BEHYMER SORENSON & PRICE LLC
CERTIFIED PUBLIC ACCOUNTANTS

December 10, 2021

To our valued clients and friends,

This year has once again been a challenge. COVID-19 has remained at the forefront of our daily lives and has continued to bring changes and uncertainty. As a result, several new tax laws were enacted during 2021 that affect both individual and business taxes.

In addition to the known tax law changes for 2021, there is the possibility of further changes that may affect 2021 tax returns. Tax law changes that have been proposed by both the President and the Congress have been many and varied. The most publicized possible changes include raising ordinary income and capital gains tax rates for individuals. Uncertainty regarding possible changes makes tax planning difficult, but we will continue to keep you aware of changes if and when they are enacted.

With that in mind, as we now approach the end of the year, it is once again time to review your year-end tax plans. Before we get to specific suggestions, here are two important considerations to keep in mind.

1. Remember that effective tax planning requires considering both this year and next year—at least. Without a multiyear outlook, you can't be sure that maneuvers intended to save taxes on your 2021 return won't backfire and cost additional money in the future. This is especially difficult this year given the uncertainty of proposed tax law changes.

2. Remember that tax planning is about achieving your personal and business financial objectives in as "tax efficient" manner as possible. Any action should not only save taxes, but also make economic sense before it's a wise move.

As always, you can call on us to help you sort through the options and implement strategies that make sense for you.

Year-End Tax Planning Moves for Individuals

Maximize Contributions to Retirement Plans. If you have a retirement plan at work, it's time to tell your company how much you want to set aside on a tax-free basis for next year. Contribute as much as you can stand, especially if your employer makes matching contributions. You give up "free money" when you fail to contribute enough to take advantage of the maximum match amount. You still have time to consider maximizing your contributions for 2021 to reduce adjusted gross income (AGI) on this year's tax return.

Individuals over the age of 70½ who are still working in 2021 may be eligible to contribute to a traditional IRA. However, if you are over the age of 70½ and considering making a charitable donation directly from your IRA (see Qualified Charitable Distribution section below) in the future, making a deductible IRA contribution will affect your ability to exclude future QCDs from your income.

Maximize the Benefit of the Standard Deduction. For 2021, the standard deduction is $25,100 for married taxpayers filing joint returns and $12,550 for single taxpayers. If your total itemized deductions are normally close to these amounts, you may be able to leverage the benefit of your deductions by bunching deductions in every other year. By timing your charitable contributions so that they are high in one year and low in the next, you claim actual expenses in the years they are bunched and utilize the standard deduction in the intervening years. We can help determine if this is an appropriate strategy for you.

Don't lose a charitable deduction for lack of paperwork. Charitable contributions are only deductible if you have proper documentation. For cash contributions of less than $250, this means you must have either a bank record that supports the donation (such as a cancelled check or credit card receipt) or a written statement from the charity that meets tax law requirements. ***For cash donations of $250 or more, a bank record is not enough.*** You must obtain, by the time your tax return is filed, a charity-provided statement that shows the amount of the donation and lists any significant goods or services received in return for the donation (other than intangible religious benefits) or specifically states that you received no goods or services from the charity.

Convert Traditional IRAs into Roth Accounts. This may be the perfect time to make a Roth conversion. The current tax rates are still relatively low compared to a couple of years ago and, while they are scheduled to remain low until 2026, changes proposed by the current administration could result in higher rates much sooner. Also, you may be in a lower-than-normal tax bracket in 2021 due to the financial fallout of COVID-19. The current tax hit from a conversion done this year may turn out to be a small price to pay for completely avoiding potentially higher future tax rates on the account's earnings.

Year-End Tax Planning Moves for Your Business

Employee Retention Credit. The Employee Retention Credit (ERC) was initially established as part of the CARES Act in March 2020. The ERC is a refundable credit available for both 2020 and 2021 to employers who either: 1) had operations fully or partially suspended by government orders due to COVID-19 or 2) had a significant decline in gross revenue during these years.

