November of 2016) that, like it or not, we must expect the unexpected.

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