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Tax Newsletter

Four Major Changes in FSA Rules
New laws offer temporary benefits

New legislation has enhanced the rules for flexible spending accounts (FSAs). Generally, participants in FSSAs will have more flexibility in managing their accounts, albeit temporarily. **Key point:** Employers may choose to implement the new law changes but are not required to do so.

Background: There are two types of FSAs that employers may offer to employees—one for healthcare expenses and one for dependent care expenses. With either type of account, contributions are made on a pre-tax basis, so employees save income and payroll taxes. And, when withdrawals are made, payouts are exempt from tax if the money is used to pay for qualified expenses.

The maximum contribution for healthcare FSAs is $2,750. It is $5,000 for dependent care FSAs.

Two new laws—the Consolidated Appropriations Act (CAA) and the American Rescue Plan Act (ARPA)—provide additional benefits, as clarified by new IRS guidance. This includes these four significant changes.

1. Grace period: For years, participants were subject to a "use-it-or-lose it rule," where any remaining funds in the FSA were forfeited at the end of the plan year. More recently, employers were able to grant a 2½-month grace period. Under the CAA, an employer may allow a **12-month grace period** for FSA funds in a plan year ending in 2020 or 2021.

2. Carryovers: As an alternative to a grace period, an employer may allow participants to carry over up to $550 in unused funds to the next plan year. But this benefit could not be combined with a grace period and was only available for healthcare FSAs. Now the CAA extends the tax break to dependent care FSAs, allows unlimited carryover amounts from 2020 to 2021 and 2021 to 2022 and permits employers to offer *both* a grace period and a carryover.

3. Dependent care increases: Normally, a dependent care FSA can provide for payment of qualified expenses for children under age 13. The CAA increases the maximum age threshold to 14 for 2021. Also, ARPA hikes the contribution limit for dependent care expenses in 2021 to $10,500—more than double the usual limit.

4. Mid-year elections: Generally, an FSA election for a plan year is irrevocable, barring a change in status. Under the CAA and IRS guidance, a plan can be amended to allow a participant to make changes to their healthcare or dependent care FSA anytime during a plan year ending in 2021, even if the participant does not have a change in status. This includes enrolling, dis-enrolling or increasing or decreasing contributions.

An employer may allow election changes on a one-time-only basis or on a specific date. Furthermore, it can limit mid-year election changes to certain actions (e.g., increasing or decreasing contributions).

Finally, the latest IRS guidance explains that a carryover from a prior year does not affect the contribution limit for the current year. For example, if you carry over $5,000 from a dependent care FSA for 2020 because your child's day care was cancelled, you can still contribute $10,500 for 2021, for a total of $15,500.

Important: The guidance from the IRS covers other technicalities. Contact your tax advisor for more information.

Guard Against Investment Scams
Six tips for spotting come-ons

Practically everyone knows someone who has been victimized by an investment scam (or knows someone else who has). It is a common occurrence and even sophisticated investors can become unsuspecting victims. What's more, the crooks are concocting new scams daily.

These scams are being developed so fast and furiously it is virtually impossible to identify them all. However, a widespread scam usually takes one of the following forms.

- Someone, perhaps an insider at a company, promises you a deal that is unrealistic. If it sounds too good to be true, it probably is.

- A promoter wants to sell you a "guaranteed" trading system. There is no such thing as an absolute guarantee in the investment world.

- You are asked to participate in a complicated deal involving offshore banking or exotic investments like diamonds, often located in a foreign country. If you do not understand what you are investing in, do not risk your money.

- Unscrupulous brokers attempt to entice you into a "pump and dump" scheme. Typically, they fraudulently pump up penny stock prices and then dump them on investors.

Some of the latest scams are variations on these basic themes. Be extremely cautious if you are approached in this manner, whether it is online, over the phone or in-person.

To assist investors, the Financial Industry Regulatory Authority (FINRA), a nonprofit organization with oversight of investment advisors, offers these six tips for spotting scams.

1. Verify credentials. Do not fall for a fancy title or other trappings of success. Fraudsters hope that if they look successful, you will not bother to check their credentials. Investment professionals must register with FINRA, the Securities and Exchange Commission (SEC) or your state securities or insurance regulator. Use FINRA BrokerCheck, a free online tool, to obtain information about investment advisers.

