YEAR-END TAX UPDATES AND PLANNING OPPORTUNITIES

There are several pieces of **proposed** legislation that could significantly change tax rates and policies for both federal income and transfer (estate/gift/generation-skipping transfer tax) taxes.

While these pieces of legislation are still just proposals and implementation is uncertain, it is important to prepare and not to overreact. However, having a plan in place is worthwhile if some of those changes become law and if those changes would impact your current planning for clients. Below is a partial list of some of the proposals and the potential planning opportunities. It is not meant to be a comprehensive review of proposed legislation: think of it as a provisions snack.

Income-Tax Provisions

1. Raise the top marginal rate from 37% to 39.6% and lower the income threshold.
2. Raise the long-term capital gains top rate to 25% (effective as of the date of publication).
3. Additional 3% surtax for ultra-high-income taxpayers (more than $5 million modified adjusted gross income).
4. Tax long-term capital gains at ordinary income rates for taxpayers with adjusted gross income (AGI) in excess of $1 million for single filers and $2 million for joint filers. This would be exclusive of the personal residence exemption.
5. Tax unrealized capital gains at death more than the limits of $1 million for single filers and $2 million for joint filers as realized gains.
6. Apply the 3.8% net investment income tax (NIIT) surtax to pass-through business income for those earning $400,000 or more.

As with any income-tax provision, the ability to control the timing of income recognition is key. Utilizing tools such as increasing pretax retirement-plan deferrals, maxing out Health Savings Account (HSA) contributions, and revisiting deferred compensation amounts can help control wage income. For portfolio income that is not required for ongoing living expenses, a nonqualified deferred annuity can be used for particularly tax-inefficient assets. Additionally, strategic use of charitable gifting and itemized deductions may be beneficial.

Estate-Tax Provisions

1. Include all grantor trusts in a taxable estate. The new provision would cause any trust treated as a grantor trust for income-tax purposes to be included in the grantor's estate for estate-tax purposes (new IRC Section 2901). Establish and fund an intentionally defective grantor trust (IDGT) before year-end.
2. Treat all sales between an individual and his or her own grantor trust as being the equivalent of a taxable sale to a third party (new IRC Section 1062). This provision is likely to impact trusts created after enactment.

3. Accelerate expiration of temporary exemption increases from 12/31/25 to 12/31/21. May want to consider filing form 706 for portability of deceased spouse's unused exemption amount (DSUEA) in cases where filing was not required; there would be extended filing for portability up to two years after death.

Retirement Provisions

1. Prohibition on Roth conversions—effective after 12/31/31.

2. Prohibit conversion of after-tax money in an IRA or qualified plan, which effectively eliminates "backdoor" and "mega-backdoor" Roth conversion strategies effective after 12/31/21. Inquire about in-service distribution availability or if a triggering event has occurred.

3. Required minimum distribution (RMD) requirements on large IRA accounts if more than $10 million and $20 million and over income thresholds ($400,000 for single filers and $450,000 for married filing jointly).

As a reminder, these are still **proposed** changes and may not make it into final legislation, if there is any. The key is to be prepared and in a position to act should any of the proposed changes become law and would have a meaningful impact on planning for your clients.

Additional Resources and Links

Is It a Next Step or SECURE 2.0 OR American Families Plan? An Update on 2021 Legislation

Retirement Strategies Blog

Ways & Means - Build Back Better Act

Summary of Key Revenue Provisions

For more information about retirement planning, please contact our Retirement Strategies Group at RSG@PacificLife.com or (800) 722-2333, ext. 3939.
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