2021 YEAR END TAX PLANNING FOR BUSINESSES AND INDIVIDUALS

Year-end tax planning is always tricky, but pending legislation prior to year-end adds a whole new layer of complexity to the equation. At the current time, the House has passed the Build Back Better (BBB) Act with numerous changes related to business and individual taxation. While these proposed changes are likely to be modified in the Senate before being enacted, we're sharing some key ideas that individuals and businesses should consider before the New Year. Every taxpayer's situation is different, so we are here to help you evaluate your position so you can decide the best moves to take.

Individuals

With so many potential changes in the tax law, it is strongly recommended that you have your tax plan in place. Even though most laws are likely to stay the same for 2021 as they have since 2018, your income and deductions may have changed which will make your tax results very different. The best way to start is by identifying any changes in your personal tax situation.

Timing Matters
Postponing income is typically desirable for those taxpayers who anticipate being in a lower tax bracket next year due to a change in their financial circumstances. In the past, postponing income went hand-in-hand with accelerating deductions. You may want to consider bunching your deductions (see bunching deductions below). If you think you will be in a higher tax bracket in 2022 due to increased income or a different tax situation, then postponing income to 2022 may not be advisable. At the time of this release, there are no proposals in the House or Senate about increasing individual income or capital gains rates; however, nothing has been finalized under the BBB Act. Please note the section below

related to surcharge taxes.

Capital Gains and Losses

If you currently have large, realized capital gains, consider harvesting capital losses. You can realize losses on stock while substantially preserving your investment position. There are several ways this can be done. For example, the original holding can be sold, then buy back the same securities at least 31 days later. Minimizing the net capital gains will also help lower the 3.8% surtax on net investment income and the QBI deduction described below. If you are in a lower tax bracket, your long-term capital gains tax rate may be 0% so make sure to analyze your situation before you sell stocks at a loss. At this time, there are no proposals that would increase capital gains tax rates.

Retirement Savings

Another way to lower your 2021 income is through retirement plans. Employees wishing to defer income to future years should take advantage of maximizing the amount contributed to their employer-sponsored retirement plan. For 401(k) plans:

- For 2021, the maximum deferral is $19,500 with an additional catch-up contribution of $6,500 for those over 50 years old as of December 31, 2021.
- For 2022, the maximum deferral is increased to $20,500 while the additional catch-up contribution remains unchanged at $6,500.

For a list of additional cost of living adjustments for 2022, we've compiled a side-by-side comparison of the dollar limitations for benefits and contributions over the past three years.

Qualified Business Income (QBI) Deduction

The rules for this deduction are very complex. Adding to the complexity are taxable income limitations, wage limitations and/or asset limitations. If you are in a specified trade or business (most service businesses), the taxable income limitations are critical and will likely make the difference of getting the QBI deduction or not. For these business owners, lowering your taxable income may help you take full advantage of this new deduction. Lowering your taxable income can be done in various ways, including:

- postponing income into 2022;
- increasing itemized deductions, such as charitable contributions;
- increasing retirement plan contributions;
- elect to aggregate several businesses together potentially allowing you a larger 20% deduction.

There are no proposed changes to QBI under the BBB Act.

Alimony
For divorces finalized on or after January 1, 2019, alimony is no longer deductible for the payer or taxable to the payee. For divorces finalized on or before December 31, 2018, the old rules still apply.
Required Minimum Distribution (RMD)
In 2020, RMDs were not required due to COVID; however, in 2021, taxpayers are required to take a distribution. Please contact your advisor if you have not received an RMD for 2021.
Education Planning
Consider funding a 529 Plan for educational purposes. There is currently no federal deduction for 529 plan contributions but in Ohio, there is a state tax deduction of up to $4,000 per beneficiary. In addition, 529 plan distributions can now be used for grades K-12 tuition (up to $10,000 per year) making them even more advantageous. If you have kids in college, you may be eligible for some tuition tax credits, even if they are working on their master's degree.
Verify Your Withholding
The IRS allows tax to be paid via several methods: payroll withholding, retirement withholding and quarterly estimates. The IRS has two safe harbors to avoid underpayment penalties. The first is by paying 100% of your prior-year tax amount (110% if your prior-year adjusted gross income was over $150,000), and the second is paying 90% of your current year's tax amount. Because the payroll withholding tables have changed again, it is likely that your payroll withholding changed even if your income stayed the same. It is important to verify that you will meet one of these safe harbors to avoid penalties.
Maximize Above-the-Line Deductions

