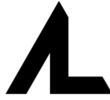

Arthur Lander C.P.A., P.C.
A professional corporation

300 N. Washington St. #104
Alexandria, Virginia 22314
phone: (703) 486-0700
fax: (703) 527-7207

November 26, 2021

Dear Clients,

We hope you have had a wonderful holiday, and that you have been able to stay healthy and safe this year. With the end of the year fast approaching, now is the time to take a closer look at tax planning strategies that could reduce your tax bill for 2021.

GENERAL TAX PLANNING STRATEGIES

General tax planning strategies for individuals include accelerating or deferring income and deductions, as well as careful consideration of timing-related tax planning strategies with regard to investments, charitable gifts, and retirement planning. For example, taxpayers might consider using one or more of the following strategies:

Investments. Selling any investments on which you have a gain (or loss) this year. For more on this, see Investment Gains and Losses, below.

Charitable deductions. Bunching charitable deductions every other year is also a good strategy if it enables the taxpayer to get over the higher standard deduction threshold under the Tax Cuts and Jobs Act of 2017 (TCJA). Another option is to put money into a donor-advised fund that enables donors to make a charitable contribution and receive an immediate tax deduction. A public charity manages the fund on behalf of the donor, who then recommends how to distribute the money over time. Don't hesitate to call if you would like more information about donor-advised funds. Scroll down to read more about charitable deductions.

Medical expenses. Medical expenses are deductible only to the extent they exceed a certain percentage of adjusted gross income (AGI); therefore, you might pay medical bills in whichever year they would do you the most tax good. In 2021, deductible medical and dental expenses must exceed 7.5 percent of AGI. By bunching medical expenses into one year, rather than spreading them out over two years, you have a better chance of exceeding the thresholds, thereby maximizing the deduction.

- Deductible expenses such as medical expenses and charitable contributions can be prepaid this year using a credit card or check. You can only deduct medical and dental expenses you paid this year - not payments for medical or dental care you will receive in a future year. For example, suppose you charge a medical expense in December but pay the bill in January. Assuming it's an eligible medical expense, you can take the deduction on your 2021 tax return.

Stock options. If your company grants stock options, then you may want to exercise the option or sell stock acquired by exercising an option this year. Use this strategy if you think your tax bracket will be higher in 2022. Generally, exercising this option is a taxable event; the sale of the stock is almost always a taxable event.

Withholding. If you know you have a set amount of income coming in this year that is not covered by withholding taxes, there is still time in December to increase your withholding before year-end and avoid or reduce any estimated tax penalty that might otherwise be due.

ACCELERATING OR DEFERRING INCOME AND DEDUCTIONS

Strategies commonly used to help taxpayers minimize their tax liability include accelerating or deferring income and deductions. Which strategy you use depends on your current tax situation.

Most taxpayers anticipate increased earnings from year to year, whether it's from a job or investments, so this strategy works well. On the flip side, however, if you are retiring and anticipate a lower income next year or you know you will have significant medical bills, you might want to consider deferring income and expenses to the following year.

In cases where tax benefits are phased out over a certain adjusted gross income (AGI) amount, a strategy of accelerating income and deductions might allow you to claim larger deductions, credits, and other tax breaks for 2021, depending on your situation. Roth IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest are examples of these types of tax benefits.

Accelerating income into 2021 is also a good idea if you anticipate being in a higher tax bracket next year. This is especially true for taxpayers whose earnings are close to threshold amounts that make them liable for the Additional Medicare Tax or Net Investment Income Tax ($200,000 for single filers and $250,000 for married filing jointly). See more about these two topics below.

- Taxpayers close to threshold amounts for the Net Investment Income Tax (3.8 percent of net investment income) should pay close attention to "one-time" income spikes such as those associated with Roth conversions, sale of a home or any other large asset that may be subject to tax.

Examples of accelerating deductions include:

- Paying an estimated state tax installment in December instead of at the January due date. However, make sure the payment is based on a reasonable estimate of your state tax.
    - Paying your entire property tax bill, including installments due in 2022, by year-end. This does not apply to mortgage escrow accounts.
    - A prepayment of anticipated real property taxes that have not been assessed prior to 2022 is not deductible in 2021.
- Under TCJA, the deduction for state and local taxes (SALT) was capped at $10,000. Once a taxpayer reaches this limit the two strategies above are not effective for federal returns.

