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## Monthly Updates 2021 Year-End Tax-Planning Edition

November 2021

### 2021 Last-Minute Year-End General Business Income Tax Deductions

Your goal should be to get the IRS to owe *you* money. Of course, the IRS is not likely to cut you a check for this money (although in the right circumstances, that will happen), but you'll realize the cash when you pay less in taxes.

Here are six powerful business tax-deduction strategies that you can easily understand and implement before the end of 2021.

#### 1. Prepay Expenses Using the IRS Safe Harbor

You just have to thank the IRS for its tax-deduction safe harbors. IRS regulations contain a safe-harbor rule that allows cash-basis taxpayers to prepay and deduct qualifying expenses up to 12 months in advance without challenge, adjustment, or change by the IRS.

Under this safe harbor, your 2021 prepayments cannot go into 2023. This makes sense, because you can prepay only 12 months of qualifying expenses under the safe-harbor rule.

For a cash-basis taxpayer, qualifying expenses include lease payments on business vehicles, rent payments on offices and machinery, and business and malpractice insurance premiums.

**Example.** You pay \$3,000 a month in rent and would like a \$36,000 deduction this year. So on Friday, December 31, 2021, you mail a rent check for \$36,000 to cover all of your 2022 rent. Your landlord does not receive the payment in the mail until Tuesday, January 4, 2022. Here are the results:

- You deduct \$36,000 in 2021 (the year you paid the money).
- The landlord reports taxable income of \$36,000 in 2022 (the year he received the money).

You get what you want—the deduction this year. The landlord gets what he wants—next year's entire rent in advance, eliminating any collection problems while keeping the rent taxable in the year he expects it to be taxable.

Don't surprise your landlord: if he had received the \$36,000 of rent paid in advance in 2021, he would have had to pay taxes on the rent money in tax year 2021.

#### 2. Stop Billing Customers, Clients, and Patients

Here is one rock-solid, time-tested, easy strategy to reduce your taxable income for this year: stop billing your customers, clients, and patients until after December 31, 2021. (We assume here that you or your corporation operates on a cash basis and calendar year.)

Customers, clients, patients, and insurance companies generally don't pay until billed. Not billing customers and patients is a time-tested tax-planning strategy that business owners have used successfully for years.

**Example.** Jim, a dentist, usually bills his patients and the insurance companies at the end of each week. This year, however, he sends no bills in December. Instead, he

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gathers up those bills and mails them the first week of January. Presto! He just postponed paying taxes on his December 2021 income by moving that income to 2022.

### 3. Buy Office Equipment

With bonus depreciation now at 100 percent along with increased limits for Section 179 expensing, buy your equipment or machinery and place it in service before December 31, and get a deduction for 100 percent of the cost in 2021.

Qualifying bonus depreciation and Section 179 purchases include new and used personal property such as machinery, equipment, computers, desks, chairs, and other furniture (and certain qualifying vehicles).

### 4. Use Your Credit Cards

If you are a single-member LLC or sole proprietor filing Schedule C for your business, the day you charge a purchase to your business or personal credit card is the day you deduct the expense. Therefore, as a Schedule C taxpayer, you should consider using your credit card for last-minute purchases of office supplies and other business necessities.

If you operate your business as a corporation, and if the corporation has a credit card in the corporate name, the same rule applies: the date of charge is the date of deduction for the corporation.

But if you operate your business as a corporation and you are the personal owner of the credit card, the corporation must reimburse you if you want the corporation to realize the tax deduction, and that happens on the date of reimbursement. Thus, submit your expense report and have your corporation make its reimbursements to you before midnight on December 31.

### 5. Don't Assume You Are Taking Too Many Deductions

If your business deductions exceed your business income, you have a tax loss for the year. With a few modifications to the loss, tax law calls this a "net operating loss," or NOL.

If you are just starting your business, you could very possibly have an NOL. You could have a loss year even with an ongoing, successful business.

You used to be able to carry back your NOL two years and get immediate tax refunds from prior years, but the Tax Cuts and Jobs Act (TCJA) eliminated this provision. Now, you can only carry your NOL forward, and it can only offset up to 80 percent of your taxable income in any one future year.

What does all this mean? You should never stop documenting your deductions, and you should always claim all your rightful deductions. We have spoken with far too many business owners, especially new owners, who don't claim all their deductions when those deductions would produce a tax loss.

