2021 YEAR END

OVERVIEW

There are still tax planning opportunities available to help you reduce your individual federal and state tax burdens before the end of the year. This guide offers potential tax-saving opportunities for individual taxpayers to consider.

Note that Congress is currently considering a variety of tax-related legislative proposals that could change the planning landscape if certain proposals become law. Thus, close consultation with your tax advisor is highly recommended.

KEY CONSIDERATIONS

Filing Status and Dependents

As a general reminder, there are several ways in which taxpayers can file an income tax return: married filing jointly, head of household, single, and married filing separately. Filing status is determined as of December 31. Taxpayers considering a change in status such as marriage, divorce, or separation should consider the impact of such change and possibly defer or accelerate the change depending on the tax impact.

If a married couple files separate returns, in certain situations they can amend and file jointly, but they cannot amend a jointly filed return to file separately once the due date has passed. A joint return may be filed even though one spouse has neither gross income nor deductions. If one spouse dies during the year, the surviving spouse may file a joint return for the year in which his or her spouse died.

Generally, married filing jointly will yield a lower overall tax liability than married filing separately. In addition, for tax years 2018–2025, the so-called “marriage penalty” generally applies to couples whose combined taxable income places them in the highest (currently 37%) tax bracket.

Certain married persons who do not elect to file a joint return may be entitled to use the lower head of household tax rates. Generally, to qualify as head of household, the taxpayer must not be a resident alien, must satisfy certain marital status requirements such as living apart, must maintain a household for a person who is their dependent, and must be entitled to claim such person as a dependent.

While the current deduction for dependents is $0 for tax years 2018-2025, certain tax deductions and credits are tied to being able to claim one or more dependents. Dependents are either a “qualifying child” or a “qualifying relative.” A qualifying child must be under age 19 at the end of the year or a full-time student who is under age 24 at the end of the year.

Know Your Adjusted Gross Income (AGI)

Because many tax benefits are tied to or limited by AGI — IRA deductions, for example — a key aspect of tax planning is to estimate both 2021 and 2022 AGI. Also, when considering whether to accelerate or defer income or deductions (discussed further below), be aware of the impact this may have on AGI and the ability to maximize itemized deductions that are tied to AGI. The 2020 tax return and 2021 pay stubs and other income and deduction-related documents are a good starting point for estimating your AGI.

Know the Tax Rates (Tax Brackets)

Another important number is your “tax bracket,” i.e., the rate at which the last dollar of income is taxed. Although the income thresholds for the tax brackets are indexed for inflation, if income increases faster than the inflation adjustment, you may be pushed into a higher bracket and thus subject to a higher marginal tax rate. If so, the potential benefit from any tax-saving opportunity is increased (as is the cost of overlooking the opportunity).

For 2021, the Alternative Minimum Tax (AMT) exemption amounts are $114,600 for joint returns and surviving spouses; $73,600 for unmarried individuals; and $57,300 for married individuals filing separate returns. The exemption phase-out range for 2021 begins at $523,600 for unmarried individuals and married individuals filing separate returns and $1,047,200 for married filing jointly. Also, for 2021, nonrefundable personal credits can offset an individual's regular and AMT, and capital gains will be taxed at lower favorable rates for AMT. For 2021, the amount of Alternative Minimum Taxable Income (AMTI) above which the 28% rate applies is $199,900 for married individuals filing joint returns and unmarried individuals and $99,950 for married filing separate returns.

If you hold stock due to the exercise of an incentive stock option (ISO) during 2021 that is now below the value at the exercise date (i.e., “underwater”), consider selling the shares before the end of the year to avoid the AMT tax due on the original exercise of the option.

Know What the “Standard Deduction” Is

Another key number is the standard deduction. For 2021, the standard deduction is $25,100 for married filing jointly and surviving spouses, $18,800 for head of household, and $12,550 for all other taxpayers. The standard deduction is important for planning the timing of one's itemized deductions (as discussed further below) as itemized deductions must exceed the standard deduction for your filing status to maximize the tax value of the deductions.

A Good Starting Point for Year-End Planning – Your 2020 and 2019 Tax Returns

Make Estimated Payments/Adjust Paycheck Withholding

Your 2020 and 2019 tax returns are a great starting point. Do you consistently owe money to the IRS or the state or do you consistently receive significant refunds? The answer to this question may mean that you should adjust your withholding and/or consider making an estimated payment to avoid owing at tax time and avoid an estimated tax penalty. Adjusting your withholding now will give you a head start on the new tax year.

You may be able to avoid the estimated tax penalty by paying withholding and/or estimated taxes based on 90% of the tax shown on the 2021 return or 100% of the tax shown on the 2020 return, whichever is less, but the estimate may need to be based on 110% of the 2021 tax if the Adjusted Gross Income shown on the 2020 return exceeds $150,000 ($75,000 in the case of married filing separately).

