

2021 Year-End Tax Planning Guide for Individuals

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Contents

Year in review – Pg.3

Section 1: Major changes – Pg. 6

Section 2: Taxes on Income – Pg. 8

Section 3: Timing Issues – Pg. 11

Section 4: Tax Breaks for Homeowners – Pg. 13

Section 5: Tax Breaks for Medical Expenses – Pg. 16

Section 6: Charitable Deductions – Pg. 18

Section 7: Tax Planning for Investments – Pg. 20

Section 8: Education Planning – Pg. 25

Section 9: Retirement Planning – Pg. 28

Section 10: Planning Across Generations – Pg. 31

We're Here to Help – Pg. 33



year in review



As we close out another eventful year, it is crucial for individuals to review their tax planning strategies and prepare for changes to come. Though not yet final, the Build Back Better Act introduces sweeping changes to individual taxes, including an increased capital gains tax rate, high income surcharge, individual retirement account (IRA) limitations and more.

Tax Legislation on the Horizon?

After passing some financial relief measures to help people weather the pandemic — including the Consolidated Appropriations Act (CAA) in late December 2020 and the [American Rescue Plan Act \(ARPA\)](#) in March 2021 — Congress has failed to pass most of the landmark tax reforms that President Biden campaigned on in 2020. As of this writing, Congress is continuing to hash out the details of Biden's Build Back Better Act (BBBA).

Although the congressional stalemate over tax law changes complicates year-end planning, there's a silver lining: The most recent draft of the BBBA no longer includes many of the proposed tax rate increases and estate tax provisions that would have adversely affected many high-income individuals and owners of pass-through entities.

Most tax breaks provided under the Tax Cuts and Jobs Act (TCJA) are expected to remain on the books for 2021.

Proposed expansion of the 3.8% NIIT

However, the BBBA draft does include a provision that would expand the 3.8% net investment income tax (NIIT) to include active business income from pass-through entities, including sole proprietorships, partnerships, limited liability companies and S corporations. Under the proposal, individuals with modified adjusted gross income (MAGI) above \$10 million would also be hit with a new 5% "surtax," plus an additional 3% on income of more than \$25 million.

One taxpayer friendly provision that's currently being proposed would increase the limit on itemized deductions for state and local taxes (SALT) from \$10,000 to \$80,000. If enacted, this would be welcomed by people who live in high-tax states.

It's currently uncertain whether any major tax legislation will pass before year end and, if a law is enacted, when the changes would go into effect.

Impact of federal relief measures

Through the first half of 2021, Congress provided some additional pandemic-related relief measures, such as increasing the child credit and tax credits for child and dependent care, making the 7.5%-of-AGI threshold of itemized medical expense deductions permanent, liberalizing the rules for using up flexible spending account (FSA) balances, providing a third round of direct relief payments, and extending unemployment benefits.

However, ***federal relief measures largely dried up by the Fall*** — even though many households continue to struggle and consumer confidence has fallen dramatically. The University of Michigan's consumer sentiment index has fallen to 79.0 in January 2021 to 66.8 in November 2021 — its lowest level in a decade. The index peaked at 101.0 in February 2020, prior to the pandemic. A key reason for the sharp decline in confidence is surging inflation on the prices of homes, energy, vehicles, food and other consumer goods.

The U.S. Department of Labor reported that the annualized rate of inflation was 6.2% in October 2021, the highest year-on-year gain since 1990. The rate of inflation has outpaced increases in wages and salaries, causing inflation-adjusted real income to fall for many Americans in 2021.

Tough economic times could be ahead

Current market conditions suggest that we may be heading into a recession. With many households and small business owners strapped for cash and the potential for tough economic times ahead, it may be prudent to preserve cash flow by lowering taxes over the short run — even if you expect Congress to enact less favorable tax rules for 2022.

Deferring income could be the answer

These economic warning signs suggest that the traditional strategy of *deferring* income and *accelerating* deductible expenses might be the right approach for many people for 2021. This strategy will *minimize* your tax obligation for 2021 and preserve cash on hand to prepare for a possible economic downturn. It can also be beneficial for self-employed people who use cash-basis accounting.

However, if you expect to report more taxable income or to be subject to higher tax rates in 2022 and you have extra cash on-hand today, you might decide to take the opposite approach: *Maximize* taxable income in 2021 while you can count on historically low effective tax rates on income and capital gains.