### 6. Deal with Your Qualified Improvement Property

In the CARES Act, Congress finally fixed the qualified improvement property (QIP) error that it made when enacting the TCJA.

QIP is any improvement made by the taxpayer to the interior portion of a building that is non-residential real property (think office buildings, retail stores, and shopping centers) if you place the improvement in service after the date you place the building in service.

The big deal with QIP is that it's not considered real property that you depreciate over 39 years. QIP is 15-year property, eligible for immediate deduction using either 100 percent bonus depreciation or Section 179 expensing. To get the QIP deduction in 2021, you need to place the QIP in service on or before December 31, 2021.

**Planning note.** If you have QIP property on an already filed 2018 or 2019 return that has not been amended, it's on that return as 39-year property. You need to fix that—and likely add some cash to your bank account because of the fix.

## 2021 Last-Minute Section 199A Tax Reduction Strategies

Remember to consider your Section 199A deduction in your year-end tax planning.

If you don't, you could end up with an unsatisfactory \$0 for your deduction amount. We'll review three year-end moves that (a) reduce your income taxes and (b) boost your Section 199A deduction at the same time.

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## First Things First

If your taxable income is above \$164,900 (or \$329,800 on a joint return), then your type of business, wages paid, and property can reduce and/or eliminate your Section 199A tax deduction.

If your deduction amount is less than 20 percent of your qualified business income (QBI), then consider using one or more of the strategies described below to increase your Section 199A deduction.

### Strategy 1: Harvest Capital Losses

Capital gains add to your taxable income, which is the income that

- determines your eligibility for the Section 199A tax deduction,
- sets the upper limit (ceiling) on the amount of your Section 199A tax deduction, and
- establishes when you need wages and/or property to obtain your maximum deductions.

If the capital gains are hurting your Section 199A deduction, you have time before the end of the year to harvest capital losses to offset those harmful gains.

### Strategy 2: Make Charitable Contributions

Since the Section 199A deduction uses taxable income for its thresholds, you can use itemized deductions to reduce and/or eliminate threshold problems and increase your Section 199A deduction.

Charitable contribution deductions are the easiest way to increase your itemized deductions before the end of the year (assuming you already itemize).

### Strategy 3: Buy Business Assets

Thanks to 100 percent bonus depreciation and Section 179 expensing, you can write off the entire cost of most assets you buy and place in service before December 31, 2021.

This can help your Section 199A deduction in two ways:

1. The big asset purchase and write-off can reduce your taxable income and increase your Section 199A deduction when it gets your taxable income under the threshold.
2. The big asset purchase and write-off can contribute to an increased Section 199A deduction if your Section 199A deduction currently uses the calculation that includes the 2.5 percent of unadjusted basis in your business's qualified property. In this scenario, your asset purchases increase your qualified property, which in turn increases your 199A deduction.



## 2021 Last-Minute Year-End Tax Strategies for Your Stock Portfolio

When you take advantage of the tax code's offset game, your stock market portfolio can represent a little gold mine of opportunities to reduce your 2021 income taxes.

The tax code contains the basic rules for this game, and once you know the rules, you can apply the correct strategies.

Here's the basic strategy:

- Avoid the high taxes (up to 40.8 percent) on short-term capital gains and ordinary income.
- Lower the taxes to zero—or if you can't do that, then lower them to 23.8 percent or less by making the profits subject to long-term capital gains.

Think of this: you are paying taxes at a 71.4 percent higher rate when you pay at 40.8 percent rather than the tax-favored 23.8 percent.

To avoid the higher rates, here are seven possible tax-planning strategies.

## Strategy 1

Examine your portfolio for stocks that you want to unload and make sales where you offset *short-term* gains subject to a high tax rate such as 40.8 percent with *long-term* losses (up to 23.8 percent).

In other words, make the high taxes disappear by offsetting them with low-taxed losses, and pocket the difference.

## Strategy 2

Use *long-term* losses to create the \$3,000 deduction allowed against ordinary income.

Again, you are trying to use the 23.8 percent loss to kill a 40.8 percent rate of tax (or a 0 percent loss to kill a 12 percent tax, if you are in the 12 percent or lower tax bracket).

## Strategy 3

As an individual investor, avoid the wash-sale loss rule.

