3Q:2021

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2021 Year End Tax Planning: Higher Stakes And More Confusing Than Ever

Year-end tax planning is more important than usual because it occurs concurrently with a turning point in U.S. tax policy. For the first time in 40 years, taxes on income and wealth transfers are headed higher.

Exactly what's about to happen – which provisions of the estate and income tax laws will be revised and the financial impact on high income and high net worth individuals-- is uncertain. It depends on Congress, politics, the economy and financial markets, thus making it impossible to predict.

In recent weeks, fears of an imminent hike in estate taxes have dissipated. Congress is expected to do nothing to change current estate tax law. Doing nothing is politically expedient for Congress. It would mean the $11.7 million individual exemption from estate tax in 2021 would continue to rise with inflation until December 31, 2025. Starting January 1, 2026, the exemption would revert to approximately $6 million (after adjusting annually for inflation).

The $11.7 million exemption -- $23.4 million for couples -- would be slashed by more than 50%, if Congress does not act, which until recently seemed the most likely scenario.

For estate planning purposes, individuals with taxable estates can relax a bit but need to stay informed through the end of 2021.

Meanwhile, income tax hikes on high income individuals are expected to be enacted by the end of 2021. President Joseph R. Biden, Jr., has proposed higher income taxes on individuals with more than $400,000 of income. This makes income-tax planning more important

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Spotlight On... Stephanie Andrade

My name is Stephanie Andrade and I have been working as a Tax Associate at the Mosaic Financial Group since February of 2020.

I am originally from Venezuela, where I completed my Bachelor in Taxation and an MBA in Finance. I am finishing my second MBA in Accounting at the University of Potomac. I started working as a tax intern in 2008 at an international company in Venezuela. My journey in the U.S.A started 4 years ago pursuing my MBA which led to joining with the Mosaic Financial Group where I focus on corporate taxes, tax preparation and financial planning.

I currently live in the Chicago suburbs with my husband, and two lovely kids. In my spare time I love working out, riding bikes, and eating barbecue. Something unique about my family is that my kids and I practice martial arts together. I am a brown belt and looking forward to becoming a black belt soon.

Tax Alert For High Income And High Net Worth Individuals

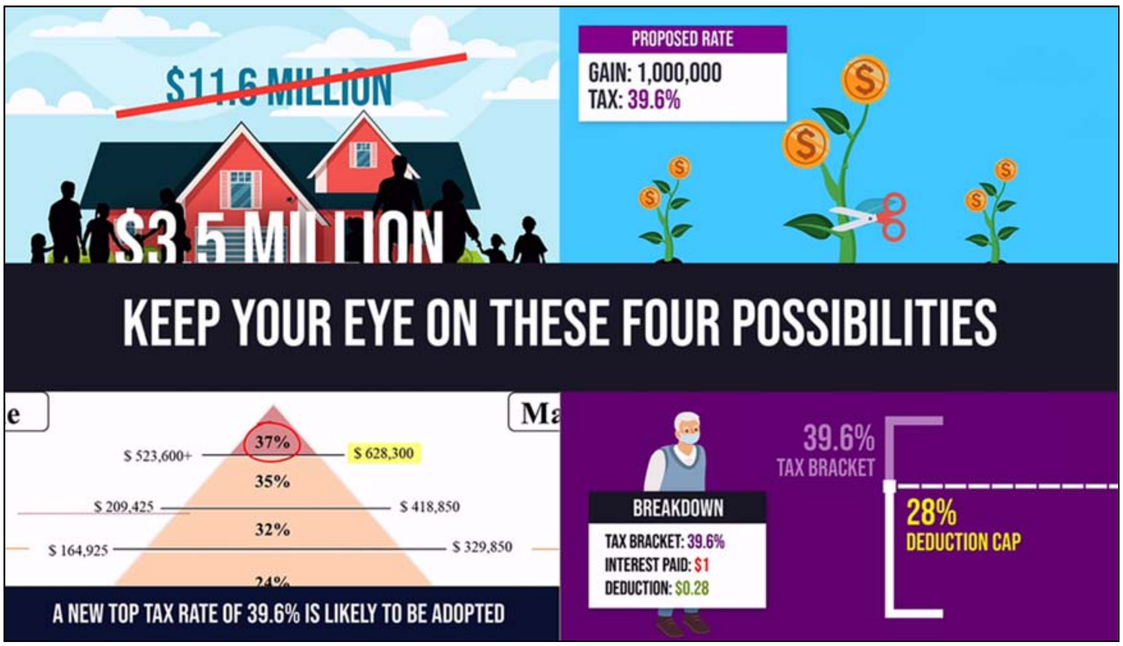
The political standoff in Washington, D.C., has complicated tax planning enormously. No one knows exactly how it will shake out but what we do know is that there are four possibilities to be prepared for.

1. The estate tax exemption is expected to be slashed dramatically, from $11.6 million, to $3.5 million per person, most likely. In addition, the estate tax rate could be stiffened.

