Getting ready for Tax Time 2022– What you need to know

“The difference between death and taxes is death doesn't get worse every time Congress meets”. *Will Rogers*

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2021 Filing season – what you need to know

- IRS began accepting and processing 2021 returns on Jan 24, 2022.
  - HIGHLY recommend electronic filing – IRS is still way behind in processing paper returns and correspondence
  - 2021 filing deadline is April 18, 2022 – virus extensions unlikely this year
  - Extension allows six more months to file but NOT to pay – must file Form 4868. Payment still due by April 18th (pay estimated amount due)
  - No Extension request needed if refund is due

2021 Filing season – what you need to know

- Almost 90% of all returns are now filed electronically (e-file)
  - Efile with direct deposit – refund rec’d within 3 weeks or less
  - Efile software catches common errors (math mistakes, missing SS numbers etc)
  - Free efile software available thru IRS - incomes of $73,000 or less (IRS.gov/FreeFile)

Major Tax Law Changes in 2020 and 2021

- American Rescue Plan Act - passed March 2021
- Consolidated Appropriations Act – passed Dec 2020
- Families First Act – passed March 2020
- CARES Act – passed March 2020
- SECURE Act – passed Dec 2019
- Other tax changes

Tax Law Changes 2021

- Forgiveness of student loans
- Discharge of main home debt
- Higher education grants
- Recovery rebates
- Emergency rental assistance
- Education benefits
- Residential energy credits
- Medical deduction floor
- PMI
- Charitable contributions
- EIP3/RRC2021
- Child tax credits
- Earned income credits
- Child and dependent care credits
- Sick and family leave credits
- Premium tax credits
- 1099-K reporting

Third Economic Impact Payments (EIP) sent in March 2021

- $1,400 per eligible taxpayer and dependent (must be U.S. citizen with valid SSN)
- Adjusted Gross Income phaseout:

MFJ	$150,000 – $160,000
HoH	$112,500 – $120,000
S, MFS	$75,000 – $80,000

  - EIP are <u>not</u> taxable income
  - Taxpayers **eligible** to be claimed as dependent on another's return are not eligible for EIP

You may be eligible for additional EIP Payments !

IRS used your 2019 or 2020 return info when paying EIP3, but what if your situation changed in 2021 :

- Never received payments
- Income decreased
- Added a dependent (or no longer a dependent)

- If so claim additional payment due on your 2021 tax return (called a “Recovery Rebate Credit”)
- You do not have to repay “excess” payments received (except for death before payment receipt)

Be sure to report the correct amount of EIP3 already received !

- MUST accurately report EIP3 payments already received when calculating Recovery Rebate Credit or your return and refund will be delayed several weeks

- IRS will send two letters showing amount paid per their records:
  - Letter 1444-C sent in 2021 after payments were sent
  - Letter 6475 sent Jan 2022

- You must file a 2021 tax return to claim a Recovery Rebate Credit payment due

Big Increase to Child Tax Credit (RCTC) for

- Credit increased to $3,000; $3,600 if child under 6
  - Was $2,000 for Child Tax Credit / Additional Child Tax Credit
- Qualifying children under age 18 are eligible
  - Was children *under age 17*
- Fully refundable for 2021 if ***principal residence is in the U.S. more than ½ of*** f 2021
- Applies to **2021** returns only

Refundable Child Tax Credit for 2021

- The *increased amount* of CTC phases out starting at income above:

MFJ	$150,000
HoH	$112,500
Others	$75,000

  - That is, the additional $1,000 ($3,000-$2,000) or $1,600 ($3,600-$2,000) if under age 6. (Lose $50 for each $1,000 over)

Refundable Child Tax Credit for 2021 (RCTC)

- The remaining $2,000 CTC phases out starting at income above:
  - MFJ $400,000
  - Others $200,000
- This can reduce the RCTC below $2,000 per child (lose $50 for each $1,000, or fraction thereof, over)

Advance Payments of RCTC for 2021

- IRS paid monthly advance payment of 1/2 of annual estimated amount in July through December 2021 ($250/$300 per month)
  - Based on 2020 tax return, or 2019 until 2020 is filed
  - Taxpayers MUST reconcile advance payments with actual credit allowed on 2021 return
  - Excess payments treated as additional tax

Another important IRS Letter to look for…

- **<u>Must</u> have** IRS Letter 6419 sent to taxpayers in January 2022 showing amount of AdvCTC (advance CTC) payments and number of qualifying children taken into account
- If married each spouse will get their own letter

Be aware of these other important 2021 changes

- Charity deduction up to $600 – even if you don't itemize deductions
- Increased child and dependent care tax credit – up to $8,000 tax reduction ! (2021 only)
- Earned Income tax credit also expanded – up to $6,700 tax reduction !
- Sick and Family Leave tax credits available if self employed and unable to work due to COVID
- "Obamacare" premium tax credit increased

Major Retirement Plan new Rules began in 2020

- Required Minimum Distributions (RMDs) now begin at age 72 (was 70 ½)
- Over 70 ½ can now continue to contribute to an IRA (if they have earned income)
- No more “stretch” IRAs – inherited IRAs and 401Ks must be withdrawn within 10 years
- Penalty free withdrawals from retirement plans up to $5K for birth/adoption of a child

Should I "itemize" my deductions?

