To Our Clients and Friends:

As we approach year-end, it's time to think about steps you can take to help reduce your 2021 tax bill. In what appears to be the new normal, 2021 is shaping up to be a year with plenty of tax law changes. COVID-related disaster relief signed into law last December made several favorable (mostly temporary) changes to the 2021 rules. Then, in March, the American Rescue Plan Act, with another set of tax law changes, was enacted. We'll highlight some of the planning opportunities these provide.

In addition to all the known changes impacting 2021, it looks like we may end the year with some other big (and probably not so favorable) tax law changes. As you undoubtably know, President Biden has proposed raising the ordinary income and capital gains tax rates on individuals. The ordinary income tax rate increase is proposed to take effect in 2022. We talk about the timing for the proposed increase in the capital gains rate later. A corporate tax rate hike has also been proposed for tax years beginning after 2021. Currently, the House is negotiating to come up with a bill based on the President's proposals.

Even though we don't know yet what, if anything, will become of President Biden's proposals, there are still many things you might consider doing before year-end to minimize your 2021 tax bill. We'll point out some strategies and things to consider in light of potentially higher tax rates in 2022. Clearly, uncertainty makes tax planning challenging, but putting it off until we know the fate of these proposals may leave you with too little time to make any moves before year end. It's best to have a plan in case of a tax increase, so that you can pull the trigger if need be.

YEAR-END PLANNING MOVES FOR INDIVIDUALS

MAKE YOUR PLAN FOR POSSIBLE HIGHER INCOME TAX RATES.

Here's what we know: President Biden, a Democrat, has proposed raising individual ordinary income and capital gains tax rates on individuals with income over certain thresholds. The Democrats have slim majorities in both the House of Representatives and the Senate. The rest, at this point, is speculation. Tax hikes could pass, but both the increased rates and the income thresholds at which they kick in may be different than the proposals—or nothing could change. But, we think it's safe to say that any planning you do should consider the possibility, depending on political outcomes and your level of income, that you will be paying a higher rate of tax in 2022 than in 2021.

If you think that you will be in a higher tax bracket in 2022 than in 2021, the conventional wisdom of deferring income and accelerating deductions is flipped upside down. Instead, you generally should try to accelerate income into 2021 (where it will be taxed at the lower rate) and defer deductions until 2022, when they will generate a bigger tax benefit. Of course, whenever you accelerate income, you have to keep the time value of money in mind and realize that you are giving up some deferral to have the income taxed at a lower rate. We can help you determine whether the tax savings associated with accelerating income into 2021 to have it taxed at a lower rate exceeds the cost of giving up the tax deferral.

With those caveats in mind, some strategies for accelerating income and deferring deductions include:

- If you have a small business, get all your billings done and collect as much of them as you can before year-end. If possible, progress bill for work in process at year-end. If you are a cash-method taxpayer, wait until after year-end to pay your bills, to the extent possible.
- Gain on the sale of business or investment property is generally taxed at the long-term capital gain rate, provided you have held the property for more than a year. If you are thinking about selling such property, get the sale closed before year-end. If you will receive payments in 2021 and later years, you might consider electing out of the installment method, which, fortunately, doesn't have to happen until you file your 2021 return, when the picture should be much clearer. Bear in mind, if you elect out of the installment method, your 2021 tax bill on the sale may be more than the payments you receive by the time the tax is due. So, you might need cash from another source to pay the tax.

SEIM JOHNSON, LLP
18081 Burt Street, Suite 200 | Omaha, NE 68022
Tel: 402.330.2660 | **Fax:** 402.330.5108
seimjohnson.com

CAUTION: The House Ways and Means committee has proposed that the increase in the capital gains tax rate would be effective for sales after 9/13/21. However, that proposal is a long way from becoming law. If that does happen, any long-term capital gains realized between now and year-end will be potentially (depending on your level of income) subject to the higher rate. In that case, closing a sale before year-end will not achieve the goal of having the gain taxed at the lower 2021 rate (but it will accelerate the gain into 2021). Sadly, we just don't know if any increased capital gain rate will be applied retroactively. Again, depending on political outcomes, the effective date of any increase on the long-term capital gains tax rate could be on the date the bill is actually enacted, or some other date. As usual, you have to balance any potential tax savings associated with accelerating a gain into 2021 with the overall economics of the deal. But, if you can get the price you want, the possibility of having the gain taxed at a lower rate if you sell in 2021 should at least be considered.