Under the wash-sale loss rule, if you sell a stock or other security and purchase substantially identical stock or securities within 30 days before or after the date of sale, you don't recognize your loss on that sale. Instead, the code makes you add the loss amount to the basis of your new stock.

If you want to use the loss in 2021, then you'll have to sell the stock and sit on your hands for more than 30 days before repurchasing that stock.

## Strategy 4

If you have lots of capital losses or capital loss carryovers and the \$3,000 allowance is looking extra tiny, sell additional stocks, rental properties, and other assets to create offsetting capital gains.

If you sell stocks to purge the capital losses, you can immediately repurchase the stock after you sell it—there's no wash-sale "gain" rule.

## Strategy 5

Do you give money to your parents to assist them with their retirement or living expenses? How about children (specifically, children not subject to the kiddie tax)?

If so, consider giving appreciated stock to your parents and your non-kiddie-tax children. Why? If the parents or children are in lower tax brackets than you are, you get a bigger bang for your buck by

- gifting them stock,
- having them sell the stock, and then
- having them pay taxes on the stock sale at their lower tax rates.

## Strategy 6

If you are going to make a donation to a charity, consider appreciated stock rather than cash, because a donation of appreciated stock gives you more tax benefit.

It works like this:

- **Benefit 1.** You deduct the fair market value of the stock as a charitable donation.
- **Benefit 2.** You don't pay any of the taxes you would have had to pay if you sold the stock.

**Example.** You bought a publicly traded stock for \$1,000, and it's now worth \$11,000. If you give it to a 501(c)(3) charity, the following happens:

- You get a tax deduction for \$11,000.
- You pay no taxes on the \$10,000 profit.

Two rules to know:

1. Your deductions for donating appreciated stocks to 501(c)(3) organizations may not exceed 30 percent of your adjusted gross income.
2. If your publicly traded stock donation exceeds the 30 percent, no problem. Tax law allows you to carry forward the excess until used, for up to five years.

## Strategy 7

If you could sell a publicly traded stock at a loss, *do not* give that loss-deduction stock to a 501(c)(3) charity. Why? If you sell the stock, you have a tax loss that you can deduct. If you give the stock to a charity, you get no deduction for the loss—in other words, you miss out on that tax-reducing loss.

## 2021 Last-Minute Year-End Tax Strategies for Marriage, Kids, and Family

If you are thinking of getting married or divorced, you need to consider December 31, 2021, in your tax planning.

Also, do you give money to family or friends (other than your children, who are subject to the kiddie tax)? If so, you need to consider the zero-taxes planning strategy.

And now, consider your children who are under age 18. Have you paid them for work they've done for your business? Have you paid them the right way?

Here are five strategies to consider as we come to the end of 2021.

### 1. Put Your Children on Your Payroll

If you have a child under the age of 18 and you operate your business as a Schedule C sole proprietor or as a spousal partnership, you absolutely need to consider having that child on your payroll. Why?

First, neither you nor your child would pay payroll taxes on the child's income.

Second, with a traditional IRA, the child can avoid all federal income taxes on up to \$18,550 in income.

If you operate your business as a corporation, you can still benefit by employing the child even though both your corporation and your child suffer payroll taxes.

### 2. Get Divorced after December 31

The marriage rule works like this: you are considered married for the entire year if you are married on December 31.

Although lawmakers have made many changes to eliminate the differences between married and single taxpayers, in most cases the joint return will work to your advantage.

**Warning on alimony!** The TCJA changed the tax treatment of alimony payments under divorce and separate maintenance agreements executed after December 31, 2018:

- Under the old rules, the payor deducts alimony payments and the recipient includes the payments in income.
- Under the new rules, which apply to all agreements executed after December 31, 2018, the payor gets no tax deduction and the recipient does not recognize income.

### 3. Stay Single to Increase Mortgage Deductions

Two single people can deduct more mortgage interest than a married couple.

If you own a home with someone other than a spouse, and you bought it on or before December 15, 2017, you individually can deduct mortgage interest on up to \$1 million of a qualifying mortgage.

For example, if you and your unmarried partner live together and own the home together, the mortgage ceiling on deductions for the two of you is \$2 million. If you get married, the ceiling drops to \$1 million.

If you bought your house after December 15, 2017, then the reduced \$750,000 mortgage limit from the TCJA applies. In that case, for two single people, the maximum deduction for mortgage interest is based on a ceiling of \$1.5 million.

