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Best Planning Ideas for Today's Tax Laws

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Tax Planning post-TCJA/SECURE/CARES

1. Recent Tax Law Changes

- TCJA
- SECURE Act
- CARES Act

2. Charitable Planning

- AGI Limitations
- LTAS
- QCD
- Bunching

3. Qualified Plans / Roth

- Earned income
- Zero or low cost conversion
- Stretch IRA – changes
- "Back-door" Roth IRA
- Roth for kids

4. Other Itemized Deductions

- SALT – use of trusts
- CT workaround
- Miscellaneous itemized deductions

5. Annual Tax Planning

- Roth / 529

6. Business Income

- Choice of entity

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Key TCJA Provisions

Positive Changes	Negative Changes
▪ **Top individual tax rate lowered from 39.6% to 37%**	▪ **State and local tax deduction limited to $10,000**
▪ No change to preferential rates on dividends and long-term gains	▪ **Deduction for miscellaneous itemized deductions suspended**
▪ **Top corporate tax rate reduced from 35% to 21%**	▪ Roth IRA conversion re-characterizations suspended
▪ Income-based reduction of itemized deductions suspended	▪ Deductible mortgage interest limited to future loans of $750k
▪ **20% deduction for qualified flow-through business income**	▪ **Limit on deductible business losses**
▪ **Expanded deductibility for cash contributions to public charities**	▪ Alternative minimum tax retained – with reduced effect
▪ Medical expense deduction retained and enhanced	▪ Estate, gift and GST retained - exemption doubled

Setting Every Community Up for Retirement Enhancement Act (SECURE Act)

Tax Years Beginning before 12/31/19	Tax Years Beginning after 12/31/19
▪ IRA and retirement account owners must take required minimum distributions ("RMDs") at age 70.5	▪ IRA and retirement account owners must take required minimum distributions ("RMDs") at age 72
▪ Taxpayers who attained the age of 70.5 years old are prohibited from contributing to an IRA	▪ Age limitation is removed. A taxpayer is able to contribute to an IRA at any age as long as they have sufficient earned income in the year of the contribution
▪ If a non-spouse beneficiary inherited an IRA or retirement account, the beneficiary had the option of taking distributions from the plan over their lifetime (or faster). Thus, some of the tax benefits from the IRA could stretch beyond the original owner's lifespan and through the lifespan of the inheriting beneficiary	▪ IRA and retirement accounts are generally required to be distributed to non-spouse beneficiaries within 10 years from the date of the account owner's death. Note that this applies to retirement accounts inherited after 1/1/2020

Roth conversion recharacterizations no longer permitted under TCJA.

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CARES Act

Retirement Accounts	Charitable Contributions	NOLs and Business Losses
RMDs waived for 2020 for defined contribution plans and IRAs – can roll back any distribution already taken until 8/31/20.	100% AGI limit for cash contributions to public charities - no DAFs or supporting organizations.	NOLs incurred from 2018 through 2020 can be carried back for up to 5 years.
Penalty-free coronavirus-related distributions up to $100k allowed in 2020 – can be repaid.	Unlike existing rules, can reach new limit by using cash beyond current AGI limits for other gifts.	NOLs may offset up to 100% of taxable income for any year prior to 2021.
2020 borrowing from retirement plan increased to $100k.	Cash to DAF of 60% AGI – plus cash to public charities of 40% of AGI can be done.	250k/500k cap on excess business losses removed retroactively from 2018 through 2020.

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Key Changes by Planning Area

Charitable Contributions	
▪ 60% AGI deductibility limit for cash to public charities	TCJA
▪ For 2020 only, 100% AGI deductibility for qualified contributions	CARES ACT
Qualified Plans	
▪ Roth re-characterizations suspended	TCJA
▪ "Stretch" Roth IRAs eliminated	SECURE ACT
▪ RMDs required at age 72	SECURE ACT
▪ RMDs suspended for 2020	CARES ACT
▪ No age limit for IRA contribution eligibility	SECURE ACT
Business Income	
▪ 199A deduction for qualified business income	TCJA
▪ NOLs / excess business losses	CARES ACT
Other itemized deductions	
▪ SALT / miscellaneous itemized deductions	TCJA / Lender case

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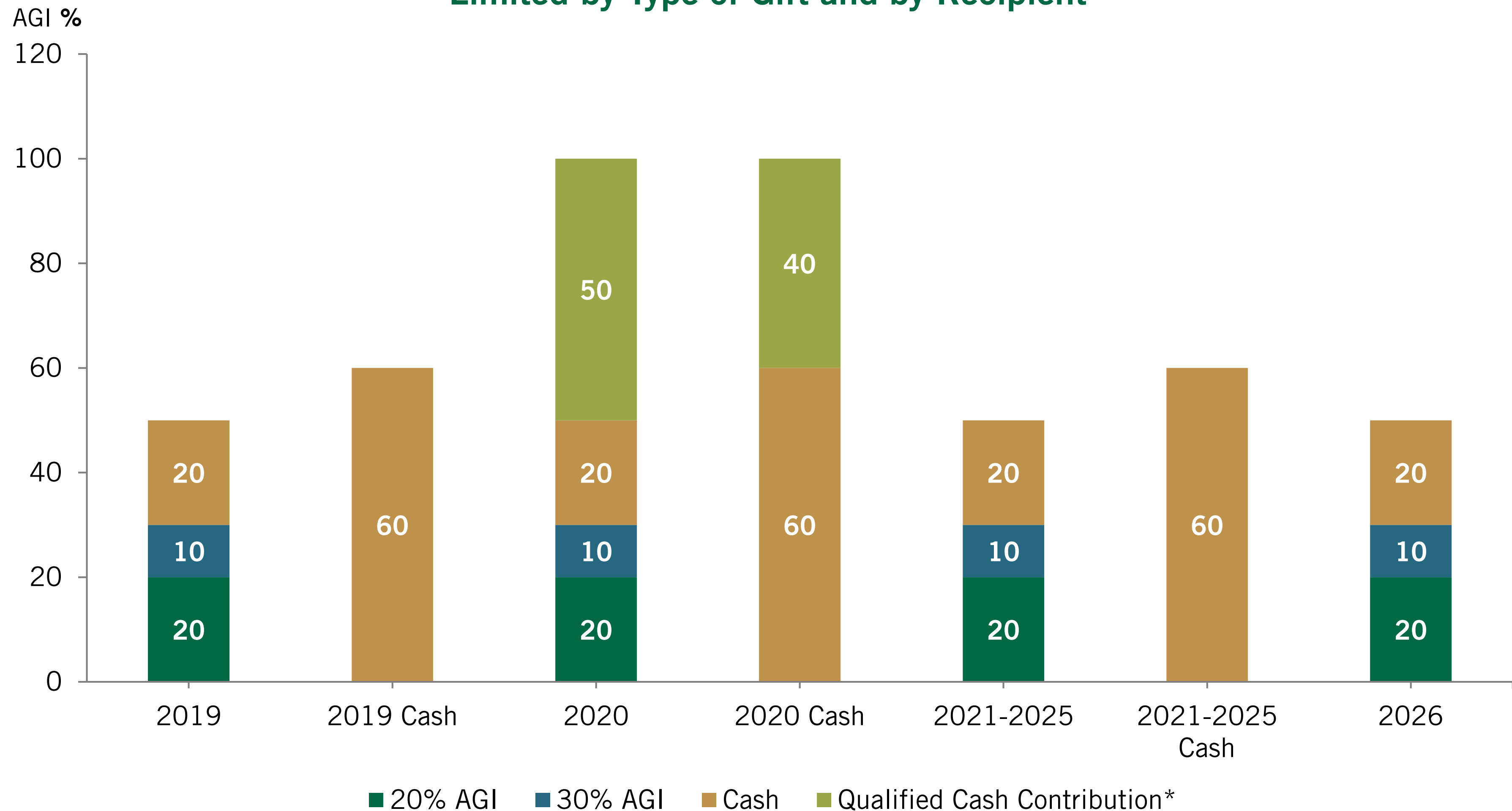
Charitable Planning – AGI Limitations



