

Taximpact

November 2021

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- estate planning
- investment management
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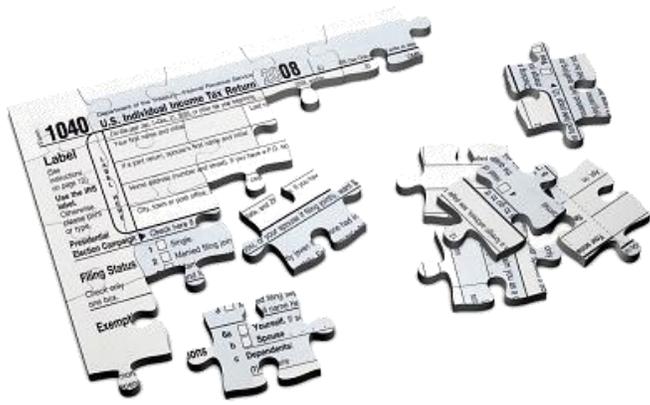
YOUR GUIDE TO

YEAR-END TAX PLANNING

Who doesn't like opportunities that allow us to reduce our taxes? Uncle Sam loves having American taxpayers as business partners; the feeling is typically not mutual. As holistic financial advisors, one of our main goals is to help our clients recognize tax reduction opportunities within their investment portfolios and overall financial planning strategies. Staying current on the ever-changing tax environment is a key role we fill so we can help our clients benefit from potential tax reduction strategies.

2021 has been an unusual year and there is still major legislation being discussed that could impact your taxes. It is the first year of a new administration, so investors should take into consideration potential future tax strategies. In addition to pointing out what individual taxpayers can do to potentially save money on their 2021 taxes, this report includes a review of possible tax law changes and some of the notable changes being proposed in the Build Back Better Act.

The Tax Cuts and Jobs Act (TCJA) enacted in 2017 brought many changes to the tax code. The TCJA included many provisions for individuals that took effect in 2018 but are currently set to expire after 2025. One big uncertainty for all taxpayers is what will happen to the tax code after 2025.



Year-end tax planning

The best time to start is now

TAX PLANNING SHOULD *ALWAYS* BE A CRUCIAL COMPONENT OF YOUR FINANCIAL PLAN

Benjamin Franklin once said, “In this world, nothing can be said to be certain, except death and taxes.” However, given the huge tax code overhaul in 2017 and potential tax law changes being considered now, wouldn’t you agree that “ever-changing tax laws” should be added to Mr. Franklin’s quote?

What should always be certain for taxpayers is making sure to start their final year-end tax planning now! Choosing the appropriate tactics will depend on issues that are specific to your financial situation. As you read through this report, mark those strategies that may apply to your situation so you can discuss them with your tax professional and financial advisor.

EVALUATE THE USE OF ITEMIZED DEDUCTIONS VS STANDARD DEDUCTION

For 2021, the standard deduction amounts increase to \$12,550 for individuals and married couples filing separately, \$18,800 for heads of household, and \$25,100 for married couples filing jointly and surviving spouses.

As a reminder, the TCJA roughly doubled the standard deduction with the intent of decreasing tax payments for those who typically claimed this deduction. Although personal exemption deductions are no longer available, the larger standard deduction, combined with lower tax rates and an increased child tax credit, may result in a lower tax bill. Before opting to use itemized deductions, you should run the numbers to determine the impact on your situation.

The TCJA still eliminates or limits many of the previous laws concerning itemized deductions. One example is the state and local tax deduction (SALT), which is still currently capped at \$10,000 per year, or \$5,000 for a married taxpayer filing separately.

CONSIDER BUNCHING CHARITABLE CONTRIBUTIONS OR USING A DONOR-ADVISED FUND (DAF)

For taxpayers who are charitably inclined, it makes sense to put together a plan. One method is “bunching.” Bunching is the consolidation of donations and other deductions into targeted years so that in those years, the deduction amount will exceed the standard deduction amount.

Another strategy to consider is a Donor-Advised Fund (DAF). A DAF is a philanthropic vehicle established at a public charity. It allows donors to make a charitable contribution of cash, stock, or other assets, receive an immediate tax benefit and then recommend grants from the fund over time.

