2021 Year-End Tax Tips

Here are some things to consider as you weigh potential tax moves between now and the end of the year.

1. Defer income to next year

Consider opportunities to defer income to 2022, particularly if you think you may be in a lower tax bracket then. For example, you may be able to defer a year-end bonus or delay the collection of business debts, rents, and payments for services. Doing so may enable you to postpone payment of tax on the income until next year.

2. Accelerate deductions

You might also look for opportunities to accelerate deductions into the current tax year. If you itemize deductions, making payments for deductible expenses such as medical expenses, qualifying interest, property and state taxes (maximum deduction of $10,000), and charitable contributions before the end of the year (instead of paying them in early 2022) could make a difference on your 2021 return.

3. Make deductible charitable contributions

If you itemize deductions on your federal income tax return, you can generally deduct charitable contributions, but the deduction is limited to 100%, 60%, 30%, or 20% of your adjusted gross income (AGI), depending on the type of property you give and the type of organization to which you contribute. (Excess amounts can be carried over for up to five years.)

For 2021 charitable gifts, the normal rules have been enhanced: The limit is increased to 100% of AGI for direct cash gifts to public charities. And even if you don't itemize deductions, you can receive a $300 charitable deduction for direct cash gifts to public charities (in addition to the standard deduction).

If you are 70 ½ or older, and have an Individual Retirement Account (IRA), then you might want to consider a Qualified Charitable Distribution (QCD). Rather than taking a distribution from your IRA and then giving cash or property to a charity, you can make a QCD, which allows for a direct transfer from your IRA to a charity. In turn, you do not recognize the income coming out of your IRA as income, and you do not take a charitable deduction for the amount going to charity. The maximum allowed QCD per taxpayer is $100,000. This technique can often provide a higher per dollar tax benefit because it directly reduces a taxpayer's AGI.

4. Bump up withholding to cover a tax shortfall

If it looks as though you will owe federal income tax for the year, consider increasing your withholding on Form W-4 for the remainder of the year to cover the shortfall. There may not be much time for employees to request a Form W-4 change and for their employers to implement it in time for 2021. The biggest advantage in doing so is that withholding is considered as having been paid evenly throughout the year instead of when the dollars are actually taken from your paycheck. This strategy can be used to make up for low or missing quarterly estimated tax payments.

5. Maximize retirement savings

Deductible contributions to a traditional IRA and pre-tax contributions to an employer-sponsored retirement plan such as a 401(k) can reduce your 2021 taxable income. If you haven't already contributed up to the maximum amount allowed, consider doing so. For 2021, you can contribute up to $19,500 to a 401(k) plan ($26,000 if you're age 50 or older) and up to $6,000 to traditional and Roth IRAs combined ($7,000 if you're age 50 or older).* The window to make 2021 contributions to an employer plan generally closes at the end of the year, while you have until April 15, 2022, to make 2021 IRA contributions.

*Roth contributions are not deductible, but Roth qualified distributions are not taxable.

6. Avoid RMDs in 2021

Normally, once you reach age 70½ (age 72 if you reach age 70½ after 2019), you generally must start taking required minimum distributions (RMDs) from traditional IRAs and employer-sponsored retirement plans. Beneficiaries of retirement plans are also generally required to take distributions after the death of the IRA owner or plan participant.

7. Weigh year-end investment moves

You shouldn't let tax considerations drive your investment decisions. However, it's worth considering the tax implications of any year-end investment moves that you make. For example, if you have realized net capital gains from selling securities at a profit, you might avoid being taxed on some or all of those gains by selling losing positions. Any losses over and above the amount of your gains can be used to offset up to $3,000 of ordinary income ($1,500 if your filing status is married filing separately) or carried forward to reduce your taxes in future years.

8. Claim 100% of Your First-Year Bonus Depreciation for Last-Minute Asset Purchases

According to the Tax Cuts and Jobs Act (TCJA), 100% first-year bonus depreciation is available for qualified new and used property that is acquired and placed in service for the calendar year 2021. Because of this, your business might be able to write off the total cost of some or all of your 2021 asset additions on your 2021 federal income tax return and possibly your state return also.

You might want to think about making additional purchases by December 31, 2021. Take a moment to speak with your tax professional for details regarding the 100% bonus depreciation break and precisely what types of assets qualify for this break.

Nevertheless, if we see substantial tax-rates escalate in 2022 and thereafter, it might be best to skip the 100% first-year bonus depreciation. A better choice might be to depreciate recently purchased assets over a number of years. Future depreciation write-offs could be worth more than a current-year 100%.

You do not need to make a decision until the deadline for filing your current-year federal income tax return and any extension. Businesses using the calendar year for tax purposes, will use the extended filing deadline of October 17, 2022, for sole proprietorships and C corporations. September 15, 2022, will be the extended deadline for partnerships, limited liability companies (LLCs) and S corporations. You will have more flexibility to respond to future tax developments when you extend your tax return.

9. Making the Most of Your Pass-Through Business Income Deduction

An important component of the TCIA is the deduction based on an individual's qualified business income (QBI) from pass-through entities. This deduction allows 20% of a pass-through entity owner's QBI. Restrictions may apply at higher income levels and another restriction based on the owner's taxable income.

Pass-through entities may include the following for QBI deduction purposes:

- Sole proprietorships;
- Single-member LLCs that are treated as sole proprietorships for tax purposes;
- Partnerships;
- LLCs that are treated as partnerships for tax purposes; and
- S corporations.

The QBI deduction may also be used for up to 20% of qualified Real Estate Investment Trust (REIT) dividends and up to 20% of qualified income from publicly traded partnerships.

Due to the limitations on the QBI deduction, year-end tax planning transfers (or absence of) may increase or decrease your allowable QBI deduction. An example would be if year-end transfers that decrease this year's taxable income can have the unexpected negative side effect of reducing this year's QBI deduction. To optimize your results, please take a moment and contact your tax professional.

10. Business Meals

There is a 100% deduction (rather than 50%) for expenses paid for food or beverages provided by a restaurant. This provision expires at the end of 2022.

11. Health Savings Account Contributions

If you have a high-deductible health insurance plan, you might be able to contribute to a Health Savings Account (HSA) and receive a tax deduction. The maximum contributions for 2021 are $3,600 for self-only coverage and $7,200 for family coverage, with an additional $1,000 contribution allowed for taxpayers over 55. One useful aspect of an HSA is once you fund it, you can either invest the money within the account and save for future qualifying medical expenses, or you can fund and use the HSA within the same year. Either way, as long as you use the distributions from your HSA for qualifying medical expenses, you are not taxed on the distributions, including earnings. This is a double benefit – tax deduction when you put money in, and tax free distributions when you take the money out! Using tax-free dollars to pay for medical expenses now or in the future is a big benefit that many people overlook.