Individuals

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Topics For Today

- Breaking news!
- Stock compensation planning
- Sale of real estate
- Planning for charitable gifts.
- IRAs
- Self-employed retirement plans.

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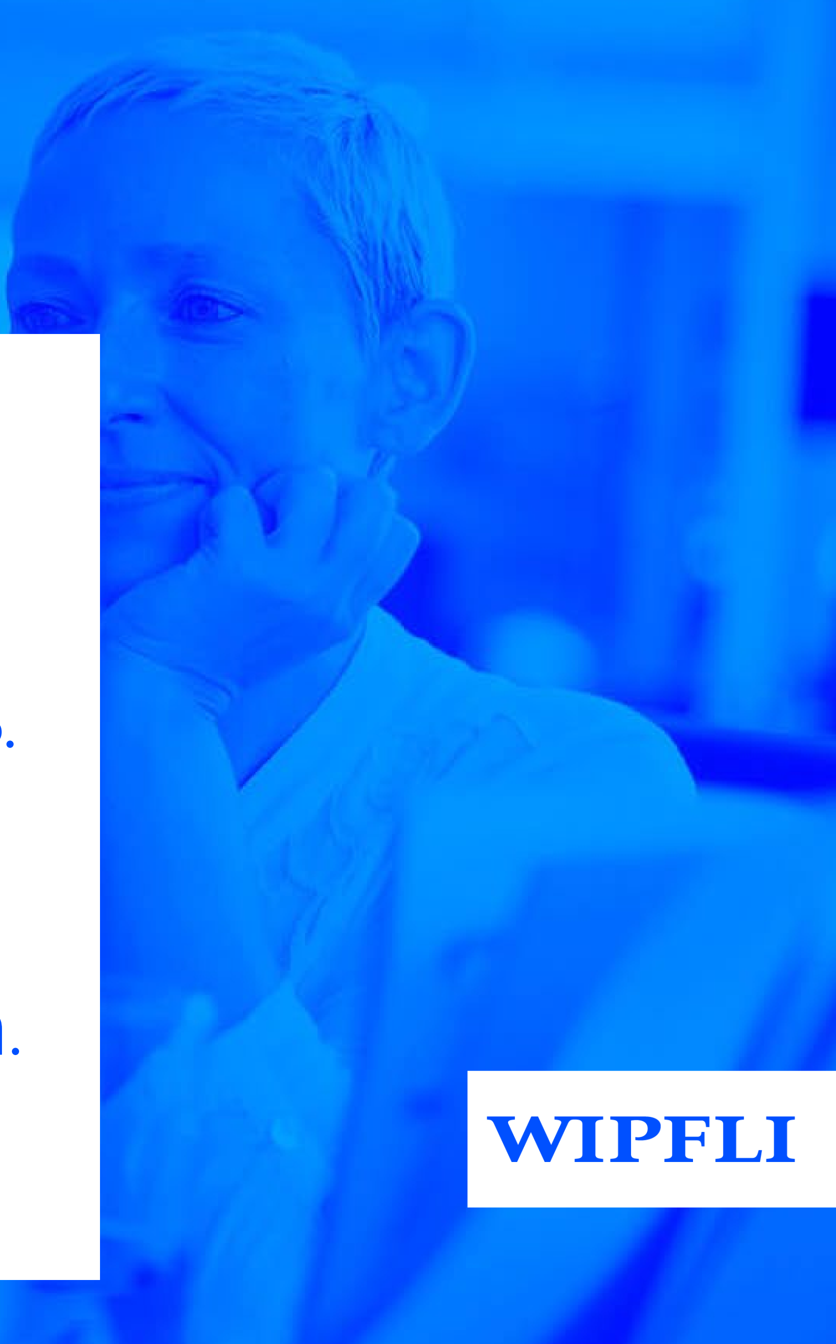
BREAKING NEWS!!!!!



Form 7203 – S Corp basis

- Draft forms and instructions issued by IRS.
- Will be required for individual returns. (Basis calc is shareholder responsibility.)
- Keep checking KMS for more information.

