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November 29, 2021

Dear Clients and Friends:

We hope this finds all healthy and well. Most of us are making plans for the holidays. Not to be overlooked should be year-end tax planning. Each of us can develop a tax strategy that reflects his/her/their situation. Contact us to help you do so.

We thank both our new and returning clients as we value working with each of you. We strive to provide the best professional services to you in a timely manner. Thank you for giving us the opportunity to serve you and the confidence you have placed in us.

In the last two years, there have been at least six major bills passed by Congress that have had significant effects on the financial and tax world and in some manner affects most taxpayers. That's a lot to keep up with. But we are up to the task. As you are likely aware, Congress is currently debating many tax provisions, but has not completed its work and may not until near year-end. Consequently, it is very difficult to tax plan for 2021 with certainty. Most of the proposed tax changes do not take effect until 2022. One thing that appears certain is that if your income is below $400,000, you should not see a tax increase and may see additional benefits. If that is your situation, the time-tested traditional tax planning strategy of accelerating deductions and deferring income is likely the desired approach (see details on the next page).

It appears possible that the itemized deduction for state and local taxes will increase for 2021, perhaps as high as $80,000. If that is the case, many taxpayers will be able to itemize again. If this would be your situation, you should consider the timing of payments of your real property taxes and fourth quarter state estimated taxes by making the payments in December. If the effective date is not until 2022, you should consider deferring payments until January. In most cases, there is no downside to deferring payment if Congress does not increase the deduction limit. However, everyone's situation is different and should be reviewed for the best result.

New Tax Provisions

Below are new provisions affecting the most taxpayers. If you are aware of other provisions that may affect you, please contact us.

- Child tax credit - Increased to $3,000 per child ($3,600 for children under 6 as of the end of the year). The qualifying age is increased to those that have not turned 18 (previously age 17) by the end of the year. The credit begins to phase-out once your adjusted gross income exceeds $150,000 for joint return filers ($75,000 for singles, and $112,500 for heads-of-household). The IRS began making advance monthly payments of the credit in July unless you opted out. Because these are prepayments of the credit, the tax return refund amount will be reduced by the prepayment amounts or could result in tax due.
- Dependent care credit - The amount of payments made to qualify for the credit increased significantly from $3,000 to $8,000 per child, with a $16,000 (previously $6,000) maximum per family. The maximum credit percentage increased from 35% to 50%, but it does phase out with higher incomes (adjusted gross income from $125,000 to $438,000).
- Taxpayers can contribute up to $10,500 for joint return filers ($5,250 for unmarried and married filing separately) to an employee FSA for dependent care (the contribution reduces taxable income).
- The Earned Income Credit has been expanded for more taxpayers to qualify.
- Unemployment benefits are fully taxable in 2021. There is no exclusion similar to the one in 2020.
- Required minimum distributions (RMDs) from retirement plans and IRAs must be taken in 2021. There is no waiver of this requirement similar to 2020.
- Educator expense deduction (maximum $250) includes amounts expended for COVID equipment and supplies.
- Taxpayers are allowed a charitable contribution deduction of $300 ($600 joint) even if they do not itemize. The donations must be cash, check, or credit card. Non-cash contributions of goods to Salvation Army, Goodwill, etc. do not qualify.
- For those that itemize, the limitation on charitable contributions is increased from 60% to 100% of adjusted gross income.
- For those that itemize, the threshold for deducting medical expenses is permanently set at 7.5% of adjusted gross income.
- Payments to certain qualified health sharing ministries and direct primary care arrangements qualify as medical expenses for deduction purposes. They do not qualify as a health insurance deduction.
- Direct charitable contributions from your IRA up to $100,000 annually remains in effect for those age 70½.
- Business meals provided by a restaurant are 100% deductible in 2021 and 2022.
- For those of you working from home as employees, there is no tax deduction for the costs you incur. You should negotiate with your employer to reimburse you for those costs. This limitation does not apply to self-employed individuals.

- Through 2025, employers can reimburse employees for student loans up to $5,250 through an education reimbursement program and the payment is not taxable income to the employee.
- For those that received PPP loans, forgiveness applications should be filed now.

