November 11, 2021

Dear Clients and Friends,

If you are a fan of memes, you will know the last two years have given us a plethora of things to laugh and cry about on the internet. If you do not know what we are talking about, please take a moment and type 'Best memes of 2020 and 2021' into your favorite search engine.

As the year end approaches, now is a good time to think about planning moves that may help lower your tax bill for this year and possibly next. Year-end planning for 2021 takes place during some uncertainty regarding pending legislation that could, among other things, increase top rates on both ordinary income and capital gain starting next year.

Below is a checklist of items that may benefit you if you act before year-end. We can better identify the actions you can take if we meet with you to tailor a particular plan. Meanwhile, please review the following list. Contact us at your earliest convenience so that we can advise you on which tax-saving moves to make.

Year-End Tax Planning Moves for Individuals

- **Surtax on Unearned Income for Higher Income Earners**
  Pending legislation could cause some changes to the surtax. Accelerating some of this type of income into 2021 could help avoid some NIIT under potential 2022 rules. Here are how the rules currently stand:

  The surtax is 3.8% of the lesser of:

  (1) Net Investment Income (NII) (e.g. – bonds, stocks, mutual funds, etc.)

  or

  (2) The excess of modified adjusted gross income (MAGI) over a threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case).

  Some taxpayers should consider ways to minimize (e.g. - through deferral) additional NII for the balance of the year, others should try to see if they can reduce MAGI other than NII, and other individuals will need to consider ways to minimize both NII and other types of MAGI.

- **An additional Medicare Tax for Higher-Income Earners**
  The 0.9% additional Medicare tax also may require higher-income earners to take year-end action. It applies to individuals whose employment wages and self-employment income total more than an amount equal to the NIIT thresholds, above. Employers must withhold the additional Medicare tax from wages in excess of

$200,000 regardless of filing status or other income. Self-employed persons must take it into account in figuring estimated tax.

There could be situations where an employee may need to have more withheld toward the end of the year to cover the tax. This would be the case, for example, if an employee earns less than $200,000 from multiple employers but more than that amount in total. Such an employee would owe the additional Medicare tax, but nothing would have been withheld by any employer.

- **Long-term Capital Gain**
  Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%, depending on your taxable income. The 0% rate generally applies to net long-term capital gain to the extent that, when added to regular taxable income, it is not more than the maximum zero rate amount (e.g., $80,800 for a married couple; estimated to be $83,350 in 2022). If, say, $5,000 of long-term capital gains you took earlier this year qualifies for the zero rate then try not to sell assets yielding a capital loss before year-end, because the first $5,000 of those losses will offset $5,000 of capital gain that is already tax-free.

- **Postpone income until 2022 and accelerate deductions into 2021**
  Deferring income and accelerating deduction may enable you to claim larger deductions, credits, and other tax breaks for 2021 that are phased out over varying levels of adjusted gross income (AGI). These include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income is also desirable for those of you who anticipate being in a lower tax bracket next year due to changed financial circumstances.

- **Roth IRA**
  If you believe a Roth IRA is better for you than a traditional IRA, consider converting traditional-IRA money invested in any beaten-down stocks (or mutual funds) into a Roth IRA in 2021 if eligible to do so. Keep in mind that the conversion will increase your income for 2021, possibly reducing tax breaks subject to phaseout at higher AGI levels. This may be desirable, however, for those potentially subject to higher tax rates under pending legislation.

- **Payroll Bonuses**
  If you have a bonus coming your way at the end of 2021, it may be of benefit to have your employer defer it until 2022. This change could lower, as well as defer your tax.

- **Itemized Deductions**
  Similar to last year, if you routinely claimed itemized deductions, you may not have been able to do so on your Federal return. That is because the basic standard deduction was increased. For the 2021 tax year, it is as follows:
    - $25,100 for joint filers,

- $12,550 for singles,
- $18,800 for heads of household
- $12,550 for married filing separately

Many itemized deductions remain either cut back or abolished.

For example:

(1) No more than $10,000 of state and local taxes may be deducted.

