Year-end planning conversations to have with clients

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Latest developments on tax policy

- Tax rate increases (39.6% on ordinary income, 25% on LTCG) seemed inevitable until Senator Sinema (D-AZ) took a stance opposing these provisions
- New surtax will apply to very high income
- Estate tax provisions – sunset of lifetime exclusion + grantor trust changes – were taken off the table as well

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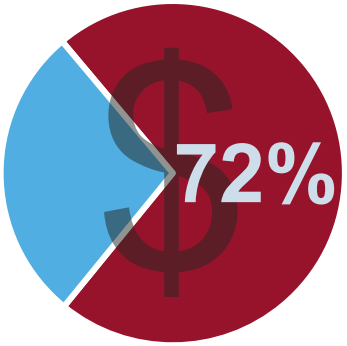
Fiscal pressures drive need for more revenue?

$3.1T

2020 annual budget deficit, highest ever



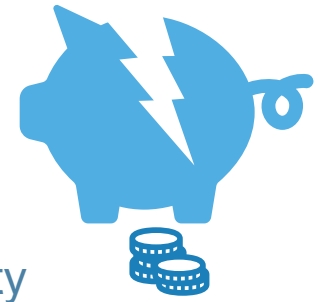
percentage of government spending devoted to mandatory programs + interest

16.4%

17.3%

percentage of revenue/GDP, 50-year average is 17.3%

2034



Social Security trust fund depleted

Sources: Congressional Budget Office (CBO), 2020; 2020 Social Security Trustees Report.

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2021 income tax brackets

INDIVIDUALS		MARRIED COUPLES	
	37%		37%
$523,600		$628,300	
	35%		35%
$209,425		$418,850	
	32%		32%
$164,925		$329,850	
	24%		24%
$86,375		$172,750	
	22%		22%
$40,525		$81,050	
	12%		12%
$9,950		$19,900	
	10%		10%

Source: Internal Revenue Service, 2021

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First step – projecting income for 2021

1. Identify marginal tax bracket
   - Cost of adding additional income?
   - Benefit of avoiding additional income?

2. How much ”room” is available until taxpayer creeps into next bracket

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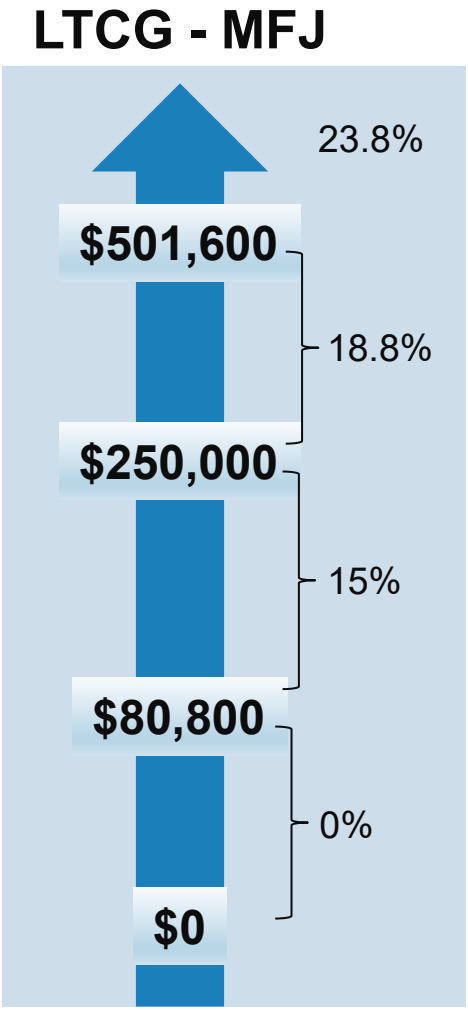
#1 Timing of income and losses

- Does a Roth conversion make sense before the end of the year?
  - Be aware of 3.8% surtax
  - Medicare Part B/D premiums
  - Taxation of Social Security benefits
  - FAFSA (2 year look-back)
- Consider a capital gains "budget"
- Maximize use of zero percent rate on LTCG
- Should retired clients consider taking more than the RMD?
- Tax-loss harvesting opportunities
- Pass-through business owners and expansion of 3.8% surtax in 2022



