2020 Tax Savings Strategies

As 2020 comes to an end and the presidential election is behind us, we are still left with the uncertainty of how the Senate will be controlled due to the two run-off elections in Georgia in early January 2021. If the House and Senate are dominated by Democrats, then taxpayers will most likely see the tax reforms as proposed by President-elect Joe Biden. However, if Republicans retain control of the Senate, then our tax policies will most likely remain unchanged.

While political outcomes are in flux, considering these tax strategies at the end of the year may positively impact your tax liability. Rockland Trust Investment Management Group's Vice President and Manager of Tax Services, Rita Yeung, CPA outlines four tax savings strategies that you may want to consider before year end.

Consider a Roth IRA Conversion

What is certain is that we are currently still at a relatively low income tax bracket and many of the temporary tax changes brought by the Tax Cuts and Jobs Act in 2017 will expire by end of 2025. Taxes are expected to increase for the high-net worth taxpayers at that point if no further tax cuts are enacted. With the possibility of tax rates increasing in the future, you may consider accelerating your income and deferring expenses to future years. Under the CARES Act, taxpayers with defined-contribution retirement plans are exempt from taking their required minimum distributions (RMD) for 2020. For those who are choosing not to take the distribution this year, you may find yourself in a lower tax bracket. If this is the case, it might be a good opportunity to consider a Roth IRA conversion to fill up the lower tax bracket. Typically, taxpayers who have RMDs are not allowed to do a Roth IRA conversion until the RMD is taken. In such a case, taxpayers would be faced with a hefty tax bill when RMDs are required and doing a Roth conversion in the same year.

Increase Your Charitable Contributions

Historically, a charitable deduction is only included as part of an itemized deduction. If it's more advantageous for the taxpayer to take a standard deduction instead, then the value on the charitable donation deduction will be lost. For 2020 however, under the CARES Act enacted by Congress as part of the stimulus package, taxpayers are allowed to take an additional deduction on their charitable donations to qualified charities up to $300 per taxpayer ($600 for married couples), even if they only take the standard deduction. Keep in mind that donations made to Donor-Advised Funds[1] will not be considered as part of this additional deduction. Additionally as part of the CARES Act, donors who take the itemized deduction are allowed to deduct up to 100% of their adjusted gross income (AGI) for cash donations made to public charities in 2020. Previously this deduction was limited to 60% of their AGI.

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1. Donor Advised Fund Definition: "A separately identified fund or account that is maintained and operated by a section 501(c)(3) organization, which is called a sponsoring organization. Each account is composed of contributions made by individual donors. Once the donor makes the contribution, the organization has legal control over it. However, the donor, or the donor's representative, retains advisory privileges with respect to the distribution of funds and the investment of assets in the account." Source: IRS

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Take Advantage of Estate Planning/Wealth Transfer Opportunities

The Federal Reserve has lowered interest rates to an exceptionally low level as a way to help stimulate the economy and help it recover from the pandemic. With these low rates continuing for the foreseeable future according to the Federal Reserve, now might be a good time to take advantage of estate planning/wealth transfer opportunities. For example, instead of gifting money directly to family members, one may choose to set up an intra-family loan instead. In order for it not to be considered as a gift, the interest on the loan must meet the minimum "applicable federal rate" as mandated by the IRS. The borrower can then use the borrowed funds to invest. As long as the rate of return on the invested funds exceeds the interest rate on the loan, the excess return will pass to the borrower free of gift or estate tax. For those who have previously set up intra-family loans, they should review the terms on the current loans and consider amending them to capture the reduced rate.

Trust in a GRAT

Another wealth transfer technique that is worth exploring during this low interest rate environment is a Grantor Retained Annuity Trust (GRAT). A GRAT is an irrevocable trust in which the grantor transfers value appreciating assets into the trust. In exchange, the grantor would retain the right to receive annuity payments throughout the term of the trust equal to the approximate present value of the assets contributed, plus rate of return as specified by the IRS when the trust is funded. At the end of the term, the remaining assets in the GRAT will pass to the designated beneficiaries, free of gift tax. The rate of return specified by the IRS is linked to the market yield on U.S. government-issued debt, which is largely determined by the Federal Reserve's monetary policy. The GRAT will be considered successful as long as the asset appreciation and income generated by the contributed assets is greater than the IRS discount rate. Because of the historically low rate we currently have (0.6% for December 2020), this wealth transfer technique is even more favorable now and easy to achieve.

These tax strategies and others can be complex. As a result, we encourage you to review any tax strategies you are contemplating with your IMG Relationship Manager and your tax professional prior to executing.

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