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To Our Clients and Friends:

2021 YEAR-END INCOME TAX PLANNING FOR INDIVIDUALS

INTRODUCTION

With year-end approaching, this is the time of year we suggest possible year-end tax strategies for our clients. This letter is designed to bring you up-to-date on the most significant tax provisions that could impact your year-end planning.

Caution! It is entirely possible that Congress could enact additional tax legislation before the end of this year. We closely monitor new tax legislation and IRS releases on an ongoing basis. Please call our firm if you want an update on the latest tax legislation and IRS notifications, announcements, and guidance or **if you need additional information concerning any item discussed in this letter.**

Be Careful! We suggest you call our firm before implementing any tax planning technique discussed in this letter. You cannot properly evaluate a particular planning strategy without calculating your overall tax liability with and without that strategy. This letter primarily contains ideas for Federal income tax planning and limited state income tax issues.

HIGHLIGHTS OF RECENT LEGISLATIVE CHANGES

Economic impact payments (EIPs). The American Rescue Plan Act created a new round of EIPs that were sent to qualifying individuals. As with last year's stimulus payments, the EIPs were set up as advance payments of a recovery rebate tax credit. If you qualified for EIPs, you should have received these payments already. However, if the IRS owes you more, this additional amount will be captured and claimed on your 2021 income tax return. If you received an EIP as an advance payment, you should receive a letter from the IRS. Keep this for record-keeping purposes to help us determine any potential adjustment.

Child tax credit. As part of the American Rescue Plan Act, there were many important changes to the child tax credit, such as the credit: 1) Amount has increased for certain taxpayers, 2) Is fully refundable (meaning taxpayers will receive a refund of the credit even if they don't owe the IRS), 3) May be partially received in monthly payments, and 4) Is applicable to children age 17 and younger. The IRS began paying half of the credit in advance monthly payments beginning in July — some taxpayers chose to opt out of the advance payments, and some may have complexities that require additional analysis.

Charitable contribution deductions. Individuals who do not itemize their deductions can take a deduction of up to $300 ($600 for joint filers). Such contributions must be made in cash and made to qualified organizations. Taxpayers who itemize can continue to deduct qualifying donations. In addition, taxpayers can claim a charitable deduction up to 100% of their adjusted gross income (AGI) in 2021 (up from 60%).

Unemployment compensation. Another thing to note that's different in 2021 is the treatment of unemployment compensation. There is no exclusion from income. The $10,200 income tax exclusion that a taxpayer may have received in 2020 is no longer available in 2021.

HIGHLIGHTS OF PROPOSED TAX CHANGES - BUILD BACK BETTER FRAMEWORK

On November 19th, the House of Representatives passed the Build Back Better Act. The bill now heads to the Senate, where the debate continues and will likely see more changes. The House passed version includes several tax changes, here are some of them:

- **Net Investment Income Tax (NIIT) Expansion.** Starting in 2022, the Build Back Better Act would expand the 3.8% surtax to cover net investment income derived in the ordinary course of a trade or business from a pass-through entity for single or head-of-household filer with a modified AGI over $400,000, a joint filer with a modified AGI over $500,000, or a married person filing a separate return with a modified AGI over $250,000. The legislation also clarifies that the surtax doesn't apply to wages on which Social Security and Medicare payroll taxes (i.e., FICA taxes) are already imposed.
- **State and local tax deduction (SALT)**. The current $10,000 SALT cap would increase to $80,000 for 2021 through 2030.
- **"Backdoor" Roth IRA conversions.** Beginning in 2022, individuals would be prohibited from converting after-tax contributions (made to either a 401(k) or a traditional IRA) to a Roth IRA.
- **Energy Efficiency.** The credit for nonbusiness energy property added to your home would be extended through 2031 (it's currently set to expire at the end of this year). In addition, the credit amount would jump from 10% to 30% of the cost of installing qualified energy efficiency improvements. The $500 lifetime cap would be replaced by a $1,200 annual credit limit, a $600-per-item limit would be placed on credits for qualified energy property, the credit would apply to the costs of home energy audits, and more.
- **Wash Sale Rules.** People investing in commodities, currencies, and digital assets such as cryptocurrency would be subject to the "wash sale" rule starting January 1, 2022. Currently, trading in those types of assets isn't covered by the rule. Basically, the rule states that you can't deduct a loss from the sale or other disposition of stock or securities if you buy the same asset within 30 days before or after you sell it. Fortunately, though, if a deduction is denied because of the rule, the loss is added to the cost basis of the newly purchased stock. So, when you sell the new stock later, the tax on any gains will be lower.
- **Surtax on wealthy individuals**. A 5% surtax on individuals with income over $10 million.

