TaxTips

Dedicated to making your life less taxing

Winter 2021-2022

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Child Tax Credit

Did you Receive Advanced Payments?

For 2021 only, the child tax credit (CTC) increased from $2,000 to $3,000 for each child under age 18, or $3,600 for each child under age 6. Unfortunately, the extra amount ($1,000 or $1,600, respectively) is reduced when income exceeds $150,000 for married taxpayers filing a joint return (MFJ) and qualifying widow(er)s (QW), $112,500 for heads of household (HOH) and $75,000 for single taxpayers. Good news though: the normal $2,000 credit amount phases out as usual at $400,000 for MFJ and $200,000 for all others. Thus, higher income taxpayers may lose some of the credit but not all of it. It's also fully refundable if you have no tax liability.

You also probably noticed that advance CTC payments were made monthly from July through December 2021. These payments were estimates of your 2021 CTC, generally based on your 2020 tax return. If you received advance payments in excess of the CTC allowed on your 2021 return due to a change in circumstances, you may have to repay some or all of the excess amount. For example, you may have a 2021 repayment in a shared custody arrangement if you claim your child only in even-numbered years. There is some repayment protection depending on your income level. However, if your income equals or exceeds $120,000 for MFJ or QW, $100,000 for HOH or $80,000 for single or MFS, plan on repaying the entire excess amount as additional income tax on your 2021 return.

In January 2022, the IRS will send Letter 6419, which provides the total amount of advance CTC payments that were disbursed to you during 2021. Keep this letter to give to us when we prepare your 2021 tax return.

Big Mistake: Filing Your Tax Return Late

Three bad things happen when you file your tax return late

You can extend your tax return and file during the period of extension; that's not a late-filed return. The late-filed return is filed after the last extension expired. That's what causes the three bad things below to happen.

1. The IRS notices that you filed late or not at all. Of course, the "I didn't file at all" people receive the IRS's "come on down and bring your tax records" letter. In general, the meeting with the IRS about non-filed tax returns does not go well. For the late filers, the big problem is exposure to an IRS audit. Say you're in the group that the IRS audits about 3 percent of the time, but you file your tax return late. Your chances of an IRS audit increase significantly, perhaps to 50 percent or higher. Simply stated, bad thing #1 is this: file late and increase your odds of saying: "Hello, IRS examiner."
2. When you file late, you trigger the big 5 percent a month, not to exceed 25 percent of the tax-due penalty. Here, the bad news is 5 percent a month. The good news (if you want to call it that) is this penalty maxes out at 25 percent.
3. Of course, if you owe the "failure to file" penalty, you likely also owe the penalty for "failure to pay." The failure-to-pay penalty equals 0.5 percent a month, not to exceed 25 percent of the tax due. The penalty for failure to pay offsets the penalty for failure to file such that the 5 percent is the maximum penalty during the first five months when both penalties apply. But once those five months are over, the penalty for failure to pay continues to apply. Thus, you can owe 47.5 percent of the tax due by not filing and not paying (25 percent plus 0.5 percent for the additional 45 months it takes to get to the maximum failure-to-pay penalty of 25 percent).

Safe Harbor for Rental Properties

Getting a qualified business income deduction

Landlords who spend at least 250 hours a year managing and maintaining their rental properties may be eligible for the Qualified Business Income (QBI) deduction. That averages out to just under five hours a week. Unlike other deductions, the qualified business income deduction does not require that you spend money. Instead, it's a straight deduction, for up to 20% of net rental income for the year. For clients who qualify, this deduction allows rental property owners to pay tax on as little as 80% of their net income from qualifying rental properties. We even have the option of grouping several rental properties together to meet the 250-hour requirement.

Qualifying for this deduction can be tough. Here are the three factors we're looking for:

- 250 hours per year spent managing and maintaining your rental properties.
- You did not live in the rental property for any part of the year.
- The property isn't rented under a triple-net lease.

To reach the 250-hour threshold for the QBI deduction, we add up the hours you spend managing the rental property, and also time spent by your property manager, landscapers, repair contractors, and any other people you hire to maintain or manage the rental properties. Rental services that count toward the 250-hour test include:

- Advertising
- Negotiating leases
- Verifying rental applications from prospective tenants
- Collecting rents
- Maintenance and repairs
- Purchasing materials
- Supervising contractors and employees

Keep meticulous records of all the time spent managing your rental properties. Reviewing your time logs is how we—and the IRS—will be able to figure out if you qualify for the QBI deduction for the year.