(2) Miscellaneous itemized deductions (e.g. – investment advisory fees) and unreimbursed employee expenses are no longer deductible.

(3) Personal casualty and theft losses are deductible only if they're attributable to a federally declared disaster and only to the extent the $100-per-casualty and 10%-of-AGI limits are met.

You can still itemize medical expenses to the extent they exceed 7.5% of your adjusted gross income, state and local taxes up to $10,000, your charitable contributions, and interest deductions on a restricted amount of qualifying personal residence debt. But, payments of those items will not save on Federal taxes if they do not cumulatively exceed the new, higher standard deduction.

In addition to the standard deduction, you can claim a $300 deduction ($600 on a joint return) for cash charitable contributions.

For those filing Oregon returns, itemizing is still beneficial to many. Be sure to still hang on to required documentation to support your itemized deductions.

Here are some possible strategies to help with these limitations that remain in effect.

- Some of you may be able to work around these deduction restrictions by applying a bunching strategy to pull or push discretionary medical expenses and charitable contributions into the year where they will do some tax good. For example, if you will be able to itemize deductions this year but not next will benefit by making two years' worth of charitable contributions this year. The COVID-related increase for 2021 in the income-based charitable deduction limit for cash contributions from 60% to 100% of MAGI assists in this bunching strategy.

- Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2021 deductions even if you don't pay your credit card bill until after the end of the year.

- If you expect to owe state and local income taxes when you file your return next year and you will be itemizing in 2021, consider asking your employer to increase withholding of state and local taxes (or make estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2021. But this strategy is not good to the extent it causes your 2021 state and local tax payments to exceed $10,000.

- Required minimum distributions RMDs from an IRA or 401(k) plan (or other employer-sponsored retirement plan) ***have not been waived for 2021***, as they were for 2020. If you were 72 or older in 2020 you must take an RMD during 2021. Those who turn 72 this year have until April 1 of 2022 to take their first RMD but may want to take it by the end of 2021 to avoid having to double up on RMDs next year.

- If you are age 70½ or older by the end of 2021, and especially if you are unable to itemize your deductions, consider making 2021 charitable donations via qualified charitable distributions from your traditional IRAs. These distributions are made directly to charities from your IRAs, and the amount of the contribution is neither included in your gross income nor deductible on Schedule A, Form 1040. However, you are still entitled to claim the entire standard deduction. (The qualified charitable distribution amount is reduced by any deductible contributions to an IRA made for any year in which you were age 70½ or older, unless it reduced a previous qualified charitable distribution exclusion.)

- Take an eligible rollover distribution from a qualified retirement plan before the end of 2021 if you are facing a penalty for underpayment of estimated tax and increasing your wage withholding will not sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2021. You can then timely roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2021, but the withheld tax will be applied pro rata over the full 2021 tax year to reduce previous underpayments of estimated tax.

- Consider increasing the amount you set aside for next year in your employer's FSA if you set aside too little for this year and anticipate similar medical costs next year. If you become eligible in December of 2021 to make HSA contributions, you can make a full year's worth of deductible HSA contributions for 2021.

- Make gifts sheltered by the annual gift tax exclusion before the end of the year if doing so may 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. You can't carry over unused exclusions to another year. These transfers may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

- If you were in a federally declared disaster area, you may want to settle an insurance or damage claim in 2021 to maximize your casualty loss deduction this year.

Year-End Tax-Planning Moves for Businesses & Business Owners

- **Paycheck Protection Program (PPP) Loan Forgiveness**
  For Federal purposes, PPP loan forgiveness may be excluded from gross income. In addition, the IRS clarified that qualified expenses that resulted in PPP Loan Forgiveness can be deducted. Many of you have already applied for the first and second round of PPP forgiveness. If you have not applied for loan forgiveness, please reach out to us if you need any additional help. If you also received an Employee Retention Credit, it is important to remember wages used for calculating loan forgiveness cannot also be used in calculation related to the Employee Retention Credit.

