PAUL H. BURGESS, ATTORNEY/CPA - "YIELDING A BETTER RESULT"
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(918) 901-9000 (starting December 2021) – Our November 2021Newsletter

Year-End Tax & Financial Strategies from "The Power of the Dual View"

This ***Tax & Financial Newsletter*** has four sections. The first Section is the *Martin* case. Martin is an example why in some cases, keep your tax records longer than the typical four to six years. In the subsequent sections are the classic year-end tax strategies, plus some new ones to reflect the always evolving tax and financial environment. Speaking of evolving, this November we are in the process of moving our offices. Our January Newsletter will follow up on the relocation, while also providing *Tax Tips!* on organizing records to help keep taxes lower and preparation costs down.

I. IMPORTANCE OF KEEPING TAX RECORDS

In *Martin v. Commissioner (2021)*, the IRS denied Mr. Martin's deductions that carried forward from previous years. The Court ruled for the IRS citing three tax rules: (1) Each tax year stands on its own, with each year being the origin of a new liability; (2) Even if the same issue was settled with the IRS in a previous year, unless the matter went to court with a judge ruling on it, the prior year settlement does not control the current year; and (3) It is well settled law that if the IRS fails to challenge a deduction during an audit of a prior year, that same deduction can be challenged in a subsequent year. Mr. Martin lost his carryover deductions because he failed to save his old tax returns and the evidence related to them. The carryover deductions are typically: (a) Real Property Depreciation, (b) Net Operating Losses (NOL), and (c) Capital Loss Carryforwards. Thus, keeping the following is important: (i) what you paid for your real property, the costs of improvements, and when purchased; (ii) the tax returns that establish or claim NOLs, and records establishing the loss; and (iii) the tax returns that have capital loss carryforwards, and the documentation proving the loss. The next sections are year-end *Tax Tips!*

II. BUSINESS TAX TIPS

✓ **My Opinion on Business Tax and Capital Gain Increases for 2022.** We follow the Dailey Tax Report, including what tax legislation is being considered, who is supporting it, and the political optics and messaging. As of this writing, I am not convinced there will be business or capital gain tax increases in 2022; and if there are, I believe the increases will apply to the very wealthiest. But no matter what, consider trimming your taxes with the "low hanging fruit" suggestions in this Newsletter.

✓ **Oklahoma Pass-Through Entity (PTE) Election:** If for 2021 your PTE (S corporations and LLC partnerships) did not elect to deduct its Oklahoma income taxes at the business level, *consider* it for 2022. The election is due March 15, 2022, and in the right circumstances it can essentially convert non-deductible state income taxes into a deduction. For every $100,000 of income, this deduction can save about $1,250 or so.

✓ **Qualify for Oklahoma PTE Election:** Yield a better tax result by converting certain sole-proprietorships or rental operations to a flow through such as a partnership or S-corporation. For example, consider adding a spouse as a partner of a sole-proprietorship to create a PTE, or S-elect a single member LLC.

✓ **Maximize the Oklahoma PTE Election:** If your cash basis business has elected to pay its Oklahoma income taxes, calculate its 2021 estimated taxable income, and pay the taxes in December 2021 even if they are not due until January or April 2022.

✓ **Business Vehicles:** December vehicle purchases will reduce taxable income. The maximum first year automobile depreciation for 2021 is $18,200. The larger SUVs and Trucks enjoy up to a 100% first year deduction! We routinely "google" our clients' vehicles to determine if it qualifies for the 100% write-off.

✓ **Mileage Deduction v. Depreciation.** Often it is better for a business to use the Mileage Per Diem Method of $.56 (2021 rate) per mile instead of using actual expenses plus depreciation. Generally lower priced vehicles with significant business miles yield a better tax result using the Mileage Deduction.

✓ **Employee Office Rents or Accountable Plan?** Employees are working from home and the trend appears it may continue. Paying rent to an employee for the business use of their home, although possible, has a few tax hurdles. A good alternative is for the employee to submit a reimbursement report for the allocable portion of the home operating expenses. Depending on the circumstances the allocable portion (square feet of office divided by square feet of the abode) is around $1,500 to $5,000 annually and the cash for the employee is payroll and income tax-free.

