SACCO & ASSOCIATES

## TAX PLANNING 2021

Now that the 2020 tax season is over, it's time to start thinking about next year's return. After all, the more tax planning you do, the more money you may be able to save. But proper tax planning requires an awareness of what's new and changed from last year – and there are plenty of tax law changes and updates for the 2021 tax year that smart taxpayers need to know about. We will touch upon some of the more important changes. The recent pandemic relief bills signed into law include several provisions that could impact your 2021 return. Other 2021 tweaks are the result of new rules or annual inflation adjustments.

There are sizeable changes for the 2021 child tax credit – but, at least for now, they're only temporary. For 2020 tax returns, the credit was worth $2,000 per child 16 years old or younger. It also began to disappear as income rose above $400,000 on joint returns and above $200,000 on single and head-of-household returns. For some lower-income taxpayers, the credit was partially "refundable" (up to $1400 per qualifying child) if they had earned income of at least $2,500. (That means the IRS issued you a refund check for the refundable amount if the credit was worth more than your income tax liability.) The American Rescue Plan, which was enacted in March 2021, provides a dramatic, one-year expansion of the child tax credit for the 2021 tax year. One of the biggest changes is to the amount of the credit. For 2021, it jumps from $2,000 to $3,000 for most children - but to $3,600 for children five years old and younger. The extra amount ($1,000 or $1,600) is reduced – potentially to zero – for families with higher incomes, though. For people filing their tax return as a single person, the extra amount starts to phase out if their adjusted gross income is above $75,000. The phase-out begins at $112,500 for head of household filers and $150,000 for married couples filing a joint return. The credit amount is further reduced under the pre-existing $200,000/$400,00 phase-out rules.

Another important change is that the 2021 credit is fully refundable. The $2,500-of- earned income required is dropped for 2021 too. Children who are 17 years old also qualify for the 2021 credit. Last but not least, half of the 2021 credit amount will be paid in advance through monthly payments starting on July 15th. You claim the other half of the credit on your 2021 tax return. You'll also have to reconcile the monthly payments that you received from the IRS in 2021 with the child tax credit that you are entitled to claim when you filed your tax return. If the credit amount exceeds the total monthly payments, you can claim the excess credit on your return. But if the credit amount is less than the payments, you may or may not have to pay the excess back. Although these enhancements only apply for the 2021 tax year, President Biden wants to extend most of them through 2025 and make the credit fully refundable on a permanent basis.

Americans were thrilled to learn that the American Rescue Plan Act authorized a third round of stimulus checks. Those checks were for $1,400 plus an additional $1,400 for each dependent in your family. However, some people didn't receive that much (or anything) because the payments were phased out for joint filers with adjusted gross incomes (AGI) above $150,000, head-of-household filers with an AGI above $112,500 and single filers with an AGI above $75,000. In fact, third-round stimulus checks were reduced to zero if your AGI was above $160,000 (joint filers), $120,0000 (head-of household), or $80,000 (singles). Unfortunately, some people who were eligible for a third-round stimulus check didn't receive a payment or got less than what they should have received. For those people, relief may be available in the form of a 2021 tax credit known as the recovery rebate credit. Technically, your third stimulus check was an advance payment of the credit. So, when you file your 2021 return, you'll have to reconcile the third stimulus check you received (if any) with the recovery rebate credit you're entitled to claim. For most people, your third stimulus check payment will equal the tax credit allowed. In that case, your credit will be reduced to 0. However, if your third stimulus check was less than your credit amount, the tax you owe will be reduced by the difference (and you might even receive a refund). And if your third- round stimulus check was more than your credit amount; you won't have to repay the difference to the IRS.

Required minimum distributions (RMDs) are back for 2021. Seniors were allowed to skip their RMD's in 2020 without having to pay a penalty. But the RMD suspension only applied for one year. So, anyone who is at least 72 years old by the end of the year is required to take an RMD for 2021.

Many key dollar limits on retirement plans and IRA's remain the same for 2021. For example, the maximum contribution limits for 401(k), 403(b) and 457 plans stay at $19,500, while people born before 1972 can once again put in $6500 more as a "catch-up" contribution. The 2021 cap on contributions to SIMPLE IRA's also stays the same at $13,500, plus an extra $3000 for people age 50 and up. The 2021 contribution limit for traditional IRA's and Roth IRA's also stay steady at $6000, plus $1000 as an additional catch-up contribution for individuals age 50 and up. However, the income ceilings on Roth IRA contributions went up. Contributions phased out in 2021 at adjusted gross incomes (AGI) of $198,000 to $208,000 for couples and $125,000 to $140,000 for singles (up from $196,000 to $206,000 and $124,000 to $139,000, respectively, for 2020).

For 2020 tax year, a new "above-the-line" deduction was allowed for up to $300 of charitable cash contributions. Only people who claimed the standard deduction on their tax return (rather than claiming itemized deductions on Schedule A) could take this deduction. The write off was originally scheduled to expire after 2020, but it was later extended to 2021 with one important enhancement. For 2020, one deduction was allowed per return, meaning married couples who filed jointly could only deduct $300, not $600. However, for 2021, one deduction is allowed per person, which means married couples can deduct up to $600 on a joint 2020 tax return.

There's a group of tax breaks that are constantly scheduled to expire, but that keep getting extended by Congress for another year or two. These tax breaks are collectively referred to as "tax extenders". Several of the "tax extender" deductions and credits were set to expire after 2020 but guess what happened. Yep, Congress kicked the can down the road once again and renewed many of them on a temporary basis. Most of the extended tax breaks are for businesses, but several of them impact individual taxpayers. Tax breaks for individuals that were extended until the end of 2021 include the following:

- Mortgage insurance premiums deduction
- Nonbusiness energy property credit for certain energy-saving improvements to your home (i.e., new energy-efficient windows and skylights, exterior doors, roofs, insulation, heating and air conditioning systems, water heaters, etc.)
- Fuel cell motor vehicle credit
- Alternative fuel vehicle refueling property credit
- Two-wheeled plug-in electric vehicle credit.

The exclusion for forgiven mortgage debt was also renewed through 2025 (although the maximum amount that can be excluded is reduced from $2 million to $750,000).

In addition, the 26% rate for the residential energy efficient property credit was extended through 2022 (the credit applies to the cost of solar electric property, solar water heaters, geothermal heat pumps, small wind turbines, fuel cell property, and qualified biomass fuel property). The rate was previously scheduled to drop to 22% in 2021, but now it won't be reduced until 2023. The credit is then set to expire after 2023. As always if you have a question about this topic or any other tax matter, please do not hesitate to contact us.