The amount of the ERC may be up to $21,000 per employee for 2021 ($5,000 for 2020) and can be claimed on amended quarterly payroll tax returns. So, if you have not yet considered the ERC, it is not too late.

Paycheck Protection Program. In response to the COVID-19 crisis, the Paycheck Protection Program (PPP) was established under the direction of the Small Business Administration (SBA). Under the program, qualifying businesses could receive loans intended to help those businesses keep workers on the payroll. The program offers loan forgiveness if the proceeds of the loan are used to pay eligible expenses and the business meets all employee retention criteria. This program was extended under the Economic Aid Act with first- and second-draw loans available through March 31, 2021.

Many businesses have already applied for and received forgiveness of these loans. If you have received a PPP loan and have not yet applied for forgiveness, we recommend that you submit your loan forgiveness application before the end of the year. You will need to work directly with the bank through which you received your PPP loan, in order to meet their specific documentation requirements for loan forgiveness.

Net Operating Losses (NOLs). Unfortunately, the relaxed NOL rules that were temporarily enacted by the CARES Act do not apply to losses arising in 2021. For NOLs created in 2021, the limitations implemented by the Tax Cuts and Jobs Act (TCJA) in 2018 once again apply. Under the TCJA rules, NOLs cannot be carried back to prior tax years, but instead are allowed to be carried forward indefinitely. Furthermore, NOLs carried forward to 2021 from earlier years can only be used to offset 80% of taxable income.

Section 179 expensing and bonus depreciation. For qualifying property placed in service in tax years beginning in 2021, the maximum Section 179 deduction is $1.05 million. The Section 179 deduction phase-out threshold amount is $2.62 million. Additionally, 100% first-year bonus depreciation is available for qualified new and used property that is acquired and placed in service in calendar year 2021. If you are contemplating the purchase of equipment, these two provisions may allow your business to write off the entire cost of some or all of your 2021 asset additions on this year's return. However, don't forget, equipment must be paid for or financed and placed in service by midnight December 31, 2021.

If you are self-employed and haven't done so yet, set up a self-employed retirement plan. If your business doesn't already have a retirement plan, now might be the time to establish one. Current retirement plan rules allow for significant deductible contributions. Call us for more information on small business retirement plan alternatives, as there are numerous options, and each has their own set of specific rules and limits.

Time Business Income and Deductions for Tax Savings. If your business is conducted via a pass-through entity, the traditional strategy of deferring income into next year while accelerating deductible expenditures into this year makes sense if you expect to be in the same or lower tax bracket next year. On the other hand, if you expect to be in a higher tax bracket in 2021 (which is possible, considering the tax law changes that have recently been proposed), take the opposite approach. Accelerate income into this year (if possible) and postpone deductible expenditures until 2021.

Also, keep in mind that tax deductible expenses paid by credit card are deemed paid on the date that they are recorded (charged), not when payment is made on the card

Maximize the Deduction for Pass-through Business Income. For 2021, the deduction for Qualified Business Income (QBI) can be up to 20% of pass-through entity owner's QBI, subject to restrictions that can apply at higher income levels and another restriction based on the owner's taxable income. Because of the various limitations on the QBI deduction, tax planning moves (and non-moves) can have the side effect of increasing or decreasing your allowable QBI deduction.

Also, it is important to note that if you want your rental properties to qualify for the QBI deduction, you need to address the filing requirements for Forms 1099-MISC and 1099-NEC. Please see our separate Form 1099 letter for more information regarding these filing requirements.

Check Your Partnership and S Corporation Stock Basis. If you own an interest in a partnership or S corporation, your ability to deduct any losses it passes through is limited to your basis. Thus, if you expect the partnership or S corporation to generate a loss this year and you lack sufficient basis to claim a full deduction, you may want to make a capital contribution (or in the case of an S corporation, loan it additional funds) before year end.

