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Tax Newsletter

Five Steps for a New Business Plan
Practical suggestions for upcoming year

Have you written a business plan for 2022? If not, you should get to work.

Developing a business plan for the upcoming year is a laborious task, but it is often critical to the continued success of the operation. Although the details will vary company to company, the best approach is to confront the challenges expected for the year, as well as addressing the strengths and weaknesses within the organization. Conversely, if a business has a mere rudimentary plan—or even worse, no plan at all—the likelihood for real progress is diminished.

Generally, a business plan will include a statement of objectives, assets and liabilities, position in the market, future direction, critical issues and so on. It may be helpful to seek insights from your professional advisors, but there is no “magic formula” for a plan’s creation. It can take whatever form you want.

Keeping that in mind, here are **five practical ideas** for developing a business plan for 2022.

1. Chart the path. Start by examining where the business is right now, where you expect it to go and how you to intend to arrive there. Of course, the plan should remain flexible enough to be modified when need be. For instance, new developments may require you to deviate from your initial approach. But most business decisions will be fundamentally sound when made within the context of the basic plan.

2. Focus on strategic action. Rather than confronting problems as they arise, be proactive. Although documenting tactics ahead of time requires in-depth analysis, this is usually time well-spent. In contrast, a hastily conceived plan will likely be of little use. Some experts have argued that the process of developing the plan is actually as helpful as having the plan itself.

3. Encourage communication. Writing out a business plan will also force you to crystallize your vision of the company. At the same time, you should seek input from other key members of your business, such as your top-level managers. A back-and-forth dialogue may be especially useful in small firms where a strong owner usually takes the lead and rarely heeds the advice of others.

4. Build up a cushion of working capital. This step requires an examination of your revenue stream and expenditures. Emphasize ways to increase accounts receivable and reduce accounts payable. If you will need to borrow money, know that a lender will likely want to refer to your business plan, featuring key projections, before it approves a loan for your firm.

5. Establish greater credibility. A comprehensive business plan may convince customers or clients to use your services or purchase your goods. It creates an air of legitimacy. This may also satisfy a psychological need to have the company taken seriously.

In summary: As mentioned above, the written document does not have to be final and absolute. Put it in a digital file. This will enable you to tinker with it and make modifications throughout the year when necessary. Again, your business advisors can provide guidance in areas where you are not experienced.

Unlock the Tax Shelter for Home Sales
Requirements for a unique tax break

Tax breaks seem to come and go, but one of the biggest and best "tax shelters" around is still standing. Thanks to Section 121 of the tax code, a taxpayer can exclude from federal income tax up to $250,000 of gain from the sale of a home—$500,000 if you are married and file a joint return. In this current residential real estate market, you might reap a tax windfall as long as you meet the requirements spelled out in the tax law.

Background: To qualify for the $250,000/$500,000 home sale tax break, the home must have been owned by you and used as your principal residence at least two of the five years prior to the sale. This special tax exclusion does not apply, however, if you sold another qualified principal residence within the last two years. (Theoretically, you could qualify for the home sale exclusion every two years.)

Keeping that in mind, here are some of the key points to know about the home sale exclusion:

- The home must have been used as your principal residence for any two of the previous five years. But the years do not have to be consecutive. Furthermore, you can meet the "use" and "ownership" requirements in different tax years.

- If you file a joint return, you can claim the maximum exclusion if (1) either spouse meets the two-year ownership test, (2) each spouse meets the two-year use test and (3) neither spouse has elected the exclusion within the last two years. This is particularly important to remember if you have recently divorced or remarried.

- In order to meet the "use" requirement, you must physically occupy the home, but short absences do not count against you. On the other hand, a longer absence, such as a one-year sabbatical by a college professor, affects the time that the home is being used as your principal residence.

- If you own two homes and live in both places during the year, the home where you stay for most of the year is generally treated as your principal residence. For instance, if you spend seven months at a winter home and five months at a summer home, the winter home is usually considered to be your principal residence. Be careful to document your stays.

- To the extent that the home has been used for business rental or use—including using a portion of the residence as a home office—you must recapture depreciation deductions attributable to the period after May 6, 1997. The recaptured income is taxable at the 25% rate.

- In some cases, you may qualify for a partial exclusion without meeting the usual two-year rule if you sell the home sooner due to a change in employment, health reasons or other unforeseen circumstances.

Reminder: This is just a general overview of the tax exclusion available for the sale of a qualified principal residence. It is strongly recommended that you consult with a professional tax advisor concerning this unique tax shelter and other tax ramifications of home ownership.

Keeping Track of Digital Assets
Six ideas for estate planning

The reach of the electronic age seems to know no bounds, but we are still figuring out some of the fall-out. For example, consider the estate planning consequences when you leave online accounts and files when you pass away, not to mention passwords that have not been disclosed to others.

In this day and age, it is not enough to develop an estate plan based on paper documents such as a will. You must also account for any "digital assets" comprising part of your estate.

The laws in the individual states pertaining to these issues are continuing to evolve. For instance, in some states, executors are given access to online accounts. In addition, online services have their own rules governing user accounts. Accordingly, here are six ideas for managing your digital assets in 2022.

1. Create an inventory. Make a list of all your online accounts, including e-mail, financial accounts, social media sites and any other site where you conduct business online. Record the vital information—including usernames and passwords—for each account as well as your other digital devices like smartphones and computers.