* Cash contribution to public charities, excluding donor advised funds and 509(a)(3) supporting organizations.

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Tax Platforms – Trump v. Biden

Trump – Selected Proposals

- Extend the individual TCJA provisions set to expire at the end of 2025
  - 37% top rate
  - 199A deduction
- Reduce or eliminate capital gains tax
- Payroll tax cut for employers and employees

Biden – Selected Proposals

- Restore pre-TCJA rates and brackets above $400k income level
- Restore Pease provision
- Phase out 199A deduction for taxpayers with income above $400k
- Tax capital gains and dividends at ordinary income rates for taxpayers with income above $1M and at death
- Limit the benefit of itemized deductions to 28% of value
- Earnings over $400k subject to social security payroll tax

Donating Long-Term Appreciated Securities* (LTAS)

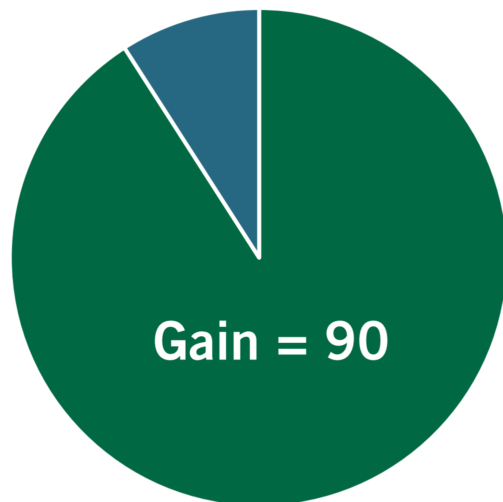
In lieu of cash, we typically encourage clients to make charitable gifts using LTAS.

Benefit of LTAS	Use of DAF	AGI Limitations
The actual economic value of the LTAS is less than its fair market value (FMV) due to the embedded capital gains tax on the underlying appreciation.	A donor advised fund (DAF), such as the Bessemer Giving Fund, is an ideal vehicle for implementing a tax efficient charitable giving strategy utilizing LTAS.	Deductions for contributions of LTAS are subject to 30% and 20% adjusted gross income (AGI) limitations based on the type of recipient.
Gifts of LTAS result in a charitable deduction equal to the full FMV of the security donated, and eliminate the embedded federal and state capital gains tax on the donated securities.	If a DAF is employed, the deduction is realized in the year the DAF is funded, even though the donor can advise the fund to make charitable distributions in subsequent years.	For 2020 only, contributions of LTAS can be combined with increased cash contributions to public charities (excluding DAFs) to deduct up to 100% of AGI.

*Publicly traded securities

Economic Value of LTAS

Long-Term Appreciated Securities
FMV = 100, Basis = 10
Inherent Gain = 90



Assuming a federal marginal capital gains tax rate of 23.8%, it would cost $21.42 in tax to sell the stock. The economic value of the $100 LTAS in the taxpayer's portfolio is therefore only $78.58*.

- Although the economic value of the contributed LTAS is $78.58, a charitable deduction is allowed for the full FMV of $100**.
- In effect, it costs the taxpayer only $78.58 to deduct $100. Compare this to a contribution of cash, where the economic cost of the deduction would be the full $100.
- Tax benefits of donating LTAS may be higher for those living in states that impose income taxes.

** Assumes AGI limits do not apply. Charitable contribution deductions are subject to various limitations based on AGI.
*FMV of $100 less Inherent tax liability of $21.42 = $78.58. [$90 gain x 23.8% = $21.42]

Qualified Charitable Distribution (QCD)

What is a QCD?

- An otherwise taxable distribution from an IRA owned or inherited by an individual 70½ and over paid directly from the IRA to a qualified charity.

Is there a limit on the amount of the qualified distribution?

- The maximum allowable QCD each year is $100,000, reduced by the cumulative deductible IRA contributions made since the individual turned 70½.
- Any benefit received from charity in return for the contribution will disqualify the QCD.
- Each spouse can contribute up to $100,000 from his owned or inherited IRA each year, even if the contribution exceeds the required minimum distribution (RMD).

What are the potential benefits of making a QCD?

- The QCD is excluded from income.
- It can be counted toward satisfying RMDs (note that beginning in 2020 the new RMD age is 72, but all RMDs have been fully suspended for tax year 2020 under the CARES Act).
- The QCD reduces AGI, such that limitations on other tax benefits tied to AGI levels may not apply. These include the 20% deduction for qualified business income.

