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CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

2021-2022 Tax Update

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ECONOMIC IMPACT PAYMENT (EIPS)

The American Rescue Plan Act (ARPA) created a 3rd round of federal economic impact payments. IRS started sending the 3rd EIPs in mid-March 2021. The full amount of the payments were $1,400 per taxpayer and per dependent. The payment could vary, depending on 2020 AGI on tax return. The terms “economic impact payment” and “Recovery Rebate Credit” are used interchangeably. The payments are considered advance credits against taxpayer’s 2021 tax liability.

CHILD TAX CREDIT (CTC)

The child tax credit has increased and became fully refundable but only for 2021 taxable year. The credit amount was increased from $2,000 per child to $3,000 per child (under 18) ($3,600 for a child under age 6) for filers under specified AGI threshold. Qualifying child should be born on or after 01/01/2004 and must have valid SSN. Taxpayers who failed to obtain an SSN for their qualifying child by the due date of their income tax return are still eligible for the $500 credit available for other dependent (under IRS § 24(h)(4)(A))

VIRTUAL CURRENCY TRANSACTIONS

The IRS has issued the guidance concerning the taxation of virtual currencies that has an equivalent value in real currency (or acts as a substitute for real currency). (IRS Notice 2014-21)

1. Taxpayers who received, sold, sent, exchanged, or otherwise acquired any financial interest in any virtual currency at any time during 2021 have to report Capital Gain or Loss from the transactions.
2. Wages paid to employee using virtual currency are taxable.
3. Payments made to independent contractors using virtual currency are taxable.
4. A taxpayer who mines virtual currency realizes taxable income.

CHARITABLE CONTRIBUTIONS

Individual taxpayers can claim cash contributions of up to 100 percent of their 2021 adjusted gross income. The CARES Act provides $300 deduction ($600 for joint filers) in cash contribution for those choose to take standard deductions, rather than itemized deduction. It is an above-the-line qualified contribution deduction for the 2021 taxable year.

PLUG-IN ELECTRIC DRIVE VEHICLES CREDIT

A) The credit ranges from $2,500 to $7,500 per a new qualified plug-in electric drive vehicle purchased in 2021. The credit is calculated based on the size of the battery and phased out when a manufacturer sells 200,000 units.

B) California has no comparable credit but has a rebate through the California Clean Vehicle Rebate Project (CVRP). Taxpayers can get a rebate amount ranges from $1,000 to $7,000 depending on the vehicle, and they are taxable income, for both federal and California. Moreover, low income families can receive an additional rebate up to $2,500.

CHANGES OF RETIREMENT PLAN

1. For the taxable years beginning after December 31, 2019, there is no age restrictions and allow taxpayers to contribute to a traditional IRA after age 70.5. California does not conform to the provisions.

2. Taxpayers who turn age 72 during the year can put off their first required minimum distributions (RMDs) until April 1 of the year after they turn age 72. Taxpayers who put off their 1st RMD must take two RMDs in the 2nd year (one for the year they turned age 72 and one for the following year.) The deadline for taking RMD is December 31 each year.

3. Taxpayers may exclude up to $ 100,000 annually in “qualified charitable distributions” (QCDs) from their AGI. It can made on or after the date the taxpayer reaches age 70.5. QCDs made to following entities are ignored for tax purposes: Private foundation; Donor-advised fund; charitable remainder trust; or charitable annuity.

NET OPERATING LOSS (NOL) MODIFICATION BY CARES ACT

1. NOLs generated in taxable year 2018-2020 can be carried back 5 years; and
2. 80% taxable income limitation created by the TCJA was suspended for 2018-2020 taxable years.
3. NOL treatment by year generated

Year NOL generated	Carrybacks	Taxable Income Limitation	Carryforward
Pre-2018	Federal: 2 years CA: 2 years for 2013-20	Federal: 100% of taxable income CA: 100% of taxable income	Federal: 20 years CA: 20 years
2018-2020	Federal: 5 years CA: Pre-2019 : 2 years Post-2018: None	Federal: a. Claimed on pre-2021 tax year return: 100% of taxable income b. Carried over to post-2020 tax year return: 80% of taxable income CA: 100% of taxable income	Federal: Indefinite CA: 20 years
Post-2020	Federal: None CA: None	Federal: 80% of taxable income CA: 100% of taxable income	Federal: Indefinite CA: 20 years

**Exception: Carryback of 2 years for insurance companies and farmers

PENALTY ISSUE FOR NOT HAVING HEALTH INSURANCE CONTINUE IN 2021

Beginning January 1, 2020, all California residents must have qualifying health insurance coverage unless they qualify for an exemption. Otherwise, nonexempt taxpayers without coverage must pay the state penalty. In 2021, it will be the higher of a flat amount of $800 per adult person ($400 per dependent child) or 2.5% of gross income that exceeds the filing threshold.

