Catherine:

Welcome to our podcast on financial planning. I'm Catherine Magana, a Certified Financial Planner™ professional. Today, we're going to focus on an important topic of financial planning, which is tax planning. Tax planning, we really look at financial situations from a tax perspective. We actually want to find an efficient way of using the tax code and look at financial planning, and they really do go hand in hand together. So we thought it was important for us today to cover the 2021 Biden tax plan and federal tax proposals. Even though there are several items that we're going to talk about today that aren't even approved yet, we thought it was important to start the conversation and start thinking ahead.

Catherine:

So we've collaborated with an enrolled agent and tax strategist, Rachel Ivanovich, with Easy Life Management, for today's talk. So thank you for joining us. We're really happy to have you here with us today. Let's go ahead and get started, and maybe we can talk a little bit about kind of some of the income taxes that may come up with these changes. Any thoughts on that?

Rachel Ivanovich:

Thanks, Catherine.

Catherine:

You're welcome.

Rachel Ivanovich:

Thanks for having me today. It's really great to be here. Honestly, like you said, these are proposals.

Catherine:

Yes.

Rachel Ivanovich:

Tax planning, as you said, is a very important topic, and I believe that a lot of people don't consider this until it's too late. So given that these are just proposals, I think it's really important also to differentiate between what has already been enacted and what is potentially coming down the pipeline at us. As you were saying, it's really hard for us to know, is it going to be next month? Is it going to be six months from now? Is it actually going to be retroactive, if it actually then does take effect before the end of the year? Let's just have a conversation kind of about what proposals are on the table.

Catherine:

Sure. No, I would agree. I mean, I think you get a lot of calls. I get a lot of calls, and everybody wants to know what should we be doing now.

Rachel Ivanovich:

Absolutely.

Catherine:

I think it is important to cover some areas that are critical or we think that might be servicing. One in particular, I think, that's come up is kind of the childcare tax credit. I think that's definitely something that's-

Rachel Ivanovich:

Absolutely.

Catherine:

... prevalent.

Rachel Ivanovich:

It's top of mind because the advance payments are starting to roll out this month. It's July of 2021. People are excited, a little extra cash in their pocket. We've been chatting with clients about does it make sense to take the money right now, or does it make sense... Because these are advance payments, and that's really important to understand, because if you take and receive the payment now, you won't be able to use that to offset tax next-

Catherine:

Later.

Rachel Ivanovich:

Yeah, next spring.

Catherine:

Oh, okay.

Rachel Ivanovich:

I think that's a really important factor for people to consider because you can opt out of receiving the advance payments. Why would you do that? I don't know. Honestly, I think a lot of people want to have the money, and it's going to stimulate the economy, they say. But at the same time, tax planning is what we're here to talk about. If you're thinking... currently for 2021 only, and this is already law, so we're going to talk about proposed versus actual.

Catherine:

Okay.

Rachel Ivanovich:

In the past, the child tax credit... there are two credits that were kind of on the table here. One is the child and dependent care tax credit, and the other is the actual child tax credit. In the past, the child tax credit was $2,000 per child, and it expired... Basically, you got the tax credit up until the child turns 17. So that's to differentiate between this new enhanced child tax credit that's on the table currently for 2021.

Catherine:

Got it.

Rachel Ivanovich:

So in the past, you'd get the $2,000 credit, a portion of which was considered refundable. The other portion is non-refundable. To explain the difference between those two and why it's important to understand why this is a great feature for the enhanced child tax credit. The refundable credit functions like a payment, whereas a non-refundable credit just reduces tax liability. Oftentimes, you'll have a tax situation and you're doing planning. If you're looking at what your tax liability is, that non-refundable credit would reduce your tax to zero, but then the remaining portion of the credit, if it's refundable, you'll actually get a refund.

Catherine:

Oh, okay. Excellent.

Rachel Ivanovich:

Okay? Yeah. There are two different kinds. This new enhanced child tax credit makes it completely refundable, so it's money in your pocket.

Catherine:

Nice. Definitely good to think about and know. Especially, like you said, down the line, if you're planning to do your taxes and if you've already taken the credit, then you don't want to do it twice.

Rachel Ivanovich:

Yes, absolutely. You're looking at the credit, and previously the credit was $2,000 per child. Now the credit is, if your child's under age six, you're getting $3,600, which is a great benefit. Then also, the enhanced child tax credit is $3,000, but it's up until age 17, including age 17. So I think this is a great benefit for families.

Catherine:

Another one that I've heard a lot about and it really affects some of the clients that are investing or have properties and investments are there's a long-term capital gains and dividends being taxed at ordinary income with taxable income over a million dollars. That's kind of a big deal.

Rachel Ivanovich:

It's huge. Yeah, it's huge. Okay, so just to differentiate, this is proposed.

Catherine:

Correct, yes.