Taxpayers can take advantage of the charitable deduction when they’re at a higher marginal tax rate while the actual payouts from the fund can be deferred until later. It can be a win-win situation for the taxpayer and the charity. **If you are charitably inclined and need some guidance, call us for our assistance.**

REVIEW HOME EQUITY DEBT INTEREST

For mortgages taken out after October 13, 1987, and before December 16, 2017, mortgage interest is fully deductible up to the first \$1,000,000 of mortgage debt. For homes purchased after December 15, 2017, the threshold has been lowered to the first \$750,000 (or \$375,000 married filing separately). All interest paid on any mortgage taken out before October 13, 1987, is called “grandfathered debt” and is fully deductible regardless of your mortgage amount. Under the TCJA, this change applies to all tax years between 2018 and 2025. Many mortgage holders refinanced for lower rates in the last few years so for larger mortgages, that could change your situation.

Home equity lines of credit (HELOCs) are deductible as well, but only if the funds were used to buy or substantially improve the home that secures the loan. When filing your taxes, please share with your tax preparer how the proceeds of your home equity loan were used. If you used the HELOC to pay off credit card or other personal debts, the interest is not deductible.

State income tax laws may vary from federal income tax laws. To view a wide range of tax info and access links to tax forms for all 50 states, go to www.sisterstates.com

NEW INCOME TAX RATES FOR 2021

For 2021, there are still seven tax rates ranging between 10% and 37%. Under current tax law, this seven-rate structure will be phased out on January 1, 2026.

FEDERAL TAX RATES	SINGLE		HEAD OF HOUSEHOLD		MARRIED FILING SEPARATELY		MARRIED FILING JOINTLY/ QUALIFYING WIDOW(ER)	
	Taxable Income Over	to	Taxable Income Over	to	Taxable Income Over	to	Taxable Income Over	to
10%	\$0	\$9,950	\$0	\$14,200	\$0	\$9,950	\$0	\$19,900
12%	9,951	40,525	14,201	54,200	9,951	40,525	19,901	81,050
22%	40,526	86,375	54,201	86,350	40,526	86,375	81,051	172,750
24%	86,376	164,925	86,351	164,900	86,376	164,925	172,751	329,850
32%	164,926	209,425	164,901	209,400	164,926	209,425	329,851	418,850
35%	209,426	523,600	209,401	523,600	209,426	314,150	418,851	628,300
37%	Over \$523,601		Over \$523,601		Over \$314,151		Over \$628,301	

REVISIT THE USE OF QUALIFIED TUITION PLANS

Qualified tuition plans, aka 529 plans, are a great way to mitigate your tax bill while planning for the challenge of paying tuition for children or grandchildren. Originally, earnings in a 529 plan could be withdrawn tax-free only when used for qualified higher education at colleges, universities, vocational schools, or other post-secondary schools.

Now, 529 plans can also be used to pay for tuition at an elementary or secondary public, private or religious school, up to \$10,000 per year. Unlike IRAs, there are no annual contribution limits for 529 plans. Instead, there are maximum aggregate limits, which vary by plan. Under federal law, 529 plan balances cannot exceed the expected cost of the beneficiary's qualified higher education expenses with limits varying by state (often ranging from \$235,000 to \$529,000).

Some states offer a state tax credit or deduction up to a certain amount for 529 plan contributions. For federal tax purposes, 529 plan contributions are considered completed gifts and, in 2021, up to \$15,000 per donor, per beneficiary, qualifies for the annual gift tax exclusion. Excess contributions above \$15,000 must be reported on IRS Form 709 and will count against the taxpayer's lifetime estate and gift tax exemption amount (\$11.7 million in 2021).

