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Dear Clients and Friends:

What a year it's been! So far, we have had to cope with a global pandemic, extreme political division, and a series of natural disasters—just to mention a few noteworthy occurrences. These events have complicated tax planning for individuals and small business owners.

What's more, new legislation enacted the last couple of years has had, and will continue to have, a significant impact. First, the Coronavirus Aid, Relief, and Economic Security (CARES) Act addressed numerous issues affected by the pandemic. Following soon after, the Consolidated Appropriations Act (CAA) extended certain provisions and modified others. Finally, the American Rescue Plan Act (ARPA) opens up even more tax-saving opportunities in 2021.

And we still might not be done. New proposed legislation is currently being debated in Congress. If another new law is enacted before 2022, it may require you to revise your year-end tax planning strategies.

This is the time to assess your tax outlook for 2021. By developing a comprehensive year-end plan, you can maximize the tax breaks currently on the books and avoid potential pitfalls.

Keeping all that in mind, we have prepared the following **2021 Year-End Tax Letter**. For your convenience, the letter is divided into three sections:

- Individual Tax Planning
- Business Tax Planning
- Financial Tax Planning

Be aware that the concepts discussed in this letter are intended to provide only a general overview of year-end tax planning. It is recommended that you review your personal situation with a tax professional.

INDIVIDUAL TAX PLANNING

Charitable Donations

There were plenty of worthy causes for individuals to donate to in 2021, including disaster aid relief. Besides helping out victims, itemizers are eligible for generous tax breaks.

TAX TACTIC: Step up your charitable giving at the end of the year. Then you can reap the tax rewards on your 2021 return. This includes amounts charged to your credit card in 2021 that you do not actually pay until 2022.

Under the CARES Act, and then extended through 2021 by the CAA, the annual deduction limit for monetary donations is equal to 100% of your adjusted gross income (AGI). Theoretically, you can eliminate your entire tax liability through charitable donations.

Conversely, if you donate appreciated property held longer than one year (i.e., long-term capital gain property), you can generally deduct an amount equal to the property's fair market value (FMV). But the deduction for short-term capital gain property is limited to your initial cost. In addition, your annual deduction for property donations generally cannot exceed 30% of your AGI.

Tip: If you do not itemize deductions, you can still write off up to $300 of your monetary charitable donations. The maximum has been doubled to $600 for joint filers in 2021.

Child Tax Credit

ARPA provides several key enhancements to the Child Tax Credit (CTC) for the 2021 tax year.

TAX TACTIC: Take full advantage of the latest rules for the CTC. Notably, ARPA includes the following changes that may benefit your family.

- The maximum credit increases from $2,000 to $3,000 for a qualifying child ($3,600 for qualifying children under age six).
- The definition of a qualifying child expands to include children under age 18 at the end of the year (up from age 17).
- The credit is fully refundable. Previously, only $1,400 was refundable.
- Although the credit begins to phase out at lower income levels, taxpayers adversely affected by these new ranges can elect to claim the $2,000 credit under the prior rules.

Finally, the IRS began making advance payments of the CTC during the second half of the year. But you may choose not to receive advance payments (or you can stop now).

Tip: Do not forget that the advance payments will be reflected on your 2021 return. This may result in a smaller tax refund than you were expecting.

Home Improvements

Previously, you could generally deduct mortgage interest on loans that qualified as either "acquisition debt" or "home equity debt," within generous limits. But the Tax Cuts and Jobs Act (TCJA) revised the rules, beginning in 2018. Notably, it eliminated the current deduction for home equity debt.

TAX TACTIC: When appropriate and allowable, convert nondeductible home equity debt into deductible acquisition debt. This may be accomplished by using home equity loan proceeds to pay for home improvements.

For 2021, you can still deduct mortgage interest on the first $750,000 of new acquisition debt, defined as debt used to buy, build or substantially improve a qualified home. (The prior threshold of $1 million is "grandfathered" for certain older loans.) The deduction for home equity loans, up to the first $100,000 of debt, is suspended for 2018 through 2025.

Thus, if you take out a new home equity loan to make a substantial home improvement, it qualifies as acquisition debt. The interest is deductible within the usual tax law limits.

Tip: If you were planning to use personal funds for a home improvement and a home equity loan for another purpose—say, a child's education—you might switch things around.

