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2021 YEAR-END TAX PLANNING NEWSLETTER

Dear Client:

As we near the end of 2021, Congress is still considering a large package of tax changes that could increase taxes in 2022 for wealthier taxpayers while potentially reducing taxes for low to middle-income taxpayers. Referred to as the Build Back Better Act, the details are still subject to substantial change as legislators continue to negotiate. It is possible an agreement might not be reached until very late in the year. Some of the provisions may be effective as of the enactment date, others could potentially be retroactive, and some might be effective starting in 2022 or later.

In general, tax planning includes accelerating deductions, postponing income, reviewing investment portfolios for possible capital gain or loss realizations, making charitable gifts, and lifetime gifts to family members. However, due to its size, the implications of the Build Back Better Act must be taken into consideration. Unfortunately, it may be enacted too late to act before December 31, 2021. Therefore, you will benefit from speaking to us now about your situation and year-end plans that might make sense for you within this changing tax landscape.

Year-End Tax Planning Moves for Individuals

• The Build Back Better plan proposes a larger tax burden for individuals, estates, and trusts with high income. These proposals include:

- A modification to the net investment income tax starting in 2022 that would classify pass-through income as investment income subject to the NIIT even if the taxpayer materially participates in the business.
- An additional tax of five percent that would apply to the modified adjusted gross income of a joint filer, single filer, or head of household in excess of $10 million ($5 million for a married taxpayer filing separately, $200,000 for an estate and trust). An additional three percent tax would apply to the modified adjusted gross income of a joint filer, single filer, or head of household in excess of $15 million ($12.5 million for a married taxpayer filing separately, $500,000 for an estate and trust). The surcharge would apply in tax years beginning after 2021.
- New limits on the favorable tax rules for investment in qualified small business stock. Possibly retroactive to the sale or exchange of qualified small business stock after September 13, 2021, favorable rules will not apply to any taxpayer with adjusted gross income of $ 400,000 or more, or any estate or trust.
- Wash sale rules may apply to a wider range of investments include foreign currency, cryptocurrency, and commodities.

• Considering the timing for these changes, wealthier taxpayers may want to consider accelerating income rather than the usual postponement of income and may also want to consider postponing deductions rather than the usual acceleration of deductions. In addition, a careful review of portfolio investments may be beneficial.

• Key tax considerations from recent tax legislation and other year-end strategies:

- The American Rescue Plan Act created a new round of EIPs that were sent to qualifying individuals. As with last year's stimulus payments, the EIPs were set up as advance payments of a recovery rebate tax credit. If you qualified for EIPs, you should have received these payments already. However, if the IRS owes you more, this additional amount will be captured and claimed on your 2021 income tax return.

If you received an EIP as an advance payment, you should have received a letter form the IRS. Keep this for record-keeping purposes and provide it to us to help us determine any potential adjustment. Even though EIPs are not taxable, you will still need this information to prepare your 2021 tax return. Please be sure to gather this information in plenty of time before your 2021 tax return is due.

- As part of the American Rescue Plan Act, there were many important changes to the child tax credit. Some of the changes include the increase in credit amount for certain taxpayers. The child tax credit has increased from $2,000 per eligible child to $3,000 per child 6-17 years old and $3,600 per child under 6 years old. In addition, the credit is fully refundable (meaning taxpayers will receive a refund of the credit even if they don't owe the IRS) and is applicable to children age 17 and younger.

  The IRS began paying half of the credit in advance monthly payments beginning in July. If you received any of these payments during 2021, be sure to include that information in your tax documents so that they can be properly accounted for on your 2021 tax return.

- Required minimum distributions (RMDs) are the minimum amount you must annually withdraw from your retirement accounts (e.g., 401(k) or IRA) if you meet certain criteria. For 2021, you must take a distribution if you are age 72 by the end of the year (or age 70½ if you reach that age before January 1, 2020). Planning ahead to determine the tax consequences of RMDs is important, especially for those who are in their first year of RMDs.

- Another thing to note that's different in 2021 is the treatment of unemployment compensation. There is no exclusion from income. The $10,200 income tax exclusion that a taxpayer may have received in 2020 is no longer available in 2021.

- Virtual currency transactions are becoming more common. There are many different types of virtual currencies, such as Bitcoin, Ethereum, and nonfungible tokens (NFTs). The sale or exchange of virtual currencies, the use of such currencies to pay for goods or services, or holding such currencies as an investment, generally has tax impacts.

- With a possible significant increase in IRS funding to enhance audit rates of tax returns, taxpayers may want to focus on making sure they have documentation to support all deductions and credits on their tax returns.