Source: Internal Revenue Service, visual depicts brackets for long-term capital gain income for married couples filing a joint tax return in 2021

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#2 Deduction planning - consider “lumping” charitable gifts

Assumptions: H&W, age 65, who donate $10,000 annually to charity; other deductions include $10,000 for SALT and $7,000 for mortgage interest; their marginal income tax bracket is 22%; their standard deduction is $27,800 since both are age 65+

	2021	2022	2023
Annual gifts			
“Lump” gifts		**NO GIFT**	**NO GIFT**

Result: With annual gifting, their total deductions = $83,400 ($27,800 x 3 years); by lumping gifts, their total deductions = $102,600 ($47,000 + $27,800 + $27,800), resulting in a difference of **$19,200** for a tax savings of approximately **$4,200,** assuming a 22% marginal tax bracket.

Example is based on 2021 IRS figures and does not account for higher standard deduction in 2022 and 2023 due to annual inflation adjustments.

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#3 Make sure you have addressed the impact of the SECURE Act with clients

Account owners

- Review and evaluate beneficiary designations
  - Leave IRA to lower-income heirs, or more heirs in general
  - Review trust arrangements
- Spend down IRA while living
- Roth conversions
- Charitable considerations
  - QCD, CRT as stretch “proxy”
- Permanent life insurance as a means to leave a tax-free legacy

Heirs

- Tax-efficient timing of distributions over the 10-year period
- If inheriting Roth, wait until the end of the 10th year to distribute

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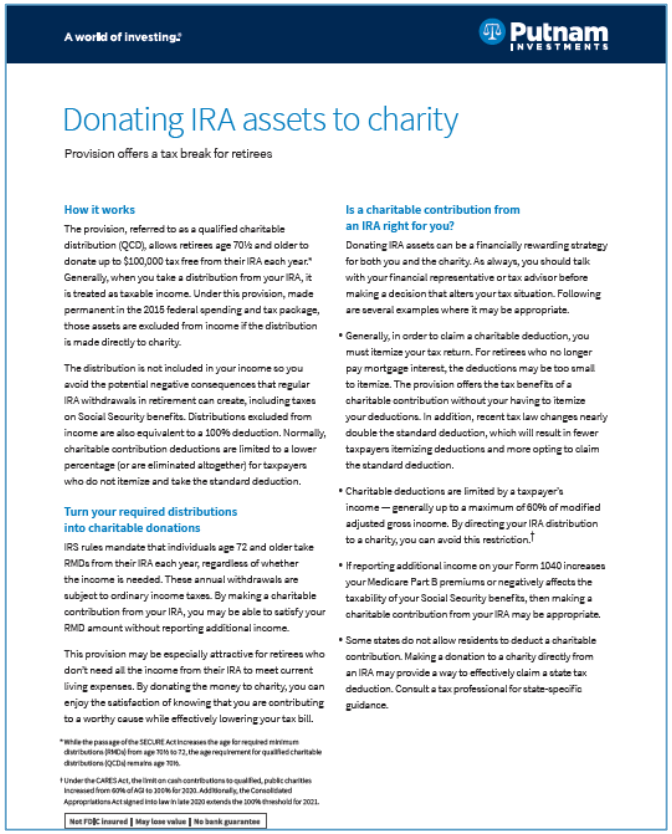
#4 Engage clients on charitable giving

- Lumping charitable gifts using a DAF
  - Also a great way to connect with other family members of clients
- Qualified Charitable Deductions (QCDs)
- Extension of CARES Act provision on 100% of AGI deduction limit
- Advanced planning for highly appreciated positions



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Donating IRA assets to charity

Provision offers a tax break for retirees

How it works

The provision, referred to as a qualified charitable distribution (QCD), allows retirees age 70½ and older to donate up to $100,000 tax free from their IRA each year.* Generally, when you take a distribution from your IRA, it is treated as taxable income. Under this provision, made permanent in the 2015 federal spending and tax package, those assets are excluded from income if the distribution is made directly to charity.

