The House recently passed the Build Back Better (BBB) Act. It now sits in the Senate and there will likely be some back and forth before they vote on a final version. As such, we are still not clear exactly what changes will be made to the tax law. Our hope is that by 2024, Congress will let us know what the 2022 tax law will be.

Our annual tax planning letter will focus on three areas:

- Elements of the BBB Act that may impact our clients' income taxes,
- General year-end tax planning considerations, and
- How to deal with concentrated positions of low basis investments

BBB Act Tax Provisions

While there are a number of tax law changes in BBB, we are closely monitoring the following three provisions which are relevant to many of our clients:

S.A.L.T. (State & Local Tax) Limit Increase: The House bill raises the cap on the itemized tax deduction (Schedule A) for state income tax and real estate tax from $10,000 to $80,000 per year.

> As a side-bar to this, many states now allow taxpayers to pay state taxes through partnerships/S Corps in which they are partners or shareholders. This bypasses the SALT limitation. This should be considered before year-end if a 2021 deduction is desired.

Roth IRA Restrictions: The House bill has two limits addressing conversions to Roth IRAs. First, it would prohibit any *after-tax contributions* in 401(k), other workplace plans, and IRAs from being converted to Roth savings. This rule would apply to all income levels starting after Dec. 31, 2021. Secondly, savers would be unable to convert *pre-tax contributions* in IRAs and workplace retirement plans if their taxable income exceeds $400,000 (single individuals), $450,000 (married couples), or $425,000 (heads of household). This rule would start after Dec. 31, 2031.

Qualified Small Business Stock (QSBS): The 100% exclusion applicable for gains of stock that qualify as QSBS (over 5-year holding, small company etc.) has been reduced to 50% if taxpayers' income is over $400k. This applies to sales after September 13, 2021.

Year-End Tax Planning

First and foremost, it is important to make sure that there have been ample taxes paid or withheld during 2021 to avoid any underpayment penalties. We refer you to the Tax Services page of our website (https://www.ffgwealth.com/tax-services/) to review the rules regarding estimated payment requirements.

Here are some other things to consider as we approach year-end:

Partners and S-Corp shareholders: Investigate if you should have the entity pay the state income tax associated with the flow through income from these entities.

Home Office Deduction: While employees are still disallowed from taking home office deductions, those that are partners for their firm (lawyers, CPAs, some investment advisors, etc.) may be able to deduct home office expenses to the extent their office was closed for all or part of the year.

Harvesting Unrealized Capital Losses: Review investment accounts and consider recognizing any capital losses by year-end. It's important to be aware of wash sale rules which means an investor cannot repurchase the sold position (or something "substantially identical") within thirty days.

Real Estate Tax: We would generally advise against prepaying the 2nd installment of your real estate tax bill until it is due next year.

Employer Benefit Plans: For those looking at their open enrollment for employer benefits, we favor maximizing the pre-tax contribution to FSAs for childcare costs. Also, we like medical plans that allow for HSA contributions which in some cases create a triple-tax-free savings vehicle (tax-deductible on the contributions, tax-deferred growth, and tax-free withdrawal if you used on qualified medical expenses).

Incentive Stock Options: For those with employer-granted Incentive Stock Options (ISOs), you should consider exercising a portion of those ISOs up to the point where your Alternative Minimum Tax (AMT) equals your regular tax. The fact that BBB did not impact cap gain tax rates means that these ISOs retain their enhanced benefits once the one-year holding period post-exercise and two year holding period post-grant are satisfied.

Roth IRA Conversion: As things stand for 2021, there remains the ability to convert all or part of an existing IRA to a Roth IRA. The amount converted would need to be recognized as income in the year of conversion. However, once in a Roth IRA, there are no more taxes to be paid on these funds, including the earnings that accumulate. Additionally, Roth IRAs are not subject to lifetime required minimum distributions (RMDs). This conversion can make sense under certain fact patterns (relatively low income in 2021, most of net worth in retirement accounts, tax on conversion paid with funds from other sources, etc.)

Donor Advised Funds (DAF): We favor setting up these accounts to manage almost all charitable giving for these reasons: (1) Funding a DAF with appreciated stock provides "tax-leveraged" charitable giving, (2) allows one to target the year of deduction when there is a max tax benefit, while retaining the timing control over ultimate distributions to charities, and (3) help organize charitable giving so deductions don't fall through the cracks and go unreported.

