2021 YEAR-END TAX PLANNING CHECKLIST

MichaelSilver

As we approach the final weeks of the year, there is still time to minimize your 2021 tax liability and get a jump start on your 2022 tax planning. This year likely brought challenges and disruptions that significantly impacted your personal and financial situation – 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 to take any last-minute steps that could save you money. This article highlights several potential tax-saving opportunities for you to consider.

Although there is uncertainty with respect to future years, being familiar with the current tax environment and working closely with your tax advisor will allow you to take advantage of existing opportunities before this year closes.

Executive Summary

In this guide, we will discuss the following year-end tax planning strategies:

- Benefits of accelerating deductions into 2021, and deferring income into 2022, and vice versa
- Planning to maximize your itemized deductions
- Retirement planning for contributions, distributions, and conversions
- Simple estate planning moves to make before year-end and next year
- Maximizing the qualified business income (QBI) deduction
- Generous asset-expensing opportunities
- Employee Retention Tax Credit (ERTC)
- Pass-through Entity Tax (PTET) Workaround

2021 Tax Planning Opportunities — Individuals

The following section highlights some tax planning opportunities for individual taxpayers. The time-honored tactic of accelerating deductions and deferring income may not always be the best strategy for every taxpayer. It's important to consider target income thresholds to maximize the benefit of deductions (itemized, tuition and fees, student loan interest) and/or the utilization of credits (child credit, education credits) that are based upon a percentage of adjusted gross income or income levels and then plan to shift income or deductions to maximize these tax benefits.

☐ For individuals who expect to be in a higher income tax bracket or have higher income in 2021 than in 2022, it may be advantageous to defer income into next year. Some tax planning strategies this close to year-end may include:

- **Installment Sales –** If you expect to sell property before the end of 2021, and it makes economic sense, consider selling the property and reporting the gain under the installment method.
- **Delay Billing –** An option for taxpayers utilizing the cash method of accounting
- **Interest and Dividends –** Since interest earned on CD's or treasury securities with maturities of one year or less are not includible in income until received at maturity, consider buying short-term bonds or certificates that will not mature until next year.
- **Year-end Bonuses –** Consider arranging with your employer to defer a year-end bonus until early-2022.

☐ On the other hand, if you expect to be in a higher tax bracket in 2022 compared to 2021, accelerating income into this year may be the advantageous move. Some ways to accelerate income this close to year-end include:

- **Issue Bills and Pursue Collection –** An option for taxpayers utilizing the cash method of accounting
- **Interest and Dividends –** If you are not in the highest capital gains bracket for 2021, but you expect to be in 2022 and you have control over when dividends are paid on an investment or from your closely held corporation that pays qualified dividends, consider authorizing such dividends prior to year-end.
- **Year-end Bonuses –** If you receive a year-end bonus that is paid early in the following year, request the bonus be paid to you before year-end.

2021 Tax Planning Opportunities — Individuals (Continued)

☐ Review your investment portfolio: determine if there are losses you can harvest to offset capital gains realized earlier in the year. If you have a net capital loss greater than $3,000 (maximum amount deductible), consider selling investments with gains before year-end. These gains will be sheltered from tax by the loss. Control taxable income to less than $80,800 (married filing joint) to take advantage of the zero capital gains tax rate. Be sure to consult your portfolio advisor, as these steps should only be taken if the results also align with your overall investment plan.

☐ Even though planning for itemized deductions is made complex by factors such as AGI levels, AMT, filing status, and the increased standard deduction ($12,550 for single filers, $25,100 for married filers filing jointly and $18,800 for heads of household), being familiar with the following concepts will help you navigate some of this complexity and maximize your itemized deduction.

- **Deduction in Year Paid –** An expense is deductible in the year in which it was paid. Medical expenses and charitable contributions paid with a credit card before year-end will generate a tax deduction in the current year even if the credit card bill is not paid until next year.
- **Donor-Advised Fund –** Interested in making a significant charitable contribution prior to year-end, but aren't sure what charity you want to donate to? Consider establishing a donor-advised fund. Money contributed to the fund can be deducted in the current year and you can decide later which charity or charities will receive the funds.
- **Bunching Itemized Deductions –** If your itemized deductions are consistently near the standard deduction, perhaps slightly below or above, consider postponing current year deductible expenses (i.e., charitable contributions) until next year to "bunch" your itemized deductions. Analyze your position from year to year to itemize your bunched itemized deductions in years of high income.

