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2021 TAX UPDATE

INTRODUCTION

There are many new tax laws that are enacted each year. Today, we will discuss some of the most current changes that are likely to impact the most seniors.

ECONOMIC IMPACT PAYMENTS (EIP)

The American Rescue Plan Act (ARPA), passed in March, 2021 created a third round of economic impact payments (EIPs). The payments were automatically sent out to taxpayers.

Payment amounts

The payments are equal to $1,400 per eligible individual ($2,400 for MFJ) plus $1,400 per dependent (as defined under IRC §152). (IRC §6428B(a))

The amount of the 2021 EIP (the economic impact payment authorized under the ARPA) is phased out for taxpayers with income above the phaseout thresholds listed here (IRC §6428B(d)):

2021 Economic Impact Payment AGI and Phaseout Levels		
Filing status	**Phaseout begins at …**	**Credit phased out at …**
Married filing joint	$150,000	$160,000
Head of household	$112,500	$120,000
Single and married filing separate	$75,000	$80,000

How initial payments were determined

Initial payments were based on a taxpayer's 2019 AGI unless the taxpayer's 2020 tax return was already processed by the IRS. If the IRS based the payment on a taxpayer's 2019 AGI, and the taxpayer subsequently filed a 2020 return showing a lower AGI amount, the IRS automatically remitted an additional payment to the taxpayer based on the 2020 return, but only if the 2020 return was filed by August 15, 2021.

Any additional stimulus for which the taxpayer is entitled must be claimed as a Recovery Rebate Credit on their 2021 income tax return.

Social Security numbers required

EIPs are only available to taxpayers with Social Security numbers. (IRC §6428B(e)(2))

Deceased taxpayers

Any individual who died before January 1, 2021, is treated as if they did not have a valid Social Security number on the tax return for such taxable year. (IRC §6428B(g)(2)(B))

Ineligible individuals

The following individuals are ineligible for the 2021 Recovery Rebate Credit:

- Nonresident aliens;
- Any individual who is a dependent of another taxpayer (the taxpayer claiming the dependent will receive a credit, the dependent will not receive their own credit); and
- Estates or trusts.

(IRC §6428B(c))

No repayment requirement

If a taxpayer received too much of an EIP relative to their 2021 AGI, there is no repayment requirement.

Lost or stolen EIP payments

The IRS released an FAQ advising taxpayers who were issued economic impact payments by check but who believe the payment was lost, stolen, or destroyed. According to the IRS FAQs, a taxpayer who was issued an EIP by check and believe the check was lost, stolen, or destroyed will not be issued a replacement check. Instead, the taxpayer must request a payment trace for the check from the IRS to determine if the check was cashed and if it was cashed, who signed the check.

If the IRS determines the EIP check wasn't cashed (or was cashed but the taxpayer did not sign the check), they will credit the taxpayer's account for the amount of the EIP, and the taxpayer can claim the Recovery Rebate Credit on their 2021 tax return.

Consult the following IRS webpage for the latest information regarding lost or stolen EIPs:

Website

https://www.irs.gov/newsroom/questions-and-answers-about-the-third-economic-impact-payment-topic-j-payment-issued-but-lost-stolen-destroyed-or-not-received

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DEDUCTIONS

In 2018, the standard deduction was nearly doubled and has been adjusted for inflation each year. Because of the higher standard deduction, most taxpayers no longer itemize their deductions. This means that most medical expenses, state and local income taxes, mortgage interest on personal-use property, and charitable contributions are no longer deductible for most taxpayers.

Standard deduction

To provide some context, the standard deduction is currently:

Standard Deductions (IRC §63)			
Filing status	**2020 (Rev. Proc. 2019-44)**	**2021 (Rev. Proc. 2020-45)**	**2022 (Not released yet)**
Married filing joint and qualifying widow(er)	$24,800	$25,100	Not released yet
Head of household	$18,650	$18,800	Not released yet
Single	$12,400	$12,550	Not released yet
Married filing separate	$12,400	$12,550	Not released yet

Additional Standard Deductions for Elderly and Blind			
Filing status	**2020**	**2021**	**2022**
Unmarried			
Elderly or blind	$1,650	$1,700	Not released yet
Elderly and blind	$3,300	$3,400	Not released yet
Married			
Elderly or blind (per taxpayer)	$1,300	$1,350	Not released yet
Elderly and blind (per taxpayer)	$2,600	$2,700	Not released yet

Charitable contributions

As part of the CARES Act coronavirus legislation passed in March, 2020, taxpayers are permitted to deduct a small amount of cash charitable contributions even if they utilize the standard deduction.