In addition, this nontraditional approach can help you to take advantage of limited-time tax savings opportunities — including today's favorable gift and estate tax rules — before they expire. Many favorable TCJA provisions that affect individuals and owners of pass-through businesses are set to expire in 2026. But they could sunset sooner, depending on what happens in Congress.

Beware: The IRS plans to ramp up tax enforcement efforts. After years of decreased IRS funding, the Biden administration would like to increase audit activity to 2010 levels. Many of these efforts would target high-income individuals, owners of pass-through entities and overseas business transactions.

Each situation is unique. Talk to your tax advisor about what's right for you and your business in light of your current and expected income, future spending plans, relevant tax laws and legislative developments.

We Can Help

As we head into 2022, an underlying tone of uncertainty remains. Strategic planning is difficult under these conditions. We continue to monitor tax law developments and encourage you to maintain an open line of communication with us. There's still a chance that the BBBA will pass in December, so be ready to make last-minute moves before year end.

Here's a brief summary of tax planning opportunities for you to consider before year end, as well as links to relevant blogs we've posted in 2020 and 2021.



"2022 promises to be an eventful year for individual taxes, as the Build Back Better Act gathers momentum. While changes are not yet set in stone, there are opportunities for individuals to make tax savvy year end moves to set them up for success in 2022 and beyond. I hope you find our Year-End Tax Planning Guide for Individuals helpful as you navigate through all the changes that may affect you and your family."

Laura H. Yalanis, CPA, MST,
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Section 1: Major Changes

Major Tax Law Developments in 2021

The tax law developments for 2021 that are potentially the most significant are still up in the air as of this writing. The House passed the Build Back Better (BBB) Act on Nov. 19, and the Senate likely will make changes to the bill and not vote on it until the latter part of December. Overall, however, the tax provisions are much more scaled back from what they were in early proposals, which is good news for the high-income taxpayers who would have been affected,

But other legislation signed into law within the last year or two is also affecting individual income taxes in 2021 and beyond.

The bipartisan Infrastructure Investment and Jobs Act (IIJA), signed into law Nov. 15, didn't have many tax-related provisions. But it did include some that will affect individuals who own cryptocurrency or certain other "digital assets."

The IIJA adds new reporting requirements and changes existing law to treat digital assets as cash. Fortunately, the provisions don't go into effect until returns are required to be filed, and statements required to be furnished, after Dec. 31, 2023.

Before the IIJA, several pieces of legislation were signed into law to provide short-term financial relief measures for Americans during the COVID-19 pandemic. Included were many tax-related provisions affecting individuals.

The Coronavirus Aid, Relief and Economic Security (CARES) Act, signed into law in March 2020, may be the most notable one. While most of its provisions were scheduled to expire in 2020, many of them have been extended into 2021 by subsequent legislation, such as the Consolidated Appropriations Act (CAA), and the American Rescue Plan Act (ARPA). These laws also included many other tax law provisions affecting individuals.

Significant CAA and ARPA provisions affecting individuals include:

- Recovery rebates of up to \$1,400 for singles and heads of households and \$2,800 for married couples filing jointly — plus \$1,400 per qualifying dependent (including adult dependents) subject to adjusted gross income (AGI) phaseouts:
 - Starting at \$75,000 for singles, \$112,500 for heads of households and \$150,000 for joint filers
 - Ending at \$80,000, \$120,000 and \$160,000, respectively
- Increased Child credit, including advance payments of part of the credit later this year
- Expanded child and dependent care tax credit
- Tax-free treatment of forgiven student loan debt
- Exclusion from gross income of the first \$10,200 in unemployment benefits received
- Permanent reduction of adjusted gross income (AGI) floor to 7.5% for medical expense deductions
- Extended nonitemizer deduction for cash donations to qualified charities through 2021
- Extended 100% of AGI deduction limit for cash donations to qualified charities through 2021
- Extended exclusion for certain employer payments of student loans through 2025
- New rules for disaster-related distributions from retirement plans

There are, however, some tax-related CARES Act provisions affecting individuals that *haven't* been extended to 2021:

- Waiver of the 10% penalty on COVID-19-related early distributions from IRAs, 401(k)s and certain other retirement plans
- Waiver of required minimum distribution rules for IRAs, 401(k)s and certain other retirement plans

Section 2: Taxes on Income

Should You Itemize or Take the Standard Deduction?