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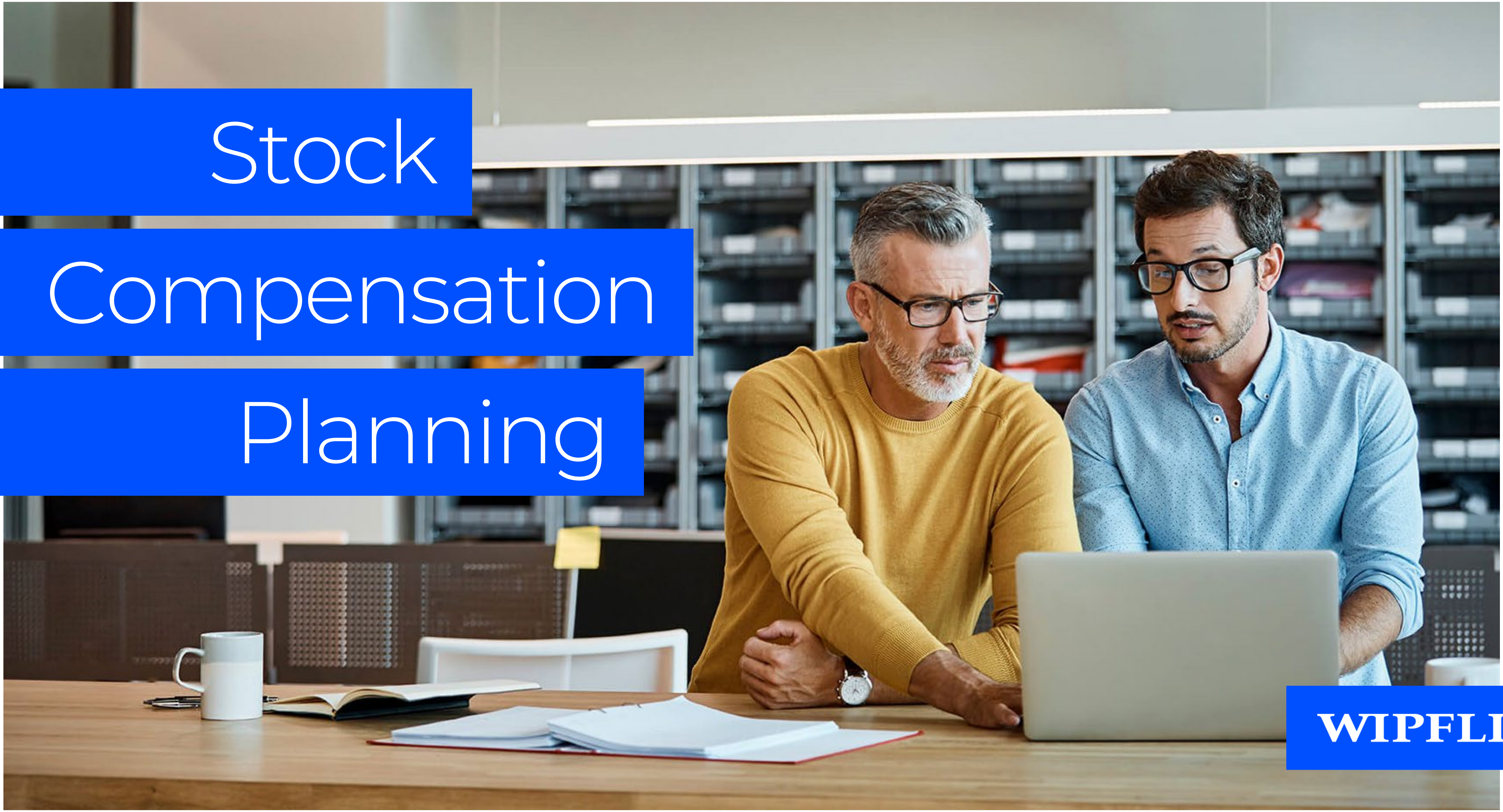
Stock Compensation Planning



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Stock Option Strategy Considerations