Will QCDs qualify for a charitable contribution deduction?

- No – the QCD is already excluded from income; no further deduction is allowed.

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Bunching Example for a Married Couple Filing Jointly

- A married couple incur $10,000 of real estate taxes, and make charitable contributions of approximately $30,000 per year.
- Over a 5 year period, charitable contributions would total $150,000 and deductible real estate taxes $50,000, combining to equal total itemized deductions of $200,000.
- Bunching all $150,000 of charitable contributions into year 1 will result in total itemized deductions over a 5 year period of $256,000. $160,000 in year 1 and $24,000 per year in years 2 through 5.
- Implementing this bunching strategy, preferably utilizing a donor advised fund such as Bessemer National Gift Fund, will yield a federal after tax benefit of up to $21,000 over 5 years, which is $56,000 of additional deductions at a top federal marginal rate of 37%.*
- This bunching strategy is applicable at all charitable contribution thresholds assuming the only itemized deductions are taxes and charitable contributions.
- *In effect, for married taxpayers with only taxes and charitable contributions*, this strategy can yield $14,000 of additional deductions for every year applied.

*Ignores any applicable state and local income tax benefit

Bunching Example – Front Loading Contributions

Contribute $30k to charity annually:

Year	1	2	3	4	5	Total
Charity	30	30	30	30	30	
RE Tax	10	10	10	10	10	
Standard	24	24	24	24	24	
Higher	**40**	**40**	**40**	**40**	**40**	**200**

Front load $150k charitable contributions in year 1:

Year	1	2	3	4	5	Total
Charity	150	0	0	0	0	
RE Tax	10	10	10	10	10	
Standard	24	24	24	24	24	
Higher	**160**	**24**	**24**	**24**	**24**	**256**

Frontloading resulted in $56k of additional deductions over 5 years

Amounts are in thousands

Planning with Retirement Plans

- Self-employment income
- Low or no-cost Roth conversion
- "Stretch" Roth IRA
- "Back-door" Roth IRA
- Roth IRA for children/grandchildren

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Simplified Employee Pension (SEP) and Solo 401(k)

Simplified Employee Pension (SEP)

- Deductible contribution of up to 25% of earned income
- Generates current year tax benefit
- Maximum contribution for 2020 is $57,000
- Easy to set up and administer
- Must cover other full-time employees
- Plan assets grow on tax-deferred basis

Solo 401(k) – no employees

- Owner is treated as both employee and employer and can make deductible contributions in both capacities
- Generates current year tax benefit
- As employee – can contribute up to 100% of earned income, but not more than $19,500 in 2020 or $26,000 if age 50 or older, plus

Solo 401(k) - continued

- As employer – can contribute up to 25% of earned income
- Total contribution in both capacities cannot exceed $57,000 in 2020 or $63,500 if age 50 or older. Can also cover spouse.
- **Greater contribution potential than SEP, especially when self-employment income is less than $285,000**
- Employee contribution can be to Roth 401(k), but will not be deductible
- Plan assets grow on tax-deferred basis
- Roth assets grow on tax-free basis

Solo 401(k) Example

Taxpayer, age 51, has earned income* of $50,000 from her consulting business, which is operated as a sole proprietorship.

As an employee, she can contribute 100% of earned income, up to $19,500 to her Solo 401(k), plus an additional $6,500 since she is older than 50.

She can also contribute up to 25% of her earned income as the employer. This amounts to an additional $12,500.

Her maximum combined deductible contributions are $38,500 for 2020.

Assuming a marginal tax rate of 37%, this reduces her 2020 federal tax by $14,245.

Her $38,500 contribution will be invested and grow on a tax-deferred basis.

Earned income	$50,000
Contribution as employee	$19,500
Age 50+ catch up	6,500
Contribution as employer	12,500
Total contribution	$38,500
Federal tax rate	37%
Tax savings	**$14,245**

*Earned income calculated as net earnings from self-employment after deducting the plan contribution and one-half of the self-employment tax. Total earnings in this example are $67,250.

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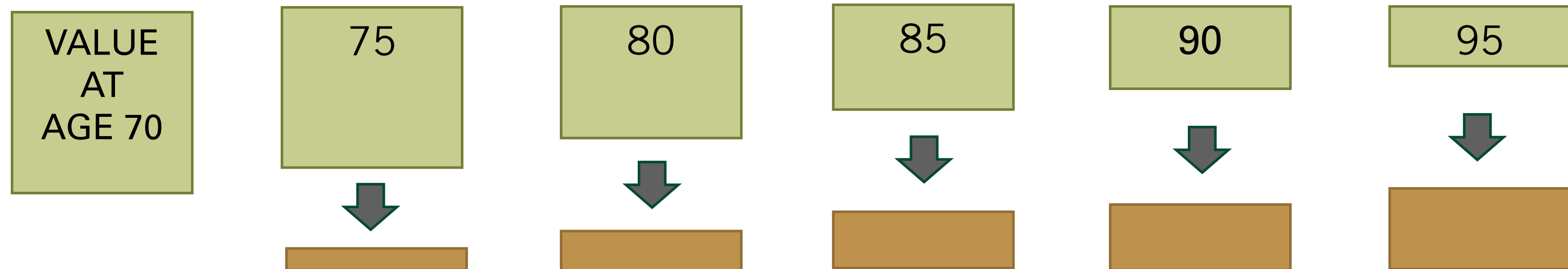
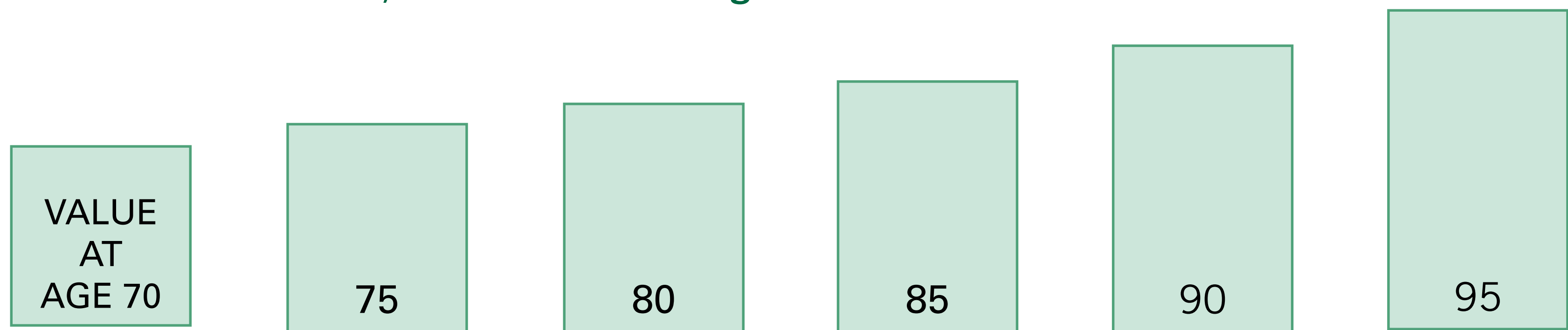
Traditional IRA v. Roth IRA