Regular income tax rates apply to ordinary income. This includes wages, self-employment or business income, short-term capital gains, nonqualified dividends, interest and, generally, distributions from tax-deferred retirement accounts.

There are still seven tax brackets under the TCJA, but five of them are slightly lower than under prior law.

2021 Regular Individual Income Tax Rates

10%	12%	22%	24%	32%	35%	37%
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When tax planning at year end, **focus on your “marginal” rate**. That’s the rate you’ll pay on your *next* dollar of income. Your marginal rate depends on your income and your filing status.

2021 Thresholds for the 37% Rate

Single	Head of Household	Married	Married Filing Separately
\$523,601	\$523,601	\$628,301	\$314,151

Warning: Unemployment compensation is taxable – the exclusion from income of up to \$10,200 of 2020 unemployment compensation for eligible taxpayers isn't available for 2021. If you received unemployment payments during 2021, you must report the income on your 2021 return. Taxable benefits include any of the special unemployment compensation authorized under the CARES Act that was extended into 2021 by the CAA and the ARPA. Check your withholding to ensure you won't have a shortfall when you file your 2021 return in 2022.

2021 Standard Deduction Allowances

Many people who have itemized in the past will decide to take the standard deduction — or alternate between these options from year to year using so-called “bunching” strategies.

Filing Status	2021
Single or married filing separately	\$12,550
Married filing jointly	\$25,100
Head of household	\$18,800

When deciding what's right for you, compare the increased standard deduction amounts to how much you've spent on items that qualify as itemized deductions for

- Home mortgage interest
- State and local tax (SALT) expenses
- Charitable contributions
- Medical expenses

Itemized deductions for mortgage interest expense, home equity loan interest and SALT are subject to tighter limits through 2025. Plus, itemized deductions for miscellaneous expenses subject to the 2% of AGI floor have been repealed.

The CAA made the 7.5% income threshold for deducting medical permanent. If you itemize, you can deduct qualified expenses in excess of the threshold. So, if you've got significant medical expenditures for 2021, it could make sense to itemize this year.

Through 2025, personal casualty and theft losses may be deducted only to the extent they're attributable to a federally declared disaster.

Will You Owe the Alternative Minimum Tax (AMT)?

The TCJA increased the thresholds at which the AMT kicks in, and it reduced or eliminated some itemized deductions that are normally added back to income in calculating the AMT. Therefore, fewer individuals will owe AMT through 2025.

If you're subject to the AMT, your tax rate may be lower . . .

26% or **28%**

. . . but more of your income will be taxed because **certain income items are treated differently**, such as:

- Incentive stock option exercises
- Accelerated depreciation adjustments and related gains
- Tax-exempt interest on certain private-activity municipal bonds

And **certain deductions aren't allowed**, such as:

- State and local income tax
- Property tax

You must **pay the AMT if your AMT liability** is higher than your regular income tax liability.

Section 3: Timing Issues

What Should You Accelerate (or Defer) This Year?

The timing of when you recognize income, or incur deductible expenses, can have a big impact on your tax bill. If you expect tax rates to remain stable or decrease from 2021 to 2022, it's generally beneficial, to the extent possible, to defer income to the next year and accelerate expenses to the current year. This reduces your current year's tax bill.

The House-passed BBB bill would increase certain taxes for some high-income taxpayers. People who expect to be affected by this proposed increases in 2022 and beyond should consider accelerating income recognition into this year and deferring expenses to next year. This will maximize income recognition in 2021, before most of the proposed increases would go into effect if they're signed into law.

The standard deduction has been nearly doubled and certain itemized deductions have been limited or suspended through 2025. As a result, more people will take the standard deduction or “bunch” itemizable expenses into alternating tax years. Timing strategies may be limited in years that you take the standard deduction.

Timing strategies can also help you avoid the AMT in 2021 — or they could trigger it if you're not careful.

Common Timing Strategies

Income Items

- Bonuses
- Self-employment income
- Retirement plan distributions
- U.S. Treasury bill income

Expenses

- Charitable contributions
- State and local income taxes
- Property taxes
- Mortgage interest

Section 4: Tax Breaks for Homeowners

Are You Turning Big Expenses into Big Tax Savings? Taxpayers who benefit from itemizing deductions can claim various tax breaks for homeownership. But some tax benefits will be limited through 2025.

