TAX NEWS

SPRING 2021

Dear Client:

We appreciate your business during this tax filing season. It has been a challenging time with the new legislation and changes to tax provisions in place as a result of the coronavirus. The staffing at the IRS campuses has been limited which has created long wait times for calls to the Service; responses to correspondence; and the review of certain tax returns which has resulted in an extended wait for refunds.

In this issue we touch on the provisions of the American Rescue Plan and the temporary tax benefits for individuals. We know that waiting for refunds or responses to correspondence can be challenging at best and frustrating at any time, and we are sharing some information from the National Taxpayer Advocate on the status of the IRS in handling the backlog.

For those with a business, the regulations for the business meal expense has temporarily changes for 2021 and 2022. We have provided a simple chart to help guide you on the deductibility of business meal expenses.

Information is provided if you have business or investment property that you are planning on selling and possibly setting up a Section 1031 tax-deferred exchange. And finally, we look at the benefits of retirement planning and why it is important at any age.

We look forward to working with you throughout the year on your tax planning needs. Our office is open throughout the year to assist you and your business.

AMERICAN RESCUE PLAN ACT OF 2021

The following is a brief summary of key provisions included in the American Rescue Plan Act of 2021, signed into law March 11, 2021, which affect the individual taxpayer.

Unemployment Benefit Exclusion for 2020: Effective for 2020 only, the first $10,200 of unemployment compensation, per person, is excluded from taxable income if modified adjusted gross income is $150,000 or less.

Premium Tax Credit: Effective for 2020 only, any advance payment that exceeds the Premium Tax Credit allowed is disregarded and does not increase tax liability on the return. This suspension applies to all taxpayers regardless of income level as a percentage of the federal poverty level.

Recovery Rebate and Round 3 Stimulus Payment: Eligible individuals may qualify for a 2021 rebate amount of up to $1,400 per taxpayer ($2,800 MFJ), plus $1,400 per dependent. This stimulus payment for dependents is not limited to dependents who are under age 17. The payment starts to phase out when AGI exceeds $75,000 (Single, MFS), $150,000 (MFJ, QW), and $112,500 (HOH) and is fully phased out at $80,000 (Single, MFS), $160,000 (MFJ, QW), and $120,000 (HOH).

Unemployment Benefits Extended: The enhanced $300 per week of Pandemic Unemployment Assistance and Pandemic Emergency Unemployment Compensation is extended to September 6, 2021 (subject to state conformity).

Child Tax Credit: Effective for 2021 only, the Child Tax Credit (CTC):

- Is increased to $3,000 per qualifying child,
- Is $3,600 in the case of a qualifying child age five or younger as of December 31, 2021,
- Age limitation is increased from age 16 to age 17, and
- Is fully refundable.

The increased CTC (over the $2,000 prior amount) phases out when modified AGI exceeds $75,000 (Single, MFS), $150,000 (MFJ, QW), and $112,500 (HOH).Once the increased CTC is phased-out, the $2,000 per qualifying child still applies until modified AGI reaches the previous thresholds.

Advance Payment of the Child Tax Credit: The IRS is instructed to establish a program for making periodic payments to taxpayers for the advance payment of the Child Tax Credit. The advance amount will be estimated by the IRS. The IRS will establish an on-line portal which allows taxpayers to elect not to receive advance payments, or to update relevant information to calculate the advance payment. These payments are scheduled to start July 15, 2021 and will continue through December 31, 2021.

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Roth vs Traditional IRA:

When making the decision of how to invest your retirement funds, you should consider several factors. Say, for example, that your tax rate is 32% and you plan to invest $5,000 in an IRA which is earning 6% interest. And, further, neither you or your spouse has a qualified plan through work so the full amount would be deductible. Do you take advantage of the current year reduction in taxable income or plan for the tax-free distribution of earnings at retirement?

TRADITIONAL IRA:

- If you invest in the traditional IRA, you will have tax deferred income of $5,000 at 32% or $1,600. This would be taxable income when there is a distribution from the IRA.
- Your tax bracket is key – do you have a crystal ball on where your income will fall at retirement? Both the original investment and earnings will be fully taxable as ordinary income when distributed.
- The ideal situation is to be in a high tax bracket at the time the funds are contributed and a low tax rate when distributions are taken.
- The traditional IRA has a required minimum distribution at age 72 (under current tax law).
- Do you have other retirement funds that also have a required minimum distribution (RMD) such as a 401(k)? Required distributions from several qualified plans or IRAs could place you in a higher income bracket which may subject you to the Net Investment Income Tax (NIIT) or your social security benefits may be taxable.
- Traditional IRAs allow for the qualified charitable distribution – funds donated directly from your IRA to a qualified charity would satisfy the RMD and bypass your individual income tax return.

ROTH IRA:

- Contributions to a Roth are not deductible, so taxes are paid at your current tax rate.
- When the Roth funds are distributed, your tax rate is immaterial as the principal has already been taxed, and the earnings are tax-free.
- You would need to satisfy a five-year waiting period to receive the funds penalty free.
- The length of time that you keep the investment favors the Roth IRA with the tax free growth of the earnings.
- There is no required minimum distribution (RMD) of the Roth. The amount of any distributions is discretionary and can remain in there to pass onto your heirs.