☐ New in 2021, taxpayers can claim a charitable deduction up to 100% of their adjusted gross income (AGI) in 2021 (up from 60%). The increased AGI limitation applies to cash donations paid to qualifying charitable organizations (exclude donor advised funds).

☐ Consider donating appreciated stock. You will receive a charitable contribution for the full fair market value and will avoid capital gain on the sale. Different deduction rules may apply to donations of cars, boats, and airplanes.

☐ If you are age 70½ or older by the end of 2021 and have traditional IRAs, consider making a qualified charitable distribution (QCD) directly from your IRA. Such distributions, up to $100,000 per year, are made directly to charities (excluding donor-advised funds) from your IRA. The amount of the contribution is neither included in your gross income nor deductible as an itemized deduction. (See next item if you contribute to an IRA after age 70½. As discussed below, you'll need to reduce the qualified distribution by the amount of aggregate post 70½ IRA contributions.)

☐ Maximize your retirement plan contributions to 401(k)s and IRAs. Maximizing pre-tax retirement contributions is generally a good tax-saving strategy. Under the SECURE Act, beginning in 2020 individuals can continue to contribute to their IRA's regardless of their age if they have earned income. The Act eliminated the ban on contributions after age 70½.

☐ Required minimum distributions (RMDs) are the minimum amount you must annually withdraw from your retirement accounts (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).

☐ Consider converting your traditional IRA to a Roth IRA if you anticipate lower income in the current year. The advantage to a Roth IRA is that the future income distributions will not be taxed. The drawback to the conversion is that the amount transferred is subject to tax now. Conversions to a Roth IRA make sense if you anticipate paying higher taxes in the future, if you have a number of years before you might tap into the Roth IRA, which gives you a chance to recoup the tax you paid at conversion, and if you will not need the income during retirement and would like to pass it on to your beneficiaries.

☐ Take advantage of estate planning opportunities still available - make gifts sheltered by the annual gift tax exclusion before year-end and 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. Married couples can make joint gifts up to $30,000 per donee. You cannot carry over unused exclusions from one year to the next so don't pass up this year's opportunity. Consider transferring income-earning property to family members in lower income tax brackets. Also, maximize contributions to a Section 529 Plan, which allows the equivalent of five years of gifts ($75,000) to each beneficiary. Make direct payments to providers for medical expenses and to schools for qualified tuition expenditures. Such payments have no amount cap and can be made in addition to the annual exclusion gifts.

2021 Tax Planning Opportunities — Business Owners

- [ ] Manage taxable income to take advantage of the 20% qualified business income (QBI) deduction. For 2021, if taxable income does not exceed $329,800 (joint filers) or $164,900 (single or head of household), the deduction is generally the lesser of 20% of QBI or 20% of taxable income. Limitations may apply if taxable income exceeds these thresholds. The deduction may be reduced or eliminated if you are engaged in a specified service trade or business (such as law, accounting, or health). If your business is not considered a specified service business and you exceed the income thresholds, your QBI deduction may be limited by the amount of W-2 wages and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the trade or business.

- [ ] Consider changing to the cash method of accounting. To qualify, a business must, among other things, satisfy a gross receipts test. This test is satisfied if, during a three-year testing period, average annual gross receipts do not exceed $26 million. Cash method taxpayers may find it a lot easier to shift income as a tax planning strategy.

- [ ] Accelerate Deductions: Consider charging expenses on a credit card, as the deduction will be allowed in 2021 even if the credit card bill is not paid until 2022.

- [ ] Consider making expenditures that qualify for the business property expensing option. For 2021, the expensing limit is $1,050,000, and the investment ceiling limit (at which point a phase-out begins) is $2,620,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. This expensing opportunity is available for qualified improvement property (generally, any interior improvement to a building, but not for enlargement of a building, elevators or escalators, or the internal structural framework) roofs, and nonresidential 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. Thus, property acquired and placed in service in the last days of 2021 will result in a full expensing deduction for the year.

- [ ] Businesses may also claim a 100% bonus first-year depreciation deduction for machinery and equipment bought new or used (with some exceptions) if purchased and placed in service this year. The 100% write-off 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 write-off is available even if qualifying assets are in service for only a few days in 2021. Note that limits on eligibility may exist for certain auto dealerships with floor plan financing as well as for some real estate ventures. Further, some states such as Illinois may not conform with the treatment of the 100% bonus depreciation for the 2021 tax year.