- **Health Savings Accounts (HSA)**. If you become eligible on or before

December 2021 to make HSA contributions, you can make a full year's worth of deductible HSA contributions for 2021.
- **Simplified Employee Pension (SEP) Contribution.** If you have self-employed income, consider putting money into a SEP. This option is available to you even if you have already deferred the maximum amount into your employer-sponsored 401(k) plan. By contributing money to a SEP, you can typically avoid both current year federal and state taxes on the amount contributed. The maximum SEP contribution for 2021 is $58,000 and it can be funded as late as the due date of your federal tax return, including extensions.
- **Student Loan Interest.** You may be eligible to take an above-the-line deduction for student loan interest paid up to a maximum of $2,500.
- **Self-Employed Health Insurance.** Partners and S-Corp shareholders owning more than 2% of the entity stock and self-employed individuals are permitted a deduction for their health insurance for themselves and their dependents. This is different than the Schedule A itemized deduction since it is above-the-line and not subject to the 7.5% Adjusted Gross Income limitation.
- **Charitable Deduction for Non-Itemizers.** As part of the CARES Act, taxpayers were allowed a charitable deduction of $300 for gifts to qualified charitable organizations in 2020, even if you are not itemizing your deductions. This has remained the same for 2021, except married taxpayers are eligible for a deduction of $600.

Bunching Itemized Deductions
With the Tax Cuts & Jobs Act ("TCJA"), many itemized deductions were either eliminated or severely limited. Bunching deductions may be a way to preserve deductions that would otherwise be wasted or lost due to the higher standard deduction. The deduction for state and local taxes and real estate taxes is limited to $10,000. If your mortgage is paid off and you don't have any high medical expenses, your only other itemized deduction would be charitable contributions. It may be worth your while to fund several years' worth of charitable contributions in one year to accelerate the deduction into that year, and then use the standard deduction in the subsequent years. One good way to do this is

through a Donor-Advised Fund. This vehicle allows you to donate the money one year and get a tax deduction while keeping the money in the fund until you distribute it to the various charities in subsequent years.

- **Medical Expense Deduction.** For 2021, medical expenses are only deductible to the extent that they exceed 7.5% of your adjusted gross income, even for taxpayers over age 65. Medical expenses include health insurance premiums, Medicare premiums, amounts paid to doctors for medical care, prescriptions, etc. Unless you have a high amount of medical expenses, you most likely will not qualify for this deduction.
- **State and Local Tax Deduction.** The TCJA limited the total deduction for state and local income taxes and real estate taxes to $10,000. If you can itemize your deductions and have not reached the $10K limit, you may want to consider paying your real estate taxes in December 2021 as opposed to January 2022. If you have already met the $10K limitation, then there is no benefit to pre-paying these taxes. Please note that under the proposed BBB Act, the state and local tax deduction would increase to $72,500.
- **Mortgage Interest Deduction.** The interest you pay on your home is typically deductible to the extent that the average mortgage balance does not exceed $750,000. For mortgages placed in service prior to December 15, 2017, the limit is $1,000,000. Home equity loan interest is only deductible if the loan was used to buy, build or improve the home. The old rule allowing a deduction for the first $100,000 of home equity interest was eliminated. Also, don’t overlook mortgage points paid upon purchase or refinancing as these may be deductible as well.
- **Charitable Contribution Deduction.** Consider making charitable contributions before year-end either in cash or non-cash such as highly appreciated stocks. If you donate highly appreciated stock, you can get a donation deduction for the fair market value of the stock and avoid capital gains tax. You can also make contributions at year-end using your credit card, even if the credit card is not paid until 2022. You can write a check to charity and mail it on December 31, 2021, and take a 2021 tax deduction even if the check doesn’t clear your bank until January 2022. Non-cash donations valued over $5,000 (except publicly-traded stock) require a written appraisal

