2021

Financial Planning Update

FEATURE

withum

WEALTH MANAGEMENT

Inside the Issue

At Withum Wealth, we believe that a large part of long-term financial success is planning ahead. With that in mind, we share with you some valuable year-end planning tips to ensure that you end the current year and start the next year feeling well informed and prepared for what's ahead.

In this 2021 Edition of our Financial Planning newsletter, you will find our year-end planning tips and take a closer look at the recently proposed tax changes. As always, please remember to consult with your tax and financial advisors before taking action and discuss the options that might be appropriate for you.

EVER-CHANGING TAX PROPOSALS

After a flurry of recent activity, Democrats have managed to pass one of their two signature spending bills and achieved tentative commitment to the other. The infrastructure bill that was approved by the Senate in August, passed the House on November 5. The social spending and climate bill was not voted on, but agreement was reached regarding its terms. Vote on this second bill will happen after the Congressional Budget Office (CBO) scores the proposal.

Agreement on how to fund the social spending and climate bill has been hard to achieve. A series of tax proposals have been debated and then discarded. Below is a list of tax changes that have survived as well as a reminder of various proposals that were considered but rejected. The modified, $1.75 trillion bill includes the following taxes on individuals:

1	NIIT: The net investment income tax (NIIT) will apply to business income of high-income taxpayers (but not to income for which FICA tax is assessed).
2	Enhanced enforcement: Additional funds are allocated to the IRS for enhanced enforcement of current laws.
3	Income surcharge: The addition of a 5% tax surcharge on income over $10 million and another 3% on income over $25 million.
4	Retirement contribution limits: New regulations prohibit contributions to IRAs if aggregate retirement account values exceed $10M. Individuals whose total retirement plans exceed $10 million must withdraw 50% of the excess. If the value exceeds $20 million, then withdrawals must come first from Roth accounts. This goes into effect after December 31, 2028.
5	Roth conversions eliminated for high income individuals: High income taxpayers ($400k for single or married filing separately taxpayers; $450k for married filing jointly taxpayers and $425k for head of household taxpayers) will not be allowed to complete Roth conversions after December 31, 2031.
6	Back door Roth strategy eliminated: After-tax contributions will not be allowed in qualified plans and conversion of after-tax IRA contributions are not allowed after December 31, 2021. This applies to everyone, not just high-income taxpayers.

As it stands as of this writing, many of the earlier tax proposals by both Biden and the House have been scrapped. Proposals that were considered but discarded include:

1	Reinstatement of the 39.6% tax bracket prior to 2026,
2	Adding a new capital gains tax rate of either 25% or 39.6%,
3	Elimination of step-up in basis by gift or on death,
4	Reduction of estate tax exemption prior to 2026,
5	Billionaire tax on unrealized gains of taxpayers with over $100 million income or $1 billion net worth, and
6	Grantor trust provisions to include such trusts in the grantor's estate and include distributions from such trusts as gifts.

Where does this leave us now? House Democrats have agreed to approve the bill as it now stands, provided the Congressional Budget Office's (CBO) score of the bill is in line with White House cost projections. The CBO evaluation will not be ready until the week of November 15. Assuming the CBO numbers turn out as projected and the House approves the bill, the bill must still be approved by the Senate and make it through the reconciliation process.

December 3 is now the deadline to meet. That is the day when the spending continuations end and the debt ceiling is expected to be reached.

YEAR END PLANNING TIPS

INVESTMENT AND TAX PLANNING

MANAGE YOUR MARGINAL TAX RATE

If you are at a tax bracket threshold, you might be able to lower your bracket by deferring some of your income to 2022. You can also consider accelerating some of your deductions like medical expenses and charitable donations (see Donor Advised Funds) into 2021 vs. paying for deductible items in 2022. Alternatively, those in relatively low tax brackets might fill the bracket by making Roth conversions.

REVIEW ANY CAPITAL TAX GAINS AND OFFSET WITH LOSSES

Depending on the outcome of the current tax proposals, the capital gains rates might be changing so it is important to evaluate your current situation and consider whether realizing gains now or in the future is more beneficial for you. If you have any unrealized losses in your investment portfolio, consider selling them to harvest a tax loss to offset any qualified gains that you have already realized.

Remember to wait at least 31 days before buying back a holding sold for a loss to avoid the wash sale rule violation.