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Risk Reduction

- Exercise + Hold
- Exercise + Sell to Cover

Liquidity

- Exercise + Sell
- Tandem Exercise

Tax Minimization

- Exercise + Hold
- Stock swap
- 83(b) election
- Gifting
- CLAT

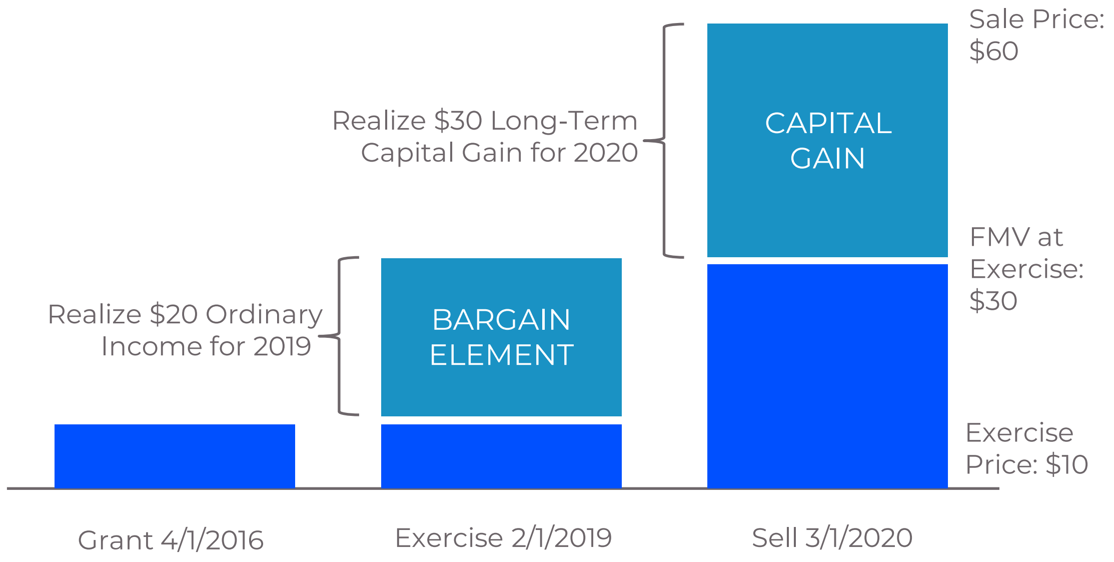
Wealth Accumulation

- Delay: continue to hold
- Exercise + sell to cover
- Stock swap
- Family gifting