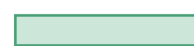
Beginning at age 70.5 required minimum distributions ("RMDs") erode value of traditional IRA.



RMDs are subject to tax; annual earnings on net after-tax reinvested RMDs also taxed.

No RMDs with Roth IRA; assets continue to grow tax-free.





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Tax Planning for Roth IRA Conversions

Charitable Giving

- Taxpayers may consider significant current or future charitable gifts as part of their overall financial plan.
- Under TCJA the maximum annual deduction for cash* gifts to public charities has been increased to 60% of adjusted gross income ("AGI"). For 2020, the CARES Act increased this to 100% of AGI for qualified contributions.
- Individuals with traditional IRAs who are charitably inclined may be able to offset the tax cost incurred with a Roth IRA conversion by making large charitable contributions in the year of conversion.
- Contributions to a donor advised fund are deductible in the current year; actual donations from the fund can be made in future years.

Suspended Losses

- Passive losses from real estate and other investments can generally be used only to offset passive income.
- Excess losses are suspended and carried forward indefinitely.
- These losses are triggered when the underlying investment is disposed of; the losses can then be applied to offset ordinary income.
- Individuals with traditional IRAs and significant suspended passive losses may consider disposing of the underlying investments in conjunction with a Roth IRA conversion. This can reduce or eliminate the related tax cost.

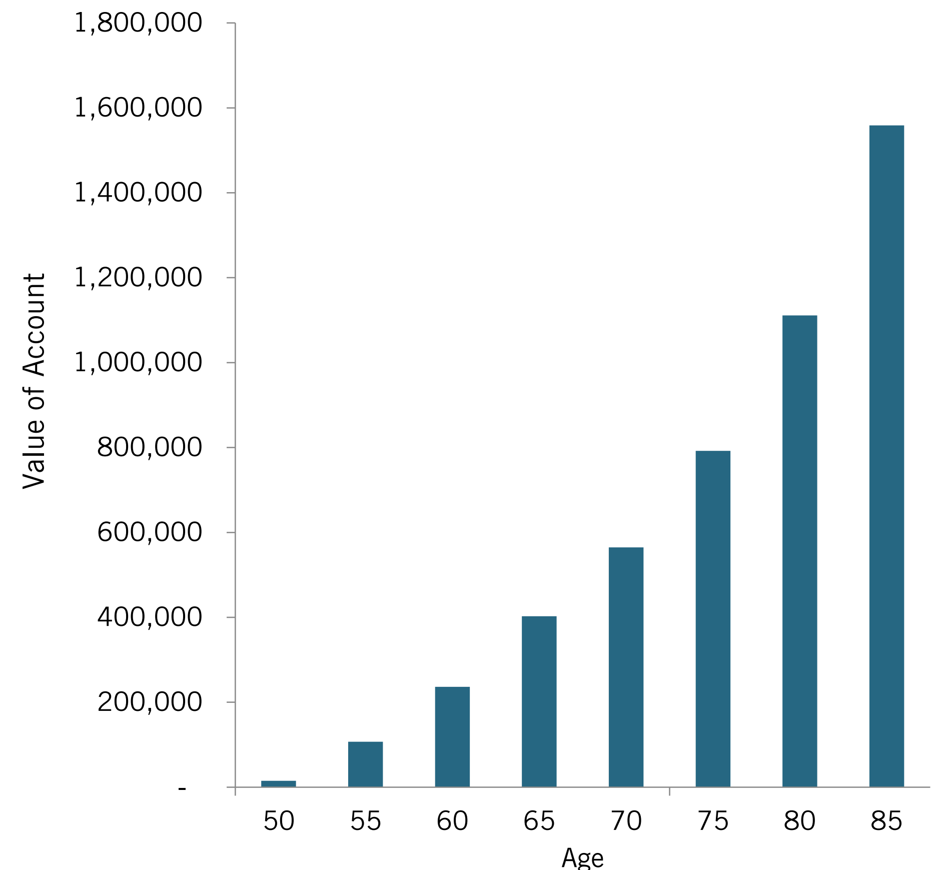
*Contributions of long-term appreciated securities may produce a more beneficial result since a deduction will be allowed for the full fair market value and the inherent gain will not be subject to tax.

Other Roth IRA Strategies

Backdoor Roth Contributions

- Income based restrictions apply to Roth IRA contributions as well as deductible contributions to traditional IRAs.
- Non-deductible contributions to traditional IRAs are permitted, however, provided an individual has sufficient earned income (wages, self-employment income, etc.)
- For 2019 the maximum contribution is $6,000 or $7,000 if age 50 or older. Similar amounts may be contributed for spouses, even if they have no earned income.
- Shortly after the contribution, the traditional IRA can be converted into a Roth IRA with no related tax cost*.
- Over time, this backdoor strategy can create significant value in a Roth IRA.

Growth of Roth IRA



Husband and wife each contribute $7,000 ($14,000) on January 1st to a Roth IRA every year for 15 years starting at age 50. Assumes a 7% tax-free growth rate. Above values represent joint total.

* This assumes the taxpayers have no existing traditional IRA accounts.