- If you have or will have long-term capital gains in 2021, defer selling stocks or other investments that have declined in value until 2022. That way, you can use the loss in 2022 (or later) to offset capital gains that will potentially be taxed at a higher rate than in 2021. Be careful, though, that you don't let taxes drive your entire decision. If you think an investment will continue to lose value, it might be best to sell it in 2021, regardless of the tax consequences. But, if you think most of the decline has already happened, you might want to wait until 2022 to sell some losers.
- Wait until 2022 to make charitable contributions, pay your real property taxes (to the extent possible) or to have elective medical procedures, dental work, routine physicals or to purchase glasses, contact lens, hearing aids, etc. Of course, don't delay any medical procedure or purchase if that would be detrimental to your health.

At this point, we think the best advice is to wait and see what happens. In the meantime, give these ideas some thought. Look at your investment portfolio to identify winners and losers so that, if you want to trigger a gain or loss in a particular year, you'll have an idea of which investments to sell. Of course, we will keep you informed of any developments on the proposed tax rate increases as soon as we know them.

BUNCH ITEMIZED DEDUCTIONS TO MAXIMIZE THEIR WORTH.

For 2021, the standard deduction amounts are $12,550 for singles and those who use Married Filing Separate (MFS) status, $25,100 for Married Filing Joint (MFJ) couples, and $18,800 for Heads of Household (HOH). If your total annual itemizable deductions for 2021 will be close to your standard deduction amount, consider bunching your expenditures so that they exceed the standard deduction in one year, and then use the standard deduction in the following year.

For example, assume your filing status is MFJ and your itemized deductions are fairly steady and around $25,000 per year. In that case, you would end up claiming the standard deduction each year. But, if you can bunch expenditures so that you have itemized deductions of $30,000 in 2021 and $20,000 in 2022, you could itemize in 2021 and get a $30,000 deduction versus a $25,100 standard deduction. In 2022 your itemized deductions would be below the standard deduction (which adjusted for inflation will be at least $25,100), so for that year, you would claim the standard deduction. If you manage to exceed the standard deduction every other year, you'll be better off than if you just settle for the standard deduction each year.

NOTE: As we mentioned earlier, if you think your tax rate is going to increase in 2022, you might want to push as many of the itemized deductions as you can into 2022 and take the standard deduction in 2021.

Probably the easiest deductible expenses to bunch are charitable contributions. Note that even if you implement this strategy and decide to take the standard deduction in 2021 (and bunch itemized deductions in 2022), you can still take an "above the line" deduction for charitable contributions in 2021, up to $300 ($600 if MFJ).

Also, consider state and local income and property taxes. In many cases, property tax bills are sent out before year-end, but can be paid after year-end. Likewise, you can make your fourth quarter installment of state income tax (generally due in January) before year-end. Choosing the year in which you pay your state and local income and property taxes is another way to get the itemized deductions into the year you want them. Remember, barring any tax law changes, the maximum amount you can deduct for state and local taxes is $10,000 ($5,000 if MFS) per year. But that limit doesn't apply to property taxes on property held for investment or in a trade or business.

WARNING: This can be a bad idea if you owe Alternative Minimum Tax (AMT) this year. That's because write-offs for state and local income and property taxes are completely disallowed under the AMT rules. Therefore, prepaying state and local taxes may do little or no good if you're an AMT victim in 2021 and won't be in 2022. Contact us if you're unsure about your exposure to AMT.

You can also choose when you make your house payment that is due on January 1. Accelerating that will give you 13 months' worth of interest in any given year. Remember that mortgage insurance premiums for eligible taxpayers also are deductible in 2021, but not in 2022.

DECIDE WHETHER SELLING INVESTMENT ASSETS BEFORE YEAR-END MAKES SENSE.

Regardless of whether you think you will be in a higher tax bracket in 2022, you should look at your investment portfolio and see if selling before year end could make tax sense. (This doesn't apply to investments held in a retirement account or IRA, where the gains and losses are not currently taxed.)