Rachel Ivanovich:

Who knows what's actually going to happen? What I've heard is for individuals whose taxable income or income is under $400,000, there will be no changes. That's a sigh of relief for a lot of people, a lot of families. But if your income is over $400,000 and if you are approaching that million dollar mark, you definitely want to start thinking, "Should I start planning ahead?" Clearly, a lot of clients have called the office who have... they work for a corporation, they receive a large amount of their compensation as stock options. It may be time to diversify. Meet with a financial advisor and really look at your portfolio, and should I sell now?

Catherine:

Well, and some other things I was thinking about is perhaps between now and the end of the year, if it does come into play, then there's some tax loss harvesting. Are there things that maybe... Are there some losses that you can take?

Rachel Ivanovich:

Absolutely. It's definitely a really good time to meet with your financial advisor to look at your portfolio. Because, as you were saying, this proposed rate, they're looking to tax long-term capital gains and qualified dividends as ordinary income. What that translates into is currently there are three long-term capital gain rates or preferential rates. If you hold assets more than a year and a day, then the gains on those assets are taxed at lower rates. Therefore, currently, if you make less than $40,000, which you don't pay anything. There's a 0%. If you are up to, I want to say from 40-ish thousand to 446,000, if you're single, you're going to be paying 15% on those long-term capital gains and your qualified dividends.

Catherine:

Yikes.

Rachel Ivanovich:

Over that, it's 20%.

Catherine:

Correct. It's really those that make over a million that are really going to get dinged on this.

Rachel Ivanovich:

Yes, and really need to start planning and/or thinking about planning. Because the other thing that they're talking about, they've proposed, is bumping the highest tax bracket from 37% up to 39.6%.

Catherine:

Yeah, that's a big deal.

Rachel Ivanovich:

Yes. It is a big deal. Definitely want to look ahead and... It isn't law yet, but it's hard to say what's going to happen.

Catherine:

Yeah. Another one that comes up a lot is the tax gains at death for unrealized gains. Being above a million dollars, that you're now going to be taxed.

Rachel Ivanovich:

Yes.

Catherine:

Kind of taking a step back and know that, once again, this is being proposed, so it's not in effect yet.

Rachel Ivanovich:

Absolutely.

Catherine:

Currently, if somebody gets an inheritance, then there's a step up in basis, and they can use that step up or the six-month date of death valuation.

Rachel Ivanovich:

It is really important to look at this because they have put this on the table. It's hard to say if it's actually going to happen. But currently, as you were saying, the step-up in basis, they are talking about taking that off the table. The step-up in basis is if you hold assets and you bought it for, I don't know, $5 a stock, and now it's worth $100 when you pass away, whoever inherits it, their basis or what their investment in it is that date-of-death value. They're thinking of taking that off the table.

Catherine:

Which is a big deal.

Rachel Ivanovich:

It's a big deal.

Catherine:

Once again, so the new proposal then is if it's over a million dollars, then at that point, they're going to be taxed.

Rachel Ivanovich:

Correct. Then there are a couple of different proposals that I've heard, and therefore, that's why it's really hard to do the planning and to dig into it. I guess at the end of the day, the question is, well, what should I do now?

Catherine:

Yeah.

Rachel Ivanovich:

As you mentioned previously, tax loss harvesting and really taking a hard look at your portfolio and looking at what is in there. Is it diversified? What can I do based on the current law? Because even though they're proposing certain things, it doesn't necessarily mean it's going to come to fruition. I mean, also they've thrown out 1031 exchanges may go away.

Catherine:

Yeah, I saw that or over $500,000.

Rachel Ivanovich:

Correct.

Catherine:

Which is another big deal-

Rachel Ivanovich:

It's huge.

Catherine:

Because a lot of people have real estate, and they're doing 1031 exchanges. So once again, here we are.

Rachel Ivanovich:

The question is should I sell? Should I do a 1031? So a 1031, for those of you who aren't familiar, is if you hold rental real estate and you have appreciated a property and you sell at a gain, you can buy another rental property, which is like-kind... They're sometimes called like-kind exchanges.

Catherine:

Correct.

Rachel Ivanovich:

It's been a great tax planning tool for those who own real estate.

Catherine:

A lot of people own real estate-

Rachel Ivanovich:

Yes.

Catherine:

Especially real estate's gone up so much in value.

Rachel Ivanovich:

Absolutely.

Catherine:

So that's a really, really big deal.

Rachel Ivanovich:

Yes.

Catherine:

The other thing that kind of comes to mind with some of these potential proposals are revisiting maybe life insurance or your estate plans.

Rachel Ivanovich:

Yes, absolutely.

Catherine:

Those are some areas I think that can be looked at. Perhaps we can talk a little bit about kind of the estate planning aspect of some of the proposals.

Rachel Ivanovich:

Estate planning is definitely a topic that people should be considering right now, even if the proposals that are currently on the table don't go through the current lifetime exemption. Every individual has what's called a lifetime exemption, which is $11.7 million. Current law is it will go down at the end, or what they're saying, the language is it's going to sunset back to pre Tax Cuts and Jobs Act, which was the end of 2017. It's supposed to go from $11.7 back down to

$5 million. What's on the table currently is that it'll even go down further to $3.5 million. Definitely looking at different planning tools and charitable remainder trusts.

