HCM WEALTH ADVISORS HENGEHOLD FINANCIAL GROUP HG CPAs

Should Taxes Make Sense?

As my dad, “Don the Tax Man,” used to tell me, don’t try to make sense of the tax code. It is simply a set of rules for the game we play. Politicians change the rules, sometimes for good reasons, and sometimes for reasons that make no sense at all. Ours is not to reason why, he would say, ours is but to play the game, by the rules we are given, and win!

The politicians are getting ready to revise the U.S. tax code once again, and you can bet that the final version won’t do away with any pages. Over the past 10 years alone, the tax code has been amended or revised over 4,000 times, with provisions covering things like pet moving expenses, deductions for clarinet lessons, and a special carve-out for repairs to whaling boats—even though hunting whales is banned by the United States government.

And some of the provisions in the tax code are inexplicably contradictory. Consider one of HCM’s favorite contradictions, the “back-door Roth.”

There is a well-established prohibition against taxpayers with higher incomes ($140,000 Single and $208,000 Joint) from making Roth IRA contributions—that is, a contribution to a special type of retirement account that receives no deduction, but from which all qualified withdrawals are taken out tax-free.

But the tax code also allows people at any income level to make contributions to a “traditional IRA” and then move those contributions to a Roth, winding up in exactly the same place as if they contributed to a Roth IRA from the start. This strategy is known as a “back-door Roth” contribution. And while the name sounds a little sketchy, it is perfectly legal and has been approved by the IRS.

At the time of this writing, we don’t know what the new tax law will include or even if the Administration will be able to organize its various factions to pass a new law.

The best advice we can offer now is to hope for the best but be prepared for the worst.

To be properly prepared we are encouraging clients to focus on the proposed changes that have near-term deadlines and either act now or decide what action they should take if the law does pass. To remain a winner in this game, it is important to be prepared to act on very short notice if the rules do change. This will create a very tight window of time for some rather large decisions as the clock is winding down for the current game.

While there are many more proposed changes, following are the areas that, because of their individual focus and effective dates, are most likely to affect the Wealth Plans of HCM and HG clients and therefore require immediate attention.

- Tax rates would go to 39.6% on January 1st for incomes over $400,000 (Single) and $450,000 (MFJ). Notice that not only has the rate gone up, but the level of income at which it is imposed has been lowered. If you find yourself in the crosshairs of this potential change it may be worth looking at accelerating income into 2021 or deferring deductions into 2022 to take advantage of the lower tax rates available this year.
- The proposed tax on large capital gains will increase from 23.8% to 28.8% (includes the NIIT) for gains after September 14, 2021. While the effective date is already in the rearview mirror, it is possible that future negotiations will move this change forward to the date of enactment (currently unknown) or January 1, 2022. To avoid the higher tax, those with large gains pending should stay alert for possible date extensions and consider moving transactions forward accordingly or consider installments if the September 14th date sticks.
- The "back-door" (Roth) would be slammed shut on January 1, 2022. This means individuals for whom this is a worthwhile strategy should consider moving quickly to complete any conversions before December 31, 2021. Contact your HCM Advisor or HG CPA as this may involve moving traditional IRA assets back to an employer plan to optimize the tax benefit.
- A new 3% surcharge would be applied to trust income above $100,000. While trust income at this level may seem like something only the "Rolls Royce Crowd" needs to worry about, this could impact "regular" people who have established trusts as either primary or contingent IRA beneficiaries. This tax is the mate to a proposed rule that would add a 3% surcharge on personal income above $5,000,000. While this one is truly out of reach for almost everyone, a once in a lifetime event, like selling a business, could run afoul of this change. Acceleration or installments may help with this problem.
- Estate planning will likely see some of the most significant changes with the lifetime exclusion being cut in half. At nearly $6,000,000 per person (adjusted for inflation) this is still an extremely large exclusion which puts estate taxation out of range for most people. However, for those that have this level of family wealth now or may reasonably expect to have it in the future (even in the distant future) reviewing your situation now is a good idea, as several of the tools we use to move family wealth outside the reach of the Tax Man may be going away as of the date of enactment (currently unknown, but before January 1st). Also, HCM can help with statistical projections to forecast what level your estate may grow to over future decades to see if you have a potential problem lurking far in the future that would benefit from action today.
- SALT. Reinstating the deduction for state and local taxes was left out of the tax bill proposed by the Ways and Means Committee. However, several east and

west coast Democratic lawmakers, with high real estate taxes back home, have pledged to their constituents that they will not sign the bill unless the SALT deduction is reinstated. This creates a special kind of problem for the Administration who desperately needs their votes to pass the bill but does not want to be seen giving tax breaks to one group of wealthy people while taking them away from others. Don't be surprised to see a deal made to "buy" those congressional votes which gives a state and local tax deduction to those making below $400,000.

- Business changes, especially for those doing business as a Sub Chapter S corporation are beyond the scope of this letter but do require attention by their shareholders.

Every year, we at HCM Wealth Advisors and HG CPAs pore over the new tax laws for contradictions, loopholes, and planning opportunities to help enhance our clients' after-tax retirement incomes. It is not what you make but what you keep after taxes that matters. This next tax bill, whenever it comes, will be no exception.

Invitation to Contact Your HCM Advisor

We want to hear from you. If you have experienced any changes in your life that may impact your financial situation, be sure to let us know. It's always best to schedule regular conversations so you can stay on top of any changes that may affect your planning, tax, or investment objectives. We would enjoy meeting in person, following the mask protocols. If you prefer, we are happy to schedule conference calls/video conferences or whatever else works best for your schedule.

Also, we want to be a resource for anyone who might benefit from our special skills. If there is someone you care about that might benefit from the type of service we offer, please connect us. We will do everything we can to assist, no strings attached.

As always, we appreciate the opportunity to work with you, and we thank you for your confidence and loyalty.

Sincerely,

Michael T. Hengehold, CPA/PFS MST RICP®

P.S. Please look for announcements regarding HCM's Monthly Town Hall Live Chats in your email inbox.