YEAR-END TAX STRATEGIES: GIFT IT, GIVE IT, GAIN IT, LOSE IT, MAX IT, USE IT

Tax-minimizing strategies, such as 401(k) plan contributions, harvesting investment losses and direct IRA-to-charity donations, must occur by the end of the year.

Overview

In September, the White House published a report estimating that from 2010 to 2018, the 400 wealthiest households in the U.S. paid an average federal income tax rate of only 8.2%.[1]

Clearly, there are a plethora of legal tax-reduction strategies that wealthy Americans utilize to help reduce their tax bills. The following is an overview of some of the most common tactics many deploy toward the end of each year.

Gift It

'Tis the season of giving, and no matter what's on your loved ones' holiday gift list, few would be unhappy to receive cash. Especially a large amount of cash. Thus, the most obvious year-end tax-optimizing strategy is to reduce your estate tax bill in the future by giving away assets now.

The IRS allows you to give away up to $15,000 a year ($30,000 for married couples) to as many people as you'd like without adverse gift tax consequences. If you give away a higher amount to any one person, you will need to file a gift tax return. However, excess amounts will not incur a gift tax until they exceed the total lifetime exclusion, which in 2021 is $11.7 million per individual ($23.4 million for most married couples).

There are three additional ways to give more than $15,000 a year without having to file a gift tax return. In certain circumstances, larger gifts to pay for someone else's medical bills or tuition and to make contributions to a qualified charity are also possible.[2]

"In addition to the emotional lift giving brings to those you care about, giving now can also be a savvy tax move for families with substantial wealth. That's because both the present value and any potential future growth of the gifted assets are removed from your taxable estate."[3]

Give It

While you're feeling generous, don't forget about charitable organizations that rely on contributions to do their good work. Pick out a few that are close to your heart, and give in a way that will help minimize your tax liability come April 15. Charitable donations must be made by the end of the year, and note that the following options are scheduled to return to previous levels starting next year.

Taxpayers *who do not itemize* may deduct up to $300 (individual) in cash donations in 2021; married couples filing a joint return may deduct up to $600. The following contributions do not qualify under this provision:

- Carried forward from previous years
- To a donor-advised fund
- To a private foundation
- To a charitable remainder trust

Taxpayers *who do itemize* may claim up to 100% of their adjusted gross income in cash contributions in 2021.[4]

RMD Gifts

IRA owners over age 72 may avoid paying taxes on their annual required minimum distribution (RMD) by making a qualified charitable distribution (QCD) instead. This strategy combines philanthropy goals with tax-minimization strategies. Investors can instruct the IRA custodian to transfer assets directly to one or more qualified charitable organizations in order to help avoid tax liability (for both the account owner and charity).[5]

- The annual amount for this tax strategy may not exceed $100,000.
- If the charitable donation is equal to or higher than the RMD, the mandate is met.
- Assets donated are not reported as taxable income.
- The taxpayer does not have to itemize — thus taking advantage of today's higher standard deduction.
- QCDs may begin at age 70 ½ (you do not have to wait until age 72).

Gain It / Lose It

If your stock portfolio has performed well this year, it may be a good time to harvest both your capital gains and losses. Harvesting gains allows you to rebalance your asset allocation strategy in order to remain on track for long-term goals.

Selling stocks that have lost ground allows you to use those losses to offset your tax bill on any gains you cashed in. When your capital losses are higher than your capital gains for the year, you can deduct up to $3,000 to reduce your taxable income and even carry over excess losses to next year's tax return. However, note that if you are planning to harvest winners and losers to mitigate your 2021 tax liability, these transactions must be completed by Dec. 31.[6]

Beware the "Wash-Sale" Rule

You may be tempted to sell some of your under-performing stocks and then buy more shares of them while prices remain low. Just be aware that you are not allowed to purchase "substantially identical" securities within 30 days of the original sale. If you do, you won't be able to claim the deduction for those losses. Also note that the wash-sale rule may apply to the sale of index funds or exchange-traded funds based on the same index.