Alternative Minimum Tax

The alternative minimum tax (AMT) is a complex calculation made parallel to your regular tax calculation. It features several technical adjustments, inclusion of "tax preference items" and subtraction of an exemption amount (subject to a phase-out based on your income). After comparing AMT liability to regular tax liability, you effectively pay the higher of the two.

TAX TACTIC: Have your AMT status assessed. Depending on the results, you may want to shift certain income items to 2022 to reduce AMT liability for 2021. For instance, you might postpone the exercise of incentive stock options (ISOs) that count as tax preference items.

Fortunately, the AMT now affects fewer taxpayers, because the TCJA boosted the AMT exemption amounts (and the thresholds for the phase-out), unlike the minor annual "patches" authorized by Congress in prior years. The chart below shows the exemptions since 2017, including a significant boost in 2018.

Filing status	**2017**	**2018**	**2019**	**2020**	**2021**
Single filers	$54,300	$70,300	$71,700	$72,900	$73,600
Joint filers	$84,500	$109,400	$111,700	$113,400	$114,600
Married filing separately	$42,250	$54,700	$55,850	$56,700	$57,300

Tip: The two AMT rates for single and joint filers for 2021 are 26% on AMT income up to $199,900 ($99,950 if married and filing separately) and 28% on AMT income above this threshold. Note that the top AMT rate is still lower than the top ordinary income tax rate of 37%.

Medical Deduction
The tax law allows you to deduct qualified medical and dental expenses above 7.5% of AGI. This threshold was recently lowered from 10% of AGI. What's more, the latest change is permanent.

To qualify for a deduction, the expense must be for the diagnosis, cure, mitigation, treatment or prevention of disease or payments for treatments affecting any structure or function of the body. However, any costs that are incurred to improve your general health or well-being, or expenses for cosmetic purposes, are nondeductible.

TAX TACTIC: If you expect to itemize deductions and are near or above the AGI limit for 2021, accelerate non-emergency expenses into this year, when possible. For instance, you might move a physical exam or dental cleaning scheduled for January to December. The extra expenses are deductible on your 2021 return.

Note that you can include expenses you pay on behalf of a family member—such as a child or elderly parent—if you provide more than half of that person's support.

Tip: The medical deduction is not available for expenses covered by health insurance or other reimbursements.

Miscellaneous

- Take advantage of the enhanced dependent care credit. Under ARPA, the maximum credit for a taxpayer with an AGI of $125,000 or less is $4,000 for one child and $8,000 for two or more children. The maximum is $1,600 or $3,200, respectively, if your AGI exceeds $183,000.

- Pay a child's college tuition for the upcoming semester. The amount paid in 2021 may qualify for one of two higher education credits, subject to phase-outs based on modified adjusted gross income (MAGI). Note: The alternative tuition-and-fees deduction expired after 2020.

- Avoid an estimated tax penalty by qualifying for a safe-harbor exception. Generally, a penalty will not be imposed if you pay during the year 90% of your current tax liability or 100% of the prior year's tax liability (110% if your AGI exceeded $150,000).

- If you are in the market for a new car, consider the tax benefits of the electric vehicle credit. The maximum credit for a qualified vehicle is $7,500. Be aware, however, that credits are no longer available for vehicles produced by certain manufacturers.

- Empty out your flexible spending accounts (FSAs) for healthcare or dependent care expenses if you will have to forfeit unused funds under the "use-it-or-lose it" rule. However, due to recent changes, your employer's plan may provide a carryover to next year of up to $550 of funds or a 2½-month grace period or both.

- If you own property damaged in a federal disaster area in 2021, you may qualify for quick casualty loss relief by filing an amended 2020 return. The TCJA suspended the deduction for casualty losses for 2018 through 2025, but retained a current deduction for disaster-area losses.

BUSINESS TAX PLANNING

Depreciation-Related Deductions
At year-end, a business may secure one or more of three depreciation-related tax breaks: (1) the Section 179 deduction; (2) first-year "bonus" depreciation; and (3) regular depreciation.

TAX TACTIC: Make sure that qualified property is placed in service before the end of the year. If your business does not start using the property, it does not qualify for these tax breaks.

1. Section 179 deductions: Under this section of the tax code, a business may "expense" (i.e., currently deduct) the cost of qualified property placed in service anytime during the year. The maximum annual deduction is phased out on a dollar-for-dollar basis above a specified threshold.

The maximum Section 179 allowance has increased gradually since it was doubled to $500,000 in 2010. As shown below, the TCJA effectively doubled the amount again in 2018.

