2021 Tax Planning Guide

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Introduction:

In March of 2020, the United States went into a state of emergency. Businesses closed their doors, children stayed home from school, and grocery store visits were minimized. We were reminded how to appropriately wash our hands, kept our distance from anyone outside of our home, and made face masks a part of our "new normal."

The effects of the Coronavirus (COVID-19) pandemic affected every aspect of life as we knew it. At the time, we weren't aware what this meant for our economy, our businesses, and our families. Looking back, we know things will never be the same.

Financially, businesses downsized or shut down altogether. People lost their jobs and started new jobs. Workers were furloughed with an indefinite start date. It's safe to say that it was a tumultuous time for financial stability.

If we've learned anything this year, we've learned that life doesn't always go to plan. The world turned upside down and everyone was left to adapt quickly. There's always an element of risk and uncertainty when it comes to the future, but when structured plans are put in place, it helps to overcome the unexpected.

This makes tax planning more crucial than ever before. Because of the rollercoaster of financial stress many families were put under, their tax return will most likely look different than what they're used to. Businesses who accepted government aid are left wondering how their taxes will be affected, if at all.

The 2020-2021 Tax Planning Guide covers important information including some of the areas most individuals and businesses have concerns. From tax rates to retirement and everywhere in between, understand how the year's events affect these topics to better prepare yourself for tax preparation.

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One of the biggest takeaways from this is year to expect the unexpected. Although estate planning can be tough, it's important to consider before it's too late.

Business

For businesses and business owners, tax planning is an essential piece of any overall business plan. While a properly executed plan serves to help a company achieve its highest potential, it also assists in helping businesses avoid egregious mistakes. In any given "normal" year, it's easy for owners to make common mistakes without proper guidance. In the age of COVID-19, the parameters of what we were previously working with have shifted quickly—leaving many business owners without much steady ground to stand on.

If you're the owner of a business that has been heavily impacted by COVID-19 due to social distancing procedures and shutdowns, your reality and focus may be deeply rooted in just trying to survive an exhaustive and chaotic year. Right now, it may feel like tax planning as a business is something that needs to be tabled for the time being. In truth, the opposite is true.

New legislation passed in spring 2020 made help for business owners available in a few formats.

Available Tax Credit

One helpful facet of COVID-19 relief for business is the roll out of tax credits as well as a new tax exemption.

Payroll Tax Credit For Required Paid Sick Leave

The Emergency Paid Sick Leave Act, also known as EPSLA, requires private employers with fewer than 500 employees to provide 80 hours of paid sick time to employees who are unable to work for virus-related reasons. It should be noted that there is an administrative exemption for companies with less than 50 employees that the leave mandate puts in jeopardy.

The pay under EPSLA is up to $511 per day with a $5,110 overall limit for an employee directly affected by the virus—and up to $200 per day with a $2,000 overall limit for an employee that is a caregiver.

The tax credit corresponding with the EPSLA mandate is a credit against the employer's 6.2% portion of the Social Security (OASDI) payroll tax. The credit amount generally tracks the $511/$5,110 and $200/$2,000 per-employee limits described above. The credit can be increased by:

- The amount of certain expenses in connection with a qualified health plan if the expenses are excludable from employee income.
- The employer's share of the payroll Medicare hospital tax imposed on any payments required under EPSLA.

Credit amounts earned in excess of the employer's 6.2% Social Security (OASDI) tax (or in excess of the Railroad Retirement tax) are refundable. The credit is electable and includes provisions that prevent double tax benefits (for example, using the same wages to get the benefit of the credit and of the current law employer credit for paid family and medical leave). The credit applies to wages paid in a period:

- Beginning on a date determined by IRS that is no later than April 2, 2020 and ending on December 31, 2020

Payroll Tax Credit for Required Paid Family Leave

The Emergency Family and Medical Leave Expansion Act (EFMLEA) division of the Act requires employers with fewer than 500 employees to provide both paid and unpaid leave (with an administrative exemption for less-than-50-employee businesses that the leave mandate puts in jeopardy). The leave generally is available when an employee must take off to care for the employee's child under age 18 because of a COVID-19 emergency declared by a federal, state, or local authority that either:

- Closes a school or childcare place
- Makes a childcare provider unavailable.

Generally, the first 10 days of leave can be unpaid and then paid leave is required, pegged to the employee's pay rate and pay hours. However, the paid leave can't exceed $200 per day and $10,000 in the aggregate per employee.

