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YEAR-END TAX TIPS

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MEET THE EXPERT

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Jones provides tax, consulting, and transactional advisory services to businesses and individuals operating in wholesale distribution, retail sales, real estate development, professional services, and investments. He is a graduate of the University of Alabama at Birmingham. Based in our Auburn office, Joel specializes in family-owned businesses, partnership and corporate taxation, multi-state taxation, not for profits, and business valuation. He frequently teaches continuing education classes for staff and clients of Kassouf and is an instructor for the Accounting and Tax Training Institute at the Auburn University Office of Professional & Continuing Education.

With the year winding down, what should companies be doing to put themselves in the best position from a tax standpoint?

Plan early. Given the year is nearly over, I would start with a meeting with tax and financial advisors as soon as possible in order to create a strategy to be executed prior to the close of the tax year. This meeting could include projections of year-end income, review of retirement plan obligations, discussions of business strategy, and discussions with legal counsel regarding completion of minutes, etc. for the current year. During that meeting, specific tax items could be discussed that would directly impact the taxable income of the business such as:

• Reviewing cash budget for capital expenditures to determine if there are items that could be purchased prior to year-end in order to take advantage of accelerated depreciation options. I would suggest that these purchases be made in conjunction with a business strategy and not purely tax motivated.
• Working with benefit plan administrator to determine the amount of any required retirement plan matching contribution and if a discretionary contributions are available
• Reviewing current year estimated income tax payments paid to determine if appropriate amounts have been paid to avoid underpayment penalties
• Reviewing accounts receivable for available write-offs of uncollectible account balances
• Reviewing inventory listings for available write-offs of obsolete items
• Reviewing charitable giving options
• If business is a pass through entity (S corporation or partnership), reviewing owner basis to ensure no surprises arise during tax preparation

What about individuals? Are there any steps they can take to improve their tax situation before the year draws to a close?

Much like the discussion regarding companies, I recommend a meeting or discussion with your tax and financial advisors prior to year-end so that necessary actions may be taken prior to close of the year end. This meeting allows for a discussion of any life events that might impact the current year tax situation and provide for dialogue regarding specific items that could directly impact the current year tax situation. These specific items include:

• Reviewing tax withholdings and tax estimate payments to ensure enough tax has been paid in to avoid underpayment penalties. I feel this area doesn't always get enough attention because many taxpayers assume that income tax withholding takes care of itself. However, if compensation levels changed from prior year, if pre-tax benefit deductions are adjusted or if incentive pay was received tax withholdings might not be at the correct amounts. This can be true even for clients who are making quarterly tax payments since many times the quarterly payments are established on the basis of consistent tax withholdings from one year to the next.
• If the individual owns an interest in a pass-through entity (S corporation or partnership), reviewing basis and, if possible, determine an estimate of reportable income from the entity.
• Reviewing investment portfolio for amounts of interest, dividend and capital gain items to determine if amounts are significantly differently than prior year. This is particularly important given that this income has no associated income tax withholding.
• Reviewing investment portfolio to determine if there are loss positions that could be realized to help offset gains in other areas
• Reviewing retirement plan contributions to ensure that, where possible, the maximum retirement plan deferral is elected.

Are there any expected tax changes from the Biden administration that could affect year-end tax planning?

Yes, there are, but the nature of the congressional negotiations makes planning very difficult. Some of the proposed changes include increasing the top individual income tax rate, increasing the corporate income tax rates, increasing the capital gains tax rate, decreasing the estate tax deduction, and eliminating the step-up basis for inherited assets. In addition to the general tax effect of these changes, the critical question related to any of the provisions is the effective date. Will these changes be effective in 2021 or after, such as January 1, 2022? Many clients are currently executing plans in anticipation of effective dates that will either be as of enactment of any legislation or subsequent to year-end. For example, some clients are currently reviewing estate plans so that changes can be made before legislation is enacted in the event the effective date is after enactment or even after 2021. There is also the distinct possibility that any finalized tax legislation could have effective dates which precede actual enactment which will definitely impact 2021 year-end tax-planning. For example, some proposals contain increases in the tax rate related to capital gains for certain taxpayers and the rate increase would apply to any sale occurring after September 13, 2021. Given the fluid nature of the proposals and negotiations, it will be important to monitor the progress of these proposals and be prepared to act quickly if necessary.

What can I be doing throughout the year, either for my business or my personal finances, to make the tax process easier?