Tax year	Deduction limit	Phase-out threshold
2010–2015	$500,000	$2 million
2016	$500,000	$2.01 million
2017	$510,000	$2.03 million
2018	$1 million	$2.50 million
2019	$1.02 million	$2.55 million
2020	$1.04 million	$2.59 million
2021	$1.05 million	$2.62 million

However, be aware that the Section 179 deduction cannot exceed the taxable income from all your business activities this year. This could limit your deduction for 2021.

2. First-year bonus depreciation: The TCJA doubled the 50% first-year bonus depreciation deduction to 100% for property placed in service after September 27, 2017 and expanded the definition of qualified property to include used, not just new, property. However, the TCJA gradually phases out bonus depreciation after 2022.

3. Regular depreciation: If any remaining acquisition cost remains, the balance may be deducted over time under the Modified Accelerated Cost Recovery System (MACRS).

Tip: The CARES Act fixed a glitch in the TCJA relating to "qualified improvement property" (QIP). Thanks to the change, QIP is eligible for bonus depreciation, retroactive to 2018. Therefore, your business may choose to file an amended return for a prior year.

Employee Retention Credit
Many business operations have been disrupted by the COVID-19 pandemic. At least recent legislation provides tax incentives for keeping workers on the books during these uncertain times.

TAX TACTIC: When it makes sense, retain your top workers as long as you can. The CARES Act authorized an employee retention credit (ERC) to offset some of the cost.

Under the CARES Act, the ERC was equal to 50% of the first $10,000 of qualified wages per quarter, for a maximum credit of $5,000 per worker. The CAA extended availability of the credit into 2021 with certain modifications, including a maximum ERC of $14,000 per worker per year. Now ARPA authorizes a maximum credit of $28,000 per worker for 2021.

In addition, ARPA allows businesses that started up after February 15, 2020 and have an average of $1 million or less in gross receipts to claim a credit of up to $50,000 per quarter.

Tip: It is possible that the ERC will be extended again, but it is currently set to expire after 2021.

Business Meals
Previously, a business could deduct 50% of the cost of its qualified business entertainment expenses. However, the TCJA permanently eliminated the deduction for entertainment expenses, including strictly social meals preceding or following a "substantial business deduction."

TAX TACTIC: Stay the course. Current law still allows deductions for certain business meals if you have the records needed to support your claims. Plus, your business may benefit from an enhanced deduction in 2021.

For starters, a business can deduct meal expenses of employees traveling away from home on business. In addition, the cost of food and beverages associated with entertainment such as sporting events and concerts may be deductible if the food and beverages are invoiced separately. The IRS has issued detailed regulations relating to these deductions.

Note that the cost of the food and beverages cannot be artificially inflated. Obtain the invoices from the appropriate venues.

Tip: ARPA doubles the usual 50% deduction to 100% of the cost of food and beverages provided by restaurants in 2021 and 2022. Thus, your business may write off the entire cost of some meals this year.

Work Opportunity Tax Credit
If your business becomes busier than usual during the holiday season, it may add to the existing staff. Consider all the relevant factors, including tax incentives, in your hiring decisions.

TAX TACTIC: All other things being equal, you may hire workers eligible for the Work Opportunity Tax Credit (WOTC). The credit is available if a worker falls into a "target" group.

Generally, the WOTC equals 40% of the first-year wages of up to $6,000 per employee, for a maximum of $2,400. For certain qualified veterans, the credit may be claimed for up to $24,000 of wages, for a $9,600 maximum. There is no limit on the number of credits per business.

Tip: The WOTC has expired—and then been reinstated—multiple times in the past, but the CAA extended it for five years through 2025.

Business Start-up Expenses

The tax law allows a small business owner to claim a first-year deduction of up to $5,000 for qualified start-up costs. Any remaining expenses must be amortized over 180 months. However, the $5,000 write-off is phased out for start-up costs exceeding $50,000.

TAX TACTIC: Open for business before the end of the year. Typically, this means you must begin offering goods or services. Otherwise, you cannot claim the current $5,000 deduction.

Generally, start-up costs are those that would be deductible as business expenses, such as:

- An analysis of potential markets, products, labor supply, transportation facilities, etc.
- Advertisements for the opening of the business.
- Salaries and wages for employees who are being trained and those instructing them.
- Travel costs to secure prospective distributors, suppliers, customers or clients.
- Salaries and fees for executives and consultants or similar professional services.