HIGHLIGHTS OF TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

Taking Advantage Of "Above-The Line" Deductions. Traditional year-end planning includes accelerating deductible expenses into the current tax year. So-called **"above-the-line"** deductions reduce both your "adjusted gross income" (AGI) and your "modified adjusted gross income" (MAGI), while **"itemized"** deductions (i.e., below-the-line deductions) do **not** reduce either AGI or MAGI. Deductions that reduce your AGI (or MAGI) can generate multiple tax benefits by: **1)** Reducing your taxable income and allowing you to be taxed in a lower tax bracket; **2)** Potentially freeing up other deductions (and tax credits) that phase out as your AGI (or MAGI) increases (e.g., Certain IRA Contributions, Certain Education Credits, Adoption Credit, Child and Family Tax Credits, etc.); **3)** Potentially reducing your MAGI below the income thresholds for the 3.8% Net Investment Income Tax (i.e., 3.8% NIIT only applies if MAGI exceeds $250,000 if married filing jointly; $200,000 if single); **or 4)** Possibly reducing your household income to a level that allows you to qualify for a "refundable" Premium Tax Credit for health insurance purchased on a government Exchange. **Planning Alert!** In addition, individuals reporting Qualified Business Income will generally find it much easier to qualify for the 20% 199A Deduction with respect to Qualified Business Income if their 2021 taxable income does not exceed $329,800 if filing a joint return or $164,900 if single. So, if you think that you could benefit from accelerating ***"above-the-line"*** deductions into 2021, consider the following:

- **Identifying "Above-The-Line" Deductions. "Above-the-line"** deductions include: Deductions for IRA or Health Savings Account (HSA) Contributions; Health Insurance Premiums for Self-Employed Individuals; Qualified Student Loan Interest; Qualifying Alimony Payments (if the divorce or separation instrument was **executed before 2019);** and, Business Expenses for a Self-Employed Individual. **Caution!** Un-reimbursed employee business expenses are not deductible at all **for 2018 through 2025.** However, employee business expenses that are reimbursed under an employer's accountable plan are excluded altogether from the employee's taxable income.

- **Accelerating "Above-The-Line" Deductions.** As a cash method taxpayer, you can generally accelerate a 2022 deduction into 2021 by *"paying"* it in 2021. *"Payment"* typically occurs in 2021 if, **before the end of 2021: 1)** A check is delivered to the post office, **2)** Your electronic payment is debited to your account, or **3)** An item is charged on a *third-party credit card* (e.g., Visa, MasterCard, Discover, American Express). **Caution!** If you post-date the check to 2022 or if your check is rejected, no payment has been made in 2021 even if the check is delivered in 2021. **Planning Alert!** The IRS says that prepayments of expenses applicable to periods beyond 12 months after the payments are not deductible in 2021.

"Itemized" Deductions. Although **"itemized"** deductions (i.e., below-the-line deductions) do **not** reduce your AGI or MAGI, they still may provide valuable tax savings. **Starting in 2018 and through 2025,** legislation substantially increased the Standard Deduction. For 2021, the Standard Deduction is: Joint Return - $25,100; Single - $12,550; and Head-of-Household - $18,800. **Planning Alert!** If you think your itemized deductions this year could likely exceed your Standard Deduction, consider the following:

- **Accelerating Charitable Contributions Into 2021.** If you want to accelerate your charitable deduction into 2021, please note that a charitable contribution deduction is allowed for 2021 if the check is **"mailed" on or before December 31, 2021,** or the contribution is made by a credit card charge in 2021. However, if you merely give a note or a pledge to a charity, no deduction is allowed until you pay the note or pledge.