EVALUATE YOUR RISK TOLERANCE AND REBALANCE IF NEEDED

Risk in a portfolio is determined by the mix of stocks, bonds and cash. Due to high equity valuations and low yields, the traditional 60 Equity /40 Fixed Income portfolio might not provide the same diversifying benefits and may benefit from outside-the-box, fresh thinking. Remember that the important thing is to have a properly diversified portfolio and focus on your long-term goals.

FUND A 529 PLAN FOR YOUR KIDS' EDUCATION

529 plans are flexible, tax-advantaged accounts that accumulate funds for higher education. These plans allow you to invest after-tax dollars in a selection of stock and bond mutual funds. The funds in the account grow tax-free and the withdrawals are tax-free for qualified expenses. Additionally, many states offer residents a full or partial tax credit or deduction for contributions to their state's plan. 529 plans can be used for higher education as well as kindergarten through 12th-grade tuition at private schools. Any unused funds can also be used for graduate, trade or vocational education or reassigned to another beneficiary (sibling, niece/nephew, yourself, etc.).

GIFTING TO LOVED ONES

ANNUAL GIFT EXCLUSION

Make sure to take advantage of your annual gift exclusion. In 2021, you can gift up to $15,000 per individual in federal tax-free gifts. For example, a couple can gift $30,000 to each of their 2 children, for a total $60,000 gifted during the year.

LIFETIME EXEMPTION

Beyond the annual exemption amount, each person has an $11.7M exemption on gifts and estate. This amount is portable, allowing a $23,400,000 exemption for a married couple. This exemption is scheduled to be cut in half in 2026. There have been discussions about expediting that change, reducing the amount as of January 1, 2022. Households with net worth in excess of the reduced exemption amount may want to consider taking advantage of the higher exemption while it lasts.

Current IRS guidance states that gifts made under the current exemption amount will not be clawed back when the exemption amount is reduced. Before making any irrevocable gift, be sure to confirm your own lifetime needs are covered with remaining assets. One strategy for households who wish to gift more than $5.85M but less than $23.4M is to attribute the gift to one spouse rather than use gift-splitting. This could increase the amount of future lifetime exemption available. The below example of a couple gifting $10M demonstrates this impact.

EXAMPLE:

Isabella and Xavier wish to gift $10,000,000 to their children in 2021. If they split the gift, then each will have a remaining $850,000 of lifetime exemption. (This assumes the current lifetime exemption is cut in half after December 31, 2021 and there is no indexing increase.) They can gift another $1.7M in the future for a total lifetime gifting amount of $11.7M that avoids estate tax. However, if the full $10,000,000 gift is attributed to Isabella, then she has no remaining lifetime exemption going forward, but Xavier has preserved a full, $5.85M exemption. This allows them to gift a combined $15.85M that is not subject to federal estate tax.

Lifetime Gift Tax Exemption Strategies

Lifetime Exemption Amount per person:

Current	$	11,700,000
Proposed	$	5,850,000

Strategy One: Split Gifts

	Isabella	Xavier	Total
2021	$ 5,000,000	$ 5,000,000	$ 10,000,000
2022	$ 850,000	$ 850,000	$ 1,700,000
Total Gifts:			$ 11,700,000

Strategy Two: Individual Gifting

	Isabella	Xavier	Total
2021	$ 10,000,000	$ -	$ 10,000,000
2022	$ -	$ 5,850,000	$ 5,850,000
Total Gifts:			$ 15,850,000

CHARITABLE DONATIONS

Donating to qualified charitable organizations can generate income tax benefits to you as you support your community. Below are several gifting strategies and suggestions as to how they are best used.

Gifting Appreciated Stock

Charitable donations may be completed by transferring appreciated securities in lieu of cash. This strategy generates an income tax deduction for the full market value of donated stock that has been held for one year, and allows you to avoid paying capital gains tax on those securities. Donating appreciated stock is more tax effective than donating cash and it can be used with Donor Advised Funds (see below). This strategy is most effective for taxpayers who itemize their deductions, have a charitable inclination and hold securities with low basis (cost).

