2021 Year-End Tax Planning

November 4, 2021

Highlights

- ✔ Pending Build Back Better Act Looms Over Year-End Planning
- ✔ Bunching Itemized Deductions
- ✔ Maximizing Electric Vehicle Credit
- ✔ Preparing for Possible Return of Corporate AMT
- ✔ International Strategies Available

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SPECIAL REPORT

Planning Strategies and Techniques Available Through End of Year

As the world continues to recover from the depths of the COVID-19 pandemic, the economy has begun a slow return to normalcy. Throughout 2021, businesses in the United States gradually opened up and total lockdowns became a thing of the past as case numbers subsided and vaccines became available. However, as the end of 2021 approaches, things are not yet completely back to normal. Pockets of the country are still dealing with elevated COVID-19 cases, supply chains continue to be disrupted, and labor shortages exist throughout the country as people are hesitant to return to work.

This year saw President Joe Biden sworn into office in January, bringing a new set of policies, priorities, and initiatives. Biden, along with a Democratic-controlled Congress, took steps early in the year to battle the COVID-19 crisis and assist lower and middle-income families dealing with the pandemic with the passage of the American Rescue Plan Act (ARPA). However, not all of the Democratic priorities were immediately handled in that initial piece of legislation, and more steps were deemed necessary. At the time of this publication, the Build Back Better Act is under consideration in Congress, with the expectation that it will become law by the end of 2021, bringing with it a slew of additional tax changes.

In the years after the Tax Cuts and Jobs Act (TCJA), year-end tax planning was generally a pretty simple manner of minimizing income, deferring it when possible, and maximizing deductions. The last two years, driven largely by the ongoing pandemic, has made tax planning a little more difficult. Massive tax changes affected nearly every type of taxpayer. Also, a change in the political makeup of the government means that the simple rules of 2018 and 2019 must be altered, with a new plan of action put in place.

As the last two years have seen so much change, both from a tax and a non-tax perspective, it is important to make sure clients have the best possible information on which to base decisions. As more change is expected in the coming months, it is essential to provide clients with solid planning advice to ensure these businesses and families thrive in the aftermath of whatever comes down the road.

LEGISLATION

When President Biden was campaigning in 2020, he promised to provide a huge increase in social spending, with more robust health, education, and welfare programs meant to improve the quality of life for lower and middle-income voters. These programs were to be paid for with tax increases on higher-income taxpayers, with a specific promise that no one making less than $400,000 would see a tax increase. Both ordinary income and capital gains tax rates were to be increased. Additionally, an increase in the corporate tax rate would help fund the huge spending initiatives.

> *"[S]teps can be taken in the last weeks of 2021 to minimize the impact of the Build Back Better Act."*

As the passage of the Build Back Better Act approaches, it appears the thresholds for tax increases will be considerably higher than planned, as will be discussed below. Additionally, there does not seem to be a simple increase in the corporate tax rate on the horizon. Nevertheless, steps can be taken in the last weeks of 2021 to minimize the impact of the Build Back Better Act.

Given the slim majorities Democrats hold in Congress, and the fact that passage in the Senate will require use of budget reconciliation rules in the face of unified GOP opposition, this may well be the only significant tax legislation Democrats can pass before the mid-term elections in 2022. Thus, what is in this bill will be important for year-end planning in 2021 and overall planning for 2022.

MINIMIZING INDIVIDUAL TAXES

Income Taxes

The key to any year-end planning strategy is to minimize taxes. This is generally done by either reducing the amount of income received or increasing the amount of deductions.

However, for some individual taxpayers, this may not be the best advice for the end of this year. The current version of the Build Back Better Act under consideration in Congress imposes a new income tax surcharge on the highest income taxpayers. An additional tax of five percent applies to the modified adjusted gross income of a joint filer, single filer, or head of household in excess of $10 million ($5 million for a married taxpayer filing separately, $200,000 for an estate and trust). An additional three percent tax applies to the modified adjusted gross income of a joint filer, single filer, or head of household in excess of $25 million ($12.5 million for a married taxpayer filing separately, $500,000 for an estate and trust). The surcharge would apply in tax years beginning after 2021.

Therefore, for taxpayers with incomes anticipated to exceed these thresholds in 2022, it may be wiser to accelerate income to 2021 as much as possible. This could take the form of paying early bonuses or distributing more income from passthrough entities in 2021.

For taxpayers whose income does not exceed these thresholds, the planning advice should take the standard form of deferring income to 2022 where possible, as it is unlikely there will be additional legislation increasing taxes in 2022.