Mortgage Interest and Property Tax Deductions

Keep in mind that these limits do not apply to deductions for rental properties.

\$1 million was generally the limit on home acquisition indebtedness under prior law. (For married people who file separately, the limit was \$500,000.) Acquisition debt incurred or refinanced *before* December 16, 2017, is still subject to these limits, with certain exceptions. In addition, you could generally deduct interest expense on up to \$100,000 of home equity debt under prior law.

\$750,000 is generally the limit on home acquisition indebtedness through 2025. (For married people who file separately, the limit is \$375,000.) These limits apply to home acquisition debt incurred *after* December 15, 2017.

Beware: Under current law, the deduction for interest on home equity debt is available *only* if the loan was used for home improvements. As under prior law, home equity interest isn't deductible for AMT purposes unless it was used for home improvements.

\$10,000 is the limit on SALT deductions. This limitation applies to property and income (or sales) taxes *combined*.

Important: The House-passed BBB includes a provision that would significantly increase the SALT limit. But it remains to be seen whether that provision will be included in a revised bill that could pass in the Senate.

Home Office Deduction

Business owners and self-employed taxpayers who use a home office *exclusively* for business can deduct actual expenses allocable to the space, including some that otherwise wouldn't be deductible, such as utilities and depreciation.

Or you can use [a simplified calculation](#) of **\$5** per square foot up to a **\$1,500** maximum.

The home office deduction has been suspended for *employees* under current law, along with other miscellaneous itemized deductions subject to the 2% of AGI floor.

Moving Expense Deduction

If you move for job-related reasons through 2025, the deduction for moving expenses has been suspended, and you must include any employer-reimbursed moving expenses in income. There's an exception for active-duty military, however.

Tax Law Changes Affecting Homeowners

- The CAA extended the exclusion from gross income of discharge of qualified principal residence indebtedness through 2025. But it also reduced the maximum indebtedness eligible for the exclusion from \$1 million to \$750,000 for individuals (\$500,000 to \$375,000 for married individuals filing separately) — for debt discharged after 2020.
- As of this writing, treatment of mortgage insurance premiums as qualified residence interest for itemized deduction purposes has not been extended to 2021.

Gain Exclusion on [Home Sales](#)

If you sold your principal residence in 2021, you may be able to exclude from your taxable income all (or part) of the gain.

Maximum Gain Exclusion

Single	Head of Household	Married	Married Filing Separately
\$250,000	\$250,000	\$500,000	\$250,000

Various tests must be met to qualify for this break, and gain that's attributable to a period of "nonqualified" use of the home may be subject to capital gains tax. **Any gain that isn't covered by the exclusion might be subject to the [net investment income tax \(NIIT\)](#) in addition to capital gains tax.**

If you're planning to sell a *second* home, consider making it your principal residence for a period long enough to qualify for the exclusion. Or, if it's a rental property and the sale is likely to generate a significant gain, consider a [like-kind exchange](#).

Warning: Like-kind exchanges of personal property, such as machinery, artwork and patents, have been eliminated through 2025 under current law.

Section 5: Tax Breaks for Medical Expenses



Are You Using Tax Breaks to Combat Rising Healthcare Costs?

Healthcare costs are on the rise, causing many employers to cut back on healthcare benefits. Today, many taxpayers are paying more out-of-pocket for medical expenses than in previous years, often because premiums have increased and/or their plans have higher deductibles and co-payments. Fortunately, various tax breaks can help take the bite out of these increases.

Medical Expense Deductions for 2021

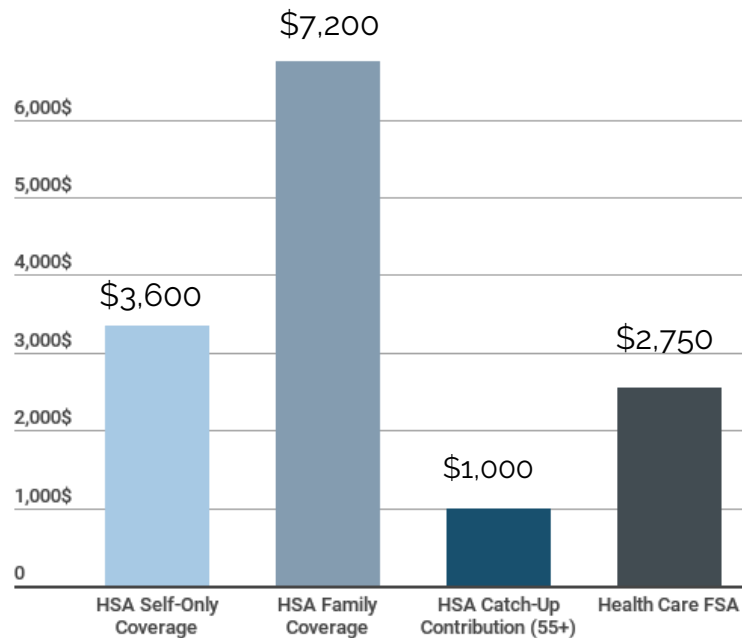
Medical expenses are deductible if you itemize, but only to the extent that they exceed the applicable AGI threshold.