- Paying 2022 tuition in 2021 to take full advantage of the American Opportunity Tax Credit, an above-the-line tax credit worth up to $2,500 per student that helps cover the cost of tuition, fees, and course materials paid during the taxable year. Forty percent of the credit (up to $1,000) is refundable, which means you can get it even if you owe no tax.

ADDITIONAL MEDICARE TAX

Taxpayers whose income exceeds certain threshold amounts ($200,000 single filers and $250,000 married filing jointly) are liable for an additional Medicare tax of 0.9 percent on their tax returns. They may, however, request that their employers withhold additional income tax from their pay to be applied against their tax liability when filing their 2021 tax return next April.

As such, high net worth individuals should consider contributing to Roth IRAs and 401(k) because distributions are not subject to the Medicare Tax. Also, if you're a taxpayer who is close to the threshold for the Medicare Tax, it might make sense to switch Roth retirement contributions to a traditional IRA plan, thereby avoiding the 3.8 percent Net Investment Income Tax (NIIT) as well (more about the NIIT below).

ALTERNATIVE MINIMUM TAX

The alternative minimum tax (AMT) applies to high-income taxpayers that take advantage of deductions and credits to reduce their taxable income. The AMT ensures that those taxpayers pay at least a minimum amount of tax and was made permanent under the American Taxpayer Relief Act (ATRA) of 2012. Furthermore, the exemption amounts increased significantly under the Tax Cuts and Jobs Act of 2017 (TCJA). As such, not as many taxpayers are affected as were in previous years. In 2021, the phaseout threshold increased to $523,600 ($1,047,200 for married filing jointly). Both the exemption and threshold amounts are indexed for inflation.

AMT exemption amounts for 2021 are as follows:

- $73,600 for single and head of household filers,
- $114,600 for married people filing jointly and for qualifying widows or widowers,
- $57,300 for married people filing separately.

CHARITABLE CONTRIBUTIONS

Property, as well as money, can be donated to a charity. You can generally take a deduction for the fair market value of the property; however, for certain property, the deduction is limited to your cost basis. While you can also donate your services to charity, you may not deduct the value of these services. You may also be able to deduct charity-related travel expenses and some out-of-pocket expenses, however.

- Contributions of appreciated property (i.e. stock) provide an additional benefit because you avoid paying capital gains on any profit.

In 2021, eligible individuals may take an above-the-line deduction of up to $300 ($600 for married taxpayers filing joint tax returns) in cash for charitable contributions made to qualified charitable organizations. Cash contributions include cash, check, electronic fund transfer, or payroll deduction. Taxpayers can claim the deduction even if they do not itemize on their 2021 taxes.

Taxpayers who itemize deductions can take advantage of a temporary suspension of limits on charitable contributions (CARES Act of 2020) that allows them to deduct cash donations to public charities in amounts of up to 100 percent of adjusted gross income (AGI). Normally, the limit for the deduction for cash contributions was 60% of AGI. They may also take advantage of the above-the-line deduction for taxpayers that don't itemize ($300 for single filers; $600 for married filing jointly).

Keep in mind that a written record of your charitable contributions - including travel expenses such as mileage - is required to qualify for a deduction. A donor may not claim a deduction for any cash contribution, check, or other monetary gifts unless the donor maintains a record of the contribution. A canceled check or written receipt from the charity showing the name of the charity, the date of the contribution, and the amount of the contribution is usually sufficient.

Qualified Charitable Distributions (QCDs). Taxpayers who are age 70 1/2 and older can reduce income tax owed on required minimum distributions (RMDs) - a maximum of $100,000 or $200,000 for married couples - from IRA accounts by donating them to a charitable organization(s) instead.

- Starting in 2020, taxpayers required to take required minimum distributions from IRAs, SIMPLE IRAs, SEP IRAs, or other retirement plan accounts can wait until age 72. In prior years, the age was 70 1/2.

INVESTMENT GAINS AND LOSSES

Investment decisions are often more about managing capital gains than about minimizing taxes. For example, taxpayers below threshold amounts in 2021 might want to take gains, whereas taxpayers above threshold amounts might want to take losses. Tax-loss harvesting - offsetting capital gains with losses - may be a good strategy to use if you have an unusually high income this year or significant losses.

- Fluctuations in the stock market are commonplace; don't assume that a down market means investment losses. If you've held the stock for a long time your cost basis may be low.