2. Capital gain taxes could be hiked in a couple of ways. The current favorable capital gains tax rate of 20% could be eliminated if your taxable income is more than $1 million. In addition, the “step-up” in the basis accorded capital gains on inherited investments may be eliminated on gains of more than $1 million. If your current estate plan hinges on leaving highly appreciated assets, like stocks, business interests, real estate, and other investments, this would slash what your heirs inherit after paying taxes.

3. President Biden has proposed raising the top tax rate. In 2021, the top tax rate is 37% and that applies to income of more than $628,300 for joint filers. A new 39.6% income tax bracket is very possibly going to be adopted. Not only would the top tax rate rise to 39.6%, but the 35% tax bracket could be eliminated, which greatly expands the number of taxpayers subject to the 39.6%.

4. The value of itemized deductions could be capped at 28% for those in the new top tax bracket. To be clear, a high-income professional or business owner in the proposed 39.6% tax bracket, who deducts mortgage interest, would be entitled to a deduction of only 28 cents for each dollar paid in mortgage interest, instead of 39.6 cents on the dollar. Itemized deductions would lose 30% of their power in lowering your tax bill annually.



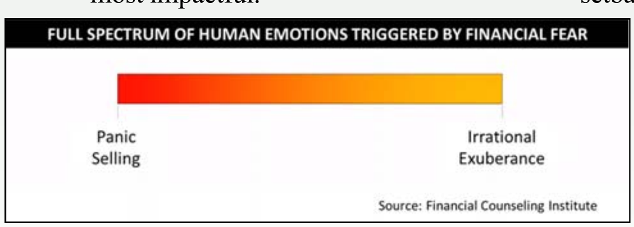
The matrix of variables is complex but keeping these four possible changes top of mind could significantly help minimize your federal income and estate taxes as tax-hike possibilities turn into certainties in the weeks ahead. ●

Dealing With Financial Fear

If you suffer from financial fear and anxiety, talking about it is likely to help.

In talking about it, according to Dr. Frank Murtha, a financial psychology expert, you go through a process of recognizing, understanding, and constructively reacting to your fear, rather than keeping it inside you and causing anxiety.

Whether your fear is running out of money in retirement, paying back a large debt, or caring for a family member with special needs, Dr. Murtha says personal financial issues evoke the full spectrum of human emotions -- from panic to irrational exuberance and everything in between -- but fear is the emotion that stands out as most impactful.



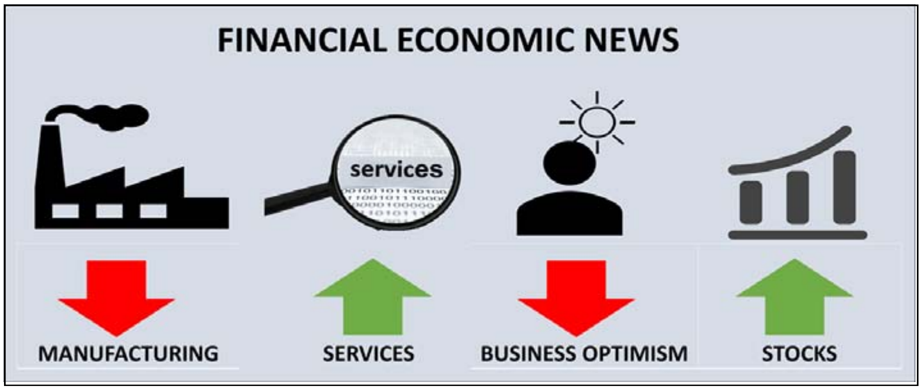
Professors Daniel Kahneman and Amos Tversky, founding fathers of the burgeoning social science of behavioral economics, famously discovered that people do not fear risk in investing; people fear a loss, specifically, a loss of control of the future.

In fact, investors who have suffered an investment loss or financial setback often will actively seek out risk to break even and avert the loss. Of course, “doubling down” may actually compound a financial problem.

How we experience fear is partly dependent on physiology -- your brain chemistry. The fear center of the brain is called the amygdala and it triggers several instinctual reactions to fear. The “fight” instinct can be evoked. Although this reaction may come in handy when you’re getting physically attacked, it is

Retirement Planning Alert For Current Financial Economic Circumstances

Here's a retirement planning alert built for current financial economic circumstances—an explanation of the current situation followed by a timely and high-value retirement investing tip.



The manufacturing purchasing managers index ticked lower in July but it's not too far off from its all-time record-high, while the service sector purchasing manager index shot higher, breaking a new record high. The service sector accounts for 89% of U.S. economic growth.

Meanwhile, business owner optimism ticked lower in July and the S&P 500 hit a new record high for the 48th time in 2021.

The Optimism Index, a monthly survey of business owners, decreased by 2.8 points in July to 99.7, reversing nearly the entire 2.9-point gain in June's report. Notably, 49% of business owners reported job openings that could not be filled, an increase of 3 points from June and a 48-year record high.