While an immediate tax deduction may seem like a good idea, planning for retirement and weighing the different options is important. However, the most important factor is to have a retirement savings plan.

The following data comes per the Federal Reserve's Survey of Consumer Finances. (numbers rounded to the nearest hundred.)

Average retirement account for those who have one:

- Under age 35: Average retirement account: $32,500
Median retirement account: $12,300
- Age 35 - 44: Average retirement account: $100,000
Median retirement account: $37,000
- Age 45 - 55: Average retirement account: $215,800
Median retirement account: $82,600
- Age 55 - 64: Average retirement account: $374,000
Median retirement account: $120,000
- Age 65 - 74: Average retirement account: $358,000
Median retirement account: $126,000

For households older than 65 years, retirement accounts begin to decline as these individuals leave the workforce and begin spending their savings.

Contact the office to discuss your options for saving for retirement. Social security will not be enough to secure a comfortable retirement and will require additional action on your part to enhance your retirement income. ■

AMERICAN RESCUE PLAN ACT OF 2021 ... CONTINUED FROM PAGE 1

Earned Income Credit: Effective for 2021 only, the Earned Income Credit for individuals without a qualifying child is expanded. The investment income limitation for 2021 is increased from $3,650 to $10,000 and indexed for inflation in future years. Effective for 2021 only, if earned income for 2021 is less than 2019 earned income, the taxpayer may elect to used 2019 earned in-come when calculating the 2021 EIC.

Dependent Care Expense Credit: Effective for 2021 only, the Child and Dependent Care Expense Credit is refundable. The dollar limitation on expenses paid for a qualifying person is increased from $3,000 to $8,000 for one qualifying person and from $6,000 to $16,000 for two or more qualifying persons. The maximum percentage of 35% is increased to 50% for AGI up to $125,000 with the credit percentage phasing out and reduced to zero when AGI reaches $438,000.

Dependent Care Assistance Program: Effective for 2021 only, the $5,000 maximum exclusion in increased to $10,500 ($5,250 MFS).

Student Loan Forgiveness Exclusion: For tax years 2021 through 2025, any discharge of student loan debt for any reason, including private student loans, may be excluded from taxable income, as long as there is no provision for the student to provide services to the discharging lender.

Contact our office to discuss your eligibility for these benefits as a result of the new legislation.

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ARE YOU WAITING FOR A REFUND?

According to data from the National Taxpayer Advocate, only about two of every 100 phone calls to (800) 829-1040 are getting through. Even then, the IRS staff person often will not be able to answer the question, especially if it is about a refund. So calling the IRS is likely to be a waste of effort.

There is a key exception to this advice for taxpayers who get a notice from the IRS asserting taxes due or requesting specific information. These letters usually give a number to call that is different from the main 800 number, and the chances of getting through are far higher—especially for calls made early or late in the day and not on Monday, according to an IRS spokesman. However, in all likelihood they also will not be able to tell you the status of your current year refund.

Recently the IRS was still processing about one million individual returns filed last year, many of them on paper. These have to be keyed in by individuals, and the IRS is moving returns to different offices to get through the backlog.

The agency is also holding about 16 million individual returns filed in 2021—and refunds due on them. It must review each one to make sure filers correctly claimed recovery rebate credits if they got (or did not get) stimulus payments. It must also double-check child tax credits and earned-income tax credits for 2020.

The IRS will also begin issuing refunds to filers eligible for an exemption of up to $10,200 per recipient of 2020 unemployment pay that Congress enacted in March after many people had already filed returns. According to a spokesman, the process will begin with simpler returns before proceeding to more complex ones, such as for married couples. It is expected to take several months to complete.

For its part, the IRS has had to do more with less, including 15% fewer employees in 2020 than in 2010. Since the beginning of the pandemic, the agency has had to delay two annual filing deadlines; coordinate a total of 470 million stimulus payments to individuals, many of whom were not in its system; and apply tax-law changes for 2020 that Congress enacted in March 2021, after millions of filers had already submitted returns. That is in addition to common staffing and logistical challenges faced by many large organizations since the start of last year.

So what does all this mean for taxpayers waiting for a refund? The IRS is requesting patience on the part of the taxpayer. "This has been a challenging year," IRS Commissioner Chuck Rettig said in testimony before Congress in April. "We greatly appreciate the patience and understanding of others." He noted that the IRS's call volume has more than doubled, to more than 1,500 calls **per second** at times.

We will do what we can to verify the status of your return, however, once the return has been accepted by the IRS all we can do is wait for processing. If your return contains any of the items noted in this article, it must go to the desk of a live person for review and then released for continued processing. As the IRS staff is still on mandatory stay-at-home rules, the number of IRS staff people allowed in the offices is limited which has slowed down all processes.