Investments and Wealth Institute

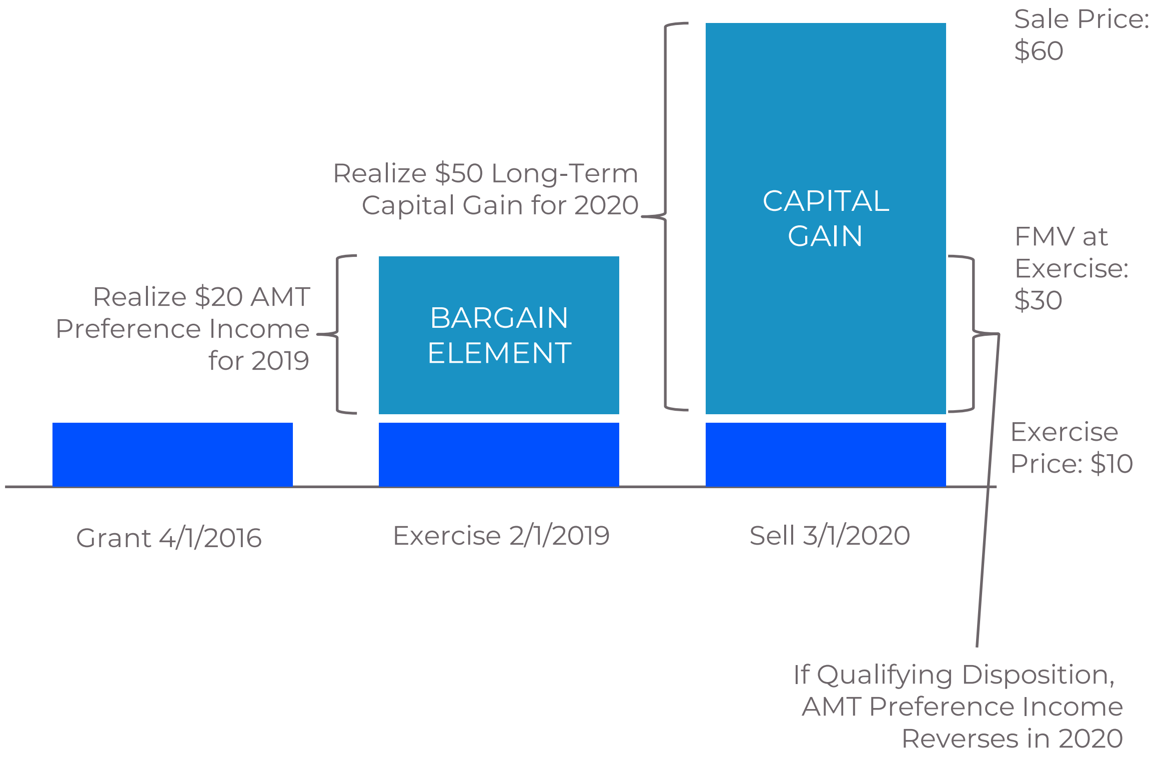
Quick Review: NQSO vs ISO

Non-Qualified Stock Option



Quick Review: NQSO vs ISO

Incentive Stock Option



ISO Holding Period Requirements and Types of Dispositions:

Qualifying Disposition: sale of ISO stock at least 2 yrs after the grant date and 1 yr after the exercise date.

Disqualifying Disposition: sale of ISO stock that does not Meet the holding period requirements above. ISO tax treatment is ordinary if a disqualifying disposition.

Timing considerations & strategies

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Consideration	Delay Exercise	Exercise + Sell	Exercise + Hold
Time to expiration	✓	✓	✓
Perceived stock price	Client may view shares as undervalued (NQSO)	Client may view shares as fairly valued or overvalued	Client may view shares as undervalued (ISO)
Liquidity needs	✗	✓	✗
Current liquidity to exercise/pay tax	✗	✓	✓
Comfort level with exposure to stock	Comfortable	Uncomfortable	Comfortable
Portfolio diversification	Diversified	Not diversified	Diversified
Tax situation	Avoid income / anticipating future tax rate decrease	Add income / anticipating future tax rate increase	Add income

Restricted Stock & Restricted Stock Units

Restricted Stock

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- Restricted stock is stock that is subject to certain restrictions,
- On the date restricted stock is granted, the employee becomes the owner of record of the restricted stock.
- Restricted stock vests (lapse of repurchase right) based on continued service or employment.
- No tax on grant if unvested, BUT in the year the restricted stock vests, the employee must include as ordinary income
- 83(b) election
  - For an employee at fast growing company, paying tax as the shares vest could be an insurmountable financial obligation if value of the shares increases over time.
  - If employee files 83(b) election, employee is taxed on spread at grant ; rather than spread on each of the vesting dates
  - 83(b) election is sensible choice if value is low and no liquidity
  - Timing of election is critical.

Restricted Stock Units (RSUs)

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- An RSU is the **right to receive** from the company, after vesting, a specified number of shares of common stock
  - RSUs can be settled in cash
- If **the employee fails to satisfy the vesting requirements, the RSU is simply forfeited** .
- If the employee satisfies the vesting requirements, the company issues shares of common stock following the vesting date, referred to as "settlement"
- A holder of an RSU is not the beneficial owner of the underlying shares. Property is not transferred when an RSU is granted and the RSU is not taxed until the RSU vests and is settled
- RSUs are generally taxed at ordinary income rates on settlement (employer withholds taxes)
- A subsequent sale of the shares is eligible for long term capital gain treatment if shares are held for 1 more year or longer (only on increase in value after settlement)
- <u>No 83(b) election is possible because property is not considered to be transferred at the time an RSU is granted</u>

2021 Planning Considerations

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- Stock compensation for C-corps
  - Proposal to end or limit capital gain exclusion under §1202 for Qualified Small Business Stock.
- Stock options
  - Proposal to tax capital gains at ordinary income tax rates could result in reduced tax efficiency of stock options as a form of compensation.

Sale of Real Estate by Individuals

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Real Estate Held by Individuals

Principal Residence

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- The residence where the taxpayer spends most of their time.
- When taxpayer has more than one residence, other factors are considered.
  - Address attached to:
    - voter registration records
    - USPS records
    - Tax returns
  - Address is near taxpayer's work, bank, or family members.

