2020 Year-End Tax Planning for Aerospace & Defense Industry Executives

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2020 has been anything but a normal year and fortunately there are also unique tax and retirement planning opportunities to be aware of for Executives in the Aerospace & Defense Industry.

Below are 5 of the best ideas to use **BEFORE** the end of 2020:

1. ***Changes to Required Minimum Distribution (RMD) Rules***
2. ***One-time Charitable Donation Opportunities and Qualified Charitable Donations***
3. ***Strategies for Restricted Stock Units (RSUs)***
4. ***Roth IRA Conversions and the Elimination of Stretch IRAs***
5. ***Historically Low Interest Rate Opportunities for Gifting/Estate Planning***

Changes to Required Minimum Distribution (RMD) Rules

Many retired executives that we work with live comfortably on their pensions and consulting jobs and do not need to start taking distributions from their IRAs until they are required by the IRS.

The SECURE Act was signed into law last December and changed the age when RMDs begin from 70 ½ to 72. So, beginning this year, anyone reaching age 72 is required to take their first RMD by April 1st of the following year.

Anyone who turned 70 ½ this year can wait. However, if someone turned 70 ½ last year **BEFORE** the SECURE Act took effect, their RMD was due by last April 1. Oops! And, if they wait until April 1st of the year after they turn age 72 to start their RMDs, there could be a 50% penalty due on three years of RMD distributions. 3X Oops!

That is the Bad News, the Good News is that RMDs for 2020 have been waived by the CARES Act to provide economic relief to those affected by the Coronavirus. However, following the example above, if future RMDs are missed, then the IRS has the option to waive the 50% penalty provided the taxpayer reaches out to the IRS and explains their mistake was the result of a "reasonable error" and they are taking "reasonable steps" to make good on the missed payments.

The first step is to take the missed distribution as soon as possible and then self-report by filing IRS form 5329 for each of the years that a distribution was missed. It is especially important that this be done **BEFORE** the IRS discovers the error as they may be far less understanding if they find it first!

One-time Charitable Donation Opportunities and Qualified Charitable Donations

Another provision of the CARES Act is the new $300 per taxpayer ($600 for a married couple) additional charitable gifting exclusion from income, i.e. "above the line" deduction, for those who do not itemize deductions. This means that taxpayers who take the standard deduction can still write off up to $300 for donations.

And for anyone that is 70 ½ and over, charitable contributions made directly from their IRAs are done with ZERO tax cost. These Qualified Charitable Donations (QCDs) allow the use of both the standard deduction and an exclusion from income which reduces Adjusted Gross Income (AGI) that is used to calculate taxes on Social Security and surcharges for Medicare Parts B and D income-related monthly adjustments.

Strategies for Restricted Stock Units (RSUs)

Many Aerospace & Defense executives receive RSUs as a performance reward that need to be included in the year-end tax planning process especially if income is expected to increase and vested shares have appreciated in value.

First, if income next year is expected to trigger the 3.8% Medicare surtax on investment income from dividends and stock sale gains and there are vested shares that can be sold, then making the decision to sell the shares this year rather than next year could help reduce the tax liability.

Also, before selling any vested shares that have risen in value, check whether you have capital-loss carryforwards from last year, or short-term losses from earlier this year to offset capital gains. With higher tax rates and Medicare surtax, the value of netting capital losses against capital gains has increased.

Another option for those who are charitably inclined is to donate shares of vested stock. If the shares have been held for at least one year, the full market value can be deducted as a charitable contribution.

If it is less than one year, the deduction is limited to the stock's value at vesting. This can be a better approach than selling appreciated stock, paying tax on the capital gains and then donating the cash.

Roth IRA Conversions and the Elimination of Stretch IRAs

Roth IRA conversions are always an area to consider for year-end tax planning especially this year for a couple reasons.

First, tax rates are historically low and guaranteed to increase when the current tax law sunsets at the end of 2025. Paying taxes now with a Roth conversion can be better than paying a higher rate later if distributions are taxed when taken from a traditional IRA.

Second, another provision of the SECURE act passed last year was the elimination of the Stretch IRA for non-spousal beneficiaries. Previously an adult child of a deceased parent could inherit the IRA and then stretch distributions over their lifetime. Now, they have just 10 years.

For example, if an adult child of a deceased parent inherits a $1,000,000 traditional IRA, they must take out the full amount within 10 years. It could be $100,000 a year or a lump sum at the end of 10 years. Either way, this could easily bump the beneficiary into a much higher tax bracket and lose much of the IRA's value to taxes.

Historically Low Interest Rate Opportunities for Gifting/Estate Planning

The low interest rate environment combined with historic lifetime gift and estate tax exemptions make a grantor retained annuity trust (GRAT) a powerful estate-planning opportunity. Assets passing to the children may include not only dividends and interest, but also appreciation of the trust's assets.

The power of this strategy comes from the ability of assets to appreciate faster than the interest rates used by the IRS, Section 7520 rate, to calculate the earnings of the trust. In November of 2020, the rate is 0.4% compared to 2.2% just last February. This increases the odds that at the termination of the trust significant assets could pass to the children without gift/estate tax.

On top of this, the estate exemption today is $11.58 million per spouse and will sunset back to $5 million per spouse at the end of 2025. 2020 is a great time to consider a GRAT.

Conclusion

These year-end tax planning ideas are just a few that we see for our clients in the Aerospace & Defense Industry. How they could help you depends on your specific situation and comprehensive financial plan. If you would like a second opinion on how these strategies could help you reach your goals, please consider our complimentary Second Opinion Service to get a different point of view and evaluate your options.