For 2021, the threshold for deducting medical expenses is 7.5% of AGI.

Health Savings Accounts (HSAs) and Healthcare Flexible Spending Accounts (FSAs)

Exceeding the AGI threshold for the medical expense deduction can be challenging for many taxpayers. Fortunately, HSAs and FSAs allow you to make **pretax** contributions and are used for **tax-free funding** of qualified medical expenses.

* 2021 HSA & FSA Contribution Limits



* Additional rules and limits apply to these accounts.

Self Employed?

Instead of making contributions to employer-provided HSAs and FSAs, self-employed taxpayers who pay their own medical and dental insurance premiums can generally deduct those costs "above the line." This can lower AGI, making it easier for the self-employed to exceed the AGI threshold for the medical expense deduction for 2021.

Uninsured? Under current law, the individual mandate penalty has been reduced to zero for months beginning after December 31, 2018.

Recent changes: Under the CARES Act, account holders can now use HSAs, health reimbursement arrangements (HRAs) or healthcare FSAs to pay for over-the-counter medications without a prescription, as well as certain menstrual care products. These changes are permanent and apply retroactively to purchases on or after January 1, 2020.

Section 6: Charitable Deductions



Is Charitable Giving an Important Part of Your Tax Planning?

If you're charitably inclined and you itemize deductions, charitable giving can be one of the most powerful tools in your tax planning toolbox.

You have complete control over when and how much you give. You can generally deduct 100% of a donation to a qualified charity if you itemize deductions.

Current law lifts two major barriers to deducting charitable donations through 2025. First, it **eliminates AGI-based phaseouts** for itemized deductions. Second, it increases the limit on your annual deduction for qualified charitable donations of cash from 50% of AGI to **60%** of AGI. Lower limits may apply to certain donations. Beware of these limits and donation deadlines as you consider year-end charitable giving.

If you decide to take the **standard deduction** (rather than itemize deductions), you could lose out on this tax break.

Enhanced breaks for 2020 and 2021: Under the CARES Act, you could claim an above-the-line universal charitable contribution deduction of \$300, if you elected to not itemize deductions. The CAA extended this deduction through 2021, also doubling it to \$600 for joint filers. The CARES Act also temporarily increased the deduction limit on charitable cash contributions from 60% to 100% of AGI, and the CAA extended this provision through 2021.

Three Donation-Related Breaks to Consider for 2021

1. Donate Appreciated Securities Rather Than Cash

Donating publicly traded appreciated stock you've held more than one year offers a **double tax benefit**:

1. You can deduct the full fair market value of the stock
2. You avoid the capital gains tax you'd owe if you sold the stock

But **don't donate stock that has lost value**. You'll enjoy a bigger tax benefit by selling the stock, recognizing the loss and donating the proceeds.

2. Make [Qualified Charitable Contributions from IRAs](#)

\$100,000 is the maximum amount you can transfer from your IRAs directly to qualified charities tax-free **if you're age 70½ or older**.

More attractive in 2021! The CARES Act suspended the required minimum distribution (RMD) rules for 2020, which dampened the incentive for a donor to make a qualified charitable distribution last year. But RMDs are back for 2021, and qualified charitable contributions can be used to satisfy your RMD.

In addition, when you make a qualified charitable distribution from your IRA, the income is excludable from AGI. The donation is not deductible on Schedule A. This can yield better tax results, such as avoiding or reducing the net investment income tax (NIIT), for some taxpayers.