and a letter from the charity acknowledging the donation to be deductible. If you are over age 70 ½, you can make a charitable contribution up to $100,000 directly from your IRA to satisfy the required minimum distribution requirement.

Proposed Individual Income Tax Changes
While the BBB Act still needs to go through the Senate and the President, below are the individual income tax provisions in the bill:

- **Child Tax Credit.** The BBB Act would extend the child tax credit through 2022. This would include the advanced payments that rolled out in 2021. The Bill would also extend the refundability of the child tax credit beyond 2022.
- **State and Local Cap Deduction.** The Bill would increase the allowed state and local tax deduction from $10,000 to $72,500 ($36,250 for married taxpayers filing separately and for trusts and estates).
- **Net Investment Income Tax.** The Bill would make taxable net investment income derived in the ordinary course of a trade or business for taxpayers with taxable income over $400,000 for single filers, $500,000 for married filing jointly or $250,000 for taxpayers married filing separately.
- **Excess Business Losses.** The Bill would make permanent the limitations on excess losses for all noncorporate taxpayers.
- **High-Income Surcharges.** The Bill would impose a surcharge on high-income taxpayers. The surcharge tax would be 5% of the amount of the taxpayer's modified adjusted gross income that exceeds $10 million ($5 million for married taxpayers filing separately and $200,000 for estate and trusts). There would also be a 3% surcharge on the amount of a taxpayer's modified adjusted gross income that exceeds $25 million ($12.5 million for taxpayers filing separately and $500,000 for estates or trusts).

IRA Changes
The proposed Bill prohibits contributions to a Roth or traditional IRA for a tax year if the contributions would cause the total value of the IRA to exceed $10 million. The Bill would also prohibit Roth conversions for both IRAs and employer-sponsored plans for taxpayers over $450,000 for married filing joint filers and $400,000 for single and married filing separately taxpayers.

Estate Tax Planning

Gifting
Take advantage of the annual gift tax exclusion. Make gifts sheltered before the end of the year to save gift and/or estate taxes. The exclusion applies to gifts of up to $15,000 made in 2021 to each of an unlimited number of individuals. You can't carry over unused exclusions from one year to the next. The transfers might also save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.
Lifetime Exemption Planning
Although the estate tax exemption is now $11,700,000 and is indexed for inflation, there is a sunset clause after December 31, 2025. After this date, the estate tax exemption will revert to the pre-TCJA amount of roughly $5.5 million. The IRS will likely not retroactively "clawback" gifts made during this temporary increase in the exclusion amount. **It is important to consider whether additional wealth transfer strategies should be implemented before any change in lifetime exemption amounts takes effect. Under the proposed BBB Act, there are no proposed changes to the lifetime exemption amount.**

Businesses

Businesses have been greatly affected by the TCJA and CARES Acts. While the rules for 2021 are mostly the same as in 2020, it is imperative to consider the TCJA and CARES rules as part of your tax plan. Under the TCJA, corporate tax rates were cut to a flat 21% (previously 35%) and the addition of the Qualified Business Income (QBI) deduction (20% business income deduction) for other taxpayers is the most profound.

The TCJA also expanded the small business gross receipts threshold to $26 million for 2021, which allows businesses to elect or remain eligible for various accounting methods, such as utilizing the cash method of accounting and treating inventory as non-incidental materials and supplies or to avoid the uniform capitalization rules for resellers and manufacturers. Your business' taxable income could be much lower under the cash method of accounting or through various other method changes allowed for small businesses.