- **Employee Retention Credit (ERC)**

  The employee retention tax credit was a broad-based refundable tax credit designed to encourage employers to keep employees on their payroll. The credit in 2021 was 70% of up to $10,000 in wages per quarter paid by an employer whose business is fully or partially suspended because of COVID-19 or whose gross receipts decline by more than 20%. The passing of the Infrastructure Investment and Jobs Act on November 15, 2021 removed the credit for 4th quarter 2021 for all businesses other than recovery startup business (see below). Deductible wages for your tax return will be reduced by the amount of the credit received.

  The American Rescue Plan Act of March 2021 added the third qualification of a recovery startup business for the ERC. To qualify as a recovery startup business, you must have one or more non-owner employees, gross receipts under $1 million for both 2020 and 2021, and started operations on or after February 15, 2020. If eligible, recovery startup businesses can claim the ERC in the third and fourth quarters of 2021. Please contact us if you have any questions about qualifying for this credit.

- **Qualified Business Income (QBI)**
  Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income (QBI).

For 2021, if taxable income for joint filers exceeds $329,800 (about half of that for others), the deduction may be limited based on whether you are engaged in a service-type trade or business (such as law, accounting, health, or consulting), the amount of W-2 wages paid by the trade or business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the trade or business. The limitations are phased in; for example, the phase-in applies to joint filers with taxable income up to $100,000 above the threshold, and to other filers with taxable income up to $50,000 above their threshold.

- **Cash Method of Accounting**
  More small businesses are able to use the cash (as opposed to accrual) method of accounting in than were allowed to do so in earlier years. To qualify as a small business a taxpayer must, among other things, satisfy a gross receipts test. For 2021, the gross-receipts test is satisfied if, during a three-year testing period, average annual gross receipts don't exceed $26 million (next year the dollar amount is estimated to increase to $27 million). Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings till next year or by accelerating expenses, for example, paying bills early or by making certain prepayments.

- **Business Property Expensing**
  Businesses should consider making expenditures that qualify for the liberalized business property expensing option. For tax years beginning in 2021, the expensing limit is $1,050,000, and the investment ceiling limit is $2,620,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. It is also available for qualified improvement property (generally, any interior improvement to a building's interior, but not for enlargement of a building, elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems.

  The generous dollar ceilings mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. The fact that the expensing deduction may be claimed in full (if you are otherwise eligible to take it) regardless of how long the property is in service during the year can be a potent tool for year-end tax planning. Thus, property acquired and placed in service in the last days of 2021, rather than at the beginning of 2022, can result in a full expensing deduction for 2021.

- **Bonus Depreciation**
  Businesses also can claim a 100% bonus first year depreciation deduction for machinery and equipment bought used (with some exceptions) or new if purchased and placed in service this year, and for qualified improvement property, described above as related to the expensing deduction. 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.

- **De Minimis Safe Harbor Election**
  Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies, assuming the costs don't have to be capitalized under the Code Sec. 263A uniform capitalization (UNICAP) rules. To qualify for the election, the cost of a unit of property can't 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's no AFS, the cost of a unit of property can't exceed $2,500. Where the UNICAP rules aren't an issue, consider purchasing such qualifying items before the end of 2021.

- **Net Operating Loss (NOL)**
  A corporation (other than a large corporation) that anticipates a small net operating loss (NOL) for 2021 (and substantial net income in 2022) may find it worthwhile to accelerate just enough of its 2022 income (or to defer just enough of its 2021 deductions) to create a small amount of net income for 2021. This will permit the corporation to base its 2022 estimated tax installments on the relatively small amount of income shown on its 2021 return, rather than having to pay estimated taxes based on 100% of its much larger 2022 taxable income.

- **Other Ideas to reduce 2021 taxable income**
  - To reduce 2021 taxable income, consider deferring a debt-cancellation event until 2022.
  - To reduce 2021 taxable income, consider disposing of a passive activity in 2021 if doing so will allow you to deduct suspended passive activity losses.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Cheers to a safe and peaceful rest of 2021.

Sincerely,

HMW CPAs & Associates, LLC