There is also an option to make a larger tax-free 529 plan contribution if the contribution is treated as if it were spread evenly over a 5-year period. For example, a \$75,000 lump sum contribution to a 529 plan can be applied as though it were

\$15,000 per year as long as no other monetary gifts are made to the same beneficiary over the next five years. Grandparents may want to consider this 5-year gift-tax averaging as an estate planning strategy. **If you want to explore setting up a 529 plan for your child or grandchild, call us and we would be happy to assist you.**

MAXIMIZE YOUR QUALIFIED BUSINESS INCOME (QBI) DEDUCTION (if applicable)

One of the most talked about changes from the TCJA enacted in 2017 is the Qualified Business Income (QBI) deduction under Section 199A. Current proposals want to change this deduction but for 2021, taxpayers who own interests in a sole proprietorship, partnership, LLC, or S corporation may be able to deduct up to 20% of their QBI. This deduction is subject to various rules and limitations so it would be wise to discuss this with your tax preparer.

There are planning strategies for business owners to consider. For example, business owners can adjust their business's W-2 wages to maximize the deduction. Also, it may be beneficial to convert independent contractors to employees where possible; before doing so, make sure the benefit of the deduction outweighs the increased payroll tax burden and cost of providing employee benefits. Other planning strategies can include investing in short-lived depreciable assets, restructuring the business, and leasing or selling property between businesses. The QBI deduction is complicated and would take an entire report to discuss, so we recommend that if you are a business owner, talk with a qualified tax professional about how Section 199A could potentially work for you.

2021 Retirement Savings Options

In 2021, if you have earned income or are still working, consider contributing to your retirement plan.

Now is an ideal time to maximize the benefits of retirement plans for 2021 and start thinking about what your strategy should be in 2022. For many investors, retirement contributions represent one of the smarter tax moves to make.

Here are some strategies worth considering:



▶ 401(K) Contribution Limits Unchanged

The elective deferral (contribution) limit for employees under the age of 50 who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan is \$19,500. The catch-up contribution limit for employees aged 50 and over who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan also remains at an additional \$6,500 (\$26,000 total). **As a reminder, these contributions must be made in 2021.**

▶ IRA Contribution Limits Unchanged

The limit on annual contributions to an Individual Retirement Arrangement (IRA) remains at \$6,000 for 2021. The additional catch-up contribution limit for individuals aged 50 and over is not subject to an annual cost-of-living adjustment and remains \$1,000 (for a total of \$7,000). **IRA contributions for 2021 can be made all the way up to the April 15, 2022, filing deadline.**

▶ Higher IRA Income Limits

The deduction for taxpayers making contributions to a traditional IRA is phased out for singles and heads of household who are covered by a workplace retirement plan and have modified adjusted gross incomes (MAGI) of \$66,000 and \$76,000 for 2021. For married couples filing jointly, in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, the income phase-out range is \$105,000 to \$125,000. For an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered, the deduction is phased out in 2021 as the couple's income reaches \$198,000 and completely at \$208,000. For a married individual filing a separate return who is covered by a workplace retirement plan, the phase-out range remains at \$0 to \$10,000 for 2021. **Please keep in mind, if your earned income is less than your eligible contribution amount, your maximum contribution amount equals your earned income.**

▶ Increased Roth IRA Income Cutoffs

The MAGI phase-out range for taxpayers making contributions to a Roth IRA is \$198,000 - \$208,000 for married couples filing jointly in 2021. For singles and heads of household, the income phase-out range is \$125,000 - \$140,000. For a married individual filing a separate return, the phase-out range remains at \$0 to \$10,000. **Please keep in mind, if your earned income is less than your eligible contribution amount, your maximum contribution amount equals your earned income.**

▶ Larger Saver's Credit Threshold

The MAGI limit for the Saver's Credit (also known as the Retirement Savings Contribution Credit) for low- and moderate-income workers in 2021 is \$66,000 for married couples filing jointly, \$49,500 for heads of household, and \$33,000 for all other filers.