3. "Bunch" donations with a Donor Advised Fund

With a donor advised fund (DAF), you can bunch donations in one tax year and then the DAF distributes the funds to your favorite charities over multiple years. DAFs allow you to receive a tax benefit in tax years that you bunch donations, while maintaining a consistent cash flow stream for your charities.

Section 7: Tax Planning for Investments



Are Taxes Taking Too Big a Bite Out of Your Returns?

Tax planning for investments is a top priority for many individuals. Of course, there are many non-tax factors you should consider before making investment decisions. But timing gains and losses on sales can help minimize taxes for 2021.

15% is generally the long-term capital gains tax rate, which also applies to qualified dividends. But the rate is 20% at higher income levels.

2021 Thresholds for 20% Long-Term Capital Gains and Dividends Tax Rate

Single	Head of Household	Married	Married Filing Separately
\$445,850	\$473,750	\$501,600	\$250,800

Under current law, the tax rates for long-term capital gains and qualified dividends are no longer tied to the tax rates for ordinary income.

Short-term capital gains (gains on investments held for 12 months or less), nonqualified dividends and taxable interest income are taxed at ordinary-income tax rates as high as 37%. You also may owe the 3.8% NIIT.

Taxes on Capital Gains

	2021 Top Rate, Including NIIT
Short-term gain	40.8%
Long-term gain	23.8%
Long-term gain on collectibles, such as artwork and antiques	31.8%
Long-term gain attributable to certain recapture of prior depreciation on real property	28.8%

If your net capital losses exceed net capital gains, you're limited in how much loss you can deduct per year against ordinary income. The limits on deducting capital losses against ordinary income for 2021 are:

for most
taxpayers

\$3,000

\$1,500

for married taxpayers
who file separately

Loss carryovers can be a valuable tax saving tool. But they disappear once a taxpayer dies.

Passive Activities

Do you materially participate in the businesses you're invested in? If not, beware of the [passive activity rules](#). In general, losses from passive activities can only be taken against passive activity income. Unused passive losses can be carried forward until you earn other passive income or you sell an investment.

Income from these types of activities involves some different considerations and planning strategies.

[Qualified Small Business Stock \(QSBS\)](#)

100% of the gain from the sale or exchange of QSBS is tax free, as long as:

1. The QSBS was acquired on or after September 28, 2010, and
2. The QSBS was held for more than five years.

To qualify as QSBS, the stock generally must have been issued by a C corporation that doesn't own assets worth more than \$50 million and that's in an active trade or business. Additional rules apply.

The House-passed BBB bill would generally eliminate the exclusion for taxpayers with modified AGIs over \$400,000, if the stock is sold after Sept. 13, 2021. But this provision could be changed or eliminated in the Senate version of the bill.

Qualified vs. Nonqualified Dividends

Dividends are an important part of your return on investment. But not all dividends are created equal for tax purposes. There are two types of ordinary dividends:

Nonqualified dividends are taxed at ordinary-income rates.

Qualified dividends are taxed at the more favorable long-term capital gains rates.

Stock-Based Executive Compensation

Many high-net-worth taxpayers earn stock-based executive compensation, including:

- Incentive stock options (ISOs)
- Nonqualified stock options (NQSOs)
- Restricted stock

Special rules apply to stock-based compensation. Year-end planning can help you decide whether to [exercise options and/or sell stock](#).

Under current law, qualified employees of eligible private companies may elect to defer paying taxes on these awards for up to **five years**.

Cryptocurrency

Beware: The IRS is cracking down on **unreported Bitcoin transactions**. Virtual currency is property for federal tax purposes, meaning that sales or exchanges of tokens for other goods are taxable events. Failure to report capital gains and losses from these transactions can result in steep penalties.

Now the IIJA adds new reporting requirements and changes existing law to treat digital assets such as cryptocurrency as cash. Fortunately, the provisions don't go into effect until returns required to be filed, and statements required to be furnished, after Dec. 31, 2023.

Qualified Opportunity Funds (QOFs)

QOFs are an investment vehicle designed to help direct resources to low income communities, known as Qualified Opportunity Zones. Qualifying investments may include real estate projects or business interests obtained after December 31, 2017.

To be eligible for this preferential treatment, a fund must hold 90% of its assets in QOZ property.

Investing in these funds offers the following tax incentives:

- Capital gain deferral
- Potential reduction of the amount of gain realized through a basis adjustment
- Potential permanent gain exclusion of the appreciation

There's no cap on how much money can be invested in opportunity zones. As **time goes by**, investors get preferable tax treatment on the profits from these new investments, and after 10 years, additional capital gains are tax free.