Minimize taxes on investments by judicious matching of gains and losses. Where appropriate, try to avoid short-term capital gains, which are taxed as ordinary income (i.e., the rate is the same as your tax bracket).

In 2021, tax rates on capital gains and dividends remain the same as 2020 rates (0%, 15%, and a top rate of 20%); however, threshold amounts have been adjusted for inflation as follows:

- 0% - Maximum capital gains tax rate for taxpayers with income up to $40,400 for single filers, $80,800 for married filing jointly;

- 15% - Capital gains tax rate for taxpayers with income of $40,400 to $445,850 for single filers and $80,800 to $501,600 for married filing jointly;

- 20% - Capital gains tax rate for taxpayers with income above $445,850 for single filers, $501,600 for married filing jointly.

Where feasible, reduce all capital gains and generate short-term capital losses up to $3,000. As a general rule, if you have a significant capital gain this year, consider selling an investment on which you have an accumulated loss. You can claim capital losses up to the amount of your capital gains plus $3,000 per year ($1,500 if married filing separately) as a deduction against income.

Wash Sale Rule. After selling a securities investment to generate a capital loss, you can repurchase it after 30 days. This is known as the "Wash Rule Sale." If you buy it back within 30 days, the loss will be disallowed. Or you can immediately repurchase a similar (but not the same) investment, e.g., an ETF or another mutual fund with the same objectives as the one you sold.

- The wash sale rule only applies to stocks and securities. It does not currently apply to cryptocurrencies such as Bitcoin, which means you can sell Bitcoin and immediately buy it back.

If you have losses, you might consider selling securities at a gain and then immediately repurchasing them since the 30-day rule does not apply to gains. That way, your gain will be tax-free, your original investment is restored, and you have a higher cost basis for your new investment (i.e., any future gain will be lower).

NET INVESTMENT INCOME TAX (NIIT)

The Net Investment Income Tax, which went into effect in 2013, is a 3.8 percent tax applied to investment income such as long-term capital gains for earners above a certain threshold amount ($200,000 for single filers and $250,000 for married taxpayers filing jointly). Short-term capital gains are subject to ordinary income tax rates as well as the 3.8 percent NIIT. This information is something to think about as you plan your long-term investments. Business income is not subject to the NIIT, provided the individual business owner materially participates in the business.

MUTUAL FUND INVESTMENTS

Before investing in a mutual fund, ask whether a dividend is paid at the end of the year or whether it will be paid early in the following year but be deemed paid this year. The year-end dividend could make a substantial difference in the tax you pay.

- Action: You invest $20,000 in a mutual fund in 2021. You opt for automatic reinvestment of dividends, and in late December of 2021, the fund pays a $1,000 dividend on the shares you bought. The $1,000 is automatically reinvested.

- Result: You must pay tax on the $1,000 dividend. You will have to take funds from another source to pay that tax because of the automatic reinvestment feature. The mutual fund's long-term capital gains pass through to you as capital gains dividends taxed at long-term rates, however long or short your holding period.

The mutual fund's distributions to you of dividends it receives generally qualify for the same tax relief as long-term capital gains. If the mutual fund passes through its short-term capital gains, these are reported to you as "ordinary dividends" that don't qualify for relief.

Depending on your financial circumstances, it may or may not be a good idea to buy shares right before the fund goes ex-dividend. For instance, the distribution could be relatively small, with only minor tax consequences. Or the market could be moving up, with share prices expected to be higher after the ex-dividend date. To find out a fund's ex-dividend date, call the fund directly.

Please call if you'd like more information on how dividends paid out by mutual funds affect your taxes this year and next.

YEAR-END GIVING TO REDUCE YOUR POTENTIAL ESTATE TAX

The federal gift and estate tax exemption is currently set at $11.70 million in 2021. The maximum estate tax rate is set at 40 percent.

Gift Tax. Sound estate planning often begins with lifetime gifts to family members. In other words, gifts that reduce the donor's assets are subject to future estate tax. Such gifts are often made at year-end, during the holiday season, in ways that qualify for exemption from federal gift tax. Gifts to a donee are exempt from the gift tax for amounts up to $15,000 a year per donee in 2021 and remain the same for 2022.

- An unused annual exemption doesn't carry over to later years. To make use of the exemption for 2021, you must make your gift by December 31.

