HARPER | PEARSON

Tax Newsletter

Seven Year-End Tax Moves for You
Tax-saving ideas for individuals

As another turbulent year winds down, individuals still have time to reduce their tax liability for 2021. Taking key federal tax legislation enacted over the last two years into account—including the Coronavirus Aid, Relief, and Economic Security (CARES) Act, the Consolidated Appropriations Act (CAA) and the American Rescue Plan Act (ARPA)—we have outlined seven popular tax-saving opportunities.

1. Charitable donations: If you itemize, you can boost your charitable deduction by donating money or property to charity at year-end. For 2021, the annual limit on your deduction for monetary gifts is equal to 100% of your adjusted gross income (AGI), the same as in 2020. Under prior law, the limit was 60% of AGI.

If you do not itemize and claim the standard deduction, you can still write off a maximum of $300 in monetary gifts to qualified charitable organizations in 2021 ($600 for joint filers).

2. Required minimum distributions: Normally, if you are age 72 or older (increased from age 70½ in 2020), you must take annual required minimum distributions (RMDs) from traditional IRAs and qualified plans like a 401(k). Otherwise, you are hit with a 50% tax penalty on top of your regular income tax liability. RMDs are based on life expectancy tables and the balance in your account on December 31 of the prior year.

The RMD rules were suspended for 2020—but 2020 only. Make sure you meet these obligations before the end of the year

3. Capital gains and losses: Currently, investors may continue to offset capital gains and losses against each other. As a result, you might realize capital gains from sales of securities to absorb capital losses from earlier in the year or realize losses to offset capital gains plus up to $3,000 of ordinary income in 2021.

The maximum tax rate on long-term capital gains for assets held longer than a year remains at 15% (20% for certain high-income taxpayers). In addition, certain low-income taxpayers (e.g., your children) may benefit from a 0% rate. **Caution:** Be aware of potential "kiddie tax" complications.

4. Medical expenses: An itemizer can deduct unreimbursed medical expenses above an annual threshold. Previously, the limit was 10% of AGI, but the threshold has now been lowered—permanently—to 7.5% of AGI.

If you are near or over the 7.5%-of-AGI threshold for 2021, you might accelerate non-emergency expenses, such as physical exams or dental cleanings, from 2022 into 2021.

5. Child Tax Credit: Many families may benefit from an enhanced Child Tax Credit (CTC) in 2021. Among other changes, the maximum credit is increased from $2,000 to $3,000 for a qualifying child ($3,600 for qualifying children under age six).

The IRS has been sending out advance CTC payments since the middle of the year. Note that the advance payments will be reflected on the 2021 return you must file in 2022.

6. Installment sales: If you sell real estate or other capital assets, you generally owe the full amount of capital gains tax in the year of the sale. However, you may benefit from installment sale reporting if you receive payments over two or more years. Essentially, you are taxed on a pro-rata basis on the amount received from the sale each year.

Not only does this defer tax, you may lower your overall tax liability if a larger portion of the capital gain is taxed over several years at the 15% rate instead of the 20% rate.

7. Estimated tax: If you underpay income tax during the year through any combination of withholding and installment payments, you could be liable for an estimated tax penalty. When it is appropriate, make adjustments to qualify for one of two “safe harbor” exceptions.

Generally, you can avoid the penalty by paying at least 90% of your current tax liability or 100% of the prior year’s tax liability (110% if your AGI for 2020 exceeded $150,000). A third safe-harbor rule provides flexibility for workers who earn most of their income during the holiday season.

Final words: These are just seven possibilities to consider. With assistance from your professional advisor, you can develop a tax plan personalized for your situation.

Seven Year-End Tax Moves for Businesses
Tax-saving ideas for business operations

Just like individuals, your business may benefit from year-end tax strategies under the latest laws of the land. Following are seven ideas for an employer to consider as 2021 draws to a close.

1. Business property: If your business activity been ramping back up, you may need to acquire equipment to keep humming on all cylinders. Under Section 179 of the tax code, you can expense, or currently deduct, up to $1.05 million of qualified business property placed in service in 2021.This amount begins to phase out above a threshold of $2.62 million. But the deduction cannot exceed the taxable income of your business.

Furthermore, a business may be able to claim 100% first-year “bonus depreciation” on any remaining cost. If any amount is still left over, it can be written off through regular depreciation deductions.

2. Employee Retention Credit: A business may qualify for the Employee Retention Credit (ERC) for keeping workers on the books in 2021. To be eligible, the employer must have suspended operations due to the COVID-19 pandemic or experienced a significant decline in gross receipts.

Congress has enhanced the ERC for 2021. Among other changes, the maximum credit has been raised to $28,000 per employee—a hefty sum. Plus, certain start-up companies are now eligible for the ERC.

3. Business meals: Despite a recent tax law crackdown on business entertainment expenses, such as the cost of meals following or preceding a substantial business meeting, you can still deduct expenses of certain business meals. This includes the cost of food and beverages associated with entertainment if invoiced separately.