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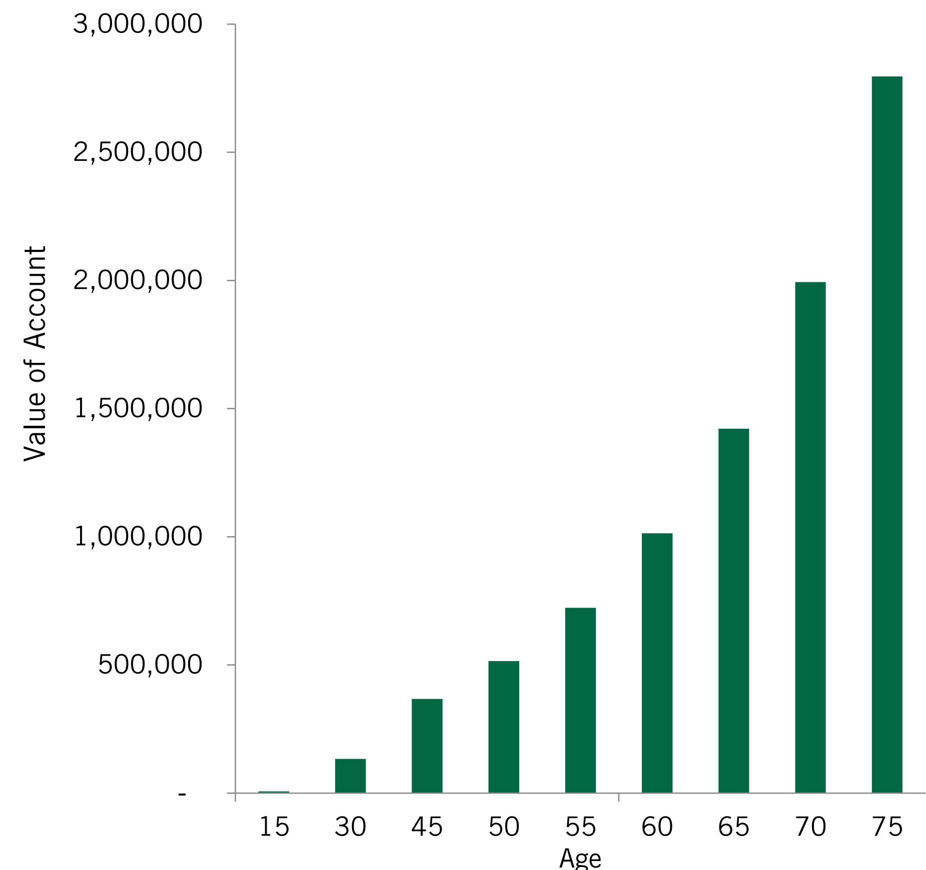
Other Roth IRA Strategies

Roth IRAs for Children

- Earned income (wages, self-employment income, etc.) is a requirement for IRA contributions of any kind.
- As children and young adults earn income from summer jobs or other employment, Roth IRA contributions of up to $6,000 are permitted (provided their income does not exceed $139,000).
- Parents may wish to fund Roth IRA contributions for their children as part of an annual giving strategy.
- Roth IRA contributions over several years for younger family members will create a significant future value owing to multiple decades of tax-free growth.

Growth of Roth IRA



A 15 year old makes a $6,000 contribution every year for 10 years. Assumes a 7% tax-free growth rate.

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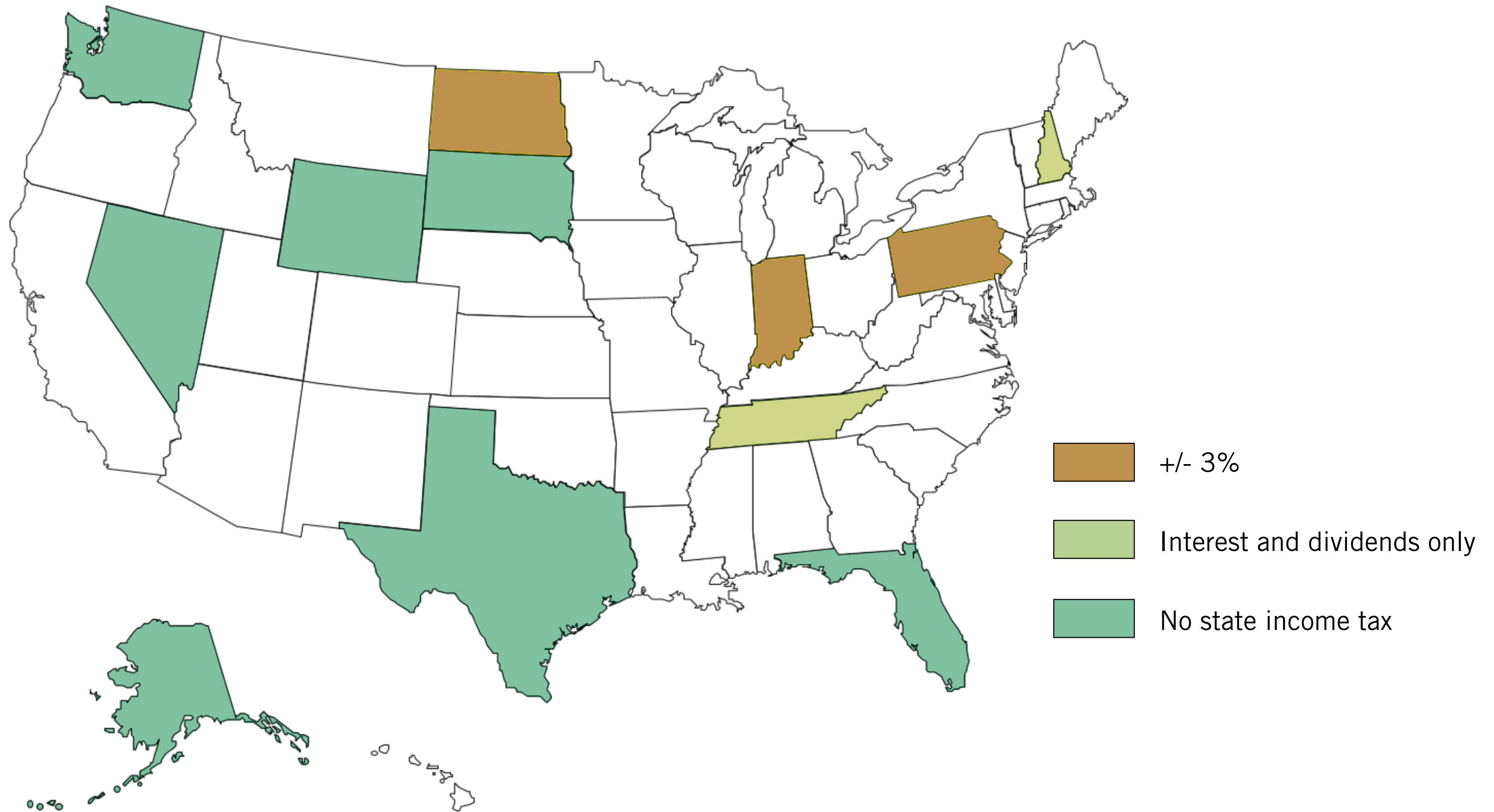
Income Tax Friendly States