Also factor in other income such as:

the 3.8% net investment income tax (NIIT), the receipt of taxable unemployment benefits and early distributions or COVID-19-related distributions from IRAs and 401(k) plans, and any IRA required minimum distribution (RMD) that you did not have to take in 2020 but must resume in 2021.

Also beware of the fact that the 2021 recovery rebate credit will be significantly less than the 2020 credit, which could further skew how much you may have owed for 2020 or may owe for 2021.

With the $10,000 deduction limit on state and local taxes (SALT) in place, the acceleration of the fourth estimated state income tax payment into December 2021 to increase the current year SALT deduction may be less important. However, accelerating or deferring the state estimated payment may make a difference in being able to claim a higher itemized deduction versus the standard deduction, so the timing of the payment still should be considered.

Consider the Timing of Income, Deductions, and Credits

Deferring the Receipt of Income Until 2022

If you expect AGI to be higher in 2021 than in 2022 or anticipate being in the same or a higher tax bracket in 2021, you may benefit by deferring the receipt of income until 2022. Deferring income is advantageous so long as the deferral does not bump you into a higher tax bracket in the succeeding year(s). Deferring income may be disadvantageous, however, if the deferred income is deferred compensation under a nonqualified deferred compensation plan subject to §409A , a special provision that makes the income includible in gross income and subject to additional tax.

If you are self-employed and file Schedule C (e.g., as a sole proprietor or single-member LLC) and operate on a calendar year, cash basis accounting method, consider delaying 2021 year-end billings to clients so that payments will not be received until 2022.

Accelerating the Receipt of Income into 2021

In some circumstances, you may benefit by accelerating income into 2021. For example, if you anticipate being in a higher tax bracket in 2022 than in 2021 or may need additional income to take advantage of an offsetting deduction or credit that will not be available in future tax years, it may make sense to accelerate the receipt of income. However, accelerating income into 2021 may be disadvantageous if you expect to be in the same or lower tax bracket for 2022.

If you are self-employed, it may be disadvantageous to accelerate income into 2021, even if you will be in a higher bracket in 2022, if the acceleration causes you to cross a threshold that would result in an offsetting reduction in the §199A qualified business income deduction. The §199A deduction phase-out thresholds for 2021 are $329,800 for married filing joint returns, $164,925 for married filing separate returns, and $164,900 for all other returns.

Some ways to accelerate income into 2021 include:

Year-End Bonuses: If your employer generally pays year-end bonuses early in 2022, see if you can have your bonus paid before the end of 2021.

Retirement Plan/IRA Distributions: If you are over age 59 1/2 and participate in an employer retirement plan or have an IRA, consider taking any taxable withdrawals before 2022. You may also want to consider making a Roth IRA rollover distribution (discussed further below).

Note that you may recontribute all or part of certain COVID-19-related distributions to an eligible retirement plan (including an IRA) within three years beginning on the day after the date you received the distribution. Repayments will be treated as though they were eligible direct rollovers. Amounts repaid are not subject to any contribution or rollover limits.

Itemized Deduction Planning – Consider “Bunching”

Deduction timing is an important element of year-end tax planning. However, deduction planning is complex due to factors such as AGI levels, the AMT, filing status, and the standard deduction.

Remember that if you are a cash method taxpayer, an expense is deductible only in the year in which it is actually paid. Under this rule, if your tax rate is going to increase in 2022, it may be a good strategy to accelerate spending into 2021 to take the deduction in 2021. Also, date checks before the end of 2021 and mail them before January 1, 2022.

Deduction planning also is affected by the standard deduction. As noted earlier, for 2021 returns, the standard deduction is $25,100 for married filing jointly and surviving spouses, $18,800 for head of household, and $12,550 for all other taxpayers.

If itemized deductions are relatively constant and are close to the standard deduction amount, little or no benefit will be gained from itemizing deductions each year. But simply taking the standard deduction each year means the loss of the benefit of itemized deductions that exceed the standard deduction. To maximize the benefits of both the standard deduction and itemized deductions, consider adjusting the timing of deductible expenses, i.e., “bunching,” so that they are higher in one year and lower the following year. This can be accomplished, for example, by paying deductible expenses in 2021, such as mortgage interest due in January 2022, and state estimated tax payments due in early 2022, or doubling up on charitable contributions every other year.

For 2021, medical expenses, including amounts paid as health insurance premiums, long-term care insurance premiums, and dental insurance premiums are deductible only to the extent that the total medical and dental expenses exceed 7.5% of AGI for all taxpayers. Bunching medical and dental expenses in one calendar year can help maximize the allowable deduction.

If you anticipate a state income tax liability for 2021 and plan to make an estimated payment typically due in January 2022, consider making the payment before the end of 2021. But recognize that the current $10,000 cap on deducting state and local taxes ($5,000 if married filing separately) may significantly impact this type of deduction planning.

Consider making charitable contributions by the end of 2021 using a credit card if the bill does not have to be paid until 2022. A pledge to make a donation is not deductible, however, unless it actually is paid by the end of the tax year.