To sweeten the pot, new legislation increases the usual deduction of 50% of the cost of qualified business meals to 100% for food and beverages provided by restaurants in 2021 and 2022.

4. Cash accounting: Generally, small business owners prefer to use the simplified cash method of accounting. However, under prior law, a C corporation that was not a personal service corporation generally could not use the cash method if its average gross receipts for the three prior tax years exceeded $5 million. But this limit was recently increased to $25 million (inflation-indexed to $26 million in 2021).

Weigh the benefits of a switch to the cash accounting method. Review all the implications with your professional tax advisor.

5. Start-up costs: During the past year, you may have pivoted into a new business undertaking or started another venture. Saving grace: The tax code provides a special write-off of up to $5,000 of qualified start-up expenses. This includes costs normally deductible by an active business. However, you must actually get the business going before 2022 to qualify for this tax break.

Start-up costs above $5,000 must be amortized over 180 months. In addition, the deduction begins to phase out for expenses above $50,000.

6. Work Opportunity Tax Credit: An employer looking to increase its staff at year-end can claim the Work Opportunity Tax Credit (WOTC) for hiring disadvantaged workers from one of several disadvantaged "target" groups. Generally, the WOTC equals 40% of the first-year wages of up to $6,000 per employee, for a maximum of $2,400 per employee. For certain veterans, the credit is available for up to $24,000 in wages, for a maximum of $9,600 per employee.

The WOTC has expired and been reinstated numerous times in the past. At long last, Congress has extended the credit for five years, through 2025.

7. Charitable contributions: Finally, your business may benefit from the current tax rules for charitable contributions. For 2021, a C corporation may deduct monetary gifts up to 25% of taxable income (increased from 10% prior to 2020) as well as benefitting from enhanced deductions for donations of food inventory of up to 25% of taxable income (increased from 15% prior to 2020).

In summary: Consult with professional advisors before the end of the year to identify the best options for your business.

Plan Ahead for Special Use Valuation
Coordinating unique estate tax technique

What will be the biggest asset in your taxable estate? For many people, it is the value of a closely-held business interest, including any real estate and tangible property that they own. Even though the tax law allows a generous estate tax exemption—indexed to $11.7 million for 2021—your family may still face estate tax exposure, especially if the exemption is lowered in the future, as it is scheduled to be.

However, you may be able to benefit from a unique tax election for "special use valuation." If your executor makes this election, it can reduce the value of your taxable estate by hundreds of thousands of tax dollars—or maybe even a million or more. As a result, this can help avoid or reduce estate tax liability in conjunction with the prevailing estate tax exemption.

Background: The fair market value (FMV) of property owned by a decedent at death is included in their taxable estate. Generally, FMV for this purpose is determined by the property's "highest and best use." For instance, if the property is a small office building that would be worth a small fortune to real estate developers that specialize in condos or strip malls, the higher value as real estate development property is treated as the FMV for estate tax purposes.

But there is another wrinkle for property of a closely-held business or a farm. If certain requirements are met, the business owner's property is valued according to its current actual use upon the owner's death instead of its highest and best use. This value may be considerably lower.

Caution: The reduction in the estate tax value under the special use valuation election cannot exceed a specified amount. The inflation-indexed maximum for decedents dying in 2021 is $1.19 million.

Also, eligibility for special use valuation is not automatic. To qualify for the special tax break, the following requirements must be met:

- The net value of the business property must be at least 50% of the decedent's gross estate and 25% of the decedent's adjusted gross estate (the gross estate reduced by certain deductible debts, expenses, claims and losses).

- The decedent must have transferred the business to a qualified heir or heirs (e.g., close family relatives).

- The business must have been owned and operated for a qualified use by the decedent or a close family relative for five out of the last eight years before the death of the decedent.

Still another hurdle: If the heirs sell or otherwise dispose of the property to outsiders within ten years of the owner's death or they begin using the property for another purpose, the estate tax savings must be recaptured. Therefore, it is important that all parties fully understand the ten-year rule and comply with the restrictions.

Finally, be aware that the special use valuation election is irrevocable. Because there is no going back, the parties should be sure this is the optimal choice for the situation. Your professional advisors can provide guidance

Should You Go in Reverse?

Are you intrigued by the idea of a reverse mortgage? It is a twist on the standard mortgage. With this arrangement, the lender effectively pays the homeowner, instead of the other way around.

This may be a way for a qualified individual (e.g., someone at least 62 years old) to tap into **home equity**, but it also fraught with perils. Plus, you might be hit with unexpected fees. Obtain expert guidance before you commit.

Facts and Figures
Timely points of particular interest

Social Security Tax—The Social Security Administration (SSA) has announced that the Social Security wage base is going up again. For 2022, the 6.2% portion of federal payroll taxes will apply to the first $147,000 of wages, up from $142,800 in 2021—a sizeable increase. The 1.45% Medicare portion of payroll taxes will continue to apply to all wages received by employees.