Properties in underdeveloped communities also may be eligible for other tax breaks, such as low-income housing, historic and energy incentives.

What is the final date for investors to place capital into a QOF?

December 31, 2021. Investors who meet this deadline are eligible for the 10% basis step-up, which grants the taxpayer a 10% reduction in the amount of capital gains recognition on the original capital gains.

Section 8: Education Planning

Are You Taking Full Advantage of Tax-Advantaged Funding Options?

Parents and grandparents worry about rising college costs. The College Board estimates that the annual cost for living on campus and attending a four-year college or university for **2020-2021** ranged from:

\$26,820 for an in-state
public college or
university

\$54,880 for a
private college or
university

Fortunately, you can contribute money to various college savings programs. Contributions aren't deductible for federal tax purposes, but earnings accumulate tax-free if you follow the rules.

College Savings Programs

	529 Plans	Coverdell Education Savings Accounts
Annual Contribution Limits?	No, but you might owe gift tax on contributions over the \$15,000 annual exclusion.	Subject to annual income limits, and only \$2,000 can be contributed per child per year.
Tax on Withdrawals?	No, if the money is used to pay for qualified higher education expenses or certain primary and secondary school expenses.	No, if the money is used to pay for qualified education expenses, including primary and secondary school expenses.

Under current law, **Section 529 plan rules** allow:

- Up to \$10,000 of tax-free annual withdrawals for qualifying elementary and high school tuition per student per year
- Transfers to ABLE accounts

In addition, under current law, up to **\$10,000 in lifetime withdrawals from Sec. 529 plans** can be used on qualified student loans.

Beware: Large contributions of more than **\$75,000** (or **\$150,000** if you're married and make a joint contribution with your spouse) will reduce your unified federal gift and estate tax exemption.

Education-Related Credits and Deductions

The tax code also offers several tax breaks for higher education spending for you and your immediate family members. These breaks may be reduced or eliminated based on your modified adjusted gross income (MAGI).

Recent changes: Beginning in 2021, the income phaseout for the Lifetime Learning Credit has been increased to match that of the American Opportunity credit.

2021 Tax Credits and Phaseouts for Higher Education Costs

	American Opportunity	Lifetime Learning
Annual Credit	100% of the first \$2,000 of education expenses; 25% of expenses between \$2,000 and \$4,000; maximum credit \$2,500 per student	20% of the first \$10,000 of qualified education expenses; maximum credit \$2,000 per tax return
MAGI Phaseout Range for Joint Filers	\$160,000-\$180,000	\$160,000-\$180,000
MAGI Phaseout Range for Other Filers	\$80,000-\$90,000	\$80,000-\$90,000
Other Notable Rules	Only for the first 4 years of higher education costs	For higher education costs during or beyond the first 4 years

Deductions for Education Costs

The deduction for qualified higher education tuition and fees expired Dec. 31, 2020. In addition, through 2025 employees can no longer claim unreimbursed work-related education expenses as a miscellaneous itemized deduction.

Under the CARES Act, if your employer pays some of your student loan debt before year end, you may exclude up to \$5,250 of those payments from income. However, you can't deduct the interest expense related to those exempted employer payments.

Section 9: Retirement Planning



Have You Maximized Your Contributions and Minimized Your Taxes?

Traditional Retirement Accounts

Employees may be eligible to make pretax contributions to various employer-sponsored retirement plans. Plus, these contributions can reduce your AGI and MAGI, which are the triggers for certain taxes and can cause the benefit of certain tax breaks to be reduced or eliminated. There are **limits to your annual contributions**.

2021 Limits for 401(k), 403(b) and 457 Plans	
Elective deferrals for people under age 50 at year end	\$19,500
Elective deferrals for people age 50 or older at year end	\$26,000
Defined contribution plan limit	\$58,000

Employees without retirement benefits and the self-employed: Consider a **traditional IRA**.

2021 Contribution Limits for Traditional IRAs	
People under age 50 at year end	\$6,000
People age 50 or over at year end	\$7,000

The deduction for traditional IRA contributions is phased out if your MAGI exceeds certain levels and you or your spouse participates in an employer-sponsored retirement plan. Traditional retirement accounts grow tax-deferred until withdrawn. So, making the **maximum contribution** allowed by law is typically a good idea.