Qualified Charitable Distributions (QCDs)

Individuals who are over 70 ½ may donate to qualified charities directly from their IRAs. Qualified donations made straight from an IRA count toward your required minimum distribution but are not included in your income. (Note: This only applies to individuals who turn 72 before the end of the year and are required to take minimum distributions.) This strategy has two advantages over other contributions. First, the QCD reduces your modified adjusted gross income (MAGI) on which Medicare premiums are based, providing a means of managing premiums. Secondly, this allows a reduction in taxable income for charitably inclined households that do not itemize their deductions. Overall, this strategy is most effective for taxpayers who will be 72 or older by the end of the year and either want to reduce their AGI to manage their Medicare premium or want a credit for charitable donations even though they take the standard deduction. The maximum annual amount that can qualify for a QCD is currently $100,000.

Donor Advised Funds (DAFs)

Donor Advised Funds (DAFs) are qualified charitable investment accounts to which an individual can make a charitable gift to enjoy an immediate tax benefit and retain advisory privileges to disburse charitable gifts over time. This is an effective strategy for taxpayers who have a year with exceptionally high income or wish to bunch donations in order to take advantage of both standard and itemized deductions. Given the current high standard deduction amounts, a bunching strategy would combine multiple years' worth of donations into one year to take an itemized deduction. In subsequent years, the standard deduction can be taken. If your donation exceeds the annual tax deduction limits allowed, you can carry forward the unused deduction over the next five years. Appreciated securities may be donated to a DAF but qualified charitable distributions cannot be made to a DAF. This is an effective strategy for taxpayers whose itemized deductions excluding charitable donations are less than the standard deduction.

RETIREMENT PLANNING

MAX OUT YOUR RETIREMENT PLAN CONTRIBUTIONS

Make sure you take advantage of contributions to your retirement plans (IRA, 401K, 403B, etc.). Your employer may offer a matching 401(k) contribution as part of your employee benefits. This is free money and if possible, you should contribute at least the amount necessary to get the full match. In 2021, you can contribute a maximum of $19,500 to a 401(k) Plan and $6,000 to a Traditional IRA. Other retirement plan contribution limits are listed below. Consult with your advisor to determine whether to make a traditional or Roth contribution to your retirement account(s).

BACKDOOR ROTH CONTRIBUTIONS

For those whose income exceeds the limits for making contributions to their Roth IRA, consider a backdoor Roth contribution. This strategy involves making a non-deductible contribution to a traditional IRA and then making a subsequent Roth conversion. This works best for those who do not have existing IRA accounts. In this situation, contributions are made to your Roth IRA with no additional tax impact.

CATCH UP CONTRIBUTIONS FOR 50 AND OLDER

If you are 50 or older, take advantage of catch-up contributions to your retirement plans and accounts. In 2021, you are able to add another $6,500 to an employer sponsored plan and $1,000 to IRA account. Please see the table below for more details.

CONSIDER ROTH CONVERSION

There is a potential to decrease overall income tax on retirement assets over the long term with a Roth IRA conversion. A Roth IRA conversion allows investors to transfer all or some of their traditional IRA assets to a Roth IRA. All future gains are shifted to the Roth IRA, a retirement account that grows tax-free and is not subject to any future distribution requirement (RMDs).

REQUIRED MINIMUM DISTRIBUTIONS (RMDS) ARE BACK

In 2020 the Coronavirus Aid, Relief, and Economic Security (CARES) Act granted investors the opportunity to pause RMDs. Required Minimum Distributions are resuming for 2021 and per the Setting Every Community Up for Retirement Enhancement (SECURE) Act the RMD age has changed from 70½ to 72 years old. Deadline for RMDs is December 31st, 2021. Here are some of the 2021 and 2022 contribution limits:

RETIREMENT PLANS	2021	2022
401(k), 403(b)-402(g)(1) - Maximum employee elective deferral	$19,500	$20,500
Defined Contribution Plan Total Limit (Employee + Employer)	$58,000	$61,000
Solo 401k Maximum Contribution (Employee + Employer)*	$58,000	$61,000
Catch-up Contribution for the plans above (age 50 or older, above annual limit)	$6,500	$6,500
IRA Contribution Limit	$6,000	$6,000
IRA Catch-up Contribution (age 50 or older, above annual limit)	$1,000	$1,000
Roth IRA Contribution Limit	$6,000	$6,000
Roth IRA Catch-up Contribution (age 50 or older, above annual limit)	$1,000	$1,000
SEP IRA Maximum Contribution	$58,000	$61,000
Catch-up Contribution	NOT permitted	NOT permitted
SIMPLE Maximum Contributions	$13,500	$14,000
SIMPLE Catch-up Contribution (age 50 or older, above annual limit)	$3,000	$3,000

Maximizing the amount you contribute will allow you to take advantage of available tax deductions and employer matching.