You'll need to keep track not only of the time you spent yourself, but also time spent by any other people you hire to work on your rental properties. Your time log will need to track four data points:

- The dates rental property services were performed
- Number of hours spent
- Who performed the work
- A description of all the work done on that day

Reminder. The safe-harbor rules above are solely for Section 199A purposes.

Beware. The passive-activity rules for material participation and status as a real estate professional contain many differences from what you see for the Section 199A tax deduction.

Time log. Your number-one important record for obtaining hassle-free tax deductions on your rental real estate is an accurate and provable time log. If you are using the new Section 199A safe harbor, you now have one additional reason to track time spent.

Partnership Spotlight

When is a Partner a 1099 Worker?

When the individual production activity of a partner is outside his or her capacity as a member of the partnership, the partnership has two choices:

1. Allocate the production income to the partner, and have the partner treat the expenses as unreimbursed partner expenses (UPE).
2. Treat the partner as a 1099 independent contractor for the individual production.

Unreimbursed Partner Expenses

As a partner in a partnership, you generally can't deduct any of the partnership expenses on your individual tax return—the partnership should pay for and deduct its own business expenses.

But if your partnership agreement or business policy forces you as an individual partner to pay for expenses out of pocket, with no reimbursement available, then you can deduct the business expenses in full on your individual tax return as UPE.

Because the UPE is a trade or business expense, it also reduces your self-employment tax.

Treatment as a 1099 Independent Contractor

The tax code is clear on how this works. IRC Section 707(a)(1) states:

If a partner engages in a transaction with a partnership other than in his capacity as a member of such partnership, the transaction shall, except as otherwise provided in this section, be considered as occurring between the partnership and one who is not a partner.

Thus, under this treatment, you would treat that activity as independent contractor activity and report the income to the partner on IRS Form 1099-NEC, Nonemployee Compensation.

The partnership agreement should *clearly* define how it will treat a partner's individual production.

Changes to the charitable contribution rules

Taxpayers who don't itemize deductions may qualify to take a deduction

Individuals will be able to claim a $300 above-the-line deduction for **cash** contributions made to public charities in 2021. This rule effectively allows a limited charitable deduction to any taxpayer claiming the standard deduction. Married taxpayers who file a joint return are allowed $600 in 2021.

For individuals, the limitation on charitable deductions that is generally 60% of modified adjusted gross income (the contribution base) doesn't apply to cash contributions made to public charities in 2021. Instead, an individual's qualifying contributions, reduced by other contributions, can be as much as 100% of the contribution base. No connection between the contributions and COVID-19 is required. **Note:** This higher limit does not apply to donations to private foundations or donor-advised funds.

Business Meals

Deduct 100% in 2021 & 2022

On December 27, 2020, in an effort to help the restaurant industry due to the COVID-19 pandemic, lawmakers enacted a new, temporary 100 percent business meal deduction for calendar years 2021 and 2022.

To qualify for the 100 percent deduction, you need a restaurant to provide you with the food or beverages.

The law requires only that the restaurant provide the food and beverages. You don't have to pay the money directly to the restaurant. For example, you qualify for the 100 percent deduction if you order a restaurant meal that's delivered by Uber Eats or Grubhub.

Your deductible business meals must be tax code Section 162 ordinary and necessary business expenses, and they must not be subject to disallowance under tax code Section 274.

You must be present at the business meal, and you must provide the business meal to a person with whom you could reasonably expect to engage or deal with in the active conduct of your business, such as a customer, client, supplier, employee, agent, partner, or professional advisor, whether established or prospective.

Remember, to qualify for the 100 percent deduction, you need a restaurant. The IRS recently provided definitions and examples of what is and is not a restaurant.

A restaurant is "a business that prepares and sells food or beverages to retail customers for immediate consumption, regardless of whether the food or beverages are consumed on the business's premises." It is not any of the following:

- Grocery stores
- Specialty food stores
- Beer, wine, or liquor stores
- Drug stores
- Convenience stores
- Newsstands
- Vending machines or kiosks

In general, the 50 percent limitation applies to business meals from the sources listed above. The restaurant creates the 100 percent deduction.