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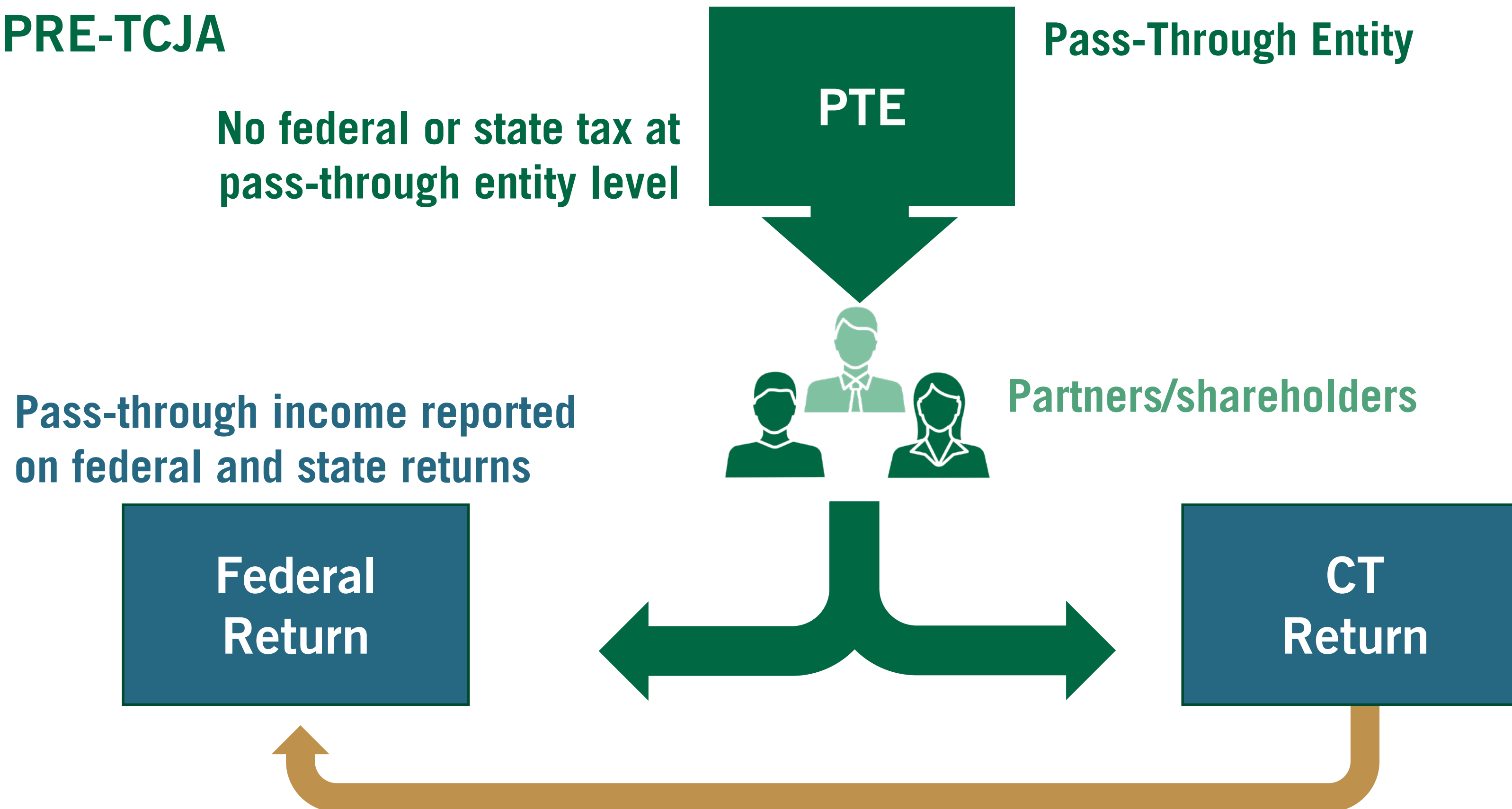
Connecticut Workaround

PRE-TCJA



Pre-TCJA, federal deduction allowed for state taxes paid on PTE income [assume 7% CT tax rate], so 93% of PTE income taxed on federal return.

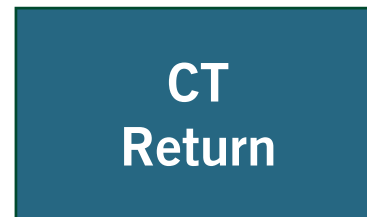
Connecticut Workaround

Connecticut imposes new tax on pass-through entities [assume 7%]. Tax is deductible at PTE level.

Connecticut tax is effectively moved from the individual level to the PTE level, where it is fully deductible.

Partners/shareholders

Reduced PTE income reported on federal and state returns.