## 4. Get Married on or before December 31

Remember, if you are married on December 31, you are married for the entire year.

If you are thinking of getting married in 2022, you might want to rethink that plan for the same reasons that apply in a divorce (as described above). The IRS could make big savings available to you for the 2021 tax year if you get married on or before December 31, 2021.

You have to run the numbers in your tax return both ways to know the tax benefits and detriments for your particular case. But if the numbers work out, a quick trip to the courthouse could save you thousands.

## 5. Make Use of the 0 Percent Tax Bracket

In the old days, you used this strategy with your college student. Today, this strategy does not work with the college student, because the kiddie tax now applies to students up to age 24.

But this strategy is a good one, so ask yourself this question: Do I give money to my parents or other loved ones to make their lives more comfortable?

If the answer is yes, is your loved one in the 0 percent capital gains tax bracket? The 0 percent capital gains tax bracket applies to a single person with less than \$40,400 in taxable income and to a married couple with less than \$80,800 in taxable income.

If the parent or other loved one is in the 0 percent capital gains tax bracket, you can get extra bang for your buck by giving this person appreciated stock rather than cash.

**Example.** You give Aunt Millie shares of stock with a fair market value of \$20,000, for which you paid \$2,000. Aunt Millie sells the stock and pays zero capital gains taxes. She now has \$20,000 in after-tax cash to spend, which should take care of things for a while.

Had you sold the stock, you would have paid taxes of \$4,284 in your tax bracket (23.8 percent x \$18,000 gain).

Of course, \$5,000 of the \$20,000 you gifted goes against your \$11.7 million estate tax exemption if you are single. But if you're married and you made the gift together, you

each have a \$15,000 gift-tax exclusion, for a total of \$30,000, and you have no gift-tax concerns other than the requirement to file a gift-tax return that shows you split the gift.

## 2021 Last-Minute Year-End Medical Plan Strategies

All small-business owners with one to 49 employees should have a medical plan for their business. Sure, the tax law does not require you to have a plan, but you should.

Most of the tax rules that apply to medical plans are straightforward when you have 49 or fewer employees.

Here are six opportunities for you to consider:

1. Make sure to claim the federal tax credit equal to 100 percent of required (2020) and voluntary (2021) emergency sick leave and emergency family leave payments. It's likely that you made payments that qualify for the credits.
2. If you have a Section 105 plan in place and you have not been reimbursing expenses monthly, do a reimbursement now to get your 2021 deductions, and then put yourself on a monthly reimbursement schedule in 2022.
3. If you want to implement a Qualified Small Employer Health Reimbursement Arrangement (QSEHRA), make sure to get that done properly now. You are late, so you could suffer that \$50-per-employee penalty should you be found out.
4. But if you are thinking of the QSEHRA and want to help your employees with more money and flexibility, be sure to consider the Individual Coverage Health Reimbursement Arrangement (ICHRA). The ICHRA has more advantages.
5. If you operate your business as an S corporation and you want an above-the-line tax deduction for the cost of your health insurance, you need the S corporation to (a) pay for or reimburse you for the health insurance, and (b) put it on your W-2. Make sure that the reimbursement happens before December 31 and that you have the reimbursement set up to show on the W-2.

6. Claim the tax credit for the group health insurance you give your employees. If you provide your employees with group health insurance, see whether your pay structure and number of employees put you in a position to claim a 50 percent tax credit for some or all of the monies you paid for health insurance in 2021 and possibly in prior years.

## 2021 5-Point Retirement Plan Account Action Plan

Recent Congressional proposals have put retirement savers on notice: the clock is ticking on some popular planning strategies. Here is a five-point retirement account action plan for year-end 2021.

1. **Ramp up for Return of RMDs** - The CARES Act waived required minimum distributions (RMDs) for 2020, but they are back in effect for 2021. IRA owners age 72 or older must take RMDs. Participants in employer plans who are age 72 or older are also subject to RMDs - assuming they do not qualify for the “still-working exception.” Beneficiaries may also be subject to RMDs.