Delaying/Reducing Income and Gains

Ordinary income is taxed at seven rates, depending upon the amount of income. Taxes on capital gains also apply at different rates depending upon the amount of taxable income. For 2021, the rates are as follows:

	0%	15%	20%
MFJ/SS	$0 - $80,800	$80,801 - $501,600	over $501,600
MFS	$0 - $40,400	$40,401 - $250,800	over $250,800
HoH	$0 - $54,100	$54,101 - $473,750	over $473,750
Single	$0 - $40,400	$40,401 - $445,850	over $445,850
E&T	$0 - $2,700	$ 2,701 - $ 13,250	over $ 13,250

For taxpayers whose income tends to fluctuate from year to year, it would be wise to examine the impact of sales of investment items. For taxpayers who think they may have lower income in 2022, it would be smart to hold off on a sale of a capital item if their income is at or near a threshold for a higher capital gains bracket.

This type of consideration should not be limited to capital gain taxes, but also the net investment income (NII) tax. The 3.8% NII tax kicks in at $200,000 of modified adjusted gross income for single and head-of-household filers, $250,000 for joint filers, and $125,000 for married taxpayers filing separately.

COMMENT. *Since the NII thresholds fall right in the middle of the 15% capital gains bracket, a taxpayer to whom the NII applies because of a sale of a capital item would likely not be able to reduce the tax to 0%. But, a taxpayer who is barely in the the 20% bracket could defer a sale and get into the 15%, meaning a sale of a capital item would only be taxed at 18.8% instead of 23.8%.*

Note that for purposes of the NII tax, a change is pending in the Build Back Better Act. A proposal in that bill would classify income received from passthrough entities as investment income subject to the NII tax even if taxpayers materially participate in the business. This change would apply beginning in 2022 to taxpayers exceeding certain income thresholds ($500,000 for joint filers; $400,000 for heads of households and single filers; $250,000 for married taxpayers filing separate returns).

Maximizing Deductions

For 2021, the inflation adjusted amounts are $25,100 for joint filers, $18,800 for heads of households, and $12,550 for all other filers. With standard deduction amounts so high, coupled with the $10,000 limitation on the deduction of state and local taxes, it is difficult for many taxpayers to claim enough deductions to make itemizing deductions beneficial. Thus, maximizing deductions may not be beneficial for all taxpayers.

One of the best ways to maximize the amount of deductions is to develop a bunching strategy. This involves accumulating charitable contributions, or even medical expenses (see below), from two or more years into one year. For example, a taxpayer may have not made any of his or her normal charitable contributions in 2020, and then made double the normal amount in 2021 in order to help surpass the standard deduction amount.

> **COMMENT.** *Note that the Taxpayer Certainty and Disaster Tax Relief Act of 2020 does allow an above-the-line charitable contribution deduction up to $300 for cash contributions by individuals who do not itemize deductions for 2021* **only**. *This special deduction applies regardless of the individual's income level.*

The same strategy can be employed for deductible medical expenses where the timing is somewhat flexible, such as for elective procedures (remember that purely cosmetic procedures are not deductible).

> **COMMENT.** *Bunching can be a very effective strategy, but it has to be effectively used, and potentially planned out two or three years in advance to maximize the benefit, while also taking into account shifts in tax policies as a result of political change.*

Energy Credits

Under current law, a tax credit of up to $7,500 is available for the purchase of a plug-in electric vehicle. Current law also eliminates the credit for vehicles produced by vehicle manufacturers in excess of a certain amount, such that the credit is no longer available for cars produced by Tesla and General Motors.

The proposed Build Back Better Act contains more than $300 million in green energy credits, and one of the credits impacted by the proposal is the plug-in electric vehicle credit. The proposal would eliminate the limitation based on the number of vehicles a maker produces, and also increases the credit to $12,500 where the vehicle and the batteries are produced at U.S. facilities meeting specific workforce standards, all effective after 2021.

> **COMMENT.** *If your client is considering buying a plug-in electric car that is produced at a qualifying facility, he or she would be wise to hold off on making that purchase until 2022, as it could mean an additional $5,000 credit. Further, if the client plans to purchase a vehicle for which the credit is not currently available, it could mean a difference of up to $12,500.*

Other Year-End Strategies

A number of other traditional year-end strategies may apply. These include:

- Maximizing Education Credits – Individuals can claim a credit for tuition paid in 2021 even if the academic period begins in 2022, as long as the period begins by the end of March.
- Increasing 401(k) Contributions – Adjusted gross income (AGI) can be reduced if individuals increase the amount of their 401(k) contributions.
- IRA Contributions – Individuals eligible for deductions for IRA contributions can claim deductions, and thus reduce AGI, for amounts contributed through April 18, 2022.
- Teacher deductions – Educators can claim a deduction for up to $250 of classroom expenses (like books, supplies, and computer equipment, as well as personal protective equipment, disinfectant, and other supplies used to prevent the spread of COVID-19), and should maximize those expenses by year-end.