✓ **Bonus Depreciation Percentages:** For 2021 and 2022, Bonus Depreciation is 100% of the cost of the asset; starting in 2023 Bonus Depreciation is scheduled to be 80%. Thus, consider year-end business asset purchases to reduce your taxes.

✓ **Restaurant Meals**: Food and Beverages are 100% deductible for 2021 and 2022 if purchased from a restaurant. Perhaps schedule the business holiday party at a local restaurant?

✓ **Tax Basis:** IRS is requiring more verification for tax basis. Make sure you have tax basis in your partnerships and S corporations to deduct any losses. Increasing your tax basis can be accomplished by several methods including loans, and capital investments.

✓ **Active Participation:** Step up your level of participation in partnerships, S corporations, or LLCs to qualify as an "active participant" for flow-through entities reporting losses.

✓ **Specified Service Businesses (SSB):** For doctors, lawyers, accountants, consultants, etc., maximize contributions to traditional IRAs, §401(k)s, and others pension plans to help qualify for the 20% business income deduction that can be and is limited for SSBs.

✓ **Payment by Check:** Cash basis businesses can date checks before the end of the year and mail them right before January 1, 2022 to obtain a 2021 deduction.

✓ **Pension Plans:** Set up pension plans before year-end and fund those plans later. In many cases if a plan is "set up" by December 31, you can contribute to the plan as late as October 15, 2022 for a 2021 tax deduction. A small employer can claim up to a $500 credit for administration costs for pension plans.

✓ **Pre-Paid Expenses & the 12 Month Rule:** A cash basis business can typically deduct any amounts paid for a right or benefit that does not extend beyond 12 months after the date of the payment. Thus, a business can pre-pay expenses in December 2021 that are for 2022. For example, pre-paying rent, health insurance, etc. can yield sizable deductions.

✓ **Leasing Vehicles & the 12 Month Rule:** This one I used myself. In December make a one-time lump sum payment on a 36-month auto lease and deduct one-third of it in December under the 12-month rule.

III. INDIVIDUAL TAX TIPS

✓ **December W-2 Withholdings:** Avoid underpayment of estimated tax payment penalties by increasing your withholdings from your November and December paychecks.

✓ **Employer Flexible Spending Accounts (FSAs).** Increase the amount you set aside in your Health FSA account if you have set aside too little for 2021. The 2021 maximum is $2,750 (same in 2022). In addition health FSA's allow participants to carry over unused benefits 2020 to 2021 and from 2021 to 2022. This is a Covid-19 temporary rule and hopefully made permanent. Burdening taxpayers with "using up" their plan savings prior to year-end or losing it, seems obtuse.

✓ **Health Saving Accounts (HSAs).** If you become eligible in December 2021 to make HSA contributions, you can contribute a full year's worth by the end of 2021. Nevertheless, this year's maximum is $3,600 for self-only, and $7,200 for family plan, and an additional $1,000 if age 50 or over.

✓ **Maximize Pension & IRA Contributions:** Increase your retirement plan contributions to take advantage of the maximum write-offs. For 2021: (1) the §401(k) contribution limit is $19,500 ($20,500 for 2022), and if age 50+ add an additional $6,500 (same for 2022); (2) the Simple Plan limits are $13,500 ($14,000 for 2022) and $3,000 extra (same for 2022) for age 50 or over; and (3) the IRA limits are $6,000 ($6,500 for 2022) and $1,000 more if age 50 or older; and (4) take full advantage of employer matching with additional contributions.

✓ **Sale of Loss Entities:** Dispose of your interests in those flow-through entities in which you have "suspended" loss carryforwards.

✓ **IRA Charity Distributions:** At age 70 ½+, you can donate up to $100,000 of your IRA and: (1) it is not included in your income, (2) it counts toward the RMD, and (3) although not deductible, with the new higher standard deduction, it can be tax advantageous.