Business Deductions Update:

For tax years 2021 and 2022, business meals purchased from or consumed in a restaurant have a temporary deduction of 100% (the regulations call for a 50% deduction for business meals). The following chart provides a snapshot of allowable business deductions:

DESCRIPTION	100%	50%	ZERO
Restaurant meals with clients and prospects	X		
Entertainment such as baseball/football games with clients			X
Employee meals for convenience of employer, in-house cafeteria		X	
Employee meals for business meeting, in a restaurant	X		
Meals served at chamber of commerce meeting in hotel	X		
Meals consumed in a restaurant during business travel	X		
Meals cooked in a hotel room kitchen during business travel		X	
Year-end party for employees and spouses	X		
Golf outing for employees and spouses	X		
Year-end party for clients/customers			X
Meals made on premises for general public at marketing event	X		
Team-building recreational event for employees	X		
Golf, theatre, or sports event with your best customer			X
Meal with prospective client/customer at the country club	X		

Contact our office for assistance in correctly tracking your business meal expenses to facilitate the preparation of the 2021 return.

LIKE-KIND EXCHANGE OF PROPERTY:

Tax-deferred Section 1031 transaction rules

With a properly constructed Section 1031 transaction, you sell your old property, buy the replacement property, and pay no taxes. The IRS Code Section 1.1031 states that no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a like kind to be held either for productive use in a trade or business or for investment.

The Tax Cuts and Job Acts (TCJA) restricted the type of asset which qualifies for the Section 1031 tax-deferred exchanged to real property only. Real property is defined by the state or local law where the property is located and can include:

1. Land used in business or held for investment purposes
2. Buildings held in a business or for investment purposes such as rental houses, apartments, hotels, motels, shopping centers, office buildings, factories, etc.
3. Other inherently permanent structures such as in-ground swimming pools, fences, parking areas, roads, bridges, tunnels, etc.
4. Structural components such as walls, partitions, doors, central air conditioning and heating, etc.

Note: under IRS regulations a movable mobile home not attached to land is not eligible for Section 1031 purposes. However, mobile homes located in either Rhode Island or New Hampshire would be eligible as these states classify all mobile homes as real property. It is critical to determine the definition of real property under your state or local laws.

To make this work, your first step is to engage a Section 1031 intermediary. The Section 1031 exchange rules are complex and include strict deadlines for identifying and acquiring the property involved. To do this right, you must retain the services of a qualified intermediary, which can be a bank, a lawyer, or a Section 1031 company. IRS laws explicitly state that you are not allowed to use your own attorney, employee, accountant, real estate agent, or a relative as the qualified intermediary.

Second, you need to buy a replacement property of equal or greater value than the property you sell. Under section 1031(a)(3), unchanged by the TCJA, real property a taxpayer receives in an exchange is not of like-kind to the relinquished property unless, within 45 days after the taxpayer's transfer of the relinquished real property, the real property is identified as replacement real property to be received in the exchange.

The third step of the Section 1031 exchange process is to complete the purchase of the replacement process including payment and retitling of the property. The facilitator will hold the cash from the sale of the first property and send it to the seller of the replacement property. The seller cannot have had constructive receipt of the funds at any time during the process.

Personal Residences Do Not Count as Section 1031 Exchange Properties

You cannot sell your personal residence and use part of the money to buy a rental. A general rule of thumb is that you cannot use a 1031 exchange if you lived in it for at least two of the past five years. Vacation homes and second homes typically do not count, either. Paragraph 280 of section 1031 outlines the usage test that can be used to determine if a vacation home you rent out periodically can be included among 1031 Exchange properties.

Conclusion

The rules are specific and are not negotiable: purchase another property of equal or greater value; it must be like-kind property; and the transaction must be completed within the specified time frames. The use of a qualified intermediary is required in order to be eligible for the tax benefits. If used properly, the Section 1031 tax-deferred exchange can provide substantial savings on the gain from investment property.

If you feel you would benefit from the valuable tax provision, contact an authorized intermediary before starting the process to assure compliance with all of the IRS regulations. ■

1031 EXCHANGE RULES:

LIKE-KIND PROPERTIES	THREE-PROPERTY RULE	200% RULE	45-DAY TIME LIMIT	180 DAY DEADLINE
1031 exchanges must be done with like-kind properties. The rules for like-kind properties have evolved over the years. In 1984, the definition of like-kind property was dramatically expanded. You now have the option to sell a rental house and buy a small apartment building. Prior to the rule change you did not have to trade a house for a house, but a three-story apartment building for another three-story apartment building.	You can identify up to three potential properties to buy as long as you close on one of them. The federal regulations limits the rollover process to up to three properties.	You can identify any number of replacement properties long as their eventual combined fair market value is not more than 200% of the relinquished property. For example, if you sell a property for $500,000 then the combined market value of the purchase should not be more than twice that or $1 million.	There is a strict 45-day time limit. You must either close on or identify and report on the potential replacement property within 45 days of selling the original property. This time limit includes weekends and holidays.	Once the replacement property is selected, the investor has 180 days from the date of the original property was sold to close on the replacement property.