93% of PTE income taxed on federal return

Connecticut provides a credit for tax paid on PTE income

Family Office as Trade or Business

Lender Management, LLC v. CIR

- Keith Lender owned 99% of Lender Management, LLC (LM)
- LM provided investment management services to three investment LLCs, owned individually by multiple generations of Lender family members
- Keith owned small interests in the LLCs
- LLCs were managed like a hedge fund, investors could withdraw at any time
- LM received a profits interest in the LLCs in exchange for services provided
- Tax Court ruled LM was engaged in a trade or business – Keith had clear profit motive

Considerations

- Hellman v. CIR – settled out of court, but court noted the ownership of the family office was the same proportion as the underlying investment partnerships managed
- May be difficult to establish profit motive where you are managing your own assets
- Profits interest approach tacitly approved in Lender? Effectively eliminates non-deductible investment management fee

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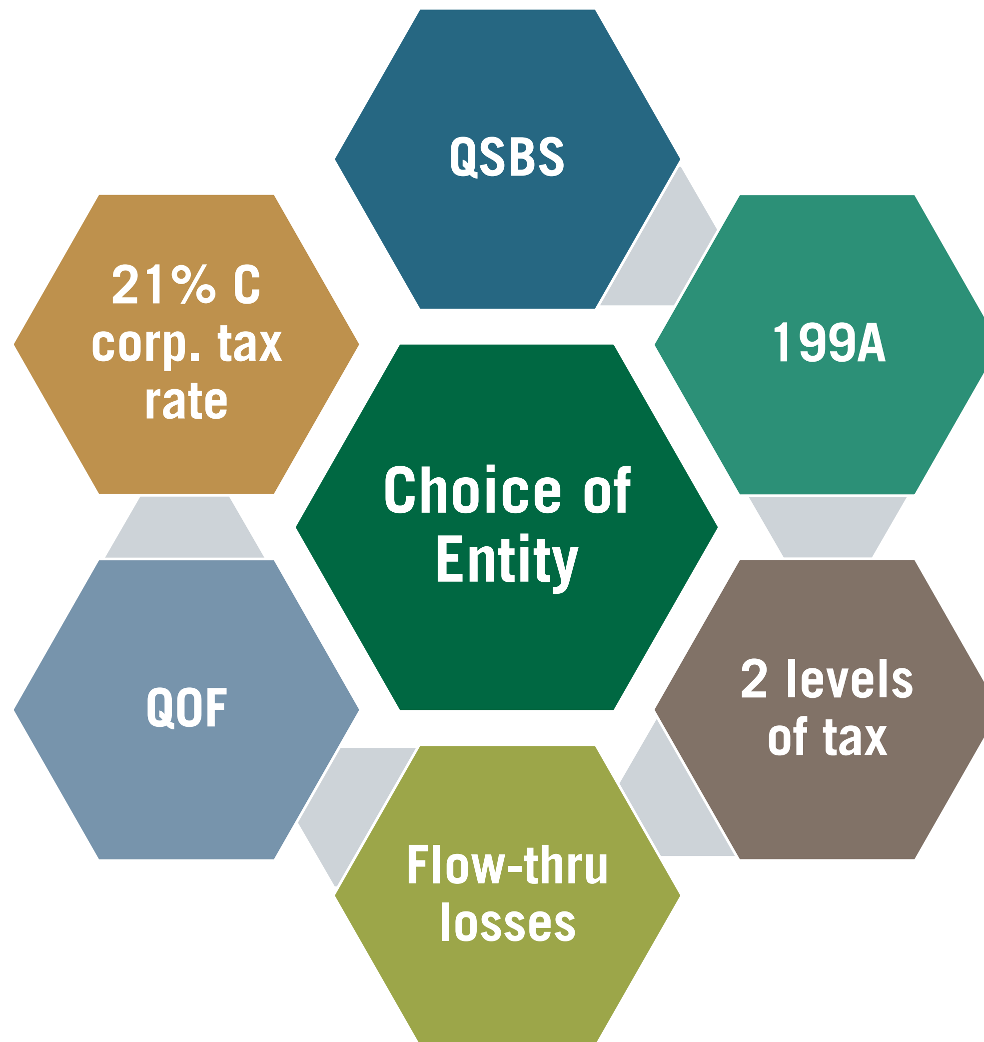
Annual Tax Planning Strategies to Consider

Action Step	Income and/or Transfer Tax Benefit
Consider selling investments to realize losses.	Losses reduce current year capital gains.
Fund a self-employed retirement plan (must have self-employment income).	Current year income tax deduction; tax deferred growth of plan assets.
Use long-term appreciated securities for charitable contributions.	Full FMV charitable deduction up to 30% of adjusted gross income (AGI) – income tax liability on appreciation amount is eliminated.
Fund a so-called "back-door" Roth IRA (must have earned income). Can also fund for non-working spouse.	Up to $7,000 per year ($14,000 if married). No required minimum distributions (RMDs). Roth income and distributions excluded from taxable income.
Front-load several years of charitable giving with a donor advised fund.	Potential income tax benefit from increased standard deduction under the Tax Cuts and Jobs Act (TCJA).
Make a Qualified Charitable Distribution (QCD) from an IRA if 70 ½ or older.	Can satisfy RMD, will reduce AGI such that limitations on tax benefits tied to AGI levels may not apply.
Make direct payments of tuition and medical expenses for children / grandchildren.	These payments will not use the donor's annual exclusion or reduce the remaining gift tax or GST lifetime exemption.
Fund a 529 plan for children or grandchildren with annual exclusion gifts. Consider front-loading up to five years.	Funds are removed from taxable estate and invested in an income tax-free account. Account balance can be used to pay education expenses beyond tuition, such as room, board, and supplies. State income tax deduction may be available.
Fund Roth IRA or so-called "back-door" Roth IRA for children or grandchildren with earned income. Limited to lesser of earned income or $6,000.	Funds are removed from donor's taxable estate and invested in a retirement account with no RMDs for plan participant. Income and qualified distributions are free from income tax.

Business Income



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Qualified Small Business Stock ("QSBS")

In an effort to stimulate small business growth, Congress enacted a provision in 1993 to allow a partial exclusion of gain from the sale of certain small business stock. This law is still in effect and depending on when the stock was acquired taxpayers may claim an exclusion from 50% of $10 million of gain to perhaps as high as 100% of total gain on the sale of QSBS.

The provision is unusually generous, in that it allows for an exclusion of the greater of 50%, 75% or 100% of $10 million in gain (depending on stock acquisition date) or an amount computed as 10 times the shareholder's basis, which could be considerably higher.

Not all gains will qualify of course, and several specific requirements must be met.