- Owners of pass-through businesses should consider reviewing possible changes to the 20 percent deduction for qualified business income, disallowance of excess business losses, changes to the taxation of carried interests, and a significant package of changes to the taxation of partnerships.

- There is a proposal to extend residential energy credits in the Build Back Better Act. However, under current law, they are due to expire at the end of 2021. Taxpayers might consider the tax impact for timing installation of energy-efficient exterior windows, doors, skylights, roofs, and insulation, as well as energy efficient heating and air conditioning systems and water heaters to take advantage of the greatest tax savings.

• In addition to new tax law changes above, the following continue to be effective tax strategies available from existing tax law.

- Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%, depending on the taxpayer's taxable income. If you hold long-term appreciated-in-value assets, consider selling enough of them to generate long-term capital gains that can be sheltered by the 0% rate. The 0% rate generally applies to the excess of long-term capital gain over any short-term capital loss to the extent that, when added to regular taxable income, it is not more than the maximum zero rate amount (e.g., $80,000 for a married couple). If the 0% rate applies to long-term capital gains you took earlier this year for example, you are a joint filer who made a profit of $5,000 on the sale of stock held for more than one year and your other taxable income for 2021 is $75,000 then before year-end, then try not to sell assets yielding a capital loss, because the first $5,000 of those losses won't yield a benefit this year. (It will offset $5,000 of capital gain that is already tax-free.

- If you believe a Roth IRA is better than a traditional IRA, consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA in 2021 if eligible to do so. Keep in mind, however, that such a conversion will increase your AGI for 2021, and possibly reduce tax breaks geared to AGI (or modified AGI).

- Many taxpayers will still not be able to itemize due to the high standard deduction amounts for 2021 ($25,100 for joint filers, $12,550 for singles and for marrieds filing separately, $18,800 for heads of household), and because many itemized deductions have been reduced or abolished. You can still itemize deductions such as medical expenses (but only to the extent they exceed 7.5% of your adjusted gross income), state and local taxes up to $10,000, your charitable contributions, and interest deductions on a restricted amount of qualifying residence debt. However, payments of those items won't save taxes if they don't cumulatively exceed the standard deduction for your filing status. Personal disaster and casualty losses are deductible only if they're attributable to a federally declared disaster, subject to certain limits. Two COVID-related changes for 2021 may be relevant here: (1) Individuals may claim a $300 ($600 for married filing joint returns) above-the-line deduction for cash charitable contributions on top of their standard deduction; and the percentage limit on cash charitable contributions has been raised from 60% of modified adjusted gross income (MAGI) to 100%.

  Some taxpayers may be able to work around these deduction restrictions by applying a bunching strategy to pull or push discretionary medical expenses, income and/or real estate taxes, and charitable contributions into the year where they will do some tax good. For example, if a taxpayer knows he or she will be able to itemize deductions this year but not next year, the taxpayer will benefit by making two years' worth of charitable contributions this year, instead of spreading out donations over 2021 and 2022. The COVID-related increase for 2021 in the income-based charitable deduction limit for cash contributions from 60% to 100% of MAGI assists in this bunching strategy, especially for higher income individuals with the means and disposition to make large charitable contributions.

- Make gifts sheltered by the annual gift tax exclusion before the end of the year if doing so may save gift and estate taxes. The exclusion applies to gifts of up to $15,000 made in 2021 to each of an unlimited number of individuals.

- If you were in federally declared disaster area, and you suffered uninsured or unreimbursed disaster-related losses, keep in mind you can choose to claim them either on the return for the year the loss occurred (in this instance, the 2021 return normally filed next year), or on the return for the prior year (2020), generating a quicker refund.

  If you were in a federally declared disaster area, you may want to settle an insurance or damage claim in 2021 in order to maximize your casualty loss deduction this year.

Year-End Tax-Planning Moves for Businesses & Business Owners

Year-end tax planning for businesses is especially difficult for 2021 because the Build Back Better Act has the potential to impact broad areas of taxation. Congress continues to negotiate a compromise. Unfortunately, it is difficult to know what is likely to emerge as the final version. In addition, although the effective date for most of the provisions in the Build Back Better Act are tied to the enactment date, January 1, 2022, or even later, a few proposals may be retroactive.

• Here are some highlights of current proposals under the Build Back Better Act that may impact businesses:

- Currently schedule to expire after 2025, disallowance of excess business losses may be made permanent. An excess business loss is the amount by which the total deductions attributable to all of the taxpayer's trades or businesses exceed their total gross income and gains attributable to those trades or businesses plus a threshold amount adjusted for cost of living. For tax year beginning in 2021, the threshold amounts are $262,000 (or $524,000 in the case of a joint return).