Energy Tax Credits

Residential Energy Efficient Property Credit. Tax incentives are available to taxpayers who install certain energy efficient property, such as solar electric property, solar water heaters, geothermal heat pumps, small wind turbines and fuel cell property. A credit is available for a percentage of the expenditures incurred for such property. You should consult your tax adviser to determine the maximum allowable credit for 2021.

Tax Considerations for Investments

The timing of your investment activities can result in significant tax consequences. A key point to keep in mind when planning investment activity in 2021 is the extent to which you may have capital loss carryovers from your 2020 tax return.

• Capital gains on property held one year or less are taxed at an individual's ordinary income tax rate.

• Capital gains on property held for more than one year are taxed at more favorable capital gains tax rates, which vary depending on the taxpayer's income and filing status.

For 2021, the maximum capital gains rate is 20% for a taxpayer with taxable income above $501,599 (in the case of a joint return or surviving spouse), $250,799 (in the case of a married individual filing a separate return), $473,749 in the case of an individual who files as head of household, or $445,849 in the case of any other individual. For taxpayers in the lower tax brackets, the capital gains rate is 0% or 15% (depending on the taxpayer's income).

Timing of Sales. Consider timing the sale of assets so as to have offsetting capital losses and capital gains. Capital losses may be fully deducted against capital gains and also offset up to an additional $3,000 of ordinary income ($1,500 for a married individual filing separately). In general, when losses are taken, long-term losses are first matched against long-term gains, and short-term losses against short-term gains. If there are any remaining losses, they may be used to offset any remaining long-term or short-term gains, up to an additional $3,000 (or $1,500) of ordinary income

If a taxpayer sells stock at a loss, he/she must wait 31 days before repurchasing the same stock or else the wash sale rules apply, which disallow the loss.

Interest and Dividends. Interest income earned on Treasury securities and bank certificates of deposit with maturities of one year or less is not includible in income until received. To defer interest income, consider buying short-term bonds or certificates that will not mature until 2022. If there is a possibility of receiving dividends from a closely held company, weigh the timing of receipt of those dividends.

Capital Gains. The timing of transactions generating capital gains and losses should be considered whenever possible. Attention should also be paid to the holding period of the investment as long-term capital gains (i.e., gains from assets held for more than one year) are taxed at preferential rates not exceeding 20%, whereas short-term capital gains are taxed at ordinary income tax rates.

To avoid recognizing capital gains altogether, you should consider donating appreciated property to charity rather than selling it, especially if doing so may result in overall itemized deductions exceeding your standard deduction for 2021.

Net Investment Income Tax. An additional 3.8% tax is levied on certain unearned income for higher-income taxpayers. The net investment income tax is levied on the lesser of net investment income or the amount by which modified AGI (MAGI) exceeds certain dollar amounts — $250,000 for married taxpayers filing jointly, $125,000 for married taxpayers filing separate returns, and $200,000 for single individuals. Investment income is: (1) gross income from interest, dividends, annuities, royalties, and rents (other than from a trade or business); (2) other gross income from any business to which the tax applies; and (3) net gain attributable to property that is not attributable to an active trade or business. Investment income does not include distributions from a qualified retirement plan or amounts subject to self-employment tax.

This rule applies mostly to passive businesses and trading in financial instruments or commodities. With this additional tax, the maximum net capital gains rate is 23.8% in 2021. Strategies to reduce exposure to the NIIT would be to exchange real property through a like-kind exchange to defer recognition of any gain until a future year when MAGI may be lower, or, if planning on selling your principal residence that has a gain over the exempted amounts ($250,000/$500,000 depending on filing status), postponing the sale until 2022 if your income will be lower in 2022.

Defer Taxes by Investing in Qualified Opportunity Funds (QOFs). A taxpayer who invests in Qualified Opportunity Zone property through a Qualified Opportunity Fund (QOF) can temporarily defer tax on the amount of eligible gains they invest. A taxpayer can defer tax on eligible gains invested in a QOF until the earlier of (1) an inclusion event, or (2) December 31, 2026. Eligible gains include both capital gains and qualified §1231 gains, but only if the gains are: (1) recognized for federal income tax purposes before January 1, 2027, and (2) not from a transaction with a related person.

The amount of time you hold the QOF investment determines the tax benefit you receive. When you make an election to defer the gain, the basis in the QOF investment becomes zero. The QOF basis increases the longer you hold your interest in the QOF. If you hold your investment in the QOF for at least 5 years, your basis (the amount of your investment) will increase by 10% of the deferred gain. If you hold your investment in the QOF for at least 7 years, your basis (the amount of your investment) will increase by an additional 5% of the deferred gain. If you hold your investment in the QOF for at least 10 years, you may be able to permanently exclude gain resulting from a qualifying investment when it is sold or exchanged. The exclusion occurs if you elect to increase the basis of your QOF investment to its fair market value on the date of the sale or exchange.