The distribution is not included in your income so you avoid the potential negative consequences that regular IRA withdrawals in retirement can create, including taxes on Social Security benefits. Distributions excluded from income are also equivalent to a 100% deduction. Normally, charitable contribution deductions are limited to a lower percentage (or are eliminated altogether) for taxpayers who do not itemize and take the standard deduction.

Turn your required distributions into charitable donations

IRS rules mandate that individuals age 72 and older take RMDs from their IRA each year, regardless of whether the income is needed. These annual withdrawals are subject to ordinary income taxes. By making a charitable contribution from your IRA, you may be able to satisfy your RMD amount without reporting additional income.

This provision may be especially attractive for retirees who don't need all the income from their IRA to meet current living expenses. By donating the money to charity, you can enjoy the satisfaction of knowing that you are contributing to a worthy cause while effectively lowering your tax bill.

Is a charitable contribution from an IRA right for you?

Donating IRA assets can be a financially rewarding strategy for both you and the charity. As always, you should talk with your financial representative or tax advisor before making a decision that alters your tax situation. Following are several examples where it may be appropriate.

- Generally, in order to claim a charitable deduction, you must itemize your tax return. For retirees who no longer pay mortgage interest, the deductions may be too small to itemize. The provision offers the tax benefits of a charitable contribution without your having to itemize your deductions. In addition, recent tax law changes nearly double the standard deduction, which will result in fewer taxpayers itemizing deductions and more opting to claim the standard deduction.
- Charitable deductions are limited by a taxpayer's income — generally up to a maximum of 60% of modified adjusted gross income. By directing your IRA distribution to a charity, you can avoid this restriction.†
- If reporting additional income on your Form 1040 increases your Medicare Part B premiums or negatively affects the taxability of your Social Security benefits, then making a charitable contribution from your IRA may be appropriate.
- Some states do not allow residents to deduct a charitable contribution. Making a donation to a charity directly from an IRA may provide a way to effectively claim a state tax deduction. Consult a tax professional for state-specific guidance.

*While the pass age of the SECURE Act increases the age for required minimum distributions (RMDs) from age 70½ to 72, the age requirement for qualified charitable distributions (QCDs) remains age 70½.

† Under the CARES Act, the limit on cash contributions to qualified, public charities increased from 60% of AGI to 100% for 2020. Additionally, the Consolidated Appropriations Act signed into law in late 2020 extends the 100% threshold for 2021.

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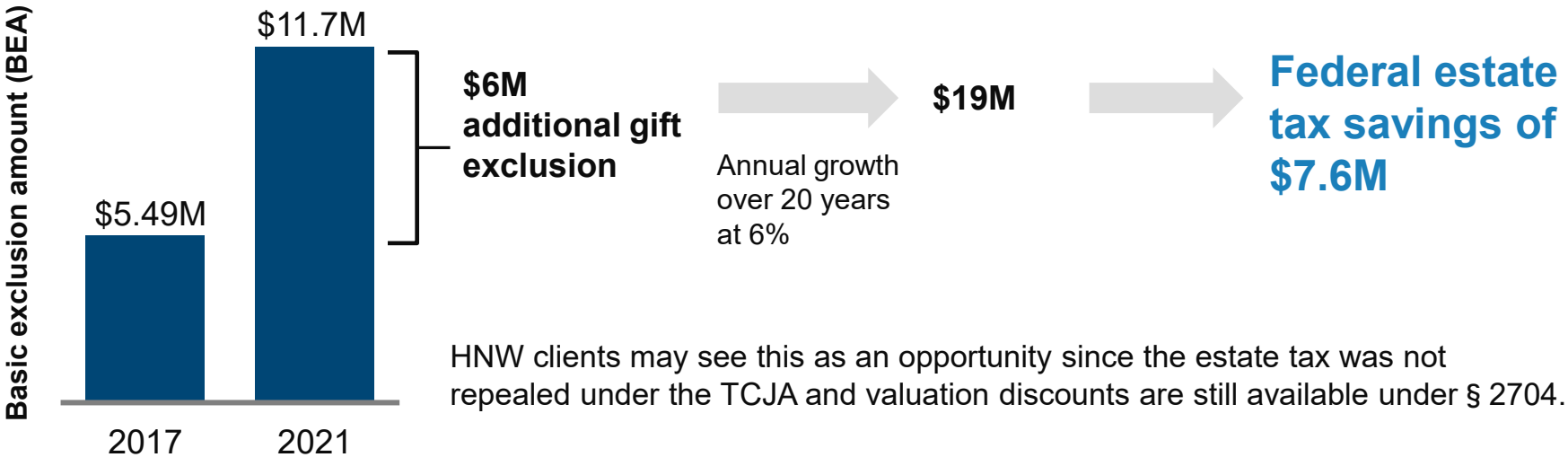
#5 Gifting and estate plan considerations