Vacation Home

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- Real estate owned by the taxpayer that is not their personal residence but is also used by the taxpayer during the tax year.
- Taxpayer uses property for the greater of:
  - 14 days
  - 10% of total days the property is rented to others at a fair market price

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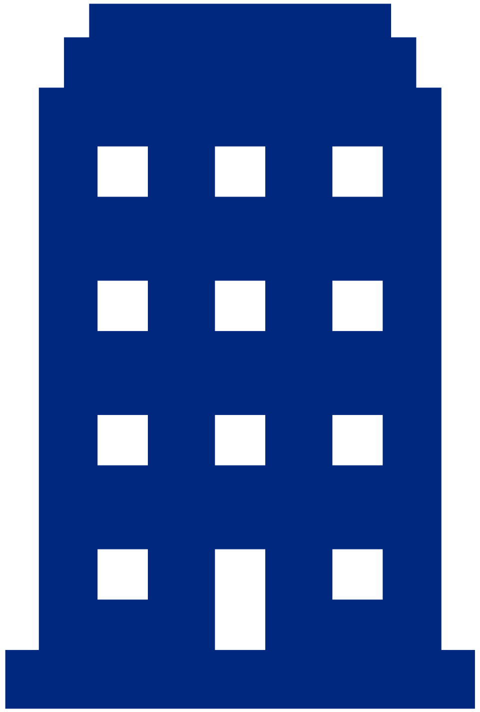
Rental Property

- Real estate taxpayer owns but does not use personally:
  - Held exclusively for the use of 3rd parties
  - Renters pay a fair market price



Real Estate Deductions

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- Principal Residence
  - Property taxes, subject to $10k SALT limit (Sch A)
  - Mortgage interest, subject to $750k indebtedness limit (Sch A)
- Vacation Home – Not Rented
  - Property taxes, subject to $10k SALT limit (Sch A)
  - Mortgage interest, subject to $750k indebtedness limit (Sch A)
- Vacation Home – Rented
  - Depreciation & expense generally allowed but may be pro-rated or limited to the amount of income produced
- Rental Property
  - Depreciation & expenses allowed but may be subject to passive activity limitations (Sch E)

Tax Treatment of Real Estate Sales

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Overview of Tax Treatment

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How the taxpayer holds the real property determines the tax treatment at the ultimate disposition.

Principal Residence

All or a portion of the net gain on the sale may be excluded. Any loss is disregarded as a personal loss.

Gain Exclusion

Vacation Home

If the property was rented prior to sale, may be treated as a rental. If not, the sale results in capital gain and no loss is allowed.

Rental or Not

Rental Property

§1231 gain or loss is recognized on the sale but depreciation taken in the past may need to be "recaptured."

Depreciation Recapture

Sale of Principal Residence

Sold at a gain

- May be eligible for capital gain exclusion - $250,000 single / $500,000 married filing jointly.
- Requirements for exclusion:
  - Property not acquired through like-kind exchange
  - Taxpayer not subject to expat tax
  - Taxpayer(s) owned <u>and</u> resided in property for 2 of the last 5 years*
  - Exclusion has not been used in the last 2 years

Sold at a loss

- Treated as a non-deductible personal loss

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Sale of Vacation Home

Property Never Rented

- Gain is treated as capital gain but is not eligible for §121 gain exclusion.
- Loss is treated as a non-deductible personal loss.
- If the property was held only for investment purposes, the loss becomes a deductible capital loss.

Property Was Rented

- Property is treated as rental property and is subject to depreciation recapture rules under §1250.
- Results in §1231 gain and loss.

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Sale of Rental Property

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- Results in §1231 capital gain and loss
- Sale is subject to §1250 depreciation recapture rules
  - Sales proceeds > original acquisition cost
    - All allowed depreciation is first considered §1250 gain, taxed at 25% rate
    - Remaining gain is considered capital, taxed at regular capital gain rates
  - Sales proceeds = original acquisition cost
    - All allowed depreciation is considered §1250 gain, taxed at 25% rate
  - Sales proceeds < original acquisition cost
    - Loss on sale that can be deducted from your ordinary income – no recapture
- Note that though taking a depreciation deduction is optional, depreciation recapture is based on the deduction <u>allowed</u>, not the deduction taken.