Qualified Dividends. Qualified dividends received in 2021 are subject to rates similar to the capital gains rates. Therefore, qualified dividends on stocks held for more than one year are taxed at a maximum rate of 20% (23.8% if subject to the NIIT). Qualified dividends include dividends received from domestic and certain foreign corporations. Nonqualified dividends are subject to ordinary income rates of up to 40.8% (37% income tax rate plus 3.8% NIIT rate). [

Mutual Funds. Some mutual funds with high turnover rates can generate a significant amount of short-term capital gains, which are taxed at your ordinary income tax rate. In addition, avoid purchasing mutual fund shares later in 2021 as such funds often declare capital gains distributions at year-end, and you will be taxed on the full distribution even though you may have only held shares for a short period of time.

Exclusion of Gain Attributable to Certain Small Business Stock. One hundred percent (100%) of the gain on the sale of "small business stock" under §1202 is excluded from income. The stock must be held for more than five years to qualify for the exclusion. (If the stock was acquired on or before September 27, 2010, other less favorable exclusion rules apply).

Installment Sales. Generally, a sale occurs when property is transferred. If a gain will be realized on the sale, income recognition will normally be deferred under the installment method until payments are received, so long as one payment is received in the year after the sale. Thus, if a taxpayer expects to sell property at year-end, and it makes economic sense, consider selling the property using the installment method to defer payments (and tax) until next year or later. Using the installment sale method also may defer exposure to the 3.8% NIIT.

Qualified Equity Grants. Individuals who work at a start-up company may be able to defer taxation on vested qualified stock while they have insufficient cash flow to cover their tax liability. The employee makes a special election regarding stock attributable to options exercised or restricted stock units settled in 2021 or later, so that no amount will be included in income for the first tax year in which the rights of the employee in the stock are transferable or are not subject to a substantial risk of forfeiture. In many cases, a qualified equity grant defers taxation until five years after the employee vests in the qualified stock.

Tax-Favored Family and Education Opportunities

Child Tax Credit. For 2021, families claiming the Child Tax Credit (CTC) may receive up to $3,000 per qualifying child between the ages of 6 and 17 at the end of 2021. You may receive $3,600 per qualifying child under age 6 at the end of 2021. The additional $1,000 per child between ages 6 and 17, and the additional $1,600 per child under age 6 are reduced (phased out) for incomes over $150,000 for married taxpayers filing a joint return and qualifying widows or widowers, $112,500 for heads of household, and $75,000 for all other taxpayers. The CTC is fully refundable for 2021.

If your 2021 AGI is too high to qualify for the additional CTC amount for 2021, you are still eligible for the basic $2,000 per child tax credit under the same rules applicable in 2020, with the higher phase-out amounts ($400,000 for married filing joint returns, $200,000 for all other returns).

Beginning in July 2021, advance payments of the 2021 CTC will be made monthly through the end of December 2021 for up to 50% of the CTC as determined based on income estimates using information included in your 2020 tax returns (or 2019 returns if 2020 return information is not available).

Other Dependent Credit. A $500 nonrefundable credit for dependents other than qualifying children (e.g., a child over the age of 16 or an elderly parent living with you who qualifies as a dependent) also is available in 2021. There is no age limit, but the dependency test must be satisfied. The credit phases out for higher income taxpayers.

2021 Recovery Rebate Credit. You may be eligible for an additional tax credit on your 2021 return similar to the previous rounds of tax credits and Economic Impact Payments (EIPs) for 2020, if you did not receive the entire amount of EIP to which you were entitled. The third EIP amount is: (1) $1,400 for an eligible individual with a valid Social Security number ($2,800 for married couples filing a joint return if both spouses have a valid Social Security number or if one spouse has a valid Social Security number and one spouse was an active member of the U.S. Armed Forces at any time during the tax year), and (2) $1,400 for each qualifying dependent with a valid Social Security number or Adoption Taxpayer Identification Number issued by the IRS

]

However, this third round is different than the prior credit EIPs. Generally, you may be eligible for the full amount of the third EIP if you (and your spouse, if filing a joint return) are: (1) a U.S. citizen or U.S. resident alien, (2) not a dependent of another taxpayer, and (3) your AGI is not more than $150,000 if married and filing a joint return or if filing as a qualifying widow or widower, $112,500 if filing as head of household or $75,000 if filing as single or married filing separately. Another difference is that an additional $1,400 is available for each dependent, including adult dependents. (Only taxpayers with "qualifying *children*" were eligible for the additional amount under the first two rounds of EIPs.)

Payments will be phased out -- or reduced -- above these AGI amounts. This means you will not receive a payment if your AGI is at least: $160,000 if married filing a joint return or if filing as a qualifying widow or widower, $120,000 if filing as head of household, and $80,000 if filing as single or married filing separately.

You will want to reconcile the amount of any EIPs you received during 2021 (if any) when you file your 2021 tax return to determine whether you received the full amount of EIPs that you may have been entitled to, or whether you may be entitled to an additional amount as a credit claimed on your 2021 return.