Roth Accounts

Contribute after-tax dollars to a Roth account now...

...and take tax-free withdrawals **later** as long as your withdrawals are "qualified."

The contribution limits are the same for traditional and Roth IRAs. (The limits apply on a combined basis, however.) Unfortunately, income-based limits may prevent higher-income taxpayers from contributing. If you're above the phaseout limit, consider a **"back door" Roth IRA**. The House-passed BBB would eliminate this option beginning in 2022. While it's uncertain if the Senate version will include that provision, 2021 might be your last chance to take advantage of this technique.

Given today's comparatively low tax rates, it could be a good time to consider a Roth conversion. This may be a tax-smart move if you expect your tax rate in retirement to be **higher** than your current tax rate. And Roth conversions also might be limited if the BBB bill becomes law. So, if a conversion would be beneficial for you, consider taking advantage of the opportunity this year.

Beware: You can no longer reverse regular-to-**Roth IRA conversions** under current law.

Retirement Plan Withdrawals

You could owe penalties for withdrawing too soon or too little, depending on your age. Withdrawals are taxed at ordinary-income tax — not long-term capital gains — rates. Plus, they could push you into a higher tax bracket and/or increase your MAGI enough to trigger the **NIIT** on some or all of your investment income. (Retirement plan withdrawals themselves aren't subject to the NIIT.)

Recent changes

[The SECURE Act](#), which went into effect Jan. 1, 2020, made these four key changes to encourage people to save more for retirement:

1. People of any age can continue contributing to retirement accounts if they have earned income.
2. The age for beginning required minimum distributions (RMDs) increased from 70½ to 72. This change applies only to individuals who reach age 70½ after December 31, 2019.
3. Eligible part-time workers can participate in 401(k) plans.
4. "Stretch" IRAs have been eliminated. Now the balance of IRAs inherited by non-spouse beneficiaries (e.g., children or grandchildren) after Dec. 31, 2019, must be distributed within 10 years.

But be aware that a couple of retirement plan changes provided for 2020 haven't been extended to 2021. Specifically, the CARES Act waived:

- The required minimum distribution rules for IRAs, 401(k)s and certain other retirement plans, and
- The 10% penalty on COVID-19-related early distributions of up to \$100,000 from IRAs, 401(k)s and certain other retirement plans.

But if you took a qualified COVID-19-related distribution in 2020, you can spread the tax hit evenly over three years. Or you can eliminate (or reduce) the tax hit by repaying all (or some) of the withdrawal to your retirement plan over the three-year period beginning the day after you took the withdrawal.

Section 10: Planning Across Generations



Can You Save Taxes by Transferring Assets to Family Members?

“Shifting” income to children or grandchildren in a lower income tax bracket saves your family taxes as a whole. Specifically, consider transferring appreciated or income-producing assets to them before year end, so that tax on any gains (if an asset is sold) or income generated is subject to their rate — which might be as low as 0%.

Kiddie Tax

Income shifting across generations works only for gifts to adults. **“Kiddie tax” rules** generally apply to:

Children
under age

18



Full-time students
under age

24

Annual Gift Tax Exclusion

\$15,000 is the gift tax annual exclusion per recipient and donor for 2021. Leverage your exclusions even further with gifts to a Section 529 education savings plan or Coverdell Education Savings Account.

Lifetime Exemption

Through 2025, the TCJA substantially increases the unified federal gift and estate tax exemption and the generation-skipping transfer (GST) tax exemption. It also maintains the step-up basis rules and the **portability provision** for married people.

\$11.7 million is the 2021 lifetime exemption.

\$23.4 million is the 2021 lifetime exemption for married couples if they implement proper planning.

40% is the top tax rate that applies to taxable estates that exceed the exemption amount.

Important: Some states (including Connecticut, Maine, Massachusetts, New York, Rhode Island, and Vermont) impose tax on residents' estates. State exemptions are often much lower than the federal exemption.

Even if your estate is below current exemption amounts, there are still important **estate planning moves** that you could make today to help your family in the future.

We're Here to Help

December 31 is an important tax deadline that you might not be aware of: with a few exceptions, it's the date by which most of your tax planning strategies must be implemented to reduce your 2021 tax bill.

[Contact our tax team](#) to set up a meeting to brainstorm financial planning strategies to help you succeed in the future — and minimize your tax obligations for 2021.



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