

Hons Tax Associates December 2021 Newsletter

Hi all

Happy end of the year holidays and best wishes for a happy and healthy year 2022

Below is December tax Newsletter with tax updates and more, avoiding as much a possible tax jargon and obscure tax things impacting only very few of us.

Tax changes

Unless last minute change, it looks like income tax rates will not (yet) go up for 2022 returns (to be filed in 2023) as Congress has not been able to agree on something at this point.

Donations

As for 2020 (but better if married), if you don't itemize on your return, in your 2021 tax return you can deduct up to \$300 ("above the line" deduction) for a money donation to a non profit (503c), and up to \$600 if married filing jointly.

The other way to deduct a donation (especially when you don't itemize) is to do a "qualified Direct Distribution" from an IRA distribution. One can also check a "donor advised fund" option.

Required Minimum Distributions (RMDs)

They are back for 2021: individuals 72 and older must take them (penalties are large) and you have till April 1, 2022 to do so if it is your first one.

IRS penalties

IRS penalties are complicated: penalties for not paying in time, not filing in time (only if you owe, not if a refund), large unreported amounts in your return, interest. However, there are a few simplifying conditions and in particular there are three "safe harbors" situations which will (each) avoid one most penalties. (assuming filing and paying on time)

1/ you owe less than \$1000 at tax time

2/ you already paid IRS for 2021 (withholdings & payments) at least 100% of your tax liability the year before. (110% if 2020 AGI was above 150k, unless married filing separately: 75k)

3/ you already paid IRS (withholdings & payments by the due dates) at least 90% of the 2021 tax liability in your coming return

The one penalty you could still pay (it seems IRS usually waives it for small amounts) is the one about the "pay as you go" rule. Suppose your business nets 100k and you do pay the IRS on January 15, 2022 (4th quarter estimated payment) enough to cover your tax liability. IRS (and the states) would still penalize you for not making 4 estimated quarterly payments, unless you could show (in the form 2210, and it is not simple) that all the income was received in the 4th quarter. So self-employed people should make the 4 estimated payments (making at least the last one on January 15 will save them however a lot of the penalties). On the other hand, if the payment is made thru W2 withholdings, IRS cannot question the timing of it, which is one of the advantages of having a business set up as an S Corp and the owner(s) paying himself (themselves) a "reasonable salary"

Child tax credit and 3r stimulus (re-visiting)

If you have children 17 years old (we get one more year this year, was 16 before) or less and you do not make too much money (IRS uses you last return filed: 2020 or 2019), you received monthly child credits payments: per child \$250 or \$300 (children 5 or less) starting in July for normally half of the credit amount to be taken in your 2021 return. For example: with one 4 years old child this would be $6 \times 300 = \$1800$, half of the \$3600 2021 child tax credit (was \$2,000 the years before)

These advance payments will be reconciled in your 2021 return and you should receive from the IRS by the end of January a notice of how much you got. Bring the notice, we will input this amount in your return, and you will get the remaining credit in your return (1800 in the example above)

In the case you did not get this notice: you need to figure out how much you got (easy to do if direct deposits from the IRS) and tell me at tax time. If you give me a wrong amount, it is most likely your refund will be delayed. It happened last year: each person I am aware of who gave me a wrong amount on the stimulus they received saw their refund delayed (and sometimes by months).

Same logic for the third stimulus money (the \$1400 per person received usually in March to May 2021). You need to give me the exact amount your received (could be less depending on your income). If a wrong amount is input in return, your refund will again most likely be delayed.

Capital gains

Capital losses offset capital gains (and up to \$3,000 more, remaining being carried forward). If you know you will have large capital gains, you or your financial adviser can look into possible capital losses for 2021 (stocks to sell at a loss usually, and before 12/31/2021).

Tax on long term capital gains: (if you are interested in how this works, re-visiting)

The way this is computed in the tax return is confusing to most of us. I will try to explain this with 3 simple examples (numbers are for 2021 tax return)

1/ suppose you file married jointly and your taxable income (which is Adjusted Gross Income (AGI), including a long-term capital gain of \$10,000, less deductions) is less than \$80,800. You will pay no tax on this capital gain: the 15% capital gain rate starts above \$80,800, your taxable income.

2/ suppose you file married jointly and your taxable income (AGI including a long-term capital gain of \$10,000, less deductions) is \$100,000. Your tax will include \$1,500 (15%) of your 10,000 LT capital gain.

2/ suppose you file married filing jointly and your taxable income (AGI, including a long-term capital gain of \$10,000, less deductions) is \$88,000. Your long term capital gain tax will be figured as follow: the capital gain above the 80,800: that is \$7,200 ($88,000 - 80,800$) will be taxed at 15%, so \$1,080 of tax, the remaining part of the capital gain under 80,800: that is \$2,800 will not be taxed.

The same logic applies for the 15% and 20% capital gain tax rate (taxable income above \$501,600 for married filing jointly brings the 20% capital gain tax rate)

So even though the tax return shows only one AGI number and one taxable income, the tax calculations (when long term capital gains and/or qualified dividends), uses two different methods to compute the tax: ordinary income tax and long term capital gain tax following the above system. This also explains why it is not always easy to quickly figure by hand the taxes on your long-term capital gains unless the situation simplifies (ie example 2), and your taxable income is known.

Net Investment Income Tax

This can be also a bit confusing and can unexpectedly come into play when a large capital gain (sale of an income property, large stock capital gains, selling employee stock options which appreciated). Its rate is 3.8% and it is assessed on the lower of:

- AGI over 250k (married filing jointly), 200k (single) or:
- Investment income: dividends, interest, capital gains, annuities, royalties, passive activities

“Active” (taxpayer materially participate in the activity) S Corp or partnership income is not investment income. Passive is...

Democrats want to expand this 3.8% surtax to cover active pass thru income (S Corps and Partnerships), but only for joint filers with income above 500k (single above 400k). It is possible this passes in 2022

And lastly a couple of IRS statistics

In the case you have been waiting, or trying to fix an IRS issue, or are waiting for an IRS answer or letter...

- As of late November, 6.5 million 2020 individual tax returns still needed to be processed (and 2.6 million 2020 amended returns)
- In 2021 only 9% of IRS callers were able to reach a live person...
- From what I have seen it looks like IRS takes at least 6 months (and usually more) to process paper returns and amended returns. They do (again, there had been Covid dues delays in 2020 tax season) deposit taxpayers checks within a few days!.