General information

- The 2021 standard deduction increases for all taxpayers. It is $25,100 for those married filing jointly, $12,550 for a single individual and those married filing separately, and $18,800 for head of household. For those taxpayers over age 65 or blind, there is an additional standard deduction of $1,350 each if married or $1,700 if single. This means the standard deduction for a married couple who are both over age 65 is $27,800.
- The maximum deduction for IRA contributions remains $6,000 annually (with an additional $1,000 for those age 50 or older). Contributions for 2021 can be made as late as April 15, 2022.
- There is no longer a penalty for failing to have health insurance coverage under the Affordable Care Act.
- The health premium tax credit for those on the health care exchanges is still in effect. No credit is available (or you will have to pay back any credit received) if your household income exceeds $51,040 if single or $104,800 for a family of four.
- Non-spousal beneficiaries of inherited retirement plan funds (including an IRA) must take the funds out within 10 years. This applies to fund owners that pass away after December 31, 2019. Distribution plans in place at that time are not changed.
- The 100% bonus depreciation deduction for business equipment purchases remains for 2021 and 2022.
- The 20% qualified business income deduction (QBID) for the self-employed and pass-through entities such as partnerships, S corporations, qualifying limited liability companies, and rental real estate enterprises remains unchanged.
- Taxpayers that took COVID related retirement plan distributions in 2020 and elected income inclusion over 3 years, must include one-third of the distribution in income in 2021 and 2022. Advance repayment is permitted.
- Casualty losses can be claimed where there is a "federally declared disaster area". COVID has been so designated. If you have personal losses, there may be a tax deduction for itemizers.
- Taxpayers can use up to $10,000 of 529 plan funds to pay off qualified student loans. This is a lifetime (not annual) limit.

Traditional Year-End Considerations

A number of traditional year-end tax planning strategies may be helpful in maximizing tax savings, depending upon your overall tax situation anticipated for the rest of 2021 and estimated for 2022. These include:

1. Take full advantage of retirement plan deductions including 401(k) plan, 403(b), IRA, and SEP contributions.
2. For those that are close to the standard deduction amount (as described earlier in this letter), consider bunching itemized deductions into 2021 (see items 3-5 below) and taking the standard deduction in 2022 or vice versa. Itemizing every other year can reap tax benefits. This is known as a "bunching strategy".
3. Donate to charity before the year end if you will itemize deductions. Utilizing a 'donor advised fund' is gaining popularity. A donor advised fund allows you to make a large donation to the fund in one year and obtain that deduction in that year. In subsequent years, you choose to make your charitable contributions out of the fund (there is no tax deduction in the subsequent year as you obtained a deduction in a prior year). Remember, donations to individuals, social clubs, political groups, or foreign organizations are not deductible.
4. Donate non cash goods before year end. If the total is over $500, special reporting requirements are required (see our website for assistance with valuation of these items).
5. Accelerate payment of other itemized deductions.
    a. If a property tax payment is not due until early next year consider paying before year end (most escrow accounts do this for you).
    b. Make January state estimated tax payments in December.
    c. Making your January mortgage payment in December accelerates the mortgage interest deduction. Make it early enough so that your mortgage lender reports it in the 2021 Form 1098.
    d. If you have high medical and dental expenses, pay any bills before the end of the year. This only applies if your total medical expenses will be more than 7.5% of your adjusted gross income and you itemize. If you have nursing home or assisted living costs, consider prepaying some of the 2022 amount.
6. Payment by credit card of expenses including those items listed in items 3-5 above results in the deduction at the time of the credit card charge, not the later payment of the credit card bill.
7. If you have capital gains, consider selling stocks that have losses to offset capital gains if it is economically prudent to do so.
8. Defer income (including bonuses, consulting income, and self-employment income) into the next year if possible. Especially if you anticipate being in a lower tax bracket in 2022.
9. Accelerate business deductions if you want to reduce net income.
10. Pay college tuition before year end if you have not reached the maximum allowed for deductions and credits.
11. If you are over 70½, consider making a qualified charitable contribution (QCD) from your IRA of all or a portion of your RMD. It allows a tax-free distribution of up to $100,000 per individual and can result in other federal and state tax benefits.

