EagleStone
Tax & Wealth Advisors

2021 Year-End Tax Planning

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Year-End Tax Planning Overview

As we wrap up 2021, it's important to take a closer look at your tax and financial plans. This year likely brought challenges and disruptions that significantly impacted your personal and financial situations — a continued global pandemic, several significant natural disasters, new tax laws and political shifts. Now is the time to take a closer look at your current tax strategies to make sure they are still meeting your needs and take any last-minute steps that could save you money.

We're here to help you take a fresh look at the health of your tax and financial well-being. Please contact us at your earliest convenience to discuss your tax situation so we can develop a customized plan. In the meantime, this document takes a look at some issues to consider as we approach year end.

It is important to consider the following when evaluating tax planning strategies:

- The objective should be to achieve your personal financial and/or business goals in the most tax-efficient manner possible.

- Minimizing taxes can potentially enhance overall investment and business returns.

- Although tax planning is most effective when done throughout the year, many tax-saving strategies can be identified and implemented as year end approaches.

- New tax legislation routinely presents tax planning opportunities. Therefore, ongoing tax planning is necessary to take advantage of tax-saving strategies.

- Effective tax planning requires accurate estimates of taxable income for 2021 and 2022; developing reliable estimates is critical to making planned tax savings.

- Not every tax planning opportunity is appropriate for every person. However, identifying specific planning ideas that work for your profile can potentially reduce your tax liabilities.

Most tax tips, suggestions, and strategies are of little practical help without an understanding of your current tax situation. This is particularly true for year-end planning and why it is important to evaluate your current tax situation while there's still time to affect your bottom line for the 2021 tax year. Tax projections will help you estimate your present tax situation and identify any possible issues you'll need to address.

Basic Tax Planning Strategies

Timing is Everything

The last few months of the year may be the time to consider deferring or accelerating income and deductions, taking into consideration the impact on both this year's and next year's taxes.

Delaying Income & Accelerating Deductions

You may be able to defer a year-end bonus, defer the sale of capital gain property (or take installment payments rather than a lump-sum payment), or delay the collection of business debts, rents, and payments for services. Doing so may allow you to defer paying tax on the income until next year. If there's a chance that you'll be in a lower income tax bracket next year, deferring income could mean paying less tax on that income as well.

Similarly, we can consider strategies to accelerate deductions into 2021. If you itemize deductions, you might accelerate some deductible expenses like medical expenses, qualifying interest, or state and local taxes (for those not exceeding the new $10,000 cap) by making payments before year end. You may also consider making next year's charitable contribution this year instead.

Accelerating Income & Postponing Deductions

What if you'll be in a higher tax bracket in 2022? If you know that you'll be paying taxes at a higher rate in 2022 (say, for example, that an out-of-work spouse will be reentering the workforce in January), you might take the opposite track. Consider whether it makes sense to try to accelerate income into 2021, and to postpone deductible expenses until 2022.

Withholding from Wages

If it is projected that you will owe a substantial amount when you file this year's income tax return, ask your employer to increase your income tax withholding amounts before the year end. Even though the additional withholding will come from your last few paychecks, it's generally treated as having been withheld evenly throughout the year. This may help you to avoid paying an estimated tax penalty due to under withholding. If your situation is the opposite, where you have significantly overpaid your taxes and estimate you'll be receiving a large refund, you can reduce your withholding accordingly, putting money back in your pocket this year, as opposed to waiting for your tax refund to come in the following year.

IRAs and Retirement Plans — A Key Part of Planning

Make sure that you're taking full advantage of tax-advantaged retirement savings vehicles. Traditional IRAs (assuming that you qualify to make deductible contributions) and employer-sponsored retirement plans such as 401(k) plans allow you to contribute funds pretax, reducing your 2021 taxable income. Contributions you make to a Roth IRA (assuming you meet the income requirements) or a Roth 401(k) aren't deductible, so there's no tax benefit for 2021, but qualified Roth distributions are completely free from federal income tax, making these retirement savings vehicles very appealing.

For 2021, you can contribute up to $19,500 to a 401(k) plan ($26,000 if you're age 50 or older), and up to $6,000 to a traditional IRA or Roth IRA ($7,000 if age 50 or older). The window to make 2021 contributions to an employer plan typically closes at the end of the year, while you generally will have until the original due date of your 2021 federal income tax return to make 2021 IRA contributions.

The 2021 Tax Planning Environment

American Rescue Plan Act

Many tax provisions were implemented under the American Rescue Plan Act (ARPA) that was enacted on March 21, 2021. This act aimed to help individuals and businesses deal with the COVID-19 pandemic and its ongoing economic disruption. Also, some tax provisions were passed late in December 2020 that will impact this filing season. Below is a summary of the highlights in recent tax law changes to help you plan:

Employee Retention Credit (ERC)

The ERC is a refundable payroll tax credit that may be claimed by eligible employers who pay qualified wages to qualifying employees. The ERC encouraged businesses to keep employees on their payroll during the pandemic. Changes were made with legislation to allow businesses to qualify for both Paycheck Protection Program (PPP) loans and the ERC.

Family And Sick Leave Credits

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 family, sick, and medical leave.

Small Business Administration (SBA) loans

Though the PPP ended on May 31, 2021, existing borrowers 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. We can help you navigate the tax and financial complexities of these programs.

Virtual currency/cryptocurrency

Virtual currency transactions are becoming more common. There are many different types of virtual currencies, such as Bitcoin, Ethereum and non-fungible 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. This is a very complex area, but we can help you work through the reporting requirements and tax consequences.