2021 Planning Considerations

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- Establishing new state of residency
  - Some clients may be relocating to lower cost states as a result of new hybrid work environments.
  - Rules for determining principal residence can also help substantiate change of residence.
- Higher tax costs for large sales
  - $250,000 single / $500,000 MFJ gain exclusion is often insufficient in highly appreciated markets like California.
  - Proposed changes to tax treatment of capital gains could result in pricey tax bills for home sellers.

Planning For Charitable Gifts In 2021

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CARES Act Provisions Carried Forward

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Above-the-line deduction

- Adjustment to AGI allowed for taxpayers making cash contributions to public charities
- New in 2021 - Higher maximum for MFJ filers!
  - $300 max for single filers/MFS
  - $600 max for MFJ filers
- Only applies to donations of cash

100% AGI Limit

- Charitably minded taxpayers can now deduct up to 100% of AGI using charitable gifts
  - 100% limit only applies to cash gifts made to public charities
  - Ordering rules apply for donors making gifts of both cash and other property (including appreciated securities)
  - Will not eliminate NIIT, if it applies

Overview of Charitable Contribution Options

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Charitable Gifting Options

Cash – 100% AGI limit, but requires significant liquidity

Securities – 30% AGI limit and avoids recognition of built-in capital gains

Property – up to 30% AGI limit and avoids recognition of built-in capital gains

QCDs – $100k annual limit and avoids recognition of ordinary income; client age 70 ½ or older

Donor Beware – Common Mistakes

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- Qualified charitable distributions (QCDs) can only be made from traditional IRAs – not Roth IRAs, not 401(k) or 403(b) accounts
- DAFs, private foundations, and supporting organizations are not eligible to receive QCDs.
- Property held at a loss should not be donated to charity
  - Selling the asset instead would potentially generate a deductible loss
  - Sell the property to record the deductible loss, then donate the cash proceeds
- Donations of property valued in excess of $5,000 require an appraisal – be sure your client understands this requirement **BEFORE** the property is donated! Appraisal requirement does not apply to marketable securities.

2021 Planning Considerations

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- Donations to donor-advised fund (DAF)
  - 100% AGI limit for cash donations specifically excludes gifts to DAFs.
  - Contributions made through to DAFs should use appreciated securities whenever possible.
  - Consider making larger gifts in 2021 to avoid proposed ACE Act rules.
- Combine estate planning and charitable goals
  - Potential changes in the lifetime limit for estate and gift taxes are prompting clients to revisit estate plans.
  - Work with client's attorney and financial planner/advisor to devise a tax-efficient gifting program that complements their estate plan.

Individual Retirement Arrangements (IRAs)

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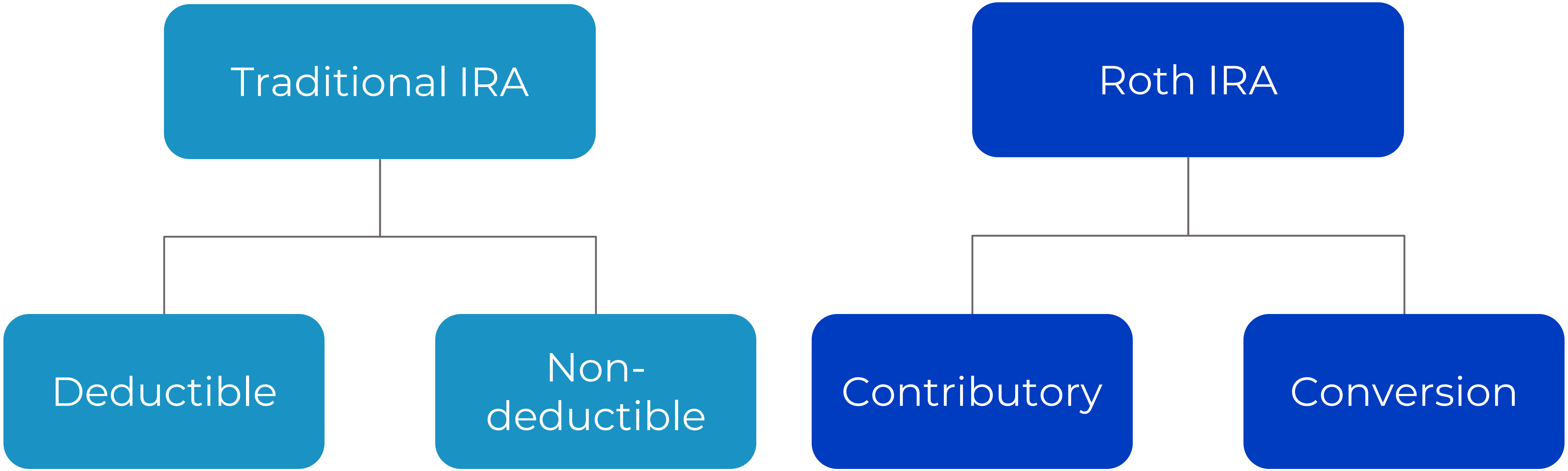
Brief Review of IRA Terms