529 Accounts: Parents and grandparents should consider maximizing contributions to these accounts each year until the needed college funding is achieved. These accounts are like Roth IRAs and better than retirement accounts as income earned in these accounts can be completely tax-free if ultimately used on "qualified education expenses".

Annual Gift Trust for Children: To the extent cash flow allows, we favor setting up an annual gift trust for children. For this type of trust, you can designate any future age for the children to receive the funds. Making annual transfers to children, for a number of years, could allow for significant wealth transfer to the next generation, free from estate taxes.

Dealing with Highly Appreciated Concentrated Positions

Many of our clients are dealing with the enviable problem of holding appreciated investment assets. In some cases, these appreciated assets are concentrated in their employer equity which has accumulated as part of their compensation. While recognizing the need to at least partially diversify, the tax cost of selling these positions has many of our clients feeling locked in.

For our clients fully engaged in our financial planning services, our investment management team has developed a number of strategies to address this issue. They include the following:

Donor Advised Fund: Use some of these holdings to fund charitable giving as noted above.

Charitable Remainder Trusts: This strategy allows one to convert a low-basis equity to an ongoing income stream for their lifetime. It also provides a current tax deduction. To achieve these favorable results, the assets must eventually pass to a charitable organization.

Transfers to Other Family Members: In some cases, clients are able to transfer the low basis shares to others and have the recipient sell the stock at a very low tax cost. The kiddie tax rules must be navigated in this case.

Qualified Opportunity Zone (QOZ) Investments: These QOZ funds usually invest in a commercial real estate, solar/wind, or farmland development project. QOZs allow taxpayers to reinvest *just* the gain on a sale to an alternative investment, and defer the gain to 12/31/2026 if completed within 180 days of the original gain recognition. If the investment is made by year-end 2021, up to 10% of the original gain can also be eliminated outright. Further, if one meets the holding period requirements (10 years from original deposit into the OZ investment), the future appreciation from the QOZ may be-tax free. We have vetted a number of these investments that have a range of risk profiles and investment objectives.

Exchange Funds: We have arranged for some of our clients to exchange some of their appreciated stock into an investment partnership which contains a variety of other stock holdings. The contribution is tax free and the end result is that the taxpayer holds a diversified portfolio that mimics the performance of a broad index such as the S&P500 or the S&P1500. The partnership interest is usually held for eight years or so and then there is a distribution of shares in these other positions.

Construct Options Collars: Purchasing a put option is akin to buying insurance on the company stock. This would protect the downside movement below the strike price. One can at least partially cover the cost of this put by selling an out of the money call option at the same time. This action is what creates the "collar" temporarily capping upside appreciation and downside losses on the named security.

Variable Prepaid Forward (VPF): Like a cashless collar, a VPF includes buying a put and selling a call. In addition, the VPF is packaged with a loan for 80% to 90% of the value of the securities that will be sold in the future (typically in 2 to 5 years)

Sell once Long Term holding period reached: The previously mentioned strategies allow for diversification away from the concentrated position in a tax-efficient manner. In all cases, these strategies must be weighed against the simpler strategy of selling all or part of the position and paying the tax at what are historically low cap gains tax rates. This "simple sell" strategy has the benefit of not being burdened with heavy transaction costs and resets basis on the reinvestment proceeds to the new / current

value. Many deferral strategies, such as some of those outlined above, kick the tax can down the road and tax rates may be higher in the future when the gains are eventually recognized.

Sell-to-SMAs: For clients who gravitate toward a "simple-sell" plan, gain recognition can be offset to some degree with a conscientious tax-loss harvesting program when reinvesting proceeds from the sale of the concentrated position. We have partnered with multiple "tax-alpha-focused" separately managed account providers ("SMAs") who build broad-based index-style portfolios (both US & Foreign stocks) but with individual securities vs funds. To boot, we can overlay Environmental, Social, Religious, and/or Governance screens to build a portfolio that is not only more tax-efficient, but custom-aligned to a client's unique set of values.

Everyone's situation is different and often-times the solution is a combination of strategies. The follow-through then becomes figuring out how best to reinvest these proceeds in a manner that provides the desired diversification at the appropriate risk level. All of this, the tax planning, the estate planning, the portfolio management, and the long-term financial modeling is connected. Our ability to analyze and provide counsel in all these areas is where our value lies.

This memo is not intended to be comprehensive. Rather, we issue it to provide an overview of a variety of tax planning considerations. We stand ready to answer any questions and discuss how these items may apply to your particular situation.

/s/

Cooper & Vogelheim | Fiduciary Financial Group

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