Credit for Adoption Expenses. For 2021, a tax credit of up to $14,440 for amounts you spend for each child you adopt may be available. Families who finalize the adoption of a child with special needs in 2021 and fulfill the eligibility requirements can claim the full credit of $14,440, regardless of whether they had any expenses. The credit phases out ratably down to $0 for taxpayers whose income is between $216,600 and $256,660.

Household and Dependent Care Tax Credit. You may be able to claim a credit for expenses such as day care, nursery school, before- and after-school care, and summer camps if you paid such expenses for the care of a qualifying individual to enable you (and your spouse, if filing a joint return) to work or actively look for work. Generally, you may not take this credit if your filing status is married filing separately.

A qualifying individual includes your dependent qualifying child who was under age 13 when the care was provided; your spouse who was physically or mentally incapable of self-care and lived with you for more than half of the year; or an individual who was physically or mentally incapable of self-care, lived with you for more than half of the year, and either: (a) was your dependent; or (b) could have been your dependent except that he or she received gross income of $4,300 or more, or filed a joint return, or you (or your spouse, if filing jointly) could have been claimed as a dependent on another taxpayer's 2021 return.

The maximum allowable amount of the dependent care credit is increased from $2,100 in 2020 to $8,000 in 2021 for two or more qualifying individuals, and from $1,050 in 2020 to $4,000 in 2021 for one qualifying individual with the ultimate credit amount depending on your income and qualifying expenses. The credit is fully refundable for 2021 if your principal place of abode is the United States for more than one-half of 2021.

Health Care Flexible Spending Accounts. For 2021, cafeteria plans can provide that employees may elect no more than $2,750 in salary reduction contributions to a health FSA. Typically, employers require the following year's election to be set prior to the end of the year. Thus, estimate the best amount to contribute before the end of 2021. A plan may allow for a carryover of unused amounts of up to $550 to 2022.

]

Health Savings Accounts. A health savings account (HSA) is a trust or custodial account exclusively created for the benefit of the account holder and his or her spouse and dependents and is subject to rules similar to those applicable to individual retirement arrangements (IRAs). Contributions to an HSA are deductible, within limits.

529 Plans. A 529 plan allows you to save for future education expenses in a tax-advantaged savings plan. 529 plans generally are available in the form of a prepaid tuition plan that allows you to lock-in future tuition at current cost or a more traditional investment account that grows tax-deferred and whose distributions used to pay qualified postsecondary education expenses such as tuition, fees, books, supplies, and room and board are income-tax-free for federal and state purposes. Many states allow for a deduction or tax credit per beneficiary for contributions to that state's 529 plans.

529 distributions may be made tax-free for elementary and secondary tuition of up to $10,000 per year per student. Such plans also may be used to pay up to $10,000 of student loans per beneficiary.

Under a special rule, you can “front-load” five years’ worth of annual gift tax exclusions and make up to a $75,000 contribution per beneficiary in 2021 ($150,000 if gift-splitting with a spouse).

American Opportunity Tax Credit for Education. The American Opportunity Tax Credit (AOTC) is available for qualified tuition and fees paid on behalf of a student (i.e., you, your spouse, or a dependent) who is enrolled on at least a half-time basis. The maximum credit is $2,500 (100% of the first $2,000, plus 25% of the next $2,000). The credit is available for the first four years of the student's post-secondary education.

The AOTC is phased out at modified AGI levels between $160,000 and $180,000 for joint filers, and between $80,000 and $90,000 for other taxpayers. Forty percent of the credit is refundable, which means that a taxpayer can receive up to $1,000 even if no taxes are owed. “Qualified tuition and related expenses” include expenditures for “course materials” (i.e., books, supplies, and equipment needed for a course of study regardless of whether the materials are purchased from the educational institution as a condition of enrollment or attendance).

One way to take advantage of the AOTC for 2021 is to prepay Spring 2022 tuition. In addition, if it is known what books the student will need for the Spring 2022 semester, those can be bought in 2021 and the costs would qualify for the credit for 2021.

The Lifetime Learning Credit for Education. The Lifetime Learning Credit (LLC) is available for qualified tuition and related expenses paid for eligible students enrolled in an eligible educational institution. This credit can help pay for undergraduate, graduate and professional degree courses — including courses to acquire or improve job skills. There is no limit on the number of years you can claim the credit. The LLC is not a refundable credit.

For 2021, the maximum credit is $2,000 (20% of qualified tuition and fees up to $10,000). A student need not be enrolled on at least a half-time basis so long as he or she is taking postsecondary classes to acquire or improve job skills. As with the AOTC, eligible students include the taxpayer, the taxpayer's spouse, or a dependent. For 2021, the LLC is phased out ratably for taxpayers with modified AGI between $80,000 and $90,000 ($160,000 and $180,000 for joint returns). If your modified AGI is $90,000 or more (or $180,000 or more for joint returns), you cannot claim the credit.