- **Medical Expense Deductions.** You could save taxes in the long run by accelerating elective medical expenses (e.g., braces, new eyeglasses, etc.) into 2021. **Planning Alert!** For 2021, you are allowed to take a medical expense itemized deduction only to the extent your aggregate medical expenses exceed 7.5% of your AGI. The 7.5% medical expense floor has been made permanent.

- **$10,000 Cap On State And Local Taxes.** As of now, **from 2018 through 2025,** your aggregate itemized deduction for state and local real property taxes, state and local personal property taxes, and state and local income taxes (or sales taxes if elected) is **limited to $10,000** ($5,000 for married filing separately).

- **Limitations On The Deduction For Interest Paid On Home Mortgage "Acquisition Indebtedness."** Before the Tax Cuts And Jobs Act (TCJA), individuals were generally allowed an *itemized* deduction for home mortgage interest paid on up to $1,000,000 ($500,000 for married individuals filing separately) of **"Acquisition Indebtedness"** (i.e., funds borrowed to purchase, construct, or substantially improve your principal or second residence and secured by that residence). Subject to certain transition rules, TCJA reduced the dollar cap for **Acquisition Indebtedness incurred after December 15, 2017 from**

$1,000,000 to $750,000 ($375,000 for married filing separately) for **2018 through 2025.** **Planning Alert!** If you think your itemized deductions this year could likely exceed your *Standard Deduction*, paying your January 2022 qualifying home mortgage payment **before 2022** should shift the deduction for any qualifying interest portion of that payment **into 2021.**

- **"Home Equity Indebtedness" Suspended For 2018 through 2025.** TCJA suspended the deduction for **interest** with respect to **"Home Equity Indebtedness"** (i.e., up to $100,000 of funds borrowed that do not qualify as "Acquisition Indebtedness" but are secured by your principal or second residence). **Caution!** Unlike the interest deduction for "Acquisition Indebtedness," TCJA **did not grandfather** any interest deduction for **"Home Equity Indebtedness"** that was **outstanding before 2018.**

Postponing Taxable Income May Save Taxes. Generally, deferring taxable income from 2021 to 2022 may also reduce your income taxes, particularly if your effective income tax rate for 2022 will be lower than your effective income tax rate for 2021.

- **Planning For Tax Rates.** The deferral of income could cause your 2021 taxable income to fall below the thresholds for the highest 37% tax bracket (i.e., $628,300 for joint returns; $523,600 if single). In addition, if you have income subject to the 3.8% Net Investment Income Tax (3.8% NIIT) and the income deferral reduces your 2021 modified adjusted gross income (MAGI) below the thresholds for the 3.8% NIIT (i.e., $250,000 for joint returns; $200,000 if single), you may avoid this additional 3.8% tax on your investment income.

- **Deferring Self-Employment Income.** If you are a self-employed individual using the cash method of accounting, consider delaying year-end billings to defer income until 2022. **Planning Alert!** If you have already received the check in 2021, deferring the deposit of the check does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.

Traditional Year-End Planning With Capital Gains And Losses. Generally, net capital gains (both short-term and long-term) are potentially subject to the 3.8% NIIT. This could result in an individual filing a joint return with taxable income for 2021 of $501,600 or more ($445,850 or more if single) paying tax on his or her **net long-term capital gains** at a **23.8%** rate (i.e., the maximum capital gains tax rate of 20% plus the 3.8% NIIT). In addition, this individual's **net short-term capital gains** could be taxed as high as **40.8%** (i.e., 37% plus 3.8%). Consequently, traditional planning strategies involving the timing of your year-end sales of stocks, bonds, or other securities continue to be as important as ever. The following are time-tested, year-end tax planning ideas for sales of capital assets. **Planning Alert!** Always consider the **economics of a sale or exchange first!**

- **Planning With Zero Percent Tax Rate For Capital Gains And Dividends.** For individuals filing a **joint return** with 2021 Taxable Income of **less than $80,800 (less than $40,400 if single),** their long-term capital gains and qualified dividends are taxed at a **zero percent rate.** **Tax Tip.** Taxpayers who have historically been in higher tax brackets but now find themselves between jobs, recently retired, or expecting to report higher-than-normal business deductions in 2021, may temporarily have income low enough to take advantage of the zero percent rate for 2021.