December 31, 2021 is the deadline for most RMDs. However, there is an exception to this deadline for a person’s first RMD. If 2021 is the first year an RMD is required for a retirement account owner, the deadline for that RMD is extended to April 1, 2022. While RMDs are not required from Roth IRAs during the owner’s lifetime, do not forget that RMDs must be taken from both inherited IRAs and inherited Roth IRAs. Missing the December 31 deadline can be catastrophic as it can mean a hefty 50% penalty on the amount of the RMD not taken.

2. **Take Advantage of Roth Conversion Opportunities Now** - Tax rates are historically low, and many believe that rates have nowhere to go but up, possibly as early as next year. Take advantage of today’s low tax rates by converting traditional retirement accounts to Roth accounts. For those looking to use back-door Roth strategies, time may be running out as Congress is

targeting these transactions in several recent legislative proposals.

To qualify as a 2021 Roth conversion, the funds must leave the IRA or company plan by December 31, 2021. For clients reluctant to absorb a big tax bill, consider a series of smaller partial conversions over time, using up lower tax brackets. Remember, Roth conversions are permanent, so be certain there are enough funds to pay the taxes before completing the conversion.

3. **Clients Who are Charitable Inclined** – Are you charitably inclined?

QCD (qualified charitable distribution) is a direct transfer of up to \$100,000 of IRA funds to a qualifying charity—the most tax-efficient way to make charitable gifts. Reduce taxable IRA balances at ZERO tax cost for clients age 70 ½ and older BEFORE year’s end. The charity gets the full donation, and the client does not have to claim the distribution as income—it’s a win-win! Note: While the SECURE Act raised the RMD age from age 70 ½ to age 72, QCDs are still available at age 70 ½.

For clients who are over age 59 ½ but not yet 70 ½, or who are looking to give more than the \$100,000 QCD limit for 2021... there is the “Mega-QCD” strategy. Note that this planning opportunity will disappear when 2021 comes to a close. Why? Normally, itemized deductions for charitable contributions can’t exceed 60% of adjusted gross income (AGI) in a single tax year. But Congress suspended the 60% charitable deduction limit for 2020 cash donations and extended that suspension to 2021. This means a client could take a withdrawal from an IRA or company plan for any amount during 2021 and donate that same amount to charity. Cash donations of up to 100% of AGI can be deducted. (Note that the client must itemize to take advantage of the Mega-QCD strategy.)

4. **Leverage UA** – The end of 2021 is the “perfect storm” for the net unrealized appreciation (NUA) strategy. Many workers are leaving jobs, taking early retirement due to the pandemic, and stock prices have reached record highs. Additionally,

Congress is threatening to do away with favorable capital gains rates for future years.

For clients with highly appreciated company stock in a company plan, NUA can allow significant tax savings by utilizing long-term capital gains rates rather than ordinary income tax rates on those shares.

If a client took a distribution of company stock from her company plan in 2021 and is looking to use the NUA tax break, it is imperative to ensure that proper steps are followed by year end. Double check that a lump sum distribution occurred. Remember, to qualify for the NUA tax break, the entire distribution must be completed in one tax year. Make sure that ALL funds have been withdrawn from the plan and that the company stock has been properly transferred to a taxable (non-IRA) account.

5. **Move Retirement Accounts Strategically** – For clients with after-tax dollars in IRAs, the pro-rata formula can be a huge stumbling block when it comes to distribution planning. The formula hinges on the percentage of pre-tax dollars a person have in all of his IRAs at the end of the year. This can be a pitfall, or an opportunity.

How so? A sizeable rollover from a plan can add taxable dollars to an IRA, resulting in an unexpected tax bill on a previous back-door Roth conversion. Or, a carefully timed reverse rollover of pre-tax dollars from an IRA to a plan can result in a tax-free conversion.

## 2021 Year End Planning Services

For most of our business clients we recommend they engage us to perform some type of year-end projection.

We have recently sent out year-end engagement letters to our S Corporation business clients regarding specific actions needed to be taken year-end. If your S Corporation would like to engage us, please return the engagement letter and we will begin this month.

For businesses, the year-end planning typically takes between 3 to 10 hours of accountant time.

For individuals, the year-end planning typically takes between 1 to 3 hours of accountant time.

Our hourly rates are posted on our website at [www.LiebCody.com](http://www.LiebCody.com) under “Fees”.

Should you like to engage us to perform year end planning and reviewing of the items listed in this newsletter please let us know by November 26<sup>th</sup>. This will allow us to review and complete the planning before the end of the year.

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