▶ Be Careful of The IRA One Rollover Rule

Investors are limited to only one rollover from all of their IRAs to another in any 12-month period. A second IRA-to-IRA rollover in a single year could result in income taxes becoming due on the rollover, a 10% early withdrawal penalty, and a 6% per year excess contributions tax as long as that rollover remains in the IRA. While individuals can only make one IRA rollover during a one-year period, there is no limit on trustee-to-trustee transfers. Multiple trustee-to-trustee transfers between IRAs and conversions from traditional IRAs to Roth IRAs are allowed in the same year. **If you are rolling over an IRA or have questions about this, please call us.**

A TAXING STORY: CAPITAL GAINS & LOSSES

Investments can provide plenty of tax-saving opportunities! Review the various sales you have realized this year on stocks, bonds, and other investments. Then review what is left and determine whether these investments have an unrealized gain or loss (unrealized means you still own the investment, versus realized, which means you have already sold the investment).

Know Your Cost Basis

To determine if you have unrealized gains or losses, you must know the investment's tax basis (the cost of the investment when you bought it). However, this gets trickier with investments that allow you to reinvest your dividends and/or capital gain distributions. We will be glad to help you calculate your cost basis.

Consider Loss Harvesting

If your capital gains are larger than your losses, you may want to do some "loss harvesting" (selling investments that will generate a loss). You can use an unlimited amount of capital losses to offset capital gains. However, you are limited to only \$3,000 married, filing jointly (\$1,500 married, filing separately) of net capital losses that can offset other income, such as wages, interest, and dividends. **Bonus:** any remaining unused capital losses can be carried forward into future years indefinitely.

Always Double-Check Brokerage Firm Reports

The cost-basis for stock sold in 2021 will be reported by the brokerage firm on IRS Form 1099-B in early 2022. Discrepancies sometimes happen so we suggest you double-check these numbers to make sure that the cost-basis is calculated correctly and does not result in a higher amount of tax than you need to pay.

Know The "Wash Sale" Rule

If you sell an investment at a loss and buy it right back, the IRS disallows the deduction. The "wash sale" rule says you must wait at least 30 days before buying back the same security in order to claim the original loss as a deduction. The deduction is also disallowed if you bought the same security within 30 days before the sale. However, you can buy a similar security, perhaps a different stock in the same sector, that will allow you to maintain your general market position while enjoying a tax break.

LONG-TERM CAPITAL GAINS TAX RATES

Tax rates on long-term capital gains and qualified dividends did not change for 2021. You may qualify for a 0% capital gains tax rate for some or all your long-term capital gains realized in 2021. This year, the 0% rate applies for individual taxpayers with taxable income up to \$40,400 on single returns, \$54,100 for head-of-household filers and \$80,800 for joint returns. If this is the case, then the strategy is to figure out how much long-term capital gains you might be able to recognize to take advantage of this tax break.

The 3.8% surtax on net investment income stays the same for 2021. It starts for single people with modified AGI over \$200,000 and for joint filers with modified AGI over \$250,000.

NOTE: The 0%, 15% and 20% long-term capital gains tax rates only apply to "capital assets" (such as marketable securities) held longer than one year. Anything held one year or less is considered a "short-term capital gain" and are taxed at ordinary income tax rates.

2021 Long-Term Capital Gains Tax Brackets

Tax Bracket/Rate	Single	Married Filing Jointly	Head of Household
0%	\$0 - \$40,400	\$0 - \$80,800	\$0 - \$54,100
15%	\$40,401 - \$445,850	\$80,801 - \$501,600	\$54,101 - \$473,750
20%	\$445,851+	\$501,601+	\$473,751+

Notable 2021 Tax Changes

Deductible Medical Expenses

The 2021 threshold for deducting medical expenses on Schedule A is 7.5% of your AGI. IRS.gov provides an extensive list of medical expenses that qualify for this deduction.

SALT

State and local income, sales, and real and personal property taxes (SALT) are still limited to \$10,000.

ALIMONY DEDUCTIONS

Under prior tax laws, alimony and separate maintenance payments could be deducted by the payor and included as income by the payee.

Under the TCJA, for divorce and separation instruments executed or modified after December 31, 2018, alimony and separate maintenance payments are no longer deductible by the payor-spouse, nor included as income for the payee-spouse.

CASUALTY AND THEFT LOSSES

The deduction for casualty and theft losses is currently allowed only for presidentially declared disaster areas.