- A threshold requirement is the type of business involved. The law defines a qualified trade or business by identifying business activities that will not qualify. These include:
  - professional services (such as health, law, engineering, architecture, consulting, financial services and brokerage)
  - banking, insurance, financing, leasing, investing, or similar businesses
  - farming, mining and operating a hotel, motel, restaurant or similar business
- Additional requirements must be satisfied, including:
  - The stock must be issued by a domestic C corporation and the shareholder cannot be a C corporation,
  - Stock must be acquired as part of an original issuance directly from the company in exchange for money, property or as compensation for services rendered
  - The aggregate gross assets of the company cannot have exceeded $50 million at any time prior to and immediately following the stock issuance
  - The stock must be held for more than five years prior to sale and,
  - The corporation must meet an active business requirement during the holding period.

Can Excludible Gain Exceed $10 Million?

Yes – excludible gain is limited to the greater of $10 million or 10 times the shareholder's aggregate tax basis in QSBS shares – applied on a per-taxpayer and per-issuer basis.

Scenario 1:

Taxpayer acquires QSBS on January 1, 2012 in exchange for $500,000. She sells the stock on January 2, 2017 for $15 million, realizing a gain of $14.5 million.

$10 million of the gain will be eligible for exclusion from income. In this scenario, $10 million is greater than 10 times her adjusted basis (10 x $500,000 = $5 million).

Although her gain was $14.5 million she is limited to a $10 million exclusion.

Scenario 2:

Taxpayer acquires QSBS on January 1, 2012 in exchange for $3 million. She sells the stock on January 2, 2017 for $25 million, realizing a gain of $22 million.

The entire $22 million gain will be eligible for exclusion from income. In this scenario, 10 times her basis (10 x $3 million = $30 million) is greater than $10 million.

Since the actual gain was only $22 million, she is limited to that amount.

Has the New Tax Law ("TCJA") Affected QSBS?

To qualify for QSBS gain exclusion, the stock must have been issued by a domestic C Corporation.

Prior to TCJA a flow-through entity, such as an LLC, partnership or S Corporation may have been a preferred vehicle for new business ventures for several reasons, including:

- Flow–through entity structure affords a single level of tax on business earnings at the individual owner level, as opposed to C Corporation where income is taxed once at the corporate level and a second time when earnings are distributed to shareholders as dividends
- C Corporation income was subject to a top tax rate of 35%

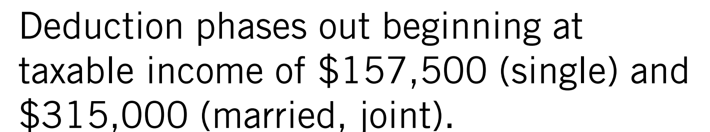
Effective January 1, 2018, under TCJA the top corporate tax rate has been reduced to 21%. This is significantly lower than the top individual rate of 37% and is also much lower than the effective top rate of 29.6% on qualified flow-through business income under TCJA.

- The reduced top tax rate of 21% on C Corporations along with the potential for full exclusion of gain on the sale of QSBS may make the C Corporation a more compelling vehicle for new business ventures.

Deduction for Flow-Through Business Income

Who benefits from 20 percent deduction on flow-through business income?

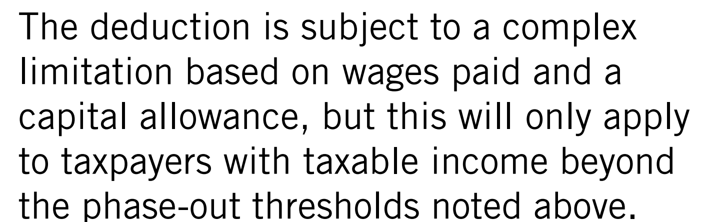
Owners of partnerships, S-corporations, LLCs or sole proprietorships if their taxable income does not exceed $207,500 (single) or $415,000 (married, joint).
All business income qualifies for the deduction.



Deduction phases out beginning at taxable income of $157,500 (single) and $315,000 (married, joint).

Owners of partnerships, S-corporations, LLCs or sole proprietorships that generate qualified business income, regardless of their level of taxable income. Excludes specified services income in the fields of health, law, consulting, athletics, financial services, brokerage services, investing, investment management, trading, dealing in securities, etc.

Engineering and architecture will qualify.



The deduction is subject to a complex limitation based on wages paid and a capital allowance, but this will only apply to taxpayers with taxable income beyond the phase-out thresholds noted above.

Qualified Opportunity Funds ("QOF")

Program Overview

- New community development program established by TCJA to promote long-term investments in low-income urban and rural communities in every state.
- Each state governor will designate at least 25 census tracts as Opportunity Zones; larger states have several hundred.
- Significant tax benefits are provided for equity investments in Opportunity Zones.
- Opportunity Funds are the vehicles that will receive investor funds and make the investments.
- A broad class of investments will qualify, including commercial and industrial real estate, housing, infrastructure and current or start-up enterprises.
- Certain "sin" businesses will not qualify.

Tax Benefits Provided

- **Tax Deferral:** Investors can invest a current recognized capital gain ("initial gain") into an Opportunity Fund. This initial gain will not be taxed until the end of 2026 or when the investment is sold, if earlier.
- **180 Days:** The investment must be made within a 180 day period after the initial gain is recognized. There is no cap on the amount of initial gain that can be invested.
- **Tax Reduction:** Tax on the initial gain will be reduced by 10 percent if the QOF investment is held more than 5 years. If the QOF investment is held more than 7 years the tax reduction is 15 percent.
- **Gain Exclusion:** If the QOF investment is held more than 10 years, the separate gain on this investment ("QOF gain") is fully excluded from income.

Choice of Entity

Entity	Pros	Cons
C Corporation	▪ 21% tax rate on income ▪ Potential for QSBS exclusion of gain on sale ▪ Potential for QOF tax benefits	▪ Double taxation ▪ Buyers may prefer to purchase assets
Partnership/LLC	▪ One level of taxation ▪ 199A deduction ▪ Potential for QOF tax benefits ▪ Use of flow-thru losses	▪ Ineligible for QSBS
S Corporation	▪ One level of taxation ▪ 199A deduction ▪ Use of flow-thru losses ▪ Distributions not subject to SE tax	▪ Ineligible for QSBS ▪ Reasonable compensation must be paid to officers
Sole Proprietorship	▪ One level of taxation ▪ 199A deduction ▪ Incorporate to potentially qualify as QSBS ▪ Use of operating losses	▪ Ineligible for QSBS ▪ Ineligible for QOF benefits

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