For 2020, the charitable contribution deduction limit for taxpayers who utilized the standard deduction was limited to $300. For 2021, this amount is increased to $600 for taxpayers who file married filing jointly and remains at $300 for single filers.

IRA-to-charity strategy

Due to the fact that most taxpayers no longer itemize their deductions, taxpayers over the age of 70 ½ have a unique opportunity to deduct larger charitable contributions even if they utilize the standard deduction.

Under the IRA-to-charity rules, taxpayers can make charitable contributions directly from their IRA account. In order to take advantage of this strategy, the charitable contributions must be sent from the IRA directly to the charity – the taxpayer cannot take a distribution from their IRA and then make the charitable contribution. The key benefits of this strategy include:

- The charitable contribution counts toward the taxpayer's required minimum distribution; and
- The charitable contribution is made pre-tax, so the taxpayer does not pay tax on this money coming out of his or her IRA.

There are a couple items to keep in mind here:

- The maximum contribution limit is $100,000 per year under the IRA-to-charity strategy;
- There are limitations that come into play if the taxpayer makes IRA contributions after age 70 ½;
- Contributions can come from any IRA account, including a Roth IRA, but there are no tax benefits to using a Roth IRA because distributions from a Roth IRA are already tax free;
- While taxpayers are not required to take distributions from their traditional IRAs until they reach age 72, the IRA-to-charity rules are still tied to the old required minimum distribution age of 70 ½.

RETIREMENT ISSUES

No more age limitation to make IRA contributions

Beginning in 2020, taxpayers can make IRA contributions at any age. (SECURE Act §107; repealing IRC §2019(d)(1)) However, contributions are still limited to the lesser of the taxpayer's earned income or the contribution limits ($6,000 in 2021, plus $1,000 catch-up for taxpayers age 50 and over).

A taxpayer who files a joint return can contribute to an IRA even if they don't have earned income as long as their spouse has sufficient earned income. (IRC §219(c)(2)) The total combined contributions of both spouses can't be more than the total earned income reported on the return.

Example of spousal IRA contribution

Jason is 75 years old and retired. His wife Amber is 68 years old and still working. Amber has earned income of $110,000. Their adjusted gross income is $140,000. They can contribute up to a total of $14,000 ($7,000 each for Amber and Jason) to a traditional IRA using only Amber's earned income.

Required minimum distributions

Taxpayers must begin taking required minimum distributions (RMDs) in the year they turn age 72. (SECURE Act §114; IRC §401(a)(9))

Taxpayers who turn age 72 during the year can put off their first RMD until April 1 of the year after they turn age 72. Taxpayers who put off their first RMD must take two RMDs in the second year (one for the year they turned age 72 and one for the following year).

Stretching out IRA funds into later retirement years

Qualified longevity annuity contracts (QLACs) are investment vehicles that allow taxpayers to remove assets from their IRAs and hold them until later retirement years. (Treas. Regs. §1.401(a)(9)6, A17(b)(2)(i))

The cornerstone of the QLAC is the removal of RMD requirements for assets place in a QLAC. They make it easier for retirees to address the risk of outliving their assets by using a limited portion of their retirement savings to purchase a policy in a retirement plan that will provide guaranteed income for life starting at an advanced age. The regulations modify the RMD rules by excluding the value of the QLAC from the total figure used to determine RMD. The regulations require that distributions commence not later than age 85 (although the contract may specify an earlier age).

Maximum QLAC investment

The premiums paid for all QLAC contracts for the benefit of any individual cannot exceed the lesser of:

- $130,000; or
- 25% of the balance of all eligible accounts held by the individual.

Eligible accounts

QLACs may be purchased under:

- Defined contribution plans (such as 401(k) accounts);
- Traditional IRAs;
- IRC §403(b) plans; and
- Governmental IRC §457(b) plans.

PROPERTY TRANSFERS – CALIFORNIA PROPOSITION 19

Proposition 19 was passed by California voters in November, 2020 and changes California's property tax law as it relates to two types of property transfers:

- Parent-child transfers; and
- Base-year transfers.

Parent-child transfers

Under Proposition 19, for transfers on or after February 16, 2021:

- In order to qualify for the principal residence exclusion, the receiving child must use the residence as their own principal residence, and only the first $1 million of additional assessed value is excluded (Proposition 19 §2.1(c)(1)); and
- The non-principal residence exclusion has been completely eliminated. However, the principal residence exclusion will apply to transfers of family farms.