TIME TO REFINANCE?

Although not quite as low as the levels we saw earlier this year, mortgage rates remain at historically low levels, providing an opportunity for potential mortgage refinance. However, in making a determination on whether to refinance, one should consider their goals. If the objective is to reduce your monthly payment and ease cash flow, then refinancing at a lower rate may be a wise choice. On the other hand, one should keep in mind overall costs including upfront and closing costs associated with a mortgage. Depending on the rate differential between existing and new, a lower rate will not always result in lower overall costs.

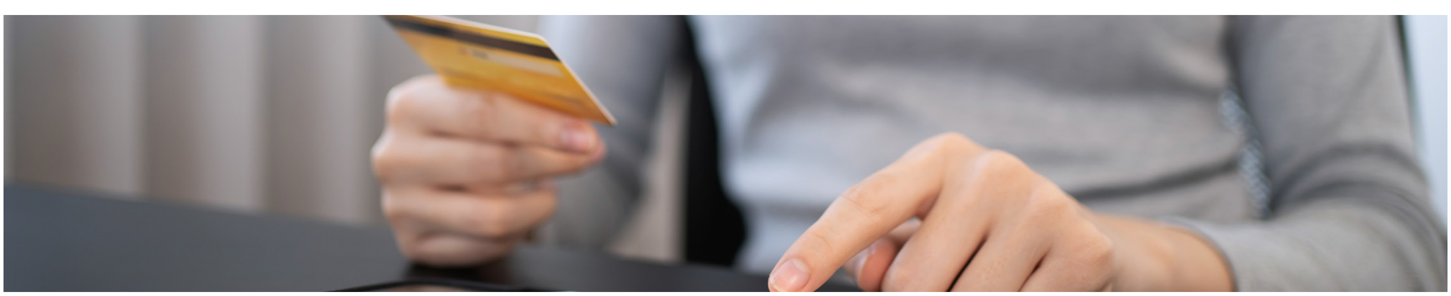
CASH FLOW MANAGEMENT

As we near the end of the year, it may a good time to review your budget, compare it to actual expenses incurred during the year, and modify (if necessary) for the year ahead. If you have yet to create a budget, year-end is a great time to do so. Some helpful rules of thumb when it comes to spending include the following:

- Housing expenses (mortgage/rent, property taxes, homeowner's insurance) should reflect < 30% of gross income
- Savings should ideally be 5-8% of gross income
- Available cash should be in the amount of 3-6 months of expenses
  - 3 months if two sources of income (i.e. both spouses working)
  - 6 months if one source of income (i.e. single earner)

PAY OFF HIGH-INTEREST DEBT AND INVEST EXCESS LIQUIDITY

Credit cards are a great tool enabling us to purchase now and pay later. However, when not paid in full and on time, credit cards incur an extraordinarily high interest rate. We highly recommend paying off any outstanding credit card debt as quickly as possible, given such high rates associated. Additionally, as the Federal Reserve has kept short-term interest rates at effectively zero, money in the bank does not earn what it once has. Given the current environment, think about investing excess capital on hand as opposed to leaving cash in the bank, in which its purchasing power erodes over time (the most recent inflation measure, Headline CPI, came in at 6.2%).



MEDICARE OPEN ENROLLMENT

The opportunity to make changes to Medicare coverage options began on October 15th and will run through December 7th. Rather than re-enrolling in the same coverage, the open enrollment period allows individuals eligible for Medicare to make changes to Part D prescription plans, Medicare Advantage plans and even switching from Parts A and B to a Medicare Advantage plan. Everyone's situation is different, so it is important to review the "annual notice of change" regarding current coverage and determine the best solution for the upcoming year.

MAKE 2022 EMPLOYER BENEFIT ELECTIONS

Open enrollment is typically in November or December of the current year. Make sure you make any necessary changes during this time and consider taking advantage of all available options.
Plan for major life events and review your goals.

How did you do with the goals you set out for 2021? Evaluate how you did and set realistic goals for the next year. If you do not have a plan already, consider putting that on your to do list. It is also important to evaluate any major events that you might have coming up (includes family, job, marriage, big purchases) and have a strategy for dealing with it.

withum WEALTH MANAGEMENT

Need More Information? Please do not hesitate to contact a member of the Withum Wealth Management Team with any questions or concerns:

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