✓ **Charitable Contributions:** Consider gifting appreciated property, typically publicly traded stock, to a charitable organization for a deduction equal to its fair market value without having to report the gain.

✓ **Achieving a Better Life Experience (ABLE) Accounts:** This is a savings account for individuals with disabilities and their families. For 2021, taxpayers can contribute up to $15,000. Earnings are not taxable and distributions are tax-free if used to pay the beneficiary's qualified disability expenses.

✓ **Single and Head of Household:** If you are single and assist your parents financially, make sure you meet the support level test to file head of household instead of single.

✓ **State Tax Returns:** A good tax advisor pays close attention to state income taxes to make sure all the state tax benefits are claimed. Most states have tax breaks that are not applicable to a federal return. Oklahoma's are extensive.

✓ **Lower College Tuition by 5%:** Take advantage of the Oklahoma §529 plans now by contributing to it in December for a 2021 Oklahoma deduction, then use it for the January 2022 tuition invoice.

✓ **§529 Plans – Higher Education Costs:** §529 plans can now be used for tuition paid in connection with enrollment or attendance at a public, private, or religious elementary or secondary school, but are subject to a $10,000 distribution annual limit.

IV. INVESTMENT TAX TIPS

✓ **Take your gains in 2021?** If your opinion is capital gain taxes will increase in 2022, then consider selling your gain positions prior to year-end.

✓ **Crypto (Virtual) Currencies:** IRS is asking this question on personal taxes: "At any time during 2021, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency?"

✓ **Crypto Currencies and Wash Sales:** Virtual currencies are not "securities" (stocks are a type of security). The 30-day wash sale rules apply to "securities." Cryptos you can sell a loss position prior to year-end, and purchase it right back to off-set your realized gain positions. If you sell "securities", you have to wait 30 days to buy it back to get the loss.

✓ **Short-Term (ST) vs. Long-Term (LT) Capital Gains:** Capital gains on property held one year or less are ST and are taxed as high as 50%. If held over a year it is LT and taxed about half as much. For taxpayers not in the highest tax brackets, the tax rate for LT capital gains can be as low as zero!

✓ **Defer the Sale:** If you have a borderline holding period, consider holding the asset a little longer than a year to take advantage of the favorable LT capital gains rates.

✓ **Offset Gains**: Consider selling capital assets that will generate a loss to offset any capital gains recognized earlier in the year. But, be careful not to waste the benefits of LT capital gains with ST capital losses.

✓ **Avoid Fluctuations:** Realizing net capital gains in 2021 and then suffering net capital losses in 2022 increases the probability of wasting deductions. Thus, a good tax strategy is to try to realize losses in years with gains or sell loss assets in year #1, and sell gain assets in year #2.

✓ **Dividend Taxes:** Most stock dividends are taxed at LT preferential rates. Thus, dividend paying stocks, and similar stocks held in mutual funds are tax advantageous investments.

✓ **Oklahoma Capital Gain Exclusion:** If you have appreciated Oklahoma real property or own stock, or LLC membership interests in companies that are located primarily in Oklahoma, the capital gain, under many circumstances, can be totally excluded from Oklahoma taxation.

✓ **Gift Appreciated Stock:** One of the best tax savings strategies can be for a parent to gift appreciated stock to their lower tax bracket adult child.

Top 5 Reasons You Should Hire an Attorney-CPA for your Tax, Legal, Accounting, & Estate Planning

1. <u>Unparalleled Perspective:</u> Seven years of rigorous formal training in accounting and law provides a broader viewpoint.

2. <u>Uniquely Qualified:</u> Extensive professional education required to maintain a legal and CPA license.

3. <u>First-Class Education:</u> Attorney-CPAs tend to be up to speed on the latest developments in their practices.

4. <u>Best of Both Worlds:</u> Bridges the gap between your legal and financial requirements.

5. <u>A Practical Solution:</u> Save time and money by hiring a single dually-licensed Attorney-CPA.

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