Coverdell Education Savings Accounts. The aggregate annual contribution limit to a Coverdell education savings account is $2,000 per designated beneficiary of the account. For 2021, the limit is phased out for individual contributors with modified AGI between $95,000 and $110,000 and joint filers with modified AGI between $190,000 and $220,000. The contributions to the account are nondeductible but the earnings grow tax-free. Coverdell account holdings can be distributed tax-free if used for qualifying expenses (higher education expenses, along with elementary and secondary education expenses).

Student Loan Interest Deduction. Taxpayers may be eligible for an above-the-line deduction for student loan interest paid on any “qualified education loan.” The maximum deduction is $2,500. The deduction for 2021 phases out for higher-earning taxpayers.

The Kiddie Tax. For 2021, a child's unearned income above $2,200 is generally subject to tax at the parent's marginal tax rate; unearned income above $1,100 but not more than $2,200 is taxed at the child's tax rate. For 2021, the amount that is used to reduce the net unearned income reported on the child's return that is subject to the “kiddie tax,” is $1,100. The same $1,100 amount is used to determine whether a parent may elect to include a child's gross income in the parent's gross income and to calculate the “kiddie tax”. For example, one of the requirements for the parental election is that a child's gross income is more than $1,100 but less than $11,000. The kiddie tax applies to: (1) children under 18 who do not file a joint return; (2) 18-year-old children who have unearned income in excess of the threshold amount, do not file a joint return, and who have earned income, if any, that does not exceed one-half of the amount of the child's support; and (3) children between the ages of 19 and 23 if, in addition to the above rules, they are full-time students.

Including a child's income on the parent's return will increase the parent's AGI and taxable income, thus resulting in a higher tax and possible reductions in credits and other amounts that are tied to AGI.

Achieving a Better Life Experience (ABLE) Accounts. This is a type of savings account for individuals with disabilities and their families. For 2021, taxpayers can contribute up to $15,000 (tied to the annual gift tax exclusion). Distributions are tax-free if used to pay the beneficiary's qualified disability expenses.

Annual Gift Tax Exclusion. The most common method used for tax-free giving is the annual gift tax exclusion, which, for 2021, allows a person to give up to $15,000 to each donee without reducing the giver's estate and lifetime gift tax exclusion amount. A person is not limited as to the number of donees to whom he or she may make such gifts. Further, because the annual exclusion is applied on a per-donee basis, a person can leverage the exclusion by making gifts to multiple donees (family and non-family). Thus, if an individual makes $15,000 gifts to 10 donees, he or she may exclude $150,000 from gift tax. In addition, because spouses may combine their exclusions in a single gift from either spouse, married givers may double the amount of the exclusion to $30,000 per donee. For 2021, the first $159,000 of gifts to a noncitizen spouse (other than gifts of future interests in property) are excluded from gift tax. A person may not carry over his or her annual gift tax exclusion amount to the next calendar year. Qualifying tuition payments and medical payments do not count against this limit

Retirement Planning Opportunities

Maximize Retirement Savings. If the maximum §401(k) contribution for 2021 was not selected, you still have time to increase contributions for the remainder of 2021 to lower your AGI in order to take advantage of some of the tax breaks described herein. Maximizing pre-tax retirement contributions generally is a good tax-saving move.

Traditional IRA. Individuals who are not active participants in an employer pension plan may make deductible contributions to an IRA. The deadline for 2021 contributions is April 15, 2022. The annual deductible contribution limit for an IRA for 2021 is $6,000. A $1,000 “catch-up” contribution is allowed for taxpayers age 50 or older by the close of 2021, making the total limit $7,000 for these individuals.

Individuals who are active participants in an employer pension plan also may make deductible contributions to an IRA, but their contributions are limited in amount depending on their AGI. For 2021, the AGI phase-out range for deductibility of IRA contributions is between $66,000 and $76,000 of modified AGI for single persons (including heads of households), and between $105,000 and $125,000 of modified AGI for married taxpayer filing jointly. Above these ranges, no deduction is allowed. A married taxpayer filing a separate return may not deduct IRA contributions if his/her modified AGI is $10,000 or more.

In addition, an individual will not be considered an "active participant" in an employer plan simply because the individual's spouse is an active participant for part of a plan year. The taxpayer may be able to take the full deduction for an IRA contribution regardless of whether their spouse is covered by a plan at work, subject to a phase-out if their joint modified AGI is $198,000 to $208,000 ($0 – $10,000 if married filing separately) for 2021. Above this range, no deduction is allowed.

IRA Rollovers. For 2021, you may make only one IRA-to-IRA rollover per year. (Direct trustee-to-trustee rollovers are not affected.) A second attempted rollover will be treated as a withdrawal and taxed at regular rates, plus a possible 10% early withdrawal penalty.

Spousal IRA. If a taxpayer files a joint return and has less compensation than his or her spouse, the IRA contribution is limited to $6,000 for 2021 plus age 50+ catch-up contributions ($1,000 for 2021), or the total compensation of both spouses reduced by the other spouse's IRA contributions (traditional and Roth).

