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Fall 2021 Special Tax Newsletter

I hope you had a good Thanksgiving weekend and are getting used to the cold (if you are in a northern climate.)

In this special tax newsletter, I want to address a few time sensitive issues caused by some pending legislation. The House on November 19, 2021, passed the Build Back Better Act. This legislation has not yet been acted on by the Senate and based on historical precedent any such action is unlikely until late December. If the legislation passes in late December and is signed into law, there will be little time to act in 2021. Therefore, I want to bring the following to your attention now.

State and Local Tax Deductions

One of the negative aspects of the 2017 tax bill was the limitation on the deduction of state and local taxes (also known as SALT.) The 2017 tax bill limited the SALT deduction to no more than $10,000 per taxpayer per year. The SALT taxes most often paid are state and local income taxes and real estate taxes. This limitation, along with the higher standard deduction, made it difficult for many taxpayers to get any tax benefit for the payment of these SALT taxes.

The House version of the Build Back Better Act increases the limitation on SALT deductions from $10,000 to $80,000 effective beginning in 2022. Therefore, it may make sense for taxpayers to defer some of their 2021 real estate taxes and estimated tax payments to 2022. Here are some guidelines:

Real Estate Taxes

If you paid your 2020 real estate tax bill in 2020 and you live in Wisconsin, I would suggest paying $2,500 of your real estate tax bill in 2021 (in order to get the $300 Wisconsin real estate tax credit) and the balance in 2022. This MAY allow you to get a tax benefit in 2022 for the amount paid in 2022, if the limitation on SALT is increased.

If you paid your 2020 real estate tax bill in 2020 and you do NOT live in Wisconsin, I would suggest paying your entire 2021 real estate tax bill in 2022. Again, this MAY allow you to get a tax benefit in 2022 for the amount paid in 2022, if the limitation on SALT is increased.

If you paid your 2020 real estate tax bill in 2021, then I would suggest paying your 2021 real estate tax bill in 2022, no matter where you live. If you are in Wisconsin, the payment of your 2020 real estate tax bill in 2021 will qualify you for the $300 credit.

2021 Fourth Quarter State Estimated Payments

If you make estimated payments for state taxes, you generally should pay your fourth quarter tax payment (due January 15th) in 2022, rather than 2021, for the same reasons listed above.

"Back Door" Roth IRA Contributions/Conversions

The following discussion will apply to some, but certainly not all clients. This discussion applies to you if you make after-tax contributions to a Traditional IRA because your income is too high to contribute to a Roth IRA, or if you make after-tax contributions to a 401k or 403B plan. This after-tax contribution to the Traditional IRA/401k/403B is often soon followed by a conversion of those after-tax dollars to a Roth IRA and is referred to as a "back door" Roth conversion.

One of the provisions in the Build Back Better Act is the elimination of conversions of AFTER-TAX IRA/401k/403B balances to a Roth IRA/Roth 401k/Roth 403B. This is the essence of the "back door" Roth conversion. The bill also limits, but does not eliminate, the ability to convert PRE-tax dollars to Roth IRAs. That is not what we are talking about here. We are discussing the conversion of after-tax, and only after-tax IRA/401k/403B contributions.

IF you have made an after-tax contribution to your Traditional IRA in 2021 (or prior years) and you normally convert that to a Roth IRA, it would be a good idea to check your Traditional IRA to ensure that you do not have any after-tax contributions still sitting in a Traditional IRA. This would generally be a $6-7,000 per year amount. If you have made non-deductible IRA contributions to a rollover IRA (which also contains pre-tax contributions) then this does not apply to you.

IF you find that you have a Traditional IRA balance of $6,000 or $7,000 and you should have previously converted that Traditional IRA to a Roth, you need to do so as soon as possible. If this is NOT done by 12/31/2021 and if the legislation in question is enacted into law, you will have that after-tax money stuck in your IRA and you likely will not be able to get it out for many years to come.

If you make after-tax contributions to a 401k or 403B and have the ability to do an "in plan Roth conversion" of those after-tax contributions, you should ensure that any and all after-tax dollars that can be converted to Roth are converted to Roth by 12/31/2021.

There are many other tax provisions in the Build Back Better Act, but these two issues seem to be the ones that may demand immediate action.

I plan to communicate with clients again in early 2022 regarding the status of this legislation.

I hope you have found this helpful. Best wishes for a safe and healthy holiday season.

Eric
Eric S. Korbitz CPA/PFS, CFP®
Korbitz Financial Planning LLC