- Only worthwhile to itemize if the total of your deductions (mortgage interest, charitable contributions, state income taxes, property taxes, deductible medical expenses) are higher than your "standard deduction".
  - estimated less than 10% of taxpayers will itemize .

2021 Standard deduction amounts

- Single – $12,550
- Married Filing Joint – $25,100
- Head of Household - $18,800
- If 65 or over:
  - Married – extra $1,350 each
  - Single or Head of Household – extra $1,700

Itemized deductions tax strategies

- Consider “bunching” deductions into the same tax year by:
  - Prepaying winter property tax bill
  - Making your January mortgage payment in December
  - Timing medical expenses if possible
  - Prepaying charitable giving or consider a “donor advised fund” for your charitable giving. Donor advised fund allows you to deduct several years worth of giving “up front” in one year.

Consider Donating Appreciated Securities (if still able to itemize)

- Donate appreciated security directly to charity instead of selling security and donating cash
- Advantage – Get a double tax benefit:
  - A charitable deduction for the full market value of the security when donated
  - Avoid paying capital gains tax on the market value gain.
- Can also donate appreciated securities into donor advised fund !

2021 Income tax rates (expire at end of 2025)

Single Taxpayers:

Taxable Income	New Rate
Up to $9,950	10% (10% in 2026)
$9,951 -$40,525	12% (15% in 2026)
$40,526 – 86,375	22% (25% in 2026)
$86,376 - $164,925	24% (28% in 2026)
$164,926 - $209,425	32% (33% in 2026)
over $209,425	35% - 37% (2026-35% - 39.6%)

2021 Income tax rates (expire at end of 2025)

Married Filing Joint Taxpayers:

Taxable Income	New Rate
Up to $19,900	10% (10% in 2026)
$19, 901 -$81,050	12% (15% in 2026)
$81,051 - $172,750	22% (25% in 2026)
$172,751 -$329,850	24% (28% in 2026)
$329,851 - $418,850	32% (was 33%)
over $418,850	35% - 37% (2026- 35% - 39.6%)

Let's look at an example…

Carl is retired, 70 years old and single. He had social security income of $25,000 and withdrawals from his IRA totaling $40,000. His itemized deductions totaled $10,000 for the year.

Total gross income …………………	$65,000
Less: non taxable social security…..	($4,775)
Less: Standard deduction …………	($14,250)
Taxable Income	$45,975
Federal taxes due	$5,863 (12.7%)

Strategy – stay in 12% bracket if at all possible !!

- Plan which “source” your annual income needs will come to control your taxable income. Possible sources:
  - Social Security and Pensions
  - 401K or Traditional IRA accounts
  - Roth IRA accounts
  - Savings accounts
  - Stock or mutual fund sales

Some interesting tax facts…

- 60% of returns filed are done by paid preparers – and another 35% use tax software (i.e. Turbo Tax)
- The average refund is about $3,000
- The top 10% of high income taxpayers (incomes of $155,000 and up) – pay about 70% of all income taxes collected. Bottom 50% of income taxpayers pay only about 3% of all taxes collected.
- Over 30% of Americans pay no income taxes.

What forms will I need to file my return?

- W-2 (employment income)
- 1099-INT (interest income)
- 1099-DIV – Dividend income
- 1099-G Unemployment income
- 1099-R – Retirement income (IRAs, pensions etc)

What forms will I need to file my return?

- 1099 –B from broker (investment sales)
- SSA-1099 (Social Security income)
- 1099-NEC – self employed income
- K-1 – income from REITS/partnerships
- 1098 – Mortgage interest expense
- 1098-T   - Tuition Statement

What forms will I need to file my return?