Oregon Corporate Activity Tax. Effective for tax years beginning on or after January 1, 2020, Oregon has implemented an annual Corporate Activity Tax (CAT) based on commercial activity conducted by businesses within the state. The annual tax rate is .57% (.0057) and is imposed on all commercial activity (i.e. gross receipts), reduced by a portion of either cost of sales or compensation paid to employees, in excess of $1 million.

Under the rules, any business with commercial activity during the tax year in excess of $1 million must file an annual CAT return. Many of you have already filed your initial CAT return for tax year 2020. For 2021, keep in mind that if you anticipate your total CAT liability to be greater than $5,000 you are required to make quarterly CAT estimated payments.

Any business with commercial activity in excess of $750,000 must register with the Oregon Department of Revenue. So, if you have not already registered (registration is required only once, not annually) and you have exceeded that threshold for 2021, we recommend that you register as soon as possible at www.oregon.gov/dor/programs/businesses/Pages/corporate-activity-tax.aspx.

Additionally, taxpayers who use a fiscal year for federal income tax purposes are now required to file the Oregon CAT return using the same fiscal tax year. Since the 2020 CAT returns were required to be filed on a calendar year basis, fiscal year companies will be required to file a short-year return for the period beginning on January 1, 2021 and ending on the last day of its fiscal year.

Review Your Spending and Savings Accounts

Take Advantage of Flexible Spending Accounts (FSAs). If your company has a healthcare and/or dependent care FSA, before year-end you must specify how much of your 2022 salary to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying dependent care costs. Watch out, though, FSAs are "use-it-or-lose-it" accounts—you don't want to set aside more than what you'll likely have in qualifying expenses for the year.

Although, FSAs are generally "use-it-or-lose-it" accounts, temporary rules enacted in response to COVID-19 allow FSA funds to be carried over from 2021 to 2022. However, the rules were not mandatory, so your company may not have adopted the changes. Be sure to check with your employer to verify if you are able to carry forward unused FSA funds to 2022. If not, you will want to make sure you drain the account by incurring eligible expenses before the deadline for this year. Otherwise, you'll lose the remaining balance. It's not that hard to drum some things up: new glasses or contacts, dental work you've been putting off, or prescriptions that can be filled early.

Consider a Health Savings Account (HSA). If you are enrolled in a high-deductible health plan and don't have any other coverage, you may be eligible to make pre-tax or tax-deductible contributions to an HSA of up to $7,200 for a family coverage or $3,600 for individual coverage. Distributions from the HSA will be tax free as long as the funds are used to pay unreimbursed qualified medical expenses. Furthermore, there is no time limit on when you can use your contributions to cover expenses. Unlike a healthcare FSA, amounts remaining in the HSA at the end of the year can be carried over indefinitely.

Contributions to the Oregon College Savings Plan. Oregon offers a tax credit for making contributions to the Oregon College Savings Plan. The credit is based on how much you contribute to the plan and what your Oregon taxable income is. The maximum credit is $300 for married taxpayers filing joint returns and $150 for single taxpayers. In order for your contributions to be eligible for the tax credit in 2021, they must be made by the date you file your 2021 tax return or April 15, 2022, whichever is earlier.

Year-End Planning Moves for Seniors

Changes to Required Retirement Distributions. The tax laws generally require individuals with retirement accounts to take withdrawals based on the size of their account and their age beginning with the year they reach age $70^1/_2$ (for those born before July 1, 1949) or age 72 (for those born after June 30, 1949). Failure to take a required minimum distribution (RMD) can result in a penalty of 50% of the amount not withdrawn. Although the requirement to take a RMD was waived for all taxpayers, regardless of age, for 2020, the RMD is once again required for 2021.