IRA Restrictions & Limits

- Taxpayer or spouse must have earned income
- Contribution limited to the lesser of $6,000 or earned income
- $1,000 catch-up contribution allowed for savers age 50 and older
- Contributions can be made up to the unextended tax deadline (i.e., April 15 in most years.)
- Distributions made before 59 ½ may be subject to early withdrawal penalty

Traditional vs. Roth

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- Traditional IRA
  - 1040 adjustment allowed for contribution to traditional IRAs, subject to AGI limits
  - Deduction is phased out
    - Single - $66,000 - $76,000
    - MFJ - $105,000 - $125,000
  - Above the phase out range, taxpayers can still make contributions but will receive basis in the contributions in lieu of a 1040 adjustment

- Roth IRA
  - No 1040 adjustment for these contributions
  - Direct contributions to Roth IRA no longer allowed after certain AGI levels
    - Single - $140,000
    - MFJ - $208,000
  - Taxpayers over the AGI limit may choose to pursue a backdoor Roth strategy

Backdoor Roth Mechanics

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Taxpayer transfers up to the annual contribution limit ($6,000) in cash to the traditional IRA.

Backdoor Roth Mechanics

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Bank Account

Traditional IRA
$6,000

Roth IRA

No 1040 adjustment is allowed and the taxpayer receives $6,000 of basis in the contribution.

Backdoor Roth Mechanics

After a short time passes, the balance of the traditional IRA is transferred to the Roth IRA using a conversion.

Backdoor Roth – Common Mistakes

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- The contribution to the traditional IRA and subsequent conversion to Roth should occur in the same <u>calendar</u> year.
  - This reduces earnings on the contribution that may be a taxable distribution.
- Only works if no other IRA balances. Otherwise only a portion of the basis from the current-year contribution will be allocated to the converted amount.
- Return Preparers – if you see a 1099-R for $6,000 or $7,000, or an amount very close, ask the client if a backdoor Roth conversion was made.

Backdoor Roth – Common Mistakes

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- Accidental conversions
  - Taxpayers executing their own conversions without the supervision of an advisor can and have accidentally converted an entire IRA balance .
  - There is no longer any way to remedy the accidental conversion of an entire IRA balance

Self-Employed Retirement Plans

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Types of SE Retirement Plans

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SEP-IRA	SIMPLE	Solo 401(k)
Contribution limit = the lesser of 25% of compensation and $58,000	Contribution limit = the lesser of 100% of compensation and $13,500	Contribution limit = the lesser of 100% of compensation or $58,000

2021 Planning Considerations

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- Proposed forced distributions from large IRAs
  - Taxpayers with accumulated qualified retirement savings in excess of $10M may be forced to pull money from the accounts in 2022 or later.
  - 2021 may present an opportunity to execute Roth conversions.
- Redepositing Coronavirus-related distributions (CRVDs)
  - Taxpayers who made use of the CARES Act provisions regarding Coronavirus-related distributions have the right to redeposit monies withdrawn.
  - Taxpayer may have made an election to be taxed on distributions in Year 1 or by default spread the tax over Years 1 through 3.
  - May need to file an amended return to recoup taxes paid.