- For 2021 only:
  - Letter 6475 from IRS (reporting third stimulus payment received)
  - Letter 6149 from IRS (reporting advance child tax credit payments received. (Both spouses will receive their own Letter 6149)

Common errors and overlooked deductions

- Choosing the incorrect “Filing Status”
- Improperly calculating cost basis of sold securities .
- Math errors and computation errors (i.e. taxable part of social security).
- Failing to report all income (especially 1099s)
- Failing to claim eligible credits (education, child care, earned income, retirement savers, dependent)

Common errors and overlooked deductions

- Misspelled or incorrect names (must match SS card)
- Incorrect bank direct deposit routing and a/c number
- Failing to deduct:
  - Gambling losses to the extent of gambling winnings.
  - Long term care insurance premiums/mortgage insurance premiums/refinance points paid
  - Medical transportation and lodging costs
  - Out of pocket charitable activities (i.e. mileage)

Common errors - failure to make adequate estimated payments

- Must make tax payments throughout the year (i.e. withholding from wages, withholding from pension or IRA payments, quarterly estimated payments etc).
- Must prepay at least 90% of your final taxes due this year or 100% of your final taxes due from the prior year return. (110% if prior year income was over $150,000).
- If you fall short – will owe interest and penalties

Will my tax return be audited?

- IRS audits less than 1% of all returns filed.
- Typical audits by mail questioning one or more specific items – very few in person .
- IRS has three years from the due date of the return to audit, unless they can prove fraud. For example – 2017 return was due April 15, 2018 – IRS had until April 15, 2021 to audit.
- Advise keeping tax return copies and supporting documents at least three years.

Will my tax return be audited?

- Audit red flags:
  - Deductions out of line with income level and overall averages
  - Large non cash charitable deductions
  - Consistent business losses or rental real estate losses .
  - Failing to claim all income
  - Home office deduction – must document exclusive business area in home.

Tax Reduction Strategies

Pay MORE tax strategy: Convert Traditional IRA to Roth

- Pay taxes on the converted funds while rates are low (new lower rates expire in 2026)
- Will reduce your RMD on your Traditional IRA – and no RMD is required for Roth IRAs.
- All Roth withdrawals (including earnings!) are tax free once Roth is open for five years.
- Roth accounts pass to heirs tax free
- Caveat – Beware of “bracket creep”

A real "no brainer" strategy - IRA Charitable Distributions

- Seniors 70 ½ and older can elect to transfer all or part of their IRA RMDs (up to $100K) directly to charity and avoid paying tax on the distribution.
- Transfer must be made direct from the IRA to the charity (check can't go to IRA holder first).
- This is called a "Qualified Charitable Distribution" – must be completed by Dec 31.

Remember your IRA Required Minimum Distributions (‘RMDs”) !

- Seniors over 70 ½ and older prior to 2020 and seniors age 72 after 2020 must take taxable “required minimum distributions” from their IRA each year. (Not required from Roth IRAs)
- RMD % amount comes from IRS tables – based on age
- Also must take RMDs from any work-related 401K or 403B accounts you have (unless still working).
- Significant penalty for failure to take RMD – penalty is 50% of the amount you should have taken

Strategy: Consider a “QLAC” to reduce your RMD

- QLAC is a Qualified Longevity Annuity Contract
- You can invest up to 25% of your IRA balance (or $130K, whichever is less) in a QLAC
- Advantage: NO RMD is required from IRA funds in a QLAC !
- You can delay the start of payments from a QLAC until as late as age 85. QLACs can provide death benefits to beneficiaries.

Strategy: Take advantage of Lower tax rates on Long term "Capital Gains"

- Long term Capital Gains (i.e. qualified dividends, sale of stocks, mutual funds, rental property, or other investments held one year or more) are taxed at special LOWER tax rates)
- Taxed at 0% IF your taxable income is less than $40,525 if single and $81,050 if married filing joint.
- Remember this is based on TAXABLE income - not on gross income.

Lower tax rates on Long term "Capital Gains"

- If taxable income is higher than these thresholds, then long term capital gains are taxed at maximum of 15%
- 15% rate on capital gains is still a bargain – as tax rate on other income can be as high as 35%.
- Up to $3,000 of net losses from investment sales are deducted against other income – and losses greater than $3,000 can be carried over and deducted in future years.

Still Time to Contribute to a Traditional or Roth IRA

- Must have earned income to contribute
- You have until April 15, 2022 to make a 2021 contribution
- Max contribution is $6,000 for 2021 (plus $1,000 if 50 or older)
- Can't contribute to Roth if total income is over $140K (single) or $208K (married, filing joint)
- May not be able to deduct all of your Traditional IRA contribution if pension plan at work

Other tax advantages to consider

- Gains on primary residence home sales tax free up to $250K (single) or $500K (married).
- No estate taxes on estates up $11.7 million (single), $23.4 million (married). Annual gift maximum - $16K single, $32K married
- Contribute to a Michigan college 529 savings plan and deduct up to $5K (single), $10K (married) on your Michigan return

Other tax advantages to consider

- Your heirs get a “step up in basis” on your home and investment assets when you pass away. (Be careful not to “gift” these assets before you die !)
- Your heirs pay no taxes on your life insurance proceeds or Roth IRA assets
- Some heirs may be required to “clean out” inherited IRAs within 10 years

Questions?

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