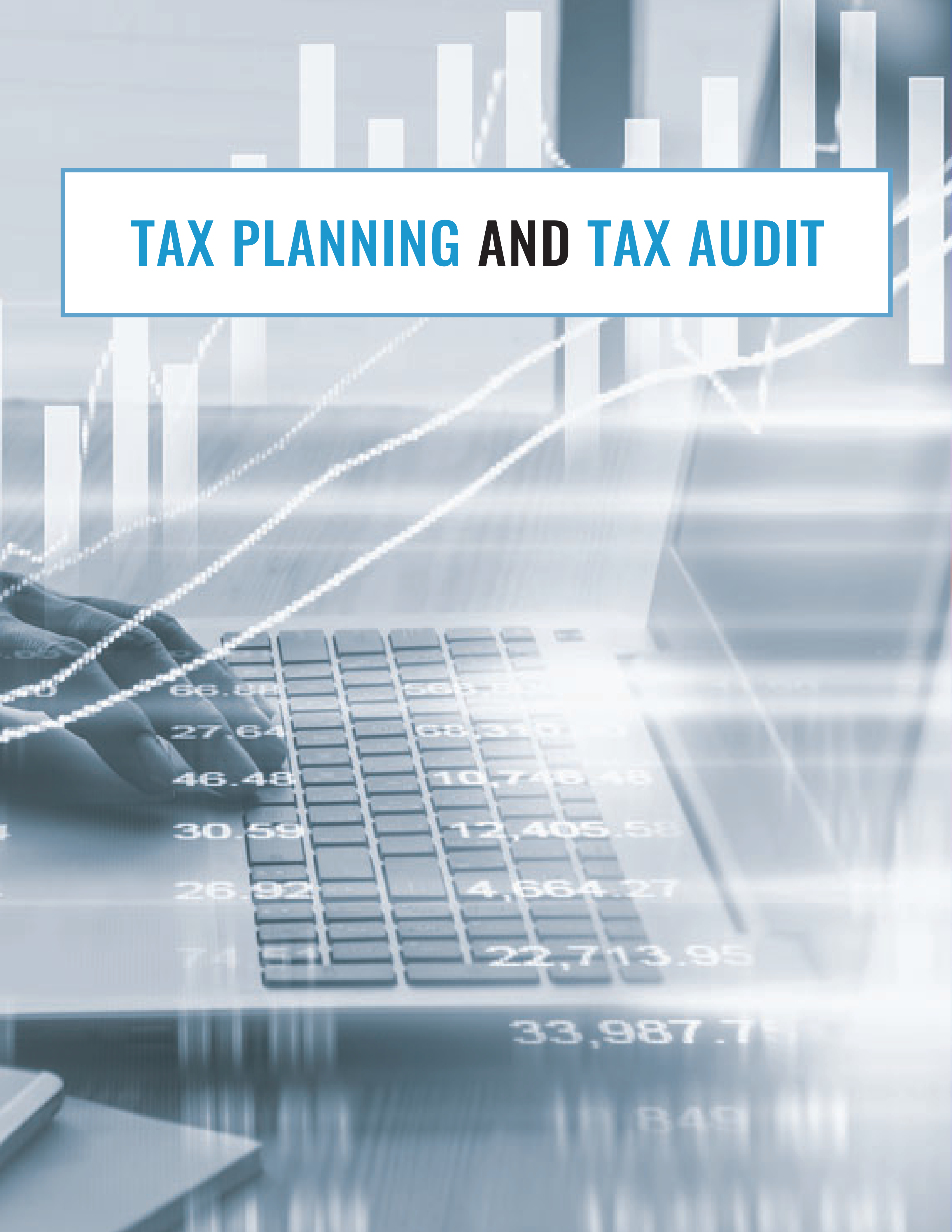
PASS-THROUGH ENTITY ELECTIVE TAX

Qualified S Corp, partnership, or LLC taxed as partnership or S Corp doing business in CA may make an election to pay a pass-through entity elective tax for 2021 to 2025 tax year. The amount equals to 9.3% of its qualified net income. This will decrease Federal net income on owner's K-1, and the owner will receive a CA tax credit equal to 100% of the state tax paid by the pass-through entity on behalf of its owner.