Roth IRA. This type of IRA allows individuals to make nondeductible contributions of up to $6,000 ($7,000 if making an eligible catch-up contribution) for 2021. Earnings grow tax-free, and distributions are tax-free provided no distributions are made until more than five years after the first contribution and the individual has reached age 59 1/2. Distributions may be made earlier on account of the individual's disability or death.

The maximum contribution is phased out in 2021 for persons with an AGI from $198,000 to $208,000 for married taxpayers filing jointly, $125,000 to $140,000 for single taxpayers (including heads of households), and between $0 and $10,000 for a married taxpayer filing separately who lived with the spouse during the year. A Roth IRA must be established and funded by April 15, 2022, for the contribution to be considered a 2021 contribution.

"Backdoor" Roth IRA. If your income is too high to make a Roth IRA contribution and you do not have a traditional IRA, you can establish a traditional account and make a nondeductible contribution. You can then convert the traditional account to a Roth IRA but will have to pay the income tax on the converted amount.

Roth IRA Conversions. Funds in a traditional IRA (including SEPs and SIMPLE IRAs), §401(a) qualified retirement plan, §403(b) tax-sheltered annuity, or §457 government plan may be rolled over into a Roth IRA. Such a rollover, however, is treated as a taxable event, and you will pay tax on the amount converted. No penalties will apply if all the requirements for such a transfer are satisfied.

401K Plans. The §401(k) elective deferral limit is $19,500 for 2021. If your employer's §401(k) allows for catch-up contributions for 2021 and you reach age 50 by December 31, 2021, an additional $6,500 may be contributed to the §401(k) account, for a total maximum 2021 contribution of $26,000 ($19,500 in regular contributions plus $6,500 in age 50+ "catch-up" contributions).

]

SIMPLE Plan Contribution. The SIMPLE plan deferral limit is $13,500 for 2021. If your SIMPLE plan has been amended to allow for catch-up contributions for 2021 and you will be 50 years old by December 31, 2021, an additional $3,000 may be contributed.

Catch-Up Contributions for Other Plans. If you will be 50 years old by December 31, 2021, an additional $6,500 can be contributed to a §403(b) plan, SEP, or eligible §457 government plan

Required Minimum Distributions. Required Minimum Distributions (RMDs) from qualified retirement plans have resumed for 2021 after being waived for 2020. If you are turning 72 in 2021 and taking your first RMD, you have until April 1, 2022, to do so. For each subsequent year, your RMD must be taken by December 31. Keep in mind that if you delay your initial RMD until April 1, you will have two RMD withdrawals for 2022 (one by April 1 and one by December 31), which may result in a larger tax liability in 2022 than if you take your first RMD by December 31, 2021.

IRA Donations to Charity. If you are 70 1/2, you can make direct contributions from your IRA to charity of up to $100,000 during 2021, but you can't claim a charitable contribution deduction. Conversely, the amounts are not included in your taxable income and can be used to satisfy your RMD.

Small Business Owners and Self-Employed Individuals

There are a variety of tax provisions that are available to you as a self-employed individual or if you are a small business owner of an entity such as a single-member LLC or an S-corporation.

Qualified Business Income Deduction (QBI Deduction). Individual taxpayers with qualified business income from a pass-through entity (partnership, S corporation, LLC or single member LLC) or a sole proprietorship may be entitled to a 2021 deduction equal to the lesser of the deductible amount of the QBI (generally 20% subject to the W-2 wage basis limit) or 20% of net taxable income from the business. Deductions may also be allowed for 20% of qualified REIT dividends and qualified publicly traded partnership income. Special rules apply for these additional items. The deduction applies to reduce taxable income and is available even if the taxpayer does not itemize deductions. (The QBI deduction does not impact the calculation of the self-employment tax).

For 2021, if taxable income does not exceed a threshold of $329,800 (joint filers), $164,925 (married filing separately), or $164,900 (all other taxpayers), the deduction is generally the lesser of 20% of QBI or 20% of taxable income. If taxable income exceeds the threshold amount, the deduction is subject to a wage basis limit that is phased-in ratably, and only a portion of the income from a specified trade or business is eligible, the W-2 wage limitation applies, and specified service trades or businesses are excluded. However, if taxable income exceeds the threshold amount by $100,000 or more for married taxpayers filing jointly, or by $50,000 or more for other filers, the wage basis limit applies in full, and income from a specified trade or business is not eligible for the QBI deduction. Calculation of the QBI deduction is a fact-intensive inquiry. If a taxpayer claims the deduction and understates the amount of tax required to be shown on his/her return by 5% or more, he/she may be subject to a 40% substantial understatement of tax penalty.

Government Provided Relief Programs. For Paycheck Protection Program (PPP) loans and other types of loans provided to businesses during the pandemic, forgiveness or cancellation of all or part of such loans will not be treated as income for tax purposes. In addition, deductions are allowed for otherwise deductible expenses paid with the proceeds of a PPP loan that is forgiven, and the tax basis and other attributes of the borrower's assets will not be reduced as a result of the loan forgiveness. Consult your legal and tax adviser for specific program rules.