To the extent you have capital losses that were recognized earlier this year or capital loss carryovers from pre-2021 years (or you have some capital losses you can trigger), selling winners before year-end will not result in any tax hit. Triggering short-term capital gains that can be sheltered with capital losses is a sweet deal because net short-term gains would otherwise be taxed at higher ordinary income tax rates.

If some of your investments have declined in value, you might want to bite the bullet and take the resulting capital losses this year. Those losses would shelter capital gains, including high-taxed short-term gains, from other 2021 sales. Even if you don't have capital gains to shelter this year, selling some losers could make sense, especially if you think they will continue to decline in value. The result would be a net capital loss for the year, which can be used to shelter up to $3,000 of 2021 ordinary income from salaries, bonuses, self-employment income, interest income, royalties, and whatever else ($1,500 if you file MFS). Any excess net capital loss from this year is carried forward to next year and beyond.

In fact, having a capital loss carryover into 2022 could work to your advantage. The carryover can be used to shelter both short-term and long-term gains recognized next year and beyond. This can give you extra investing flexibility in those years because you won't have to hold appreciated securities for over a year to get a preferential tax rate. And if your capital gains are subject to a higher tax rate in 2022, having a capital loss carryover into next year to shelter those gains could be a very good thing.

TAKE ADVANTAGE OF TAX CREDITS EXTENDED THROUGH 2021.

Several credits for purchasing or installing energy efficient property were scheduled to expire after 2020 but have been extended through 2021 (2023 for residential energy efficient property). Credits are still available for: (1) energy-efficient home improvements, (2) residential energy efficient property (including solar energy equipment), (3) fuel-cell vehicles, (4) electric motorcycles, and (5) alternate fuel vehicle refueling equipment. If you're thinking about purchasing any of these, let us know. We can help you determine whether your expenditure qualifies for a credit. If it does, and you purchase before year-end, you will effectively be letting Uncle Sam pay for a portion of your new energy-saving property.

CONSIDER A ROTH IRA CONVERSION.

This may be the perfect time to make that Roth conversion you've been thinking about, especially if you think you will be in a higher tax bracket in 2022. Although you will pay tax as if the assets had been distributed from the traditional IRA, your future Roth IRA distributions can potentially be tax-free. And, unlike traditional IRAs, Roth IRAs don't have minimum distribution requirements during the account owner's lifetime.

CLAIM 100% GAIN EXCLUSION FOR QUALIFIED SMALL BUSINESS STOCK.

100% of the gain on an eligible sale of Qualified Small Business Stock (QSBS) that was acquired after 9/27/10 can be excluded from income. QSBS must be held for more than five years to be eligible for the gain exclusion. Either 50% or 75% of the gain (depending on when the QSBS was acquired) can be excluded for stock acquired before 9/28/10. QSBS is stock originally issued after 8/10/93 by a C corporation with aggregate gross assets of $50 million or less from 8/10/93 to immediately after the stock is issued. The taxpayer must have acquired the stock at its original issue, or in a tax-free transaction such as a gift, inheritance, or partnership distribution. Note that the House tax writing committee has proposed a limit on the exclusion for taxpayers with AGI over $400,000 for sales after 9/13/21. As we've mentioned, that is not a done deal, but something you will need to consider. Contact us if you think you own stock that could qualify.

CONSIDER INTRAFAMILY LOANS.

Interest rates are at a historic low. This scenario creates an attractive opportunity for those interested in assisting family members financially and transferring assets in a tax-efficient manner. Individuals who wish to lend money to relatives may do so at interest rates lower than what commercial lenders offer, thus allowing the borrower to save money on interest. There's a minimum rate that can be charged by the lender called the Applicable Federal Rate (AFR). Loans with interest rates below the AFR may be subject to gift tax rules. While it's generally advisable to stay above the AFR to avoid being caught by the gift tax rules, individuals can use the annual and lifetime gift exclusions to maximize the benefit to the borrower.