Estate, Gift and Generation-Skipping Taxes

Exemption amounts for gift, estate, and generation-skipping taxes are another issue that the tax proposals are trying to change. For 2021, the limits are \$11.7 million (\$23.4 million for married couples), up from \$11.58 million in 2020. Any amount over that is subject to 40% Federal taxes. Additionally, the income tax basis step up/down to fair market value at death continues. This high amount provides high net worth individuals a significant planning window to make gifts and set up irrevocable trusts.

As a reminder, the estate tax exclusion is due to revert to pre- 2018 levels of \$5 million (adjusted for inflation) in 2026.

On November 26, 2019, the Treasury Department and the IRS issued final regulations under IR-2019-189 confirming that individuals who take advantage of the increased gift tax exclusion or portability amounts in effect from 2018 to 2025 will not be adversely impacted when the TCJA provisions expire on January 1, 2026. Claiming the portable exemption will remain an important discussion topic for decedents with larger estates. For those who have larger estates, please call us to discuss your situation.

Make Use of the Annual Gift Tax Exclusion

In 2021, you may gift up to \$15,000 tax-free per beneficiary. These annual exclusion gifts do not reduce your \$11,700,000 lifetime gift tax exemption. The annual exclusion gift doubles to \$30,000 per beneficiary for gifts made by married couples of jointly held property or when one spouse consents to "gift-splitting" for gifts made by the other spouse.

Make Gifts to Trusts

If direct and immediate, these gifts often qualify as annual exclusion gifts (\$15,000 in 2021) and upon meet certain requirements, removes the property from your estate. The annual exclusion gift can be contributed for each beneficiary of a trust. We are happy to review these details with your estate planning attorney.

ROTH IRA CONVERSIONS

To take advantage of still historically low interest rates, some IRA owners may want to consider converting part or all their traditional IRAs to a Roth IRA. This is not a simple or easy decision, but Roth IRA conversions can be helpful to taxpayers. However, they can also create immediate tax consequences and trigger additional rules and potential penalties. Further, under the TCJA, you can no longer unwind a Roth conversion by recharacterizing it. It's best to run the numbers with a financial professional and calculate the most appropriate strategy for your situation. Call us if you would like to review your Roth IRA conversion options.

CHARITABLE GIVING



This is a great time of the year to clean out and donate items to charity.

Remember that you can only write off these donations to a charitable organization if you itemize your deductions.

Send cash donations by December 31, 2021 and be sure to hold on to your cancelled check or credit card receipt as proof of your donation. If you contribute \$250 or more, you will need a written acknowledgement from the charity.

If you plan to make a significant gift to charity, consider gifting appreciated stocks or other investments you've owned for more than one year to boost the savings on your tax returns. Your contribution deduction is the fair market value of the securities on the date of the gift, not the amount you paid for the asset, and so you avoid having to pay taxes on the profit!

Do not donate investments that have lost value. It is best to sell the asset with the loss first and donate the proceeds so you can take both the charitable contribution deduction and the capital loss. Also, if you give appreciated property to charity, the unrealized gain must be a long-term capital gain for the entire fair market value to be deductible. (The amount of the deduction must be reduced by any unrealized ordinary income, depreciation recapture and/or short-term gain.)

The law allowing taxpayers age 70½ and older to make a Qualified Charitable Distribution (QCD) in the form of a direct transfer of up to \$100,000 directly from their IRA to a charity (including all or part of the Required Minimum Distribution) was made permanent in 2015. If you meet the qualifications to use this strategy, the funds must come out of your IRA by December 31, 2021.

Today's Tax Law Proposals

As of the writing of this report, the proposed tax law changes had still not been finalized. Let's look at the current situation.