Catherine:

I think one of the things that... Yeah, grantor remainder trust.

Rachel Ivanovich:

Exactly.

Catherine:

One of the things that we often see is the annual gifting. So the $15,000 per donee per year, and if you're married, then you can give-

Rachel Ivanovich:

30.

Catherine:

... up to 30. I think those are some things that may be revisiting.

Rachel Ivanovich:

Those are absolutely huge to consider right now, is to really look at that $15,000 annual exclusion. There's zero reporting requirements for that. As you mentioned, you can give $15,000 to any one individual. A lot of people should be thinking about 529 accounts, which are a great, great investment tool. They're governed by gift tax rules, meaning you can put up to $15,000 per individual per year. You don't have to file a gift tax return for that. So definitely something-

Catherine:

Yeah, 529 plans, especially of those that have grandkids or even kids or want to gift money-

Rachel Ivanovich:

Yes, nieces and nephews.

Catherine:

Yes, and it grows tax deferred-

Rachel Ivanovich:

Tax free.

Catherine:

And it comes out tax free if they use it for education.

Rachel Ivanovich:

Exactly, yeah.

Catherine:

There's definitely some amazing benefits there.

Rachel Ivanovich:

What I've also heard, and I don't know if this is... Well, clearly proposed. I mean, I've heard so many things, but I have heard that large gifts... It may be a good time to be considering larger gifts at this point, because if you look at gift and estate tax planning over the years, you'll have that lifetime exclusion amount and the gift... Or if you make a large gift, if it is over the $15,000 annual exclusion where there is no reporting requirement, it'll just carve away from your exclusion. I have heard that those large gifts, that if you give them pre American Family Plan actually being enacted, you may be grandfathered in under the old rules. I do think that's something to consider if, if you're thinking about making a large gift to a family member or a child.

Catherine:

I know we talked a lot about the unknowns, and we're getting a lot of questions, and we do think, yes, we want to plan ahead. I know I'm a planner. You're a planner.

Rachel Ivanovich:

Yes.

Catherine:

It is hard when we don't have the actual information or know for sure.

Rachel Ivanovich:

Absolutely.

Catherine:

A lot of things might get retro or grandfathered and we don't know. In the past, we've also seen things get approved last minute, and so I think it's just being mindful of what's to come. Are there some things that perhaps you may want to do, maybe along the way as you know things might come down the line? But part of this is also maybe planning, but then waiting to see what comes up.

Rachel Ivanovich:

Absolutely. As we all know, there are certain tools that are already in place that you can use. You can plan for Roth conversions. I think it's a case-by-case situation. Every individual really wants to look at if you have money in an IRA account, is this a good year to do a conversion?

Catherine:

I absolutely love Roth conversions as well. Once again, it is case by case, but for those that are potentially in some gap years for retirement or collecting Social Security or Medicare and just different things that perhaps you factor that in. I think it is... there is potential ways to reduce your... taxes now than later.

Rachel Ivanovich:

Absolutely. Yeah, and maybe if your businesses is having a down year, it might be a good year to consider that as well, to do that conversion in a year when your income's a little bit lower.

Catherine:

Is there anything else that we didn't touch on that maybe-

Rachel Ivanovich:

We didn't mention the net investment income tax, because that is something that you can plan for. I do think that working with a tax advisor, a tax strategist, working with your financial advisors, because as we were saying, the long-term capital gains rates currently do have that preferential treatment of the lower rates. If that does go up to be taxed as ordinary income, you're not only looking at the 39.6%, but you've also got the additional 3.8 net investment income tax to consider. And if you're in a high income state, such as California, New York, New Jersey, you may be paying 51% in taxes on long-term capital gains and qualified-

Catherine:

That's a big change from what we're used to.

Rachel Ivanovich:

It's a huge change. If you actually look, that would put the United States as the highest, yes, country in the world for-

Catherine:

For gains?

Rachel Ivanovich:

... for long-term capital gains.

Catherine:

Oh, interesting.

Rachel Ivanovich:

Yeah, it was very interesting for me to see. It's hard to say what's going to happen.

Catherine:

Yeah. Well, I thought today we wanted to talk a little bit about tax planning. Once again, doing financial plans, it all goes hand in hand. Rachel, thank you for your time today.

Rachel Ivanovich:

Absolutely. It's my pleasure.

Catherine:

Is there a way that people can contact you if needed? Do you have a phone number, email or anything?

Rachel Ivanovich:

Absolutely. They can reach out to me at Rachel@elmtax.com or they can call me at my office 760-730-1817.

Catherine:

Great. Well, thank you so much for joining us today. We hope you learned something and it was worthwhile for you. Thank you, and you'll hear from us again. Thanks.

Rachel Ivanovich:

Thank you.