2. Store information for safekeeping. There are several places you can store this information but be careful. For instance, if you write it down on paper, it can fall into the wrong hands. Alternatively, you might keep it in a safe deposit box or give it to your attorney to hold. But remember that others will still have to know where it is located. If you decide to store the information online, use a secure and reputable service.

3. Grant access to personal representatives. Once you have created your inventory, notify the people who will need to act if you are incapacitated or pass away. Most important, let them know where to find the necessary information and how to access it. Remember that they should adopt the same security measures as you do.

4. Coordinate with paper documents. These will work hand-in-hand with your digital assets. Typically, you should ensure that the attorney-in-fact named in a durable power of attorney and the executor designated by your will have the authority to deal with your online accounts. Your attorney can provide the necessary language for tying up any loose ends.

5. Stay up-to-date. When you acquire new accounts and adopt additional services and devices, or change usernames and passwords, you must update your list so that it remains current. Try to check it periodically, but certainly review the list at least once a year.

6. Seek professional guidance, when appropriate. As mentioned above, you do not have to go it alone. Work with your professional advisors as part of the estate planning process.

Finally, take advantage of the positives available through modern technology, but beware of the potential negatives.

Tax Verdict on Legal Expenses
When are deductions allowed?

Is there any justice when it comes to deducting legal expenses? It depends on your point of view. Under current law, most legal expenses of a personal nature are nondeductible, but you can generally write off legal expenses incurred by a business.

Background: Previously, you could deduct personal legal expenses incurred in one of the following three situations:

1. Collection or production of taxable income.

2. Managing, conserving or maintaining income-producing property.

3. The determination, collection or refund of any tax.

For example, you may have qualified for a deduction of legal expenses relating to a divorce. But this is no longer the case—at least for the time being.

Reason: Personal legal expenses were deducted as miscellaneous expenses subject to an overall floor of 2% of adjusted gross income (AGI). But the Tax Cuts and Jobs Act (TCJA) suspended miscellaneous expense deductions for 2018 through 2025. Thus, you cannot claim deductions for any of those expenses on your 2021 return, regardless of your AGI.

As things stand now, the law is scheduled to revert to the prior rules in 2026. However, Congress could repeal this provision, accelerate the timeline or extend it.

In any event, you may still deduct personal legal expenses in a handful of instances, including fees paid in employment discrimination cases where you are the plaintiff and claims against the federal government for damage to personal property.

Saving grace: As a general rule, legal expenses incurred to acquire real estate or defend or protect its ownership are capitalized and added to the "basis" of the property. This may allow you to claim depreciation deductions over time or reduce your taxable gain when the property is sold. Similarly, legal fees incurred in connection with buying a personal residence are added to its basis. When the home is sold, this reduces any taxable gain.

Conversely, many legal fees relating to a business are deductible. For example, if you are self-employed individual, legal expenses incurred for the following purposes may be deductible on Schedule C.

- Collection of income from a customer or client (plus relevant court costs);
- Declaring business bankruptcy;
- Handling and maintaining income-producing equipment;
- Litigation directly involving the business (plus related attorney fees);
- Defending your business reputation;
- Defending patents, trademarks and copyrights; and
- Drafting or negotiating contracts.

Also, be aware that tax advice for business purposes is generally deductible, but tax-related fees of a personal nature are not deductible under current law.

In summary: For 2021 returns, you generally cannot deduct legal expenses relating to personal matters, but you may be able to write off fees relating to business practices. Obtain expert advice for any expenses that fall into a gray area.

IRS Increases Retirement Plan Limits

The IRS has announced cost-of-living adjustments (COLAs) for certain retirement plans for 2022. As opposed to recent years, when COLAs have been slim or nonexistent, there are some notable increases, as shown below.

	Limit for 2021	Limit for 2022
Maximum annual dollar benefit for a defined benefit plan	$230,000	$245,000
Maximum dollar limit on additions to a defined contribution plan	$58,000	$61,000
Maximum amount of compensation take into account for qualified retirement plans	$290,000	$305,000
Dollar limit for elective deferrals to a 401(k) plan	$19,500 ($26,000 if age 50 or over)	$20,500 ($27,000 if age 50 or over)
Dollar limit for contributions to a SIMPLE plan	$13,500 ($16,500 if age 50 or over)	$14,000 ($17,000 if age 50 or over)

Note: The annual limit for contributions to **traditional and Roth IRAs** remains at $6,000 for 2022 ($7,000 if you are age 50 or over). However, the phase-out levels for IRA and Roth contributions have been adjusted upward.

Facts and Figures
Timely points of particular interest

Mileage Rates—The IRS has announced the standard mileage rates for 2022. These are the flat rates that taxpayers may use in lieu of deducting actual expenses in certain situations. The standard mileage rate for business driving increases to 58.5 cents per mile (up 2,5 cents per mile); the rate for medical purpose driving increases to 18 cents per mile (up 2 cents per mile); and the rate for charitable driving, which is set by statute, remains at 14 cents per mile. Do not forget to add in related tolls and parking fees.

Kiddie Tax Grows—The kiddie tax continues to be a thorn in the side of families where a young child has significant investment income. How it works: Unearned income above an annual threshold that is received by a dependent child under age 19, or a full-time student under age 24, is taxed at the top tax rate of the child's parents—not the child's usual tax rate. The IRS recently announced the threshold for 2022 is $2,300, up from $2,200 on 2021 returns.

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