Tip: If it suits your purposes, you can elect to have all business start-up costs amortized over 180 months. This may be preferable for an entrepreneur expecting a low tax liability in 2021.

Miscellaneous

- Stock up on routine supplies (especially if they are in high demand). If you buy the supplies in 2021, they are deductible in 2021, even if you do not use them until 2022.
- Under the CARES Act, a business could defer 50% of certain payroll taxes due in 2020. Half of the deferred amount is due at the end of 2021, so meet this obligation if it applies.
- Maximize the qualified business interest (QBI) deduction for pass-through entities and self-employed individuals. Note that special rules apply if you are in a “specified service trade or business” (SSTB).

- If you pay year-end bonuses to employees in 2021, the bonuses are generally deductible by your company and taxable to the employees in 2021. A calendar-year company operating on the accrual basis may be able to deduct bonuses paid as late as March 15, 2022, on its 2021 return.

- Generally, repairs are currently deductible, while capital improvements must be depreciated over time. Therefore, make minor repairs before 2022 to increase your 2021 deduction.

- Have your C corporation make monetary donations to charity. ARPA extends a 2020 increase in the annual deduction limit from 10% of taxable income to 25% for 2021.

- Keep records of collection efforts (e.g., phone calls, emails and dunning letters) to prove debts are worthless. This may allow you to claim a bad debt deduction.

FINANCIAL TAX PLANNING

Securities Sales

Traditionally, investors time sales of assets like securities at year-end for optimal tax results. For starters, capital gains and losses offset each other. If you show an excess loss for the year, you can then offset up to $3,000 of ordinary income before any remainder is carried over to the next year. Long-term capital gains from sales of securities owned longer than one year are taxed at a maximum rate of 15% or 20% for certain high-income investors. Conversely, short-term capital gains are taxed at ordinary income rates reaching as high as 37% in 2021.

TAX TACTIC: Review your portfolio. Depending on your situation, you may want to harvest capital losses to offset gains or realize capital gains that will be partially or wholly absorbed by losses. For instance, you might sell securities at a loss to offset a high-taxed short-term gain.

Be aware of even more favorable tax treatment for certain long-term capital gains. Notably, a 0% rate applies to taxpayers below certain income levels, such as young children. Furthermore, some taxpayers who ultimately pay ordinary income tax at higher rates due to their investments may qualify for the 0% tax rate on a portion of their long-term capital gains.

However, watch out for the "wash sale rule." If you sell securities at a loss and reacquire substantially identical securities within 30 days of the sale, the tax loss is disallowed. A simple way to avoid this harsh result is to wait at least 31 days to reacquire substantially identical securities.

Tip: The preferential tax rates for long-term capital gains also apply to qualified dividends received in 2021. These are most dividends paid by U.S. companies or qualified foreign companies.

Required Minimum Distributions

Normally, you must take "required minimum distributions" (RMDs) from qualified retirement plans and traditional IRAs after reaching age 72 (70½ for taxpayers affected prior to 2020). The amount of the RMD is based on IRS life expectancy tables and your account balance at the end of last year.

If you do not meet this obligation, you owe a tax penalty equal to 50% of the required amount (less any amount you have received) on top of your regular tax liability.

The CARES Act suspended the RMD rules for 2020—but for 2020 only. The RMD rules are reinstated for this year.

TAX TACTIC: Make arrangements to receive RMDs before January 1, 2022. Do not procrastinate. If you wait too long, you may miss the December 31 deadline if the financial institution cannot accommodate you quickly enough or you run into other complications.

As a general rule, you may arrange to receive the minimum amount required, so you can continue to maximize tax-deferred growth within your accounts. However, you may decide to take larger distributions—or even the full balance of the account—if that suits your needs.

Tip: The IRS has revised the tables for 2022 to reflect longer life expectancies. This will result in smaller RMDs in the future.

Net Investment Income Tax
Moderate-to-high income investors should be aware of an add-on 3.8% tax that applies to the lesser of "net investment income" (NII) or the amount by which MAGI for the year exceeds $200,000 for single filers or $250,000 for joint filers. (These thresholds are not indexed for inflation.) The definition of NII includes interest, dividends, capital gains and income from passive activities, but not Social Security benefits, tax-exempt interest and distributions from qualified retirement plans and IRAs.