Proposals that are currently no longer being discussed:

- the restoration of the 39.6% top tax bracket
- a retroactive increase of 20% capital gains rate to 25% for individuals earning over \$400,000 and married filing jointly taxpayers earning more than \$450,000
- changes to Roth IRA conversion rules
- the termination of the temporary increase in the Unified Credit (replacing the current \$11.7 million estate and gift tax exemption with an exemption of approximately \$6 million per person starting in 2022)

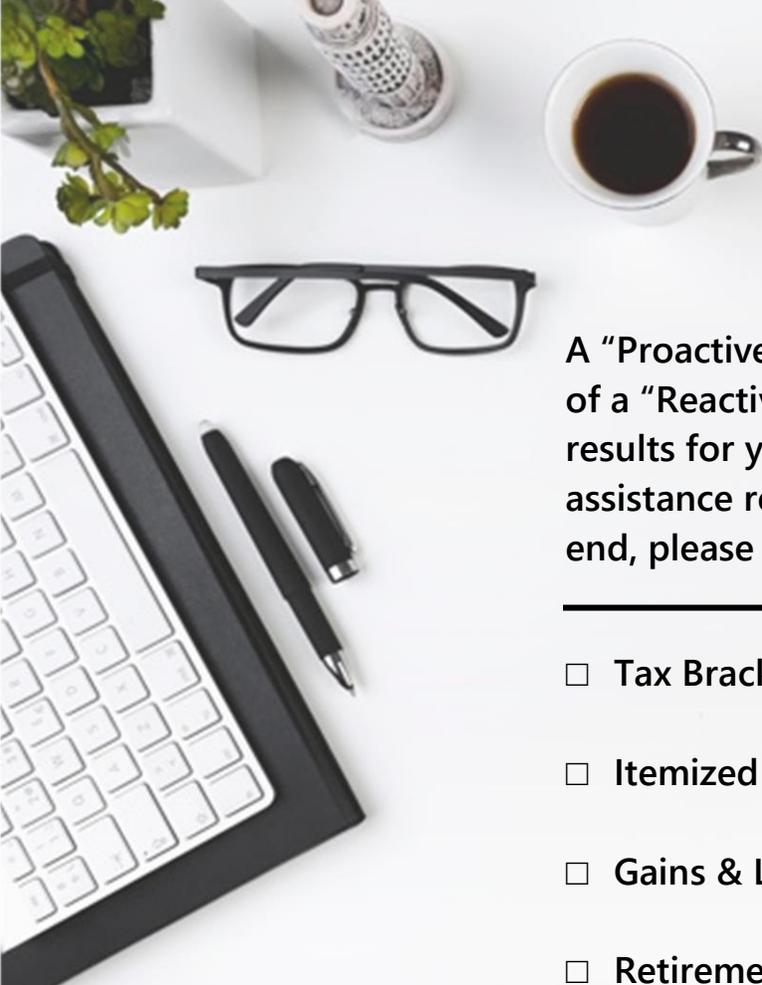
Proposals still being considered starting in 2022:

- Expansion of 3.8% Net Investment Income Tax (NIIT) to apply to net income derived in the ordinary course of trade or business for taxpayers with a taxable income of more than \$500,000 for joint filers and \$400,000 for single filers
- A new surtax on high income earners that calls for a new additional tax on individuals with a modified adjusted gross income of over \$5,000,000 and further increases for those with AGI's over \$25,000,000. Please note this does not include state taxes.
- Change in SALT tax limitations starting in 2022

Please remember it is uncertain as of our late-October/early-November writing of this report as to which tax changes, if any, will be passed into law. The purpose of this section is to help make clients aware of any potential key proposals for tax planning purposes.

Our goal is to keep clients updated when tax laws change so that they can proactively plan. **If you would like to discuss any of these potential tax law changes with us, please feel free to contact us and we'd be happy to assess your unique financial situation.**

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2021 YEAR-END TAX PLANNING CHECKLIST

A “Proactive” approach to your tax planning instead of a “Reactive” approach could produce better results for your financial situation. If you need assistance reviewing any of these items prior to year-end, please call us and we’d be happy to help you!

- Tax Bracket Management
- Itemized Deduction Timing
- Gains & Loss Harvesting
- Retirement Planning
- Education Planning
- Charitable Planning
- Estate Planning
- Planning for Major Financial and/or Life Events Next Year/Future
- Planning for Any Other Personal Situations/Concerns

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