The tax credit corresponding with the EFMLEA mandate is a credit against the employer's 6.2% portion of the Social Security (OASDI) payroll tax (or against the Railroad Retirement tax). The credit generally tracks the $200/$10,000 per employee limits described above. The other important rules for the credit, including its effective period, are the same as those described above for the payroll sick leave credit.

Income Tax Sick Leave Credit for The Self-Employed

EFMLEA provides a refundable income tax credit (including against the taxes on self-employment income and net investment income) for sick leave to a self-employed person by treating the self-employed person both as an employer and an employee for credit purposes. Thus, with some limits, the self-employed person is eligible for a sick leave credit to the extent that an employer would earn the payroll sick leave credit if the self-employed person were an employee.

Accordingly, the self-employed person can receive an income tax credit with a maximum value of $5,110 or $2,000 per the payroll sick leave credit. However, those amounts are decreased to the extent that the self-employed person has insufficient self-employment income determined under a formula or to the extent that the self-employed person has received paid sick leave from an employer under the Act. The credit applies to a period:

- Beginning on a date determined by the IRS that is no later than April 2, 2020 and ending on December 31, 2020.

Income Tax Family Leave Credit For The Self-Employed

The Emergency Paid Sick Leave Act, also known as EPSLA, requires private employers with fewer than 500 employees to provide 80 hours of paid sick time to employees who are unable to work for virus-related reasons. It should be noted that there is an administrative exemption for companies with less than 50 employees that the leave mandate puts in jeopardy.

The pay under EPSLA is up to $511 per day with a $5,110 overall limit for an employee directly affected by the virus—and up to $200 per day with a $2,000 overall limit for an employee that is a caregiver.

EFMLEA provides to the self-employed a refundable income tax credit (including against the taxes on self-employment income and net investment income) for family leave similar to the self-employed sick leave credit discussed above. Thus, a self-employed person is treated as both an employer and an employee for purposes of the credit and is eligible for the credit to the extent that an employer would earn the payroll family leave credit, if the self-employed person were an employee.

Accordingly, the self-employed person can receive an income tax credit with a maximum value of $10,000 as per the payroll family leave credit. However, under rules similar to those for the self-employed sick leave credit, that amount is decreased to the extent that the self-employed person has insufficient self-employment income determined under a formula or to the extent that the self-employed person has received paid family leave from an employer under the Act. The credit applies to a period:

- Beginning on a date determined by IRS that is no later than April 2, 2020 and ending on December 31, 2020.

Retirement

Planning for retirement is often pushed to the wayside because it's a far away thought. Before you know it, retirement is on the horizon and there's not enough time to save for your life after you leave the workforce.

The events of this year have created opportunities for those who are currently saving for retirement. The Coronavirus Aid, Relief, and Economic Security (CARES) Act worked to help people cope with the extreme financial impact brought on my mandated shutdowns and pandemic-related instability.

Here are some major tax planning changes to consider concerning retirement:

Generally, Previously, the age you needed to begin withdrawing funds was 70 ½ years old. However, when the Setting Up Every Community for Retirement (SECURE) Act was signed on December 20, 2019, that age limit was pushed to 72. This allows the account to grow for a longer time without needing to pay taxes on these funds. This can be a viable solution for those able to delay the start of RMDs as it'll keep your tax bill a bit lower.

In 2020, we saw many delayed payments for different areas of finance. RMDs were also affected by these regulations as RMDs were waived for the year. Begging the question: Should you pull out the funds you were expected to use, or let them continue to exist inside the account?

Depending on your financial situation, the answer differs. Leaving it in means you'll have to draw more out next year. However, even though the limit was waived, you may want to take voluntary distributions as you may benefit from lower tax rates.

Further still, taking taxable deductions can get you into a lower tax bracket, ultimately reducing future IRA debt. You can use these funds and convert into Roth IRAs or estate planning.

Required Minimum Distribution Changes

Unfortunately, you cannot let retirement funds accumulate in your account forever. Required Minimum Distributions is the smallest amount you are required to take from your account once you hit a certain age. This regulation is relevant for:

- Traditional IRAs
- SEP IRAs
- SIMPLE IRAs
- 401(k) plans
- 403(b) plans
- 457(b) plans
- Profit sharing plans
- Other defined contribution plans

*not applicable for ROTH IRAs

Roth Conversions

Converting to a ROTH IRA can also be a beneficial solution for policyholders as 2020 specifically presents a unique opportunity. Tax rates are historically low and many people may have had lower income as a result of the pandemic.