- [ ] As in previous years, businesses, including self-employed individuals and owners of certain real estate, may be able to take advantage of the de minimis safe harbor election to expense the costs of lower-cost assets and materials and supplies. To qualify for the election, the cost of a unit of property cannot 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 is no AFS, the cost of a unit of property cannot exceed $2,500. Consider purchasing such qualifying items before the end of 2021 and ensure that the purchase invoice clearly states the quantity and per unit cost if multiple items are bought.

- [ ] For tax years beginning in 2021, businesses can establish and fund a profit-sharing plan up through the extended due date of the 2021 corporate tax return. This allows a tax deduction to the company and jump starts individual retirement savings.

- [ ] Excess Loss Limitations: The CARES Act repealed a prior federal law that limited a taxpayer's ability to deduct 100% of business losses, called excess business losses, for years beginning before January 1, 2021. The original law limited business losses that exceeded $262,000 on an individual income tax return (or $524,000 for married filing jointly). It may be advantageous to amend your 2018, 2019, or 2020 returns if business losses were limited in those years.

- [ ] New in 2021, businesses will be able to deduct 100% of business meals under the Consolidated Appropriations Act. These business meals costs must be paid for food or beverages provided by a restaurant.

- [ ] The Employee Retention Tax Credit (ERTC) encourages companies to maintain their workforce by providing eligible businesses with a fully refundable tax credit on qualified employee wages. Eligible businesses may receive as much as $5,000 per employee in 2020, and up to $7,000 per employee per quarter in 2021 Q1-Q3 – clearly, a very valuable taxpayer incentive. Qualifications for the 2021 credit are different from those for the 2020 credit. Determining if your business is eligible for the credit can be a complicated process. We can help you determine if you're eligible for the ERTC credit and how to apply for them.

2021 Tax Planning Opportunities — Business Owners (Continued)

- [ ] Pass-through Entity Tax (PTET) Workaround: Many high income tax rate states, such as Illinois, California, and New York, etc., have enacted legislation to help passthrough owners (shareholders in S Corporations and partners in partnerships) make an election to deduct state income taxes at the entity level instead of having the owners pay income taxes—which would otherwise be limited to the $10,000 State and Local Tax (SALT) deduction on Sch A. Taxes paid by the business would be deducted as an ordinary business expense for federal tax purposes and would pass-through to the owner, thereby bypassing the $10,000 SALT limitation. Legislation varies by state with each state requiring its own election, due dates, forms, and other disclosures.
- [ ] Single member LLC owners that are disregarded entities for tax purposes and are in a PTET state (as described above), may want to consider adding a non-voting member (even if their share/ownership is a nominal amount, i.e., 0.1%) so that the LLC is now a partnership, and it can take advantage of the state legislation for the SALT limitation work around.

These are just some year-end tax planning strategies that you may benefit from in 2021. It is important to keep in mind that tax planning is very much an individualized tool. While this article has focused on tips for 2021, it is not too early to begin thinking about steps to take for 2022. The month of December is usually when employers distribute 2022 paperwork, so:

- Estimate your 2022 out-of-pocket medical expenses and childcare expenses to contribute pre-tax income to your FSA (flexible spending accounts);
- Plan your 401(k) contribution, aiming to contribute, at a minimum, the amount required to receive your employer's match; and
- If you have a qualified HDHP (high deductible health plan) to maximize contributions to your HSA (health savings account).

As of the writing of this news alert, the U.S. Congress has passed the U.S. Infrastructure Bill into law. The bill contains various federal tax provisions which will be covered in a future tax alert.

If you have any questions about year-end tax planning or if you need further assistance, please contact us.

Carlos Salgado, CPA, MSA, Tax Senior – Carlos works with mid-size enterprises focusing on flow-through taxation within a variety of industries, including, manufacturing and distribution, professional services, real estate, and retail. He has provided accounting and tax services for over five years, including compliance, tax planning, and management consulting. Carlos has been with MichaelSilver since 2019. He is a member of the AICPA and ICPAS.

Josh Prince, CPA, MST, Senior Manager – Josh works with high-net-worth individuals and flow-through entities within a variety of industries, including real estate, family offices, professional service organizations, and retail. Josh is the firm's Resident Expert on PPP loan forgiveness and the Employee Retention Tax Credit. Josh has provided income tax planning and compliance services for more than 11 years, helping clients formulate tax planning strategies for their personal and business needs. Before joining MichaelSilver in 2017, Josh spent 7 years at national sized accounting firms. He is a member of the AICPA and ICPAS.