12. If you believe a Roth IRA is better than a traditional IRA, consider Roth conversions.
13. Consider additional contributions to your Health Savings Account if you have a high deductible health plan. Married couples who both are over age 55 may each make an additional $1,000 contribution to their separate HSAs.
14. If you have a gifting strategy, make sure all gifts are made before the year end. An individual can gift $15,000 tax free to each recipient annually. The gifting limit increases to $16,000 in 2022.
15. **Consult us**. Many of these strategies can be complicated.
    a. Selling losing stocks may not be a good strategy depending upon numerous other factors. Some of these factors are your capital gains tax rate, expectations for the stock value in the future, etc.
    b. If you expect to earn more next year, accelerating deductions and postponing income may not save you money depending upon your tax bracket and more. You may want to do the opposite.
    c. See number 10. Depending upon your income you may not qualify for education credits or deductions.

Capital Gains/Dividends, AMT, Net Investment Income Tax and More

The tax rate on net capital gains is no higher than 15% for most taxpayers. Net capital gain may be taxed at 0% for taxpayers with taxable income less than $40,400 for single and married filing separately; $80,800 for married filing jointly or qualifying widow(er); and $54,100 for head of household. Taxpayers in this situation can sell stock at a gain and buy the same stock back immediately with no tax due as long as the gain does not push them into the higher tax bracket. However, a 20% rate on net capital gain applies to the extent that a taxpayer's taxable income exceeds $445,850 for single; $501,600 for married filing jointly; $473,750 for head of household, and $250,800 for married filing separately). The 3.8% net investment income tax may also apply for some taxpayers.

Keep in mind the "wash sale rules" when reviewing year-end capital gains and dividends. Wash sales are sales of stock or securities in which losses are realized, but not recognized for tax purposes, because the seller acquires substantially identical stock or securities within 30 days before or after the sale. Nonrecognition, however, applies only to losses; gains are recognized in full.

The Net Investment Income Tax (NIIT) is a 3.8% tax that is applied to investment income (dividends, interest, rental income, etc.) and capital gains for earners above certain threshold amounts ($200,000 for single and head of household filers and $250,000 for married taxpayers filing jointly). Business income is not considered subject to the NIIT provided the individual business owner materially participates in the business. Perhaps there is planning here to avoid or mitigate the tax. **NOTE:** The proposed Build Back Better Act includes a provision to remove the "materially participation" exemption and subject all S corporation, partnership, and LLC income to the 3.8% NIIT. The proposed effective date is January 1, 2022 and applies to those with income exceeding $500,000 on a joint return, $400,000 for single filers and heads of household, and $250,000 for married taxpayers filing separate returns. Taxpayers in this situation should consider accelerating income into 2021 if they project they would be subject to this additional tax in 2022.

Identity Theft and IRS and State Correspondence Issues

While not as big of a concern as recent years due to implemented verification procedures, identity theft is still a concern. Please protect your identity in all aspects of your life and contact us immediately if you believe there is an issue with your returns or you believe you are a victim of identity theft. **Remember, the IRS does not contact taxpayers by email or telephone. Emails and phone calls purportedly from the IRS are scams. If in doubt, contact us.** That being said, Congress has authorized collection agencies to contact taxpayers, which most of the time will be by phone. You are not required to provide them with any information. If you receive correspondence from the IRS or your state taxing agency, please open it immediately and contact us. Don't put it aside. The requested response time can be anywhere from 10-30 days. Our experience is that many times the information that the IRS or state has obtained independently is incorrect. We can generally respond on your behalf with no additional tax due.

Our office continues to implement up-to-date measures for security and identity theft protections.

Other

Life Events: Marriage, death of a spouse, the birth or adoption of a child, retirement, a new job, loss of a job, the purchase of a new residence, a change in filing status, and other life events impact year-end tax planning. Sometimes timing matters.

We urge everyone to review their retirement plan and IRA beneficiary forms to make sure that they are up-to-date. Please be aware that upon your death the beneficiary form controls where the funds go, not your will or trust, so making sure these forms are accurate is essential. We have seen instances after death where the funds went to the unintended divorced spouse or an undeserving family member because these forms were not changed. The result was not the one intended by the deceased. In order to "stretch" your IRA payouts, your IRA needs to have a designated beneficiary. Beneficiary forms for life insurance policies should also be reviewed.