YEAR-END BUSINESS STRATEGIES

Corporate AMT

The proposed Build Back Better Act would resurrect the corporate alternative minimum tax (AMT) which was eliminated by the Tax Cuts and Jobs Act, although in a slightly altered form. Proposed to be effective for tax years beginning after 2022, the new corporate AMT would equal 15 percent of the corporation's "adjusted financial statement income" for the tax year, reduced by a corporate AMT foreign tax credit. The tax would only apply to corporations with average annual adjusted financial statement income in excess of $1 billion for the three prior tax years. This threshold is reduced to $100 million in the case of certain foreign-parented corporations. Certain exceptions also apply to the determination of an applicable corporation where there is a change in ownership or a consistent reduction in income.

A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement, for purposes of determining when to include income for tax purposes. That amount is adjusted for various purposes, including certain adjustments in the case of consolidated returns or for certain foreign income.

COMMENT. *Affected corporations may want to try to accelerate profitability on their financial statements into 2021 where possible, as the new AMT is likely to be included in any final bill and would have a significant impact on a corporate tax bill in 2022.*

Depreciation and Expensing

The TCJA provided very generous depreciation and expensing limitations. Businesses may want to take advantage of 100-percent first-year depreciation on machinery and equipment purchased during the year. Additionally, Code Sec. 179 expensing has an investment limitation of $2,620,000 for 2021, with a dollar limitation of $1,050,000.

COMMENT. *These provisions do not apply to 2021 only, so there is time to take advantage of them in later years. However, if a business has been considering expanding capacity or acquiring new equipment, there has never been a better time to do so than in 2021, from a tax benefit standpoint.*

Research and Development Expenses

The TCJA required that any research and development costs incurred after 2021 would have to be amortized ratably over five years rather than deducted in the year the costs are incurred (or amortized over five or ten years at the election of the taxpayer, subject to specific requirements). Any R&D costs that a business can incur before the end of the year should be accelerated in order to take advantage of the immediate deduction that is still available.

COMMENT. *Note that the proposed Build Back Better Act includes a provision that would delay the TCJA amortization requirement to 2026, so this strategy may not be as urgent as it seems if that provision survives.*

Excessive Employee Remuneration

The American Rescue Plan Act disallowed deductions by publicly held corporation of compensation in excess of $1 million to the eight highest paid employees of the corporation, as well as the chief executive officer and the chief financial officer. This limitation is effective for tax years beginning after 2026. However, a provision of the Build Back Better Act would accelerate this limitation to apply to tax years beginning after 2021.

COMMENT. *Impacted corporations may want to accelerate compensation to specified employees to 2021 in anticipation of the possibility that the proposal will be included in a final bill. As mentioned above, such acceleration could also be to the advantage of the employee, given the potential for the new surcharge in the proposed Build Back Better Act.*

International Year-End Tax Strategies

A number of international tax changes are included in the proposed Build Back Better Act that should be reviewed prior to 2022 to determine whether year-end tax planning changes would be beneficial. These include the new corporate minimum tax rate of 15% and the change to calculating GILTI on a country-by-country basis. Both of these proposals mirror the Organization for Economic Co-operation and Development's (OECD) global agreement, which was recently endorsed by the G20. The OECD's agreement is slated to begin in 2023. Legislative changes are also proposed to the foreign tax credit. These changes include having the foreign tax credit limitation calculated on a country-by-country basis, eliminating the foreign branch limitation category from the FTC computation, reducing the 20% GILTI haircut to 5% and eliminating the FTC carryback. Companies should review their current FTC planning strategies to see whether they should be adjusted in light of these proposals.

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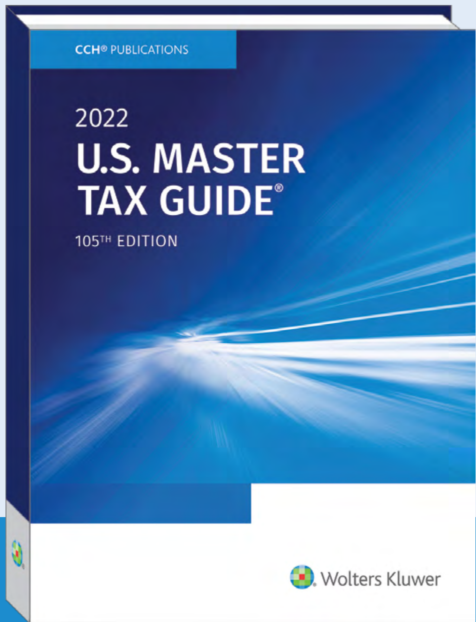

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