2. Do not chase after phantom riches. Be skeptical of investment pitches that guarantee a certain return or promise spectacular profits. The reality is that every investment involves risk.

3. Ignore the "everyone is doing it" story. Be wary of a sales pitch that focuses on how many people are investing without telling you why the investment is sound. Remember that scam artists often prey upon members of the same social circle, religious group or ethnic background.

4. Refuse to be rushed. If a promoter tells you that the offer is for a "limited time only," or that investment opportunities are limited, consider it to be a red flag. A legitimate investment will still be there tomorrow.

5. Do not feel obligated to invest just because the seller gives you something for free. Salespeople count on those freebies to guilt you into buying what they are selling.

6. Arm yourself with relevant information. Learn to spot the warning signs of investment fraud so you can protect yourself and your loved ones.

For more information, visit the websites for FINRA and the SEC. **Practical advice:** Look before you leap into investments.

Do You Have to File a Gift Tax Return?
Protection by annual gift tax exclusion

Are you planning to give gifts to family members in 2021? As long as the gifts do not exceed the limits for the annual gift tax exclusion, you have no federal gift tax worries. Generally, you do not even have to file a gift tax return.

However, there are times when you DO have to file a gift tax return, Form 709, for 2021, and other times when you may choose to file a return even if you are not technically required to.

Background: Under the annual gift tax exclusion, gifts up to a specified limit are completely exempted from federal gift tax, without eroding any of the unified estate and gift tax exemption. The annual gift tax exclusion for 2021 is $15,000 per recipient (the same as 2020). Unlike most other inflation-based adjustments, the exclusion may increase only in $1,000 increments.

For instance, if you gave five family members $15,000 each in 2021, for a total of $75,000, you would owe zero gift tax. What's more, the exclusion is doubled to $30,000 per recipient if your spouse consents to join in the gift. However, in the case of this "split gift," you must file a gift tax return (unless you reside in a community property state).

The unified estate and gift tax exemption, which applies to both lifetime gifts and amounts in your taxable estate, can pick up the slack if your gifts exceed the annual gift tax exclusion amount. However, this erodes the exemption that can subsequently be used to shelter your assets from estate tax. As of the date of publishing June's newsletter, exemption effectively shelters $11.7 million from tax in 2021.

If you are required to file a gift tax return, it is generally due by April 15th of the following tax year, just like your federal income tax return. For instance, for gifts above the exclusion or split gifts made in 2021, the deadline for the gift tax return is April 15, 2022. If you apply for an extension for your federal income tax return filing, the extension applies to your gift tax return. Thus, you may be able to postpone filing until October 17, 2022. (October 15, 2022 is a Saturday.)

Note that you may file a gift tax return, even if you are not required to, for purposes of establishing the value of assets with the IRS. This may also provide a measure of audit protection. The IRS frequently audits estates if it suspects that assets have been undervalued. By filing a gift tax return where you honestly disclose the value of the gifts, a safe harbor rule prohibits audits after three years has passed. But this safe-harbor rule does not apply in the event of fraud or inadequate disclosure.

Final words: This is usually not a do-it-yourself proposition. Rely on your professional tax advisors to avoid any dire tax consequences.

Doing the Tax Laundry

Generally, you can offset capital gains by losses from securities sales, plus up to $3,000 of ordinary income. But the "wash sale rule" can put a crimp in your plans.

How it works: If you acquire substantially identical securities within 30 days of a sale, you do not realize any current tax benefit from a loss. Instead, the amount of the disallowed loss is added to your basis in the new securities.

One common midyear tax move is to wait at least 31 days to buy back the same or similar securities. Alternatively, you might buy the securities and then wait at least 31 days to sell the original shares at a loss.

Facts and Figures
Timely points of particular interest

Tax Talk—Talk of new federal tax legislation is in the air. For instance, recent proposals would increase the **capital gains and qualified dividends tax** for certain high-income individuals and repeal the "step-up in basis" on inherited assets. But these proposals are a long way from enactment and could be modified or dismissed altogether. Also, the effective date for any change is uncertain. We will continue to monitor developments and keep you posted.