For transfers of property before February 16, 2021, a transfer of ownership in California real estate generally resulted in a reassessment for property tax purposes with certain exceptions, including two exclusions from reassessment that applied for transfers between parents and children:

- The principal residence exclusion allowed the transfer of a principal residence of unlimited value between parents and children; and
- The $1 million lifetime non-principal residence exclusion allowed the transfer between parents and children of up to $1 million of assessed value of all other types of property (for example, second homes or rental properties). For a married couple, this would be a combined $2 million lifetime exclusion.

Base-year transfers

For transfers on or after April 1, 2021, Proposition 19 also allows taxpayers who are over age 55, severely disabled, or a victim of a disaster to transfer their property tax adjusted base-year value to a replacement property anywhere in the state (previously this benefit was limited to only a few counties). (Proposition 19 §2.1(b))

Allowing homeowners to transfer their base-year home values preserves the taxpayer's Proposition 13 tax base, which can equate to significant property tax savings for homes that have been owned for a long period of time.

Taxpayers who are over age 55 or disabled can transfer the base-year value of the relinquished property up to three times.

In addition, these taxpayers are no longer limited to replacement properties of equal or lesser value. If they purchase a replacement property with a higher FMV than their original property, the assessed value of the replacement property would be equal to the assessed value of the original property, plus the difference in FMV between the original property and the FMV of the replacement property.

TAX LAW CHANGES ON THE HORIZON

President Biden's tax proposals, none of have made any significant legislative progress yet, would alter the federal tax landscape in some significant ways. Here, we'll discuss some of the key items to watch.

Increased income tax rates

President Biden proposes to increase the top individual income tax rate from 37% to 39.6%. At this time, it appears a rate increase is only proposed for the top individual income tax bracket.

However, the top income bracket threshold would apply at lower income levels, as follows:

Comparison of President Biden's Tax Proposal and Current Law		
Top income tax bracket threshold	**Biden's proposal**	**Current law (2021)**
Married filing joint	$509,300	$628,300
Single	$452,700	$523,600
Head of household	$481,000	$523,600
Married filing separate	$254,650	$314,150
Note: These amounts would be adjusted for inflation after 2022		

Capital gains rates

President Biden proposes to tax long-term capital gains and qualified dividends at ordinary income rates for taxpayers with adjusted gross income over $1 million, with 37% being the highest rate (40.8% when factoring in the 3.8% net investment income tax rate).

Estate and gift transfers

Under the proposal, the donor or deceased owner of an appreciated asset would realize capital gain at the time of transfer. For the donor, the amount of the gain realized would be the excess of the asset's fair market value on the date of the gift over the donor's basis in that asset. For a decedent, the amount of gain would be the excess of the asset's fair market value on the decedent's date of death over the decedent's basis in that asset.

The proposal contains numerous exclusions and technical rules applicable to estate and gift transfers. For most taxpayers, this proposal would be the end of the basis-step up rules on death, which are hugely beneficial for all taxpayers seeking to preserve wealth for their heirs.

Like-kind exchanges

The proposal would allow the deferral of gains on like-kind exchanges up to an aggregate amount of $500,000 for each taxpayer ($1 million for married taxpayers filing jointly) annually. Any gains from like-kind exchanges in excess of $500,000 ($1 million for married taxpayers filing jointly) would be recognized by the taxpayer in the year the taxpayer transfers the relinquished property.

This provision would be effective for like-kind exchanges completed in taxable years beginning after December 31, 2021.

Like-kind exchanges are immensely popular real estate transactions that allow taxpayers to change their investment from one property to another, often a larger investment property, by deferring the tax liability on the exchange. Heavily limiting these rules would have a profound effect on the real estate market.

Repeal of state and local tax limitation?

Neither a partial nor full repeal of the $10,000 state and local tax (SALT) deduction limitation is contained within President Biden's proposals. However, a growing number of House Democrats have expressed that they will only support a tax bill if it contains a full repeal of the SALT cap. It seems that a tax bill will have difficulty passing in the House without these Congressional representatives.

For now, we'll have to wait and see whether a repeal of the SALT cap will make its way into a tax bill once introduced.

Increased corporate tax rates

President Biden has proposed an increase to the corporate tax rate from 21% to 28% for taxable years beginning after December 31, 2021. A couple key Senate Democrats have indicated an unwillingness to vote a corporate tax increase to 28%, so a lower compromise may be necessary.

While the corporate tax rate only applies to C corporations, which is not nearly as common for small businesses as the S corporation or LLC structure, the vast majority publicly traded companies are C corporations. A tax rate increase for these businesses will have a negative effect on the value of publicly traded stock, where most of us have our retirement savings invested.

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