If you turned age 72 in 2021, you can delay your 2021 required distribution to 2022 if you choose. But, waiting until 2022 will result in two distributions in 2022—the amount required for 2021 plus the amount required for 2022. While deferring income is normally a sound tax strategy, here it results in bunching income into 2022. Thus, think twice before delaying your 2021 distribution to 2022—it might throw you into a higher tax bracket or bring you above the modified AGI level that will trigger the 3.8% net investment income tax. You may also want to avoid delaying your distribution if you believe that tax rates will increase in 2022. However, it could be beneficial to take both distributions in 2022 if you expect to be in a substantially lower bracket in 2022. For example, you may wish to delay the 2021 required distribution until 2021 if you plan to retire late this year or early next year, have significant nonrecurring income this year, or expect a business loss next year.

Qualified Charitable Distributions. If you plan on making additional charitable contributions this year and you have not yet received your 2021 required distribution from your IRA, you might want to make a tax-free distribution to a qualified charitable organization. Qualified Charitable Distributions (QCDs) allow IRA owners and beneficiaries to make cash donations totaling up to $100,000 to IRS-approved public charities directly out of their IRAs. QCDs are federal-income-tax-free to you, but you get no itemized charitable write-off on your Form 1040. That's okay because the tax-free treatment of QCDs equates to an immediate 100% federal income tax deduction without having to itemize your deductions or worry about restrictions that can reduce or delay itemized charitable write-offs. **However, to qualify for this special tax break, the funds must be *transferred directly* from your IRA to the charity**. Once you receive the cash, the distribution is not a QCD and won't qualify for this tax break.

Year-End Tax Planning Investment Moves

Manage Investment Gains in Taxable Accounts. If you hold investments in taxable brokerage firm accounts, consider the tax advantage of selling appreciated securities that have been held for over 12 months. As of the date of this letter, the federal income tax rate on long-term capital gains recognized in 2021 is only 15% for most taxpayers, although it can reach a maximum of 20% at higher income levels. Additionally, the 3.8% Net Investment Income Tax (NIIT) can apply at higher income levels.

Harvest Capital Losses. Not all your investments may be winners. One simple year-end investment strategy is reviewing your securities portfolio for any losers that can be sold before year-end to offset gains you have already recognized this year or to get you to the $3,000 ($1,500 married filing separate) net capital loss that's deductible each year. Don't worry if your net loss for the year exceeds $3,000, because the excess carries over indefinitely to future tax years. Be mindful, however, of the wash sale rule when you jettison losers—your loss is deferred if you purchase substantially identical stock or securities within the period beginning 30 days before and ending 30 days after the sale date.

Don't Overlook Estate Planning

For 2021, the unified federal gift and estate tax exemption is a generous $11.7 million and the federal estate tax rate is currently 40%. Even though these big exemptions may mean you are not currently exposed to the federal estate tax, your estate plan may need updating to reflect the current estate and gift tax rules. Also, you may need to make some changes for reasons that have nothing to do with taxes.

The annual gift exclusion amount for 2021 is $15,000 (increasing to $16,000 for 2022) per individual taxpayer per year. This means you can gift up to $15,000 to as many individuals as you like without filing a Federal Gift Tax Return. However, any gift of cash or value over $15,000 will require a Federal Gift Tax Return. This does not mean you will pay any tax on the gift, but you will be required to file a separate tax return.

On the subject of estate planning: if you do not have a will or trust, or your will or trust is out-of-date due to life changes, we strongly encourage you to meet with your attorney to have these updated.

Conclusion

Through careful planning, it's possible your 2021 tax liability can still be significantly reduced, but don't delay. The longer you wait, the less likely it is that you will be able to achieve a meaningful reduction. The ideas discussed in this letter are a good way to get you started with year-end planning, but they are no substitute for personalized professional assistance.

Please don't hesitate to call us with questions or for additional strategies on reducing your tax liability. We would be happy to set up a planning meeting or assist you in any other way that we can.

Best regards,

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