Tax Swapping

You may, however, avoid the wash-sale rule when it comes to other types of mutual funds, even if they are similar in nature. Because actively managed funds are not likely to have the exact same holdings as funds that track the same index, an investor may sell shares for a loss and then reinvest in a similar fund for basically the same market exposure. This strategy, called tax swapping, enables you to use mutual fund losses to offset gains from other investment sales or carry them forward in future years.[7]

Take Your Full RMD

Even if you don't need retirement account assets to support your lifestyle, it's important to take your RMDs (or employ the QCD technique described earlier) by Dec. 31 each year. Any amount not withdrawn that is less than the required distribution will be subject to a 50% penalty.[8]

One way to help avoid RMDs — and their requisite tax bill — is to roll over (401(k)) or convert (traditional IRA) your retirement funds to a Roth IRA before you turn age 72. In fact, rather than face a huge tax bill on a big conversion done all in one year, it's a good idea to begin moving portions over several years while you are still working and can pay the tax with current income.

Because a Roth IRA does not require mandatory distributions, your assets may continue growing undeterred, and you'll never have to pay taxes again on the money withdrawn. Upon your death, even your designated beneficiary(s) may be able to receive Roth assets with no income tax liability.[9]

Max It: 2021 Contribution Limits

If you haven't already, the end of the year is a great time to max out annual tax-advantaged account contributions. For employer-sponsored retirement plans, every dollar you defer reduces your taxable income by the same amount for that year. The following are the contribution limits for 2021:[10]

Employer Retirement Plans

401(k), 403(b), 457(b) Catch-up contribution (age 55+)	$19,500 $6,500
SIMPLE Plan Catch-up contribution (age 55+)	$13,500 $3,000
SEP Plan	$58,000
Roth/Traditional IRA Catch-up contribution (age 50+)	$6,000 $1,000

You have until your tax filing deadline to make contributions to a Roth or traditional IRA. If you delay until next year, be sure to specify which contributions are for 2021.

Health Savings Account

Individual Family Catch-up contribution (age 50+)	$3,600 $7,200 $1,000

Use It (Or Lose It)

Many employers sponsor a flexible spending account (FSA), which gives employees the opportunity to defer a portion of their paycheck to a medical savings account, tax-free. The only caveat is that the employee must use this money to pay for eligible medical expenses within a specific time frame. Due to the pandemic, employers have the option to extend the period for using funds and/or carry over limited amounts to the following year, so check with your employer for rules specific to your plan. Also be aware that any assets left in the account when a worker leaves the company are forfeited.

The maximum annual salary deferral for an FSA is $2,750.[11] If you haven't spent the amount you deferred to this account, look for ways to do so by the end of the year. That means it's a good time to get your vision checked, purchase new glasses or contacts, get dental cleanings for the family or other medical appointments that often get overlooked throughout the year. You can even use this money to stock up on household health care supplies, including over-the-counter medications, feminine products, reading glasses and sunscreen.

Final Thoughts

As the year draws to an end, you may get busy as family, friends and co-workers gather for parties and celebrations. We hope you enjoy this holiday season. But remember that this is also a good time to take stock of your assets, consider ways to gift prudently and set yourself up for another prosperous year in 2022. We look to working with you to help ensure a financially secure future.

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[3] Ibid.
[4] IRS. Sept. 17, 2021. "Expanded tax benefits help individuals and businesses give to charity during 2021; deductions up to $600 available for cash donations by non-itemizers." https://www.irs.gov/newsroom/expanded-tax-benefits-help-individuals-and-businesses-give-to-charity-during-2021-deductions-up-to-600-available-for-cash-donations-by-non-itemizers.
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[11] Stephen Miller. SHRM. March 1, 2021. "IRS Clarifies Relief for FSA Carryovers." https://www.shrm.org/resourcesandtools/hr-topics/benefits/pages/irs-guidance-clarifies-relief-for-fsa-carry-overs.aspx. Accessed Nov. 9, 2021.