IRAs: There are strict restrictions on moving money between IRA accounts. Account-to-account transfers are unlimited. Taking distributions yourself and redepositing the funds (known as rollovers) can only be done once in a 12-month period no matter how many IRAs that you have.

Underpaid taxes: If you believe that you are underpaid in federal or state income taxes, consider increasing your withholdings for the rest of the year to avoid or lessen any potential underpayment penalties. If you are not subject to withholdings, increase your remaining estimated tax payments.

Michigan: The Michigan exemption amount increased to $4,900 for 2021 and will be indexed for inflation in future years.

Charitable deductions: As we head into the holiday giving season, please know that all cash donations to charity must be documented – no exceptions. You do not have to provide all supporting documents to us, but you must have them in your files. You are no longer allowed any write-offs for contributions of cash or other monetary gifts unless you retain either a bank record such as a canceled check, or a written statement from the charity. For donations of over $250, the canceled check is not enough – you must have the statement from the charity prior to the filing of your tax return. Also, for clothing and household item donations to Goodwill, Salvation Army, and other charities, please create an itemized list and value each item. This is the documentation the IRS requires. We can provide guidance on values (visit our website for assistance with these values). Items donated to charity must be in "good or better" condition.

Mileage Rates: The 2021 standard mileage rate for business miles is $.56 per mile. The medical mileage rate for 2021 is $.16 and for charitable miles it is $.14. The IRS requires good records to substantiate your mileage deductions. There is no substitute for a mileage log to prove business miles driven. The simplest log is to record your miles on your calendar or utilize a phone app. Charitable mileage is also deductible including those trips to volunteer at church, school, food pantry, thrift store, or a non-profit organization. Medical miles to the doctor or pharmacy are also deductible, if you qualify for a medical deduction.

Office in home deduction: There are two methods to choose from. Under the simplified method, the taxpayer can deduct $5 per square foot annually for no more than 300 square feet for a maximum deduction of $1,500 under this method. You can use the deduction of tracking actual expenses if that method is more advantageous for you.

Businesses: *Meals*– make sure to document time, place, amount, business purpose, and who you met with for each expense. Meals provided to employees for the convenience of employer (such as when they work overtime) are 50% deductible unless provided by a restaurant; then they are 100% deductible. The IRS always reviews these expenses in an audit. *Inventory* – New rules provide flexibility in keeping track of this. *Assets* – Immediate write-off of total cost of most non-real estate assets. *Vehicles* – If you deduct actual vehicle expenses rather than the cents-per-mile method and you are contemplating the purchase of a vehicle before year-end, depending on the cost and size of the vehicle, you may be able to deduct the entire amount in 2021 for certain large vehicles.

Foreign Bank and Brokerage Accounts: This does not apply to foreign investments held in US brokerage accounts. If you have any foreign trust, bank and/or brokerage accounts with a combined value greater than $10,000 on **any day of the year**, or you hold specific foreign financial assets (excluding land) greater than $50,000 at the end of the tax year, you are required to report them. The IRS concentrates resources in this area, and the penalty for failure to file the form can be the greater of $100,000 or 50% of the account balance. Also, be sure to tell us about any income generated by these accounts, even if you did not receive a 1099.

Social Security Earnings Statements: We recommend that every year or two you review the earnings that Social Security has on file for you. It is much easier to correct any errors now rather than many years later at retirement. Go to www.ssa.gov and set up an account. It will allow you to verify your earnings and get an estimate of your future benefits (and much more).

Conclusion

This letter is meant to summarize the most common tax law changes and planning items, but it cannot cover everything. If you are aware of a provision that affects you, please contact our office to discuss the effects on your personal tax and financial situation. Sometimes tax planning involves avoiding surprises when taxes are due in April. If you have unusual transactions to report for 2021, give us a call soon so that we can make sure you are prepared and have done all you can in 2021 to help your tax situation.

Our 2021 tax organizer will arrive in January. Returning clients will receive a personalized organizer which will contain information from last year's return. We hope the organizer will make it easier to collect this year's information. New clients will receive a generic organizer for their use.

For more details about the year-end planning ideas we have discussed, and to review other strategies, please contact our office. Together, we can create a customized 2021 year-end tax strategy tailored to you.

In the meantime, have a wonderful Holiday Season! We look forward to hearing from you soon.

Doug and associates