CALSAVERS PROGRAM

CalSavers is a state-administered Roth-like retirement plan that private employers must offer to their CA employees if the employer does not provide its own retirement plan unless few conditions. IRS classifies CA's CalSavers program as Roth IRA. TP who elect to withhold into CalSavers but who do not qualify to contribute to Roth IRA can have their contributions recharacterized as traditional IRA if the process is made before 04/15/22. Religious organizations with 501(c)(3) exemption are not required to register. The registration June 30, 2021, deadline applies to employers with 50-99 employees. For 5 or more employees, registration deadline fall on June 30, 2022.

TAX PLANNING AND TAX AUDIT



MEDICAL EXPENSE DEDUCTIONS

The IRS allows all taxpayers to deduct only the amount of the total medical expenses that exceed 7.5% of their adjusted gross income. Medical mileage rate for 2021 is 16 cents.

INCOME EXCLUSION OF CANCELLATION OF DEBT ON PRINCIPAL RESIDENCE

Gross income does not include cancellation of debt if the income for discharged debt from taxpayers' qualified principal residence indebtedness discharged prior to January 1, 2026. (But limited to $750,000 of acquisition debt ($375,000 for MFS)). California has not allowed the principal residence exclusion since 2013.

CONTRIBUTION TO RETIREMENT SAVINGS

The contribution to Retirement Savings Plan (401(k), SEP IRA, etc.) is recommended. For 2021, the maximum amount for 401(k) is $19,500 ($26,000 if age 50 or older), and the maximum amount for SEP IRA (Simplified Employee Pension) is $58,000. In 2022, taxpayers can contribute up to $20,500 ($27,000 if age 50 or older) for 401(k) and up to $61,000 for SEP IRA.

RETIREMENT PLANS: TRADITIONAL IRA AND ROTH IRA

Taxpayer can contribute up to $6,000 ($7,000 if age 50 or older) to an IRA account by April 15, 2022 to be eligible for tax deduction for 2021. Taxpayer may convert a traditional IRA to a Roth IRA. There is no limit for conversion income, however, the conversion may result in taxable consequence in certain situations (paying back tax benefit from Traditional IRA).

DISTRIBUTION OF RETIREMENT ACCOUNT

Distribution that occur before an account holder reaches the age of 59 ½ are taxed as ordinary income and may be subject to a 10% penalty. Amount received from IRAs or qualified plans may be rolled over tax-free if rollover is made within 60 days of the date of the distribution. There are limited exceptions from the 10% additional tax for distributions made for medical and educational purposes and for "first-time homebuyers". Please contact our office for more details when exception applies in 2021.

GIFT TAX / ESTATE TAX EXCLUSION

For 2021, the annual gift tax exclusion is $15,000 ($16,000 for 2022). A taxpayer, making a gift valued more than $15,000 to anyone other than spouse, should report the gift on the tax return. For 2021, a unified gift and estate tax exemption per person is $11,700,000 ($12.06 million for 2022). It is schedule to reduce back to $5 million after 12/31/25. Please consult with a tax advisor before making a gift more than the annual exclusion since exceeding amounts will count against the lifetime exclusion.

FOREIGN-EARNED INCOME EXCLUSION

In 2021, a U.S. individual living abroad can exclude up to $108,700 of foreign-earned income if the taxpayer satisfies either the bona fide residence test or the physical presence test. The exclusion applies separately to each spouse; as such, if both spouses are qualified individuals, the spouses when filing jointly may exclude up to $217,400. A qualified individual is either a person whose tax home is in a foreign country and who is a U.S. citizen with a bona fide residence in a foreign country for an uninterrupted period which includes an entire taxable year; or a U.S. citizen or resident who, during any period of 12 consecutive months, is present in a foreign country or countries during at least 330 full days in such period (physical presence test). Please contact our office for more details.

REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS (FBAR)

Taxpayers with an interest in, or signature or other authority over, foreign financial accounts, whose aggregate value exceeded $10,000 at any time during 2021, must report Foreign Bank and Financial Accounts (FBAR) by April 15, 2022. Foreign financial accounts include bank accounts, brokerage accounts, mutual funds, trusts, or other type of foreign financial accounts. Under IRC Section 5321 the maximum penalty for an FBAR violation is $13,481 unless the violation is willful. For willful violations, the penalty may be the greater of $134,806 or 50% of the balance in the account at the time of the violation, for each violation.