If you currently have a traditional IRA, it may not be a bad idea to evaluate a 2020 Roth conversion - before tax rates increase. Tax increases may come as early as 2021, so now is the time to review and plan moving forward. When you convert, the low tax rates of today are locked in. These numbers can make a huge difference when it comes to finally beginning your relaxation after years of hard work.

As we reach the end of the year, it is the best time to predict the cost of a conversion to see if it financially makes sense. You'll have a good idea of your 2020 income and a better grasp on the status of your employment or business success.

Consult your financial advisor for the best direction for your situation.

Income & Deductions

Income fluctuation has been a big concern for individuals and families alike in 2020. According to the U.S. Department of Labor, over 40 million unemployment claims were filed after the onset of the virus. Such an astronomical number leads us to assume that many Americans were left with big shifts in income - whether it was less hours or a complete lack of income in general.

Stimulus Checks

Government aid and its effect on your taxes has been a conversation for many. The economic impact payment or stimulus payment ($1,200 single filers/$2,400 for married filers) is known as a refundable tax credit for your 2020 taxes. What this ultimately means is that you keep the stimulus money you received and will not incur taxes on it, regardless of what your income looks like for the year.

Another point to note is if you did not receive your stimulus payment this year, you can receive it next year when you file your 2020 tax return. This also goes for any discrepancies in payment of the stimulus check.

Deductions

In 2020, standard deductions are as follows:

- Single Taxpayers/Married individuals filing separately: $12,400 (+200 from 2019)
- Married, Filing Jointly: $24,800 (+400 from 2019)

Estate Planning

This year's economic downturn has been stressful for almost everyone, but as with anything, it's important to look for the silver linings and opportunities.

Take Advantage of Low Interest Rates

Currently, interest rates are low, which can open up opportunities for families looking to transfer wealth to their younger generation—and with minimal tax consequences. Some possible strategies that could be implemented in this environment are:

Grantor Retained Annuity Trusts: This irrevocable trust allows the Grantor to transfer assets while receiving fixed annuity payments from the trust for a set number of years. After the Grantor Retained Annuity Trust (GRAT) makes these required annuity payments for the specified duration, the remaining property is then passed to beneficiaries. In a low-interest-rate environment, the GRAT is an effective option for transferring wealth by minimizing the gift tax. Transferring property to a GRAT serves as a gift for tax purposes.

Sales to Irrevocable Grantor Trust: Much like the GRAT, contributions to an Irrevocable Grantor Trust (IGT) are considered gifts where estate tax and gift tax purposes, however, the difference is that the assets of the Irrevocable Grantor Trust are treated as though they are owned by the Grantor. This is for income tax purposes. As a result, the Grantor of the IGT is able to sell owned assets to the trust without having to recognize any capital gains. For income tax purposes, the trust and the seller are seen as one.

Intra-Family Loans: For those wishing to pass money to family members, providing a low interest cash loan to the individual is an option to consider. These enable the family lender to serve as the bank and assist children, grandchildren, or other family members with large purchases such as houses, businesses, or property without having to make a current gift.

Refinance Existing Loans

Since interest rates continue to be low, evaluating refinancing an older existing loan may be financially beneficial.

Gift Tax Annual Exclusion

With so many chaotic things happening in 2020, it's more important than ever that we look out for our own. Oftentimes, this can mean taking care of them financially. Economic hardship has befallen many Americans this year due the pandemic, and it's likely that a family member may be in need of monetary assistance. The gift tax annual exclusion permits an individual to give $15,000 to one or more individuals in a given year, with the only caveat being that the gift be of present interest.

Exclusions for Medical and Educational Expenses

With many people struggling to keep up with expenses due to lost wages during the pandemic, bigger expenses such as medical costs or tuition payments may be an extraordinary burden on children or grandchildren. For those wishing to pay for the medical or educational expenses of a family member, there exists a special provision that allows for two methods of transferring funds while circumventing gift tax and estate tax consequences.

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Now's The Time To Plan

If one thing is certain, this past year has been nothing short of a roller coaster. The need for stabilizing, grounding forces—especially financially—has shed light on the true importance of tax planning.

We never know exactly what lies ahead any given year, but finding solutions where possible to reduce your tax liability can allow you to enter any uncertainty with as much confidence as possible. Knowing that you have a strategy in place that you trust and a CPA firm you can lean on for guidance no matter what life throws at you is important.

Now is the time to begin your tax planning journey, and we can help. The team at Chandler & Knowles CPAs is here to support you through our tax planning services, so don't hesitate to reach out to us.

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