TAX TACTIC: After a careful analysis, estimate both your NII and MAGI for 2021. Depending on the results, you may be able to reduce your NII tax liability or avoid it altogether.

For example, you might invest in municipal bonds ("munis"). The interest income generated by munis does not count as NII, nor is it included in the calculation of MAGI. Similarly, if you turn a passive activity into an active business, the resulting income may be exempt from the NII tax. Caution: These rules are complex, so obtain professional assistance.

Tip: When you add the NII tax to your regular tax plus any applicable state income tax, the overall tax rate may approach or even exceed 50%. Factor this into your investment decisions.

Section 1031 Exchanges
Beginning in 2018, the TCJA generally eliminated the tax deferral break for Section 1031 exchanges of like-kind properties. However, it preserved this tax-saving techniques for swaps involving investment or business real estate. Therefore, you can still exchange qualified real estate properties in 2021 without paying current tax, except to the extent you receive "boot" (e.g., cash or a reduction in mortgage liability).

TAX TACTIC: Make sure you meet the following two timing requirements to qualify for a tax-deferred Section 1031 exchange.

- Identify or actually receive the replacement property within 45 days of transferring legal ownership of the relinquished property.

- Have the title to the replacement property transferred to you within the earlier of 180 days or your 2021 tax return due date, plus extensions.

Note that the definition of "like-kind" is relatively liberal. For example, you can exchange an apartment building for a warehouse or even raw land.

Tip: Proposed legislation would eliminate the tax break for real estate. If this technique appeals to you, start negotiations that can be completed before the end of the year.

Estate and Gift Taxes

Going back to the turn of the century, Congress has gradually increased the federal estate tax exemption, while establishing a top estate tax rate of 40%. At one point, the estate tax was repealed—but for 2010 only—while the unified estate and gift tax exemption was severed and then subsequently reunified.

Finally, the TCJA doubled the exemption from $5 million to $10 million for 2018 through 2025, with inflation indexing. The exemption is $11.7 million in 2021.

TAX TACTIC: Develop a comprehensive estate plan. Generally, this will involve various techniques, including trusts, that maximize the benefits of the estate and gift tax exemption. The table below shows the progression of the exemption and top estate tax rate for the last ten years.

Tax year	Estate tax exemption	Top estate tax rate
2012	$5.12 million	35%
2013	$5.25 million	40%
2014	$5.34 million	40%
2015	$5.43 million	40%
2016	$5.45 million	40%
2017	$5.49 million	40%
2018	$11.18 million	40%
2019	$11.40 million	40%
2020	$11.58 million	40%
2021	$11.7 million	40%

Furthermore, you can give gifts to family members that qualify for the annual gift tax exclusion. For 2021, there is no gift tax liability on gifts of up to $15,000 per recipient ($30,000 for a joint gift by a married couple). This reduces the size of your taxable estate.

Tip: You may "double up" by giving gifts in both December and January that qualify for the annual gift tax exclusion for 2021 and 2022, respectively.

Miscellaneous

- Contribute up to $19,500 to a 401(k) in 2021 ($26,000 if you are age 50 or older). If you clear the 2021 Social Security wage base of $142,800 and promptly allocate the payroll tax savings to a 401(k), you can increase your deferral without any further reduction in your take-home pay.

- Sell real estate on an installment basis. For payments over two years or more, you can defer tax on a portion of the sales price. Also, this may effectively reduce your overall tax liability.

- Weigh the benefits of a Roth IRA conversion, especially if this will be a low-tax year. Although the conversion is subject to current tax, you generally can receive tax-free distributions in retirement, unlike taxable distributions from a traditional IRA

- From a tax perspective, it is often beneficial to sell mutual fund shares before the fund declares dividends (the ex-dividend date) and buy shares after the date the fund declares dividends.

- Consider a qualified charitable distribution (QCD). If you are age 70½ or older, you can transfer up to $100,000 of IRA funds directly to a charity. Although the contribution is not deductible, the QCD is exempt from tax. This may improve your overall tax picture.

CONCLUSION

This year-end tax-planning letter is based on the prevailing federal tax laws, rules and regulations. Of course, it is subject to change, especially if additional tax legislation is enacted by Congress before the end of the year.

Finally, remember that this letter is intended to serve only as a general guideline. Your personal circumstances will likely require careful examination. We would be glad to schedule a meeting with you to assist with all your tax-planning needs.

Very truly yours,

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