- **Timing Your Capital Gains And Losses.** If the value of some of your investments is less than your cost, it may be a good time to harvest some capital losses. For example, if you have already recognized capital gains in 2021, you should consider selling securities **prior to January 1, 2022** that would trigger a capital loss. These losses will be deductible on your 2021 return to the extent of your recognized capital gains, plus $3,000. **Tax Tip.** These losses may have the added benefit of reducing your income to a level that will qualify you for other tax breaks, such as: **1)** The American Opportunity Tax Credit, **2)** The Child Tax Credit, **3)** The Adoption Credit, or **4)** Causing your taxable income to drop below the $329,800/$164,900 thresholds for purposes of the 20% 199A Deduction (previously mentioned). **Planning Alert!** If, within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the "wash sale" rules (although the disallowed loss will increase the basis of the acquired stock). **Tax Tip.** There is no wash sale rule for gains. Thus, if you decide to sell stock at a gain in order to take advantage of a zero capital gains rate, or to absorb capital losses, you may acquire the same securities within 30 days without impacting the recognition of the gain.

REMINDERS

Required minimum distributions (RMDs). RMDs are the minimum amount you must annually withdraw from your retirement accounts (e.g., 401(k) or IRA) if you meet certain criteria. For 2021, you must take a distribution if you are age 72 by the end of the year (or age 70½ if you reach that age before Jan. 1, 2020). You can delay receipt of the first distribution until as late as April 1st of the following year. Note that if you do this, you will have two distributions in the following year since additional distributions must be taken by December 31 of each year. Planning ahead to determine the tax consequences of RMDs is important, especially for those who are in their first year of RMDs.

IRA Distribution Strategy. When planning your IRA withdrawal, you might consider making charitable donations through a qualified charitable distribution (QCD). A QCD is a direct transfer of funds from your IRA custodian to a qualified charity and counts towards satisfying your RMD for the year. A QCD is allowed up to $100,000 per year and you need to be at least 70 1/2 to qualify. The QCD is excluded from your income which lowers your adjusted gross income (AGI) for Federal and most states. This strategy is especially beneficial to Connecticut taxpayers because itemized deductions are not allowed.

Fraudulent activity remains a significant threat. Our firm takes data security seriously and we think you should as well. Fraudsters continue to refine their techniques and tax identity theft remains a significant concern. Beware if you:

- Receive a notice or letter from the IRS regarding a tax return, tax bill or income that doesn't apply to you
- Get an unsolicited email or another form of communication asking for your bank account number, other financial details or personal information
- Receive a robocall insisting you must call back and settle your tax bill

Make sure you're taking steps to keep your personal financial information safe. Let us know if you have questions or concerns about how to go about this.

Virtual currency/cryptocurrency. Virtual currency transactions are becoming more common. There are many different types of virtual currencies, such as Bitcoin, Ethereum and non-fungible tokens (NFTs). The sale or exchange of virtual currencies, the use of such currencies to pay for goods or services, or holding such currencies as an investment, generally has tax impacts. We can help you understand those consequences.

Gift tax exclusion. For 2021, $15,000 of gifts made by a donor to each donee is excluded from the amount of the donor's taxable gifts. This exclusion will increase to $16,000 in 2022.

THE CONNECTICUT TAX AMNESTY PROGRAM

Beginning November 1, 2021 taxpayers may apply for Connecticut's three-month tax amnesty program offering penalty waiver and a 75% reduction in interest in outstanding liabilities for eligible taxpayers. The program will run through January 31, 2022. Eligible periods include tax years 2020 and prior.

Most taxpayers with known and eligible liabilities will receive an amnesty letter from the DRS. Taxpayers may still be eligible without an offer letter as taxpayers may have liabilities unknown to the DRS or may not be registered in the state.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our Firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note!** The information contained in this material should not be relied upon without an independent, professional analysis of how any of the items discussed may apply to a specific situation.

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