Starting from 2011, taxpayers with specified foreign financial assets that exceed certain thresholds must report those assets to the IRS on Form 8938.

Taxpayers living in the US

- Single or Married Filing Separately: Total value of assets was more than $50,000 on the last day of the tax year, or more than $75,000 at any time during the year.
- Married Filing Jointly: Total value of assets was more than $100,000 on the last day of the tax year, or more than $150,000 at any time during the year.

Taxpayers living outside the US:

- Single or Married Filing Separately: Total value of assets was more than $200,000 on the last day of the tax year, or more than $300,000 at any time during the year.
- Married Filing Jointly: Total value of assets was more than $400,000 on the last day of the tax year, or more than $600,000 at any time during the year.

PRINCIPAL RESIDENCE

Taxpayers may qualify to exclude income gained from selling primary residence (living at least 2 years out of the previous 5 years) up to $ 250,000 of gain on sale of home if single (up to $ 500,000 if married filing jointly). Please contact our office for more details.

REINVESTED DIVIDENDS

Taxpayers, not updating mutual fund cost basis for dividends received and investing back into mutual fund in form of additional shares, will end up being double taxed. This is a common mistake that many taxpayers make. Reinvested dividends should be considered as additional purchases of stock at different prices. Please keep any related record.

CAPITAL GAIN (LONG-TERM)

Rate	Taxable Income Breakpoint (2021)			
	Single	Married Filing Jointly	Married Filing Separately	Head of Household
0%	$40,400	$80,800	$40,400	$54,100
15%	$445,850	$501,600	$250,800	$473,750
20%	No Breakpoint			

**Depending on the amount of adjusted gross income (AGI), net investment income tax (3.8%) can be added.

INVESTMENT INTEREST

If taxpayers borrow money to buy property for investment, interest that taxpayers pay is investment interest and is tax deductible. Deductible investment interest is limited to taxpayers' net investment income. Taxpayers are allowed to carry over disallowed investment interest deduction into next tax year.

INSTALLMENT SALE

Owner Financing (Seller Financing) or Installment Sale is a sale of property where at least one payment is to be received after the tax year in which the sale occurs. It allows for the deferral of gain recognition because the seller recognizes the gain over the taxable years in which the payments are actually received. This method does not apply to the sale of stock and bond.

NET OPERATING LOSS (NOL)

For losses arising in tax years beginning January 1, 2018 to December 31, 2021, it is 100% of taxable income to claim on pre-2021 taxable year return (temporary repeal of 80% taxable income limit). Carryovers are allowed indefinitely (California NOLs can be carried forward up to 20 years).

AUTOMOBILE EXPENSE

For 2021, the standard mileage rate is 56¢ per mile. Taxpayers should keep a detailed mileage log for substantiation. Commuting mileage incurred while traveling from home to one or more regular places of business are generally non-deductible.

PAYCHECK PROTECTION PROGRAM (PPP)

If borrowers do not apply for forgiveness within 10 months after the last day of the covered period, then the borrowers must begin making loan payment to their PPP lender. For loans of $ 150,000 or less, SBA created a new direct forgiveness portal for borrowers to apply for forgiveness. PPP loan forgiveness is not taxable income, but tax-exempt income. Still, it increase basis for partners of partnerships & S Corporation shareholders. CA will follow the federal treatment regarding recognizing tax-exempt income, once gross income decreases over 25%.

EMPLOYEE RETENTION CREDIT (ERC)

ERC is a refundable tax credit against certain employment taxes. To be eligible, you must experience either the full or partial suspension of the operation due to COVID-19, or significant decline in gross receipts. Maximum credit was $5,000 per employee and per year during 2020, and $7,000 per employee and per quarter for 2021 till 3rd quarter. Please contact our office for more details.

PAID SICK AND FAMILY LEAVE CREDIT

There is reset of 10-day paid sick leave benefit period, so employers that previously claimed the credit for 2020 and 1st quarter of 2021 may claim another 10 days of paid sick leave, during 04/01/21 to 09/30/21. Self-employed individuals can claim refundable credits similar to the paid sick and family leave credit. Please contact our office for more detail.

SECTION 179 AND SPECIAL DEPRECIATION

Section 179 allows business owners to deduct up to $1,080,000 for purchasing equipment, and the phase-out threshold is $2,562,000 in 2021. Qualified new or used equipment's bonus depreciation amount can be claimed as an expense up to 100% from September 28, 2017 to December 31, 2022.