Individuals

- The number of tax brackets remain the same; however, as they are every year, the 2021 tax brackets were adjusted to account for inflation.
- The standard deduction increased for individuals and couples to $12,550 and $25,100, respectively, for 2021.
- Personal exemptions will remain at $0.
- Cash contributions deductible for non-itemized taxpayers of up to $300 for individual taxpayers and $600 for married individuals filing joint returns.
- Itemized deductions:
  - State and property tax deductions are limited to $10,000.
  - Miscellaneous itemized deductions have been eliminated.
  - Medical expenses are deductible to the extent they exceed 7.5% of income for 2021.
- For 2021 only, ARPA made the child tax credit refundable; increased the age from under 17 at 12/31/2021 to under 18; and increased the maximum to $3,000 if six years old or older, $3,600 if under six at 12/31/2021. Half of the credit was payable (monthly) in advance, to be reconciled with the return and allowing for a higher AGI phaseout and a minimum $2,000 safe harbor.
- Tax credits for residential energy efficiency have now been extended, retroactively, through 12/31/2021. The tax credit for builders of energy efficient homes has also been retroactively extended through 12/31/21. Tax deductions for energy efficient commercial buildings allowed under Section 179D of the Internal Revenue Code were made permanent under the Consolidated Appropriations Act of 2021.

Businesses

- Business Meals — There is a 100% deduction (rather than the prior 50%) for expenses paid for food or beverages provided by a restaurant. This provision is effective for expenses incurred after December 31, 2020, and expires at the end of 2022.
- Purchases of Property and Equipment — With tax-favorable options available to businesses, many purchases can be completely written off in the year they are placed in service. Plus, there are tax-favorable rules that permit qualified improvement property to qualify for 15-year depreciation and, therefore, also be eligible for 100% first-year bonus depreciation.
- Net Operating Losses — If you have significant losses from 2018 to 2020, you may be able to carry those losses back up to five years, which can significantly impact a prior year where there was a tax liability.
- Methods of Accounting — More businesses can use the cash method of accounting. This can be helpful for cashflow purposes and is generally easier to apply than the accrual method of accounting. There are qualifications that must be met, but we can help you understand if your business would benefit.
- Sales And Use Tax Considerations — States are continuing to make changes to their Sales and Use Tax laws and filing requirements following the U.S. Supreme Court ruling in *South Dakota v. Wayfair, Inc.* Please ask us how this case impacts your business.

The New Maryland Entity-Level Tax

As a response to the federal cap of $10,000 on the state and local tax (SALT) deduction passed in 2020, several states (Connecticut, Louisiana, Maryland, New Jersey, Oklahoma, Rhode Island, and Wisconsin) have enacted an option to have the passthrough entity (S corporations & partnerships) be taxed on the entity level.

The IRS released a letter on November 9, 2020, announcing proposed regulations clarifying that state and local income taxes imposed on and paid by a partnership or an S corporation on its income will be allowed a deduction on the federal partnership or S corporation (and not being limited).

As a result, state and local income taxes, whether mandatory or elective, will be deductible at the level of the federal partnership or S corporation and not passed through to individual partners or shareholders of the entity who are subject to the SALT deduction limitation that applies to individuals who itemize deductions for federal income tax purposes.

There is still time to plan accordingly and pay in estimated state income taxes on the entity level before year end, thus providing a federal tax deduction on your 2021 partnership or S corporation tax return.

The Infrastructure Investment and Jobs Act and the Build Back Better Act – Overview

The President signed the Infrastructure Investment and Jobs Act on November 15, 2021. The House is still debating budget reconciliation legislation (The Build Back Better Act). The following are “selected” provisions included in these tax bills. We have included brief summaries of some of these provisions. We have by no means included all changes included in the Infrastructure Investment and Jobs Act and the Build Back Better Act, and the provisions of the Build Back Better Act we have included are subject to change as the legislation makes its way through Congress.

Selected provisions from Infrastructure Investment and Jobs Act (H.R. 3684) signed by President Biden on 11/15/21:

- Employee Retention Credit (ERC) terminated for wages paid after September 30, 2021, through December 31, 2021. ERC continues for “Recovery Start-Up Business” for wages paid through December 31, 2021.
- Brokers must report digital asset transactions and digital assets subject to Form 8300 reporting for transactions of more than $10,000 after 2022.
    - Definition of “Broker” expanded to include anyone who for consideration effectuates “Transfers of Digital Assets on Behalf of Another Person.”
    - "Digital Asset" defined as "Any Digital Representation of Value Recorded on a Cryptographically-Secured Distributed Ledger or Any Similar Technology."

Selected Provisions from The Build Back Better Act (H.R. 5376):

- Increases SALT cap to $80,000 ($40,000 for married individuals filing separately, estates and trusts) for taxable years beginning after 2020 and before 2031.
- Generally, extends child tax credit provisions of ARPA through 2022 and increases Safe Harbor recapture amount.
- Extends Earned Income Credit provisions of ARPA through 2022.
- 30% credit for wildfire mitigation expenditures made pursuant to a qualified state wildfire mitigation program paid or incurred after enactment.
- Extends ARPA changes to Premium Tax Credit (PTC) for tax years beginning after 2021 and through 2025.

In Summary

The above highlights some of the key year-end tax planning areas for consideration along with changes from the Infrastructure Investment and Jobs Act, Build Back Better Act, and American Rescue Plan Acts. Since all of these provisions together are quite complicated, we suggest an analysis be performed using tax software to calculate your approximate 2021 tax liabilities between now and the end of the year.

Please contact our office if you have any specific questions or need further guidance. We appreciate the opportunity to be of service to you.

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