Timing
Generally, the essence of good tax planning is to defer income and accelerate deductions. But for 2021, that may not be appropriate. If the Biden tax proposals are implemented, corporate tax rates will increase and there will be a phaseout of the QBI 20% deduction for pass through entity owners with over $400,000 of taxable income. Personal income tax rates could go back up to the maximum 39.6% rate enacted before the TCJA. Currently, the Build Back Better bill passed by the House has removed these tax increases but because the Senate will likely change the bill, the results are still in limbo. While the likelihood of these proposals being enacted is unclear, the potential implications need to be addressed and considered in any tax plan.
Paycheck Protection Program Loans
These PPP loans, as written, were supposed to be tax-free if complicated employee retention metrics were met. The IRS briefly interpreted them to be taxable in 2020, but Congress fixed the misinterpretation in subsequent legislation to clarify that forgiveness is tax-free but it could still have important basis implications for pass through entities.
Net Operating Losses (NOLs)
The CARES act made significant modifications to the TCJA rules. The NOL rules were expanded to allow 5-year carrybacks of NOLs generated from 2018-2020. Additionally, 100% of NOLs generated before 2021 can offset taxable income as opposed to the 80% indicated under the TCJA rules. For 2021, the old rules apply to disallow NOL carrybacks and only allow NOLs to offset up to 80% of taxable income.
Accelerated Depreciation
Take advantage of generous depreciation rules for assets such as computers, software, equipment, furniture or certain property improvements purchased in 2021.

- **Section 179.** Allows you to expense otherwise depreciable property if placed in service in 2021. You may elect to expense up to $1,050,000 of fixed asset costs (with a dollar-for-dollar phase-out for purchases greater than

$2,620,000). If the cost of your Sec. 179 property placed in service during 2021 is $3,670,000 or more, you cannot take the deduction. Additionally, the deduction is limited to business income. Certain real estate improvements can be "Qualified Improvement property" (QIP) and still be eligible for the Sec. 179 deduction.
- **Bonus.** In addition to the Sec. 179 deduction, your business can also deduct first-year bonus depreciation equal to 100% of the cost of most fixed assets with a tax life of 20 years or less. Under the TCJA, the law has eliminated the requirement that eligible property must be new to qualify for bonus depreciation (if the property was not acquired from a related party). The 100% first-year bonus depreciation will remain in effect through 2022, in which the applicable percentages will then be phased out through 2026. The CARES act has clarified this further by confirming that QIP is a 15-year property eligible for 100% bonus depreciation. QIP includes most non-residential improvements to the interior of a building.

De Minimis Safe Harbor Election

The "de minimis safe harbor election" (also known as the book-tax conformity election) allows businesses to expense lower-cost assets, materials and supplies. To qualify for the election, the unit of property cost cannot exceed $5,000 if the taxpayer has an applicable financial statement (e.g., a certified audited financial statement along with an independent CPA's report). If there's no applicable financial statement, the cost of a unit of property can't exceed $2,500.

Tax Credits

There are numerous tax credits that can help lessen the tax burden for a business and its owner. The CARES Act added the Employee Retention Credit.

- **R&D Credit.** Businesses that incur certain research and development (R&D) costs, such as wages, supplies and contract research, are eligible for this general business R&D tax credit. Eligible small businesses with $50 million or less in gross receipts, may also be able to claim the R&D credit against the employer's payroll tax (i.e. FICA) liability under TCJA rules.
- **Work Opportunity Tax Credit.** Businesses that hire individuals from targeted groups (i.e. qualified veterans, long-term unemployment recipients, ex-

felons) are eligible for a tax credit equal generally to 40% of up to $6,000 of the individual's first-year wages paid (per employee).
- **Employee Retention Credit.** A credit is available of up to 70% of wages paid before September 30, 2021, by employers forced to close or partially close by government order or experiencing a 20% or greater quarterly reduction in sales. This credit is now available to PPP loan recipients if the same wages used for the credit are not used for forgiveness of the PPP loans.