- Under current law, a tax credit may be available in 2021 for a taxpayer who places a new qualified plug-in electric drive motor vehicle in service. The maximum credit is $7,500 and is reduced once a manufacturer sells 200,000 eligible vehicles for use in the United States. However, taxpayers may want to hold off on making that purchase until 2022. Under proposals in the Build Back Better Act, it could mean an additional $5,000 credit. If the credit is not currently available, the tax savings increase to $12,500.

• Changes in the taxation of corporations and pass-through entities always makes it a good idea to review choice of entity decisions to make sure the current entity structure continues to make the most sense.

• The following are some expiring provisions. Taxpayers might consider taking advantage of these tax benefits in 2021 before they expire.

- The recently passed Infrastructure Investment and Jobs Act includes a tax provision that terminates the employee retention credit (ERC) early. With the exception for wages paid by an eligible recovery startup business, wages paid after September 30, 2021 are no longer eligible for the credit. The ERC encourages businesses to keep employees on their payroll during the pandemic. The ERC is a refundable payroll tax credit that may be claimed by eligible employers who pay qualified wages to qualifying employees. In some cases, changes were made with legislation to allow businesses to qualify for both Paycheck Protection Program (PPP) loans and the ERC.

- The American Rescue Plan Act extended the family and sick leave credits to September 30, 2021. These credits are intended to compensate employers and self-employed people for coronavirus-related paid sick and family and medical leave.

- Under present law, research and experimental expenditures are deductible in the year paid or incurred or at the taxpayer's option, amortizable over a period of not less than 60 months beginning in the month that benefits are first realized from expenditures. Beginning in 2022, research and experimental expenditures performed in the United States are required to be amortized ratably over five years and over fifteen years for foreign research. Taxpayers may want to consider the implications of the upcoming changes in 2022 tax year.

• Though PPP eligibility ended on May 31, 2021, existing burrowers may be eligible for PPP loan forgiveness. Even though the PPP loan forgiveness is not taxable for federal purposes, there may be state implications. There are also other COVID-19 relief measures offered through the SBA that can have a significant impact on tax implications for 2021.

• As a reminder, employers that took advantage of the option to defer payroll taxes due from the period beginning on March 27, 2020 and ending on December 31, 2020 must prepare to make the payments. Half of the deferred payroll taxes are due on December 31, 2021, with the remainder due on December 31, 2022.

• In addition to new tax law changes above, the following continue to be effective tax strategies available from existing tax law.

- Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income. For 2021, if taxable income exceeds $329,800 for a married couple filing jointly, $164,900 for singles, married filing separately, and heads of household, the deduction may be limited based on whether the taxpayer is engaged in a service-type trade or business (such as law, accounting, health, or consulting), the amount of W-2 wages paid by the trade or business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the trade or business. The limitations are phased in for example, the phase-in applies to joint filers with taxable income between $329,800 and $429,800 and to all other filers with taxable income between $164,900 and $214,900.

Taxpayers may be able to achieve significant savings with respect to this deduction, by deferring income or accelerating deductions so as to come under the dollar thresholds (or be subject to a smaller phaseout of the deduction) for 2021. Depending on their business model, taxpayers also may be able increase the new deduction by increasing W-2 wages before year-end. The rules are quite complex, so don't make a move in this area without consulting your tax adviser.

- Businesses should consider making expenditures that qualify for the Section 179 (business property expensing option). For tax years beginning in 2021, the expensing limit is $1,050,000, and the investment ceiling limit is $2,620,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. It is also available for qualified improvement property (generally, any improvement to a building's interior, but not for enlargement of a building, elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems. The expensing deduction is not prorated for the time that the asset is in service during the year. The fact that the expensing deduction may be claimed in full (if you are otherwise eligible to take it) regardless of how long the property is held during the year can be a potent tool for year-end tax planning. Thus, property acquired and placed in service in the last days of 2021, rather than at the beginning of 2022, can result in a full expensing deduction for 2021.

- Businesses also can claim a 100% bonus first year depreciation deduction for machinery and equipment bought used (with some exceptions) or new if purchased and placed in service this year, and for qualified improvement property, described above as related to the expensing deduction. The 100% writeoff is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the 100% bonus first-year writeoff is available even if qualifying assets are in service for only a few days in 2021.

- Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies, assuming the costs don't have to be capitalized under the Code Sec. 263A uniform capitalization (UNICAP) rules. To qualify for the election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS; e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed $2,500. Where the UNICAP rules aren't an issue, consider purchasing such qualifying items before the end of 2021.

- To reduce 2021 taxable income, consider deferring a debt-cancellation event until 2022.

- To reduce 2021 taxable income, consider disposing of a passive activity in 2021 if doing so will allow you to deduct suspended passive activity losses.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Very truly yours,

Barto, Hoss & Company, P.C.

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