Norwalk Business Service, Inc.

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*****Year-End Tax Planning*****

Dear Client:

With year-end approaching, it is time to start thinking about moves that may help lower your tax bill for this year and next. This year's planning is more challenging than usual due to the uncertainty surrounding pending legislation that could, among other things, increase top rates on both ordinary income and capital gain starting next year.

Whether or not tax increases become effective next year, the standard year-end approach of deferring income and accelerating deductions to minimize taxes will continue to produce the best results for all but the highest income taxpayers, as will the bunching of deductible expenses into this year or next to avoid restrictions and maximize deductions.

If proposed tax increases do pass, however, the highest income taxpayers may find that the opposite strategies produce better results: Pulling income into 2021 to be taxed at currently lower rates, and deferring deductible expenses until 2022, when they can be taken to offset what would be higher-taxed income. This will require careful evaluation of all relevant factors.

The items below are just some of the year-end steps that can be taken to save taxes. Our office will be closed the week after Christmas. Contact us before then if you have any questions about tax planning steps you can take.

- Higher-income individuals must be wary of the 3.8% surtax on certain unearned income. The surtax is 3.8% of the lesser of: (1) net investment income (NII), or (2) the excess of 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).
- Pending legislative changes to the 3.8% net investment income tax NIIT proposed to be effective after this tax year would subject high income (e.g., phased-in starting at $500,000 on a joint return; $400,000 for most others) S shareholders, limited partners, and LLC members to NIIT on their pass-through income and gain that is not subject to payroll tax. Accelerating some of this type of income into 2021 could help avoid NIIT on it under the potential 2022 rules, but would also increase 2021 MAGI, potentially exposing other 2021 investment income to the tax.
- Working parents will receive an expanded child and dependent care credit for 2021 only. The credit is worth 50% of the first $8,000.00 paid for one child, and up to $16,000.00 for two or more children. To qualify for the full credit, taxpayers must have an AGI of under $125,000.00.
- Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%, depending on the taxpayer's taxable income. If you hold long-term appreciated-in-value assets, consider selling enough of them to generate long-term capital gains that can be sheltered by the 0% rate. 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 if doing so will enable you to claim larger deductions, credits, and other tax breaks for 2021 that are phased out over varying levels of AGI. These include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may actually pay to accelerate income into 2021. For example, that may be the case for a person who will have a more favorable filing status this year than next (e.g., head of household versus individual filing status), or who expects to be in a higher tax bracket next year. That's especially a consideration for high income taxpayers who may be subject to higher rates next year under proposed legislation.
- It may be advantageous to try to arrange with your employer to defer, until early 2022, a bonus that may be coming your way. This might cut as well as defer your tax. Again, considerations may be different for the highest income individuals.
- You can claim a $300 deduction ($600 on a joint return) for cash charitable contributions in addition to the standard deduction.
- 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.
- 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 70 1/2 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 70 or older, unless it reduced a previous qualified charitable distribution exclusion.)
- 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.

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

- Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income. For 2021, if taxable income exceeds $329,800 for a married couple filing jointly, (about half that for others), the deduction may be limited based on whether the taxpayer is engaged in a service-type trade or business (such as law, accounting, health, or consulting), the amount of W-2 wages paid by the business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the business

- 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 interior improvements to a building (but not for its enlargement), elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems.
- 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.
- Sometimes the disposition of a passive activity can be timed to make best use of its freed-up suspended losses. Where reduction of 2021 income is desired, consider disposing of a passive activity before year-end to take the suspended losses against 2021 income. If possible 2022 top rate increases are a concern, holding off on disposing of the activity until 2022 might save more in future taxes.

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.

Very truly yours,

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