- Husband-wife joint gifts to any third person are exempt from gift tax for amounts up to $30,000 ($15,000 each). Though what's given may come from either you or your spouse or both of you, both of you must consent to such "split gifts."

- Gifts of "future interests" are assets that the donee can only enjoy at some future period such as certain gifts in trust and generally don't qualify for exemption. Gifts for the benefit of a minor child, however, can be made to qualify.

    - If you're considering adopting a plan of lifetime giving to reduce future estate tax, don't hesitate to call the office for assistance.

- Cash or publicly traded securities raise the fewest problems. You may choose to give property you expect to increase substantially in value later. Shifting future

appreciation to your heirs keeps that value out of your estate. But this can trigger IRS questions about the gift's true value when given.

- You may choose to give property that has already appreciated. The idea here is that the donee, not you, will realize and pay income tax on future earnings and built-in gain on the sale.

Gift tax returns for 2021 are due on the same date as your income tax return (April 18, 2022). Gifts over $15,000 (including husband-wife split gifts totaling more than $15,000) and gifts of future interests must file a gift tax return. Though you are not required to file if your gifts do not exceed $15,000, you might consider filing anyway as a tactical move to block a future IRS challenge about gifts not "adequately disclosed." Please call the office if you're considering making a gift of property whose value isn't unquestionably less than $15,000.

TAX RATE STRUCTURE FOR THE KIDDIE TAX

Children with unearned income are allowed a standard deduction of the greater of $1,100 or the child's earned income plus $350, but not more than the regular standard deduction ($12,750 in 2021). The next $1,100 of unearned income is taxed at the child’s tax rate. Any amounts over $2,200 are taxed at the rates for single individual filers.

Exception. If the child is under age 19 (or under age 24 and a full-time student) and both the parent and child meet certain qualifications, then the parent can include the child's income on the parent's tax return.

OTHER YEAR-END MOVES

Roth Conversions. Roth conversions allow a taxpayer to convert funds in a pre-tax individual retirement account or 401(k) to a post-tax Roth IRA. The amount withdrawn from the IRA is considered income and subject to tax; however, future Roth IRA distributions are tax-free.

- You do not have to convert your entire IRA to a Roth IRA at once; you can convert all or part of it during different tax years. For example, if you have $90,000 in a 401(k), you can convert it over three years - $30,000 in the first year and $30,000 per year for the next two years. This strategy works well for taxpayers who want to eliminate to minimize RMDs (Required Minimum Distributions) at age 72 from their IRAs and leave more of your retirement account funds to heirs.

Converting to a Roth IRA from a traditional IRA makes sense if you've experienced a loss of income (lowering your tax bracket) or your retirement accounts have decreased in value. Please call if you would like more information about Roth conversions.

Maximize Retirement Plan Contributions. If you own an incorporated or unincorporated business, consider setting up a retirement plan if you don't already have one. It doesn't need to be funded until you pay your taxes, but allowable contributions will be deductible on this year's return.

If you are an employee and your employer has a 401(k), contribute the maximum amount ($19,500 for 2021), plus an additional catch-up contribution of $6,500 if age 50 or over, assuming the plan allows this, and income restrictions don't apply.

If you are employed or self-employed with no retirement plan, you can make a deductible contribution of up to $6,000 a year to a traditional IRA (deduction is sometimes allowed even if you have a plan). Further, there is also an additional catch-up contribution of $1,000 if age 50 or over.

Health Savings Accounts. Consider setting up a health savings account (HSA). You can deduct contributions to the account, investment earnings are tax-deferred until withdrawn, and any amounts you withdraw are tax-free when used to pay medical bills. In effect, medical expenses paid from the account are deductible from the first dollar (unlike the usual rule limiting such deductions to the amount of excess over 7.5 percent of AGI). For amounts withdrawn at age 65 or later not used for medical bills, the HSA functions much like an IRA. To learn more about HSAs, please see, Tax Benefits of Health Savings Accounts, below.

529 Education Plans. Maximize contributions to 529 plans, which can now be used for elementary and secondary school tuition as well as college or vocational school.

Thank you for reading our year-end tax planning letter, and we hope you have a fantastic holiday season. Implementing these strategies before the end of the year could help save money on your tax bill. When you are ready to work on your taxes, please contact us today at (703) 486-0700!

Best regards,

Art Lander