QUIK TIPS

1. If by year-end you haven't contributed funds to your IRA, or if you've put in less than the maximum allowed, don't worry. You can contribute to either a traditional or Roth IRA up until the April due date for filing your tax return. Your employer contributions to a Keogh, SEP, or a SIMPLE plan are due by the time you file your tax return unless you have a valid extension then you have until the extended due date to make the contribution.

2. Are you planning on making any substantial gifts? Talk to me first. For 2021, gifts with values exceeding $15,000 must be reported to the IRS. The threshold increases to $16,000 in 2022.

3. The new standard mileage rates for the use of a car, including vans, pickups, or panel trucks are:

	2022	2021
Business rate per mile	58.5¢	56.0¢
Medical and Moving rate per mile	18.0¢	16.0¢
Charitable rate per mile	14.0¢	14.0¢

4. Did you know that there is still up to a $7,500 dollar tax credit for purchasing a qualified electric plug-in vehicle? Call me for all the details.

5. As a self-employed taxpayer, you may contribute to a sole-owner 401(k) retirement plan as both an employer and as an employee. As an employer, you may contribute up to 25 percent of your total income to your retirement plan. As an employee, you may also contribute up to an additional $19,500 in 2021 ($26,00 if age 50 or over). Your maximum contribution to an individual 401(k) plan is the lesser of $58,000 ($64,500 if age 50 or over). or the sum of the employer and employee maximums. Unlike other retirement plans such as SEPS and SIMPLE IRAs, an individual 401(k) plan allows you to take out loans from plan assets.

6. The Federal Estate Tax exemption for 2021 is $11,700,000. The rate is 40%. Additionally, heirs get to use stepped-up basis to value assets inherited. The exemption in MA, ME & NY is only $1 million with a top tax rate of 16%.

7. In 2021 the tax rate of 37 percent will affect individuals and Heads of Households whose taxable income exceeds $523,601 ($628,301) for married taxpayers filing a joint return.

8. If you turned age 72 on July 1, 2021, or later you are not required to begin your required minimum distributions (RMD) from your IRA until April 1, 2022. You will also need to take your 2022 distribution by December 31st. Failure to do so results in a 50 percent penalty on the amount you do not take.

9. Long Term Care Premiums may be tax deductible with limits based on your age and whether you itemize deductions. Self-employed taxpayers may include the allowable premiums with their self-employed health insurance whether they itemize or not.

Solar panels

Tax credit Still Available

The residential energy efficient property credit has been reinstated through 2021. This means you could get a tax credit for installing solar panels on your home. You can even get a credit if you shared the cost of solar panels not directly located on your home, such as at an off-site community solar array or similar arrangement that generates solar energy directly for your home. The credit is equal to 22% of the expenditures made in 2021. There are some limitations on the credit. Additionally, unused credit amounts may be carried to future tax years.

As with any tax law, there are many variables that come into play for this credit. If you are thinking about making energy efficient improvements, let's get together and make improvements not only for our planet but for your taxes as well.

Child and dependent care credit

More Taxpayers may be eligible

For 2021 only, the child and dependent care credit increased significantly and is fully refundable even if you have no tax liability, so don't forget to keep track of your work-related child-care expenses.

The dollar limit for eligible expenses is $8,000 for one child and $16,000 for two or more qualifying children. If your income is $125,000 or less, you get the maximum 50% credit rate. Otherwise, if your income is more than $125,000, the 50% rate decreases as your income rises. The credit becomes unavailable when your income exceeds $438,000.

In addition, you may be eligible to exclude up to $10,500 ($5,250 if MFS) of employer-provided dependent care benefits from gross income for 2021. However, you cannot use any child-care expenses paid with these tax-free benefits for the child and dependent care credit.

A Final Word from Charlie

As the 2021 year-end approached, I received quite a few emails and calls on a variety of subjects relating to taxes. So, I publish this newsletter to provide you some tax saving tips and to keep you abreast of some of the nuances in the tax code.

In addition to preparing your tax return for you I can assist you with retirement income planning. I can help you save for your retirement through a variety of plans that will grow with the market without any risk of losing your money, guaranteed! Don't wait any longer. Contact me today so I can help you accomplish your retirement goals.