- Annual gift exemption + direct payments for medical / education
- Grandparent gifting into 529 plans
- Gifting appreciated assets to family member in lower brackets
- Lifetime gifts in lieu of impending sunset?



HNW clients may see this as an opportunity since the estate tax was not repealed under the TCJA and valuation discounts are still available under § 2704.

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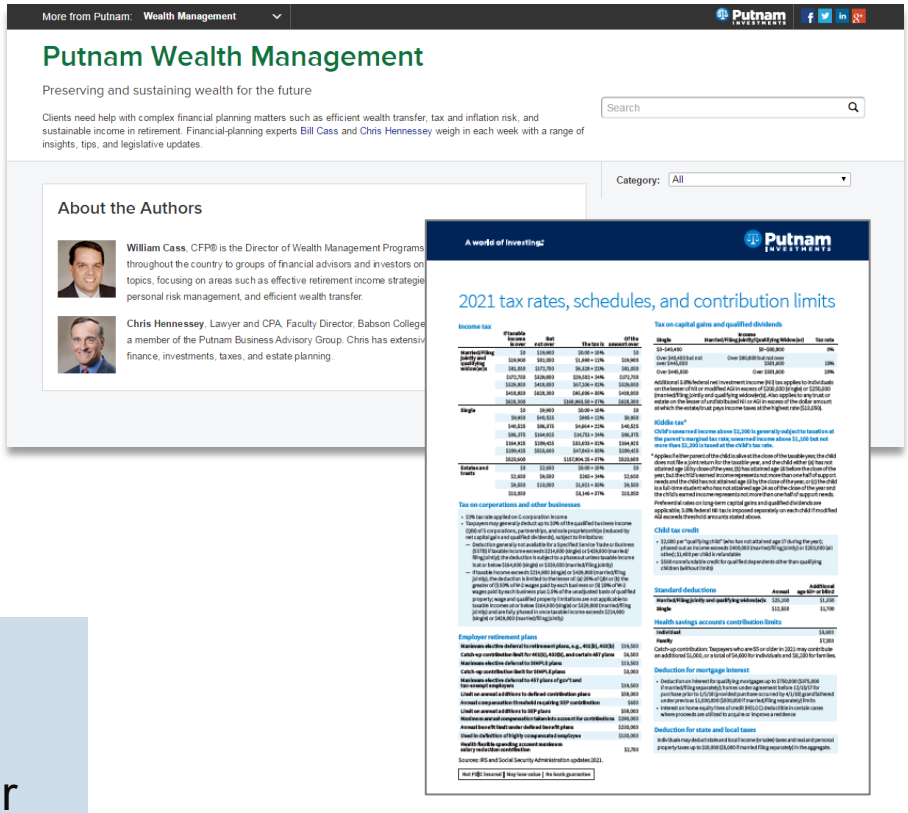
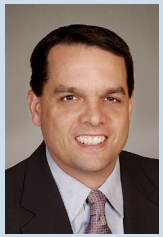
Resources designed to help you engage clients and prospects

- Client seminar and investor education pieces on the tax landscape and planning ideas
- Wealth Management Center blog articles and resources
  - Putnamwealthmanagement.com
- Video commentary and podcasts





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