Home Office Deduction. For self-employed individuals and small business owners (but not employees), expenses attributable to using the home office as a business office are deductible if the home office is used regularly and exclusively: (1) as a taxpayer's principal place of business for any trade or business; (2) as a place where patients, clients, or customers regularly meet or deal with the taxpayer in the normal course of business; or (3) in the case of a separate structure not attached to the residence, in connection with a trade or business. [547 T.M. III.B ; TPS ¶2460.02.A]

Depreciation and Section 179 Expense Election. If the taxpayer is in business and purchases equipment, he/she may depreciate such equipment or make a “§179 election,” which allows the taxpayer to expense (i.e., currently deduct) otherwise depreciable business property (but not investment property). For 2021, the allowable deduction is $1,050,000 (with a phase-out beginning at $2,620,000). A $26,200 per vehicle limitation applies to the cost of SUVs.

Bonus Depreciation. Business or investment property placed in service in 2021, including certain used property, may be eligible for a 100% bonus depreciation deduction (separate from §179 expensing). Taxpayers engaged in a business may want to consider accelerating the placing in service of property or the decision to purchase assets for use in the business, in order to take advantage of this deduction. Taxpayers may not take a bonus depreciation deduction for the same expense that is deducted under §179 .

NOL Carryback/Carryforward Period. Generally, a net operating loss (NOL) arising in 2021 may not be carried back and must be carried forward

Capitalization v. Expensing for Materials and Supplies and Repairs. A deduction is allowed for materials and supplies that have an acquisition or production cost of $200 or less. A de- minimis safe harbor provides that for repairs to be deductible, among other requirements, the unit of property must cost less than $5,000 per invoice or item substantiated by the invoice for taxpayers with applicable financial statements and $2,500 per invoice for taxpayers without applicable financial statements.

Self-Employed Health Insurance Premiums. Self-employed individuals may claim 100% of the amount paid during the tax year for insurance that constitutes medical care for themselves, their spouses, and their dependents as an above-the-line deduction, without regard to the general 7.5% of AGI floor

SEP IRA Contributions. For 2021, self-employed individuals generally can make a SEP contribution that cannot exceed the lesser of 25% of compensation or $58,000. The SEP contribution is an above-the-line deduction that reduces the AGI subject to tax. Note that the self-employment tax is calculated before SEP contributions are calculated. A SEP IRA must be established by the due date of the return (plus any extensions) for the tax year to which the qualifying contribution is made. Thus, an individual can wait until after the close of 2021 to establish and determine their SEP contribution for 2021

Employing Family Members. Wages for the services of one spouse who works for the other spouse are subject to income tax withholding and Social Security and Medicare taxes but not to the Federal Unemployment Tax Act (FUTA).

You can hire your children to work in your business as well. Payments are subject to income tax withholding, regardless of the child's age. However, payments for the services of a child under age 18 are not subject to Social Security and Medicare taxes if the business is a sole proprietorship or a partnership in which each partner is a parent of the child. In addition, payments to a child under age 21 are not subject to FUTA.

Payments for the services of a child are subject to income tax withholding as well as Social Security, Medicare and FUTA taxes if they work for: (1) a corporation, even if it's controlled by the child's parent, or (2) a partnership, even if the child's parent is a partner, unless each partner is a parent of the child.

Wages that you pay to a parent are subject to income tax withholding and Social Security and Medicare taxes, but are not subject to FUTA tax.

In addition to being able to deduct wages paid to a family member as a business expense, a key tax benefit is that any child, regardless of age, can contribute to an IRA provided they have earned income. Your children can also contribute to a Roth IRA. If your child is a minor (under age 18 in most states; under age 19 or 21 in others), you will need to open a custodial account.

REPORTING

FinCEN Form 114: U.S. persons holding any financial interest, in or signature or other authority over, a foreign financial account exceeding $10,000 at any time in a calendar year must file a Report of Foreign Bank and Financial Accounts (FBAR) with the Treasury Department. The report must be filed electronically. The due date for the 2021 FBAR is the same as the tax filing deadline for Form 1040, i.e., April 18, 2022, with an automatic six-month extension to October 17, 2022.

Penalties: The tax code imposes a host of penalties for late-filed returns, failing to file returns and failing to pay tax. The tax code also imposes a host of penalties concerning the accuracy of returns. Many penalties are subject to inflation adjustments.

Health Care: For tax year 2021, taxpayers must continue to report full-year coverage, claim a coverage exemption, or report a shared responsibility payment on the tax return.

Cryptocurrency Transactions: Taxpayers must report certain transactions involving cryptocurrency

STATE CONSIDERATIONS

While most states follow federal tax rules to some extent, states have varying conformity to the Internal Revenue Code and several decouple from some or many federal tax provisions.