Since the March 23rd, 2020, Covid bear market low, the Standard & Poor's 500 stock index is up more than 60%! Inflation uncertainty and the Covid variant could cause a sharp drop in stock prices anytime, but a recession is not threatening, and the economy is growing fast.

Financial conditions, as they are currently, make it wise to consider whether the next sharp drop in stock prices would present a strategic tax opportunity to convert traditional IRA or 401(k) assets invested in stocks into tax-free Roth IRAs.

With tax rates expected to be going up, and the stock market breaking records for 11 months, retirement savers should proactively investigate converting to a Roth IRA in 2021.

A Roth IRA conversion gives you a tax-free income stream for life and, when you die, your spouse gets tax free income for life, too. Your children or other non-spouse beneficiaries get tax free income for 10 years and then a tax-free lump sum inheritance after 10 years.

This is an important tip that we cannot emphasize enough but it requires action by the end of 2021. ●

not helpful in financial dealings.

A more common reaction to fear is flight -- the desire to remove the reason for experiencing fear, to retreat to safety and get back in control of your situation. In financial terms, the flight instinct may make you want to sell a losing investment at the height of a pandemic or amid a global financial crisis.

The other lesser-known neurobehavioral fear reaction is another F word. Can you guess what it is? The answer is "freeze." Freezing is a typical reaction in times of rising fear. You become too afraid to do anything! "People get stuck, unable to make a decision to change a situation and they let anxiety get the best of them," says Dr. Murtha. "A big part of dealing with financial anxiety is simply getting unstuck."

Talking about financial anxiety can help you unburden yourself and that is often the first step toward re-instilling a sense of control, which is the key to fighting fear. ●

Making A Life-Changing Financial Difference To A Spouse And Needy Loved Ones

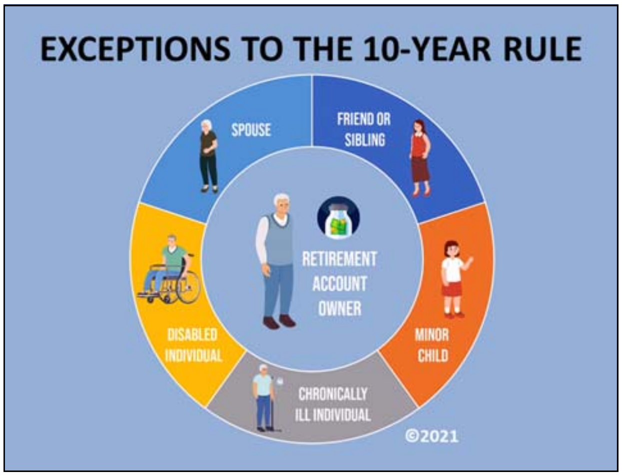
Tax law and estate planning might bore you to death, but this brief tip could make a life-changing financial difference to your surviving spouse, and other loved ones, including disabled and chronically ill family or friends, as well any minor children in your life.

These individuals are among the five exceptions to the usual distribution rules on the inheritance of assets in IRA, 401(k), or other federally qualified retirement plans.

New rules, that went into effect on January 1st, 2020, with the enactment of The Secure Act, require the beneficiary of inherited IRA or 401(k) accounts to deplete the money in those accounts within 10 years. It was a technical change that many overlooked in the rush of tax law changes that occurred in 2020 during the pandemic. But it made a big difference in tax planning.

To be clear, until 2020, beneficiaries of an inherited IRA or 401(k) were not required to liquidate an inherited account within 10 years, as is now required, which had left open a major tax break: They had the option to stretch out distributions over their actuarial life expectancy, thus, leaving the assets to compound tax-free for a much longer period. The 10-year mandatory distribution rules carved out some key exceptions for certain individuals that now require attention, if you intend to pass on your retirement plan, IRA, or other qualified plan assets to a spouse, chronically ill or disabled individual or minor child.

For a disabled individual, who inherits federally qualified retirement assets, for instance, stretching out distributions over decades could transform the inheritance into an income stream for life. The same is true for a widower, chronically ill individual, or minor child that inherits your retirement account.



In addition, a fifth exception to the usual distribution rules applies to a beneficiary that is less than 11 years younger than the retirement account owner. A sibling or friend who is 10 years or less your junior, who inherits qualified retirement account assets, also may use their life expectancy -- instead of taking required distributions over 10 years.

If you own a sizable IRA, 401(k) or other qualified account, and your beneficiary is your spouse, a friend or sibling 10 years or less younger, an individual with a disability, chronic illness, or a minor child, the five exceptions to the 10-year rule pose complicated tax planning as well as legal and investment issues requiring personal advice from a professional that is beyond the scope of this article. ●

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while complicating things to do now in preparation.

As August 2021 comes to an end, this is an early warning that year-end tax planning in 2021 will be a cliffhanger and requires the attention of high-income/high-net worth individuals now. While details of the coming tax hikes are impossible to predict, one thing is certain: planning for the complex matrix of possible changes to the Tax Code, starting right now, would be smart. ●