To ensure the loan is an arm's length transaction, follow these steps: (1) have a properly worded and signed document, (2) file the documents with the necessary authorities, (3) provide the lendee with a formal document that summarizes the amount of interest paid each year, and (4) either collect the loan payments or establish the payments will be gifted. Please contact us if you are interested in taking advantage of intrafamily loans.

CONTRIBUTE TO A TRADITIONAL IRA.

Individuals over the age of 70½ who are still working in 2021 can contribute to a traditional IRA. However, if you're over age 70½ and considering making a charitable donation directly from your IRA (known as a Qualified Charitable Distribution or QCD) in the future, making a deductible IRA contribution for years you are age 70½ or older will affect your ability to exclude future QCDs from your income. Please contact us for further explanations of QCDs and how they can be an effective way to give to charity and reduce your taxable income.

YEAR-END PLANNING MOVES FOR SMALL BUSINESSES

If you own a business, consider the following strategies, in addition to planning for possibly higher tax rates in 2022 as discussed above. Note that proposed tax rate increases would potentially affect income earned by sole proprietors, pass-through entities, and corporations.

ESTABLISH A TAX-FAVORED RETIREMENT PLAN.

If your business doesn't already have a retirement plan, now's a good time to consider one. Current retirement plan rules allow for significant deductible contributions. For example, if you're self-employed and set up a SEP-IRA, you can contribute up to 20% of your self-employment earnings, with a maximum contribution of $58,000 for 2021. If you're employed by your own corporation, up to 25% of your salary can be contributed with a maximum contribution of $58,000.

Other small business retirement plan options include the 401(k) plan (which can be set up for just one person), the defined benefit pension plan, and the SIMPLE-IRA. Depending on your circumstances, these other types of plans may allow bigger deductible contributions.

Contact us for more information on small business retirement plan options, and be aware that if your business has employees, you may have to cover them too.

PLAN ASSET PURCHASES.

100% first-year bonus depreciation is available for qualified new and used property that is acquired and placed in service in calendar-year 2021 (and unless something changes, 2022). That means your business might be able to write off the entire cost of some or all of your 2021 asset additions on this year's return.

Consider Purchasing Vehicles That Qualify for Bonus Depreciation. Depreciation deductions (including bonus depreciation) on both new and used passenger vehicles (cars and light trucks and vans) that are acquired and placed in service in 2021, are limited as follows:

- $18,200 for Year 1 if bonus depreciation is claimed ($10,200 if no bonus depreciation claimed).
- $16,400 for Year 2.
- $9,800 for Year 3.
- $5,860 for Year 4 and thereafter until the vehicle is fully depreciated.

You can avoid these depreciation limits if you purchase a heavy SUV, pickup or van for your business because these are not considered passenger automobiles. A heavy vehicle is one that has a manufacturer's Gross Vehicle Weight Rating (GVWR) above 6,000 pounds. A vehicle's GVWR can be verified by looking at the manufacturer's label, which is usually found on the inside edge of the driver's side door where the door hinges meet the frame. Provided all the other requirements are met, you can claim 100% bonus depreciation on one of these heavy vehicles.

> **NOTE:** Only vehicles that are used more than 50% for business qualify for bonus depreciation.

Some assets that don't qualify for bonus depreciation are eligible for Section 179 expensing. 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 begins to phase-out when the cost of Section 179-eligible property placed in service during the year exceeds $2.62 million. This means that you could possibly write off the entire cost of business asset purchases in 2021. Given that, you might consider purchasing additional assets before year-end.

> **CAUTION:** If you think tax rates are going up in 2022, you might wait until then to place property that qualifies for bonus depreciation or Section 179 expensing in service. Placed in service generally means that the asset is ready to be used for its intended purpose. For many assets (such as a personal computer or cell phone) that's the day you buy it. But some assets (like heavy equipment) require installation and/or assembly before they can be used. So, if you decide you want to take any bonus depreciation or Section 179 deduction for an asset in 2021, be sure that you make all the necessary arrangements to have that asset ready for use before year-end.

CONCLUSION

This letter only covers some of the year-end tax planning moves that could potentially benefit you, your family, and your business. Please contact us if you have questions, want more information, or would like us to help in designing a year-end planning package that delivers the best tax results for your particular circumstances.

Best regards,

Seim Johnson, LLP

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