Accounting Method
Review your methods of accounting for tax purposes to determine if you are using the optimal methodologies to maximize tax deductions. Deducting certain prepaid items, accruing for company payroll or bonuses (must be paid within 2.5 months of year-end) and reviewing all depreciation methods are common areas to analyze. A change to the cash method of accounting may now be available even for businesses with inventory.
Cash Method
Many businesses, especially service-based businesses, utilize the cash method of accounting. These businesses should accelerate deductions into the current year by bunching expenses to the extent possible. Under TCJA even more businesses are eligible if they are considered 'small' (<$26M in gross receipts).
LIFO (Last-in-First-Out) Inventory
While not new, this method allows, in periods of rising inflation, for deductions for the cost of goods sold to be maximized, substantially reducing taxable income.
State and Local Taxes
We are seeing an increase in changes to state tax laws and regulations, as well as their approach to tax audits. Most states are becoming increasingly aggressive in trying to capture tax revenue from out-of-state businesses. The Wayfair decision will require increased sales tax filings for most out-of-state sellers of goods. Make sure your business is not caught off guard. Specific state and local tax areas to be mindful of include income tax, sales and use tax, payroll and property tax. Additionally, pass through entities may want to revisit how they choose to file at the state level. Some states allow an entity-level assessment of the income tax which bypasses the $10,000 itemized deduction limitation at the individual level due to TCJA. The taxes are deducted from the business' income and don't get

deducted on the individual return as an itemized deduction but as a reduction of taxable income.

Tax Basis

If you own an interest in a partnership or S corporation where losses may be limited due to basis limitations, consider whether you need to increase your basis in the entity to deduct a loss from it for this year.

Meals & Entertainment

The TCJA brought stricter limitations on deductions for both meals and entertainment expenditures, including eliminating a deduction of entertainment, amusement or recreation expenses. Business activities that include a meal and an entertainment component should be broken out and tracked as separate line items or should be purchased as separate transactions, as meal expenditures may still be 50% or 100% deductible. Businesses should consider categorizing meals and entertainment expenses into three categories: entertainment/nondeductible expenses, 100% deductible items, and 50% deductible items. Note that meals for employees are no longer 100% deductible in most cases now. A special CARES act carve out now allows meals from restaurants to be 100% deductible for 2021 and 2022.

Interest Deductions

If your business is not 'small' (<$26M in gross receipts), deductions for interest under the TCJA rules can be suspended. The rules in this area are complex and wide-ranging but proper planning can ensure that deductions are not missed unexpectedly. Generally, a 30% of "Adjusted Taxable Income" (ATI) limit is applied. The CARES Act expanded this further to 50% of ATI in 2020, but that expansion is eliminated for 2021. Furthermore, the ATI calculations will no longer include an add-back for depreciation expenses starting in 2022. This could substantially reduce the amount of deductible interest in 2022 compared to 2021. Taxpayers should plan for this change as early as possible.

Passive Losses

To reduce 2021 taxable income, consider disposing of a passive activity in 2021 if it will allow you to deduct suspended passive activity losses.

IC-DISC

If your business has foreign sales, consider utilizing an IC-DISC. A business that has export sales and utilizes an IC-DISC can create a tax benefit in which a portion of its income is taxed at the long-term capital gains rate.

Foreign Reporting

The foreign reporting requirements are comprehensive and complex for businesses with activities outside of the U.S. Business owners and employees who have any financial interest in or signature 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). The Foreign Account Tax Compliance Act (FATCA) requires businesses to report and possibly withhold payments made to foreign entities. Investments, assets, and legal entities outside the U.S. may subject the business to various reporting requirements.

These are some of the year-end steps that can be taken to minimize your tax burden. We can help tailor a customized plan that will work best for your tax planning goals. Additional ideas and information may be found in our 2021 Tax Planning Guide.

Please contact your BMF Advisor if you would like to review any of the items mentioned, schedule a tax planning strategy session or discuss potential implications of the various tax law changes.