MEAL & ENTERTAINMENT

Client entertainment expense (sporting event tickets, theater tickets, golf outings, and yacht excursions) is non-deduction since 2018. Meals for employees are 50% deductible and meals for employees while traveling for business are 50% deductible. Client meals, Employee meals while traveling for business, and meals provided for the convenience of the employer are 100% deductible during 2021-2022 if provided by a restaurant. Further, holiday parties, company picnics, and other occasional employee appreciation events are 100% deductible. Taxpayers should keep related events and meals expense documents to claim the full deduction.

PENSION PLAN

Putting more money into retirement account is a good idea in terms of tax savings and getting ready for retirement early. Taxpayers should consult with tax advisors and financial advisors before starting a pension plan.

CALIFORNIA SEXUAL HARASSMENT TRAINING

In 2019, CA Sexual harassment training deadline was extended to January 1, 2021 for employers with 5 or more employees. The employees still required to receive training every 2 year after their last completion date, which is why it is important for business owners to retain a record of all employees' training for a minimum of two years. The next deadline for the training is January 1, 2023. If an employee has not yet received the proper training during 2021, then he or she must complete a course in 2022.

INCOME TAX AUDIT

SOURCE OF LIVING EXPENSE	When taxpayers' expenditures are greater than their reported income, supporting documents for source of fund, which used for their living expenses exceeding their income, are required.
SOURCE OF FUND	Taxpayers should have supporting documents for the source of funds of down payment used to acquire a real estate or business
BANK DEPOSIT	When the deposit includes non-sale deposits, supporting documents, such as copies of cancelled checks and deposit slips, should be kept as your substantiation. Otherwise, they may be treated as additional income
CHARITABLE CONTRIBUTION	Taxpayers who make charitable contributions equaling $250 or more must have records and written receipt from the qualified organization. Taxpayers who make charitable contribution less than $250 should keep canceled checks. Taxpayers donating an item or a group of similar items valued at more than $5,000 must also complete Section B of Form 8283, which generally requires an appraisal by a qualified appraiser.
SEPARATE BANK ACCOUNT	Keeping separate accounts (business and personal) is always the smart thing to do. The proper way to transfer business income to personal account is either by paying yourself a salary and/or making a transfer as withdrawal/distribution to personal accounts.
CASH TRANSACTION	A currency transaction report (CTR) is a report that U.S. financial institutions are required to file for each deposit, withdrawal, exchange of currency, or other payment or transfer, by, through or to the financial institution, which involves a transaction in currency of more than $10,000. The bank will report to the IRS if any attempts known as structuring, which are intentional attempts to withdraw and deposit more than $3,000 but less than $10,000 to avoid CTR. A taxpayer must also report using Form 8300 if he/she received an aggregated amount over $10,000 during a taxable year from a customer.

INCOME TAX AUDIT

FOREIGN GIFT

Gifts or bequests valued at more than $100,000 from a nonresident alien individual or foreign estate or gifts valued at more than $16,649 for 2021 from foreign corporations or foreign partnerships must be reported to IRS by filing Form 3520.

FORM 1099 FILING REQUIREMENT

A taxpayer may subject to a penalty if he/she files a form 1099 without meeting form 1099 filing requirements. The penalty applies if taxpayers fail to file in a timely manner, fail to include all information required to be shown on a return, and/or include incorrect information. Penalty ranges from $50 to $270.
(1099 filing deadline: 01/31/2022 for 1099-NEC, 02/28/2022 for 1099-MISC, DIV, INT, R, C, B, S.)
(1099 E-file deadline: 01/31/2022 for 1099-NEC, 03/31/2022 for 1099- MISC, DIV, INT, R, C, B, S)

RECORD KEEPING

Bank statements, cancelled checks, receipts, invoices and all other documents used to prepare income tax returns should be kept at least 4 years from the date tax returns were filed. When taxpayers acquire or sell property, whether business or personal, taxpayers should keep escrow documents and/or other documents supporting real estate transactions for at least 4 years from the date tax returns are filed.

AUDIT NOTICE

When taxpayers receive an audit notice, the first thing for them to do is contact their tax advisors. Sometimes auditors visit business site without prior arrangement. Taxpayers should always ask for proper identification, inquire about the reason for visitation and contact tax advisors before giving out any information to auditors.

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