Planning is so important. I know it is an ongoing theme, but I really believe the best approach is to meet with tax and financial advisors no less than annually to create and work a plan that includes business strategy planning, tax planning, estate planning, and personal financial planning. Creating an ongoing line of communication will allow for routine communication of life and business events to advisors to allow for assistance with planning strategies related to those events. It also allows for discussions of any new investments in closely held entities which sometimes complicate the tax process. These ongoing discussions further aid in monitoring income tax withholdings on special payrolls and bonuses to ensure the withholding is adequate.

From a purely tax process perspective, my suggestion is to accumulate documents throughout the year which might impact the tax return. Keep a folder of tax payments, contribution receipts, etc. and routinely place documents in those folders as the documents arrive so that all documentation is complete when tax preparation time arises. This will help reduce the number of requests for information and help eliminate the need to chase down documentation.

How can charitable giving be used to reduce tax liability near the end of the year?

Charitable giving is a great opportunity for individuals to not only support causes that are important to them, but also help reduce tax liabilities by providing deductions for the amounts given to the charities. 2021 provides unique opportunities in this area given the higher adjusted gross income (AGI) threshold in 2021. While most taxpayers support charities through recurring cash donations there are three additional items that taxpayers should consider:

• Donating appreciate stock to a qualified charity. This option not only allows taxpayers to support charitable purposes, but provides this support without using cash reserves or having to realize gains on stock appreciation. It is important to keep in mind the documentation rules and limitation rules that apply to these types of gifts.
• Donating through a Qualified Charitable Distribution from an IRA. This option allows taxpayers who hold a traditional or inherited IRA with a beneficiary over 70 ½ to direct the IRA custodian to make a payment of up to $100,000 directly to a qualified charity. This type of payment does not take the form a deduction, but instead prevents the taxpayer from realizing that IRA distribution in income for the year of the Qualified Charitable Distribution since the payment was directed to a charity. Since this distribution is not a deduction, the benefit is available for taxpayers who do not otherwise itemize. In addition, since the distribution is not included in adjusted gross income (AGI), it helps mitigate the impact of other tax calculations driven by AGI such as phase-outs of itemized deductions, net investment income and Medicare surtax calculations and taxation of Social Security benefits.
• Contributing through a donor advised fund. This is great option for taxpayers who might not otherwise have total itemized deductions that exceed the current year standard deduction.

It is also important to remember the documentation requirements needed to substantiate contributions as well as the necessity of confirming the tax exempt status of charitable organizations.

In addition to accountants, what other types of professionals can pay a key role in the tax process for business?

In my mind, the tax process for a business is a year-round process that involves many professionals because most business decisions impact the taxes of the business. I think at a minimum it is imperative for a business and its owners to have relationships with business and personal bankers, investment advisors, business and estate planning attorneys, and business and personal insurance professionals. Decisions made throughout a business tax year involve issues that cross many of these areas, and input from these advisors is critical to good decisions.

What should I be asking my accountant at the end of the year to make sure my company or my personal finances are in the best possible position?

There are several questions that both businesses and individuals should consider asking tax professionals as year-end approaches:

• Would you perform a year-end tax projection so that I can have an idea of taxes that might need payment in January and April? While paying income taxes is a personal obligation for individuals and a cost of doing business for companies, it ultimately becomes a cash flow management component, and it is always helpful to know how much is due and when payment is needed. A great way to manage this process is to prepare projections during the year and especially near year end to estimate the taxes due in January and April for the current year and due in April for the next year. Many times the question of cumulative tax payment arises in March and April since the first quarter estimate for the next tax year is due at the same time as any balance due for the previous period.
• Should I consider purchasing any equipment or other depreciable assets? These purchases can provide substantial tax benefits to companies and certain individuals if purchased before the close of the current tax year. However, I typically like to talk through this analysis with clients to determine if the purchase makes business sense and is not just a tax motivated decision.
• How much can I give to charity this year? While current tax law does provide deductions for gifts to qualified charities, the amount deductible in any particular tax year is subject to limitations based on either adjusted gross income for individuals or taxable income for certain companies. 2021 provides a unique opportunity related to charitable giving since qualified contributions can offset 100% of adjusted gross income if the qualified contribution is made in calendar-year 2021.

Given the uncertainty over the future of tax policy, how can companies plan their tax strategies for the future?

The current uncertainty in tax policy makes things rather interesting for both advisors and clients because it is very difficult to plan and execute tax strategies. While there are a number of proposals that have surfaced over the past year, the fluid nature of congressional negotiations and politics seems to change proposals almost daily. In order to help manage this uncertainty, my recommendation to companies is to:

·Closely monitor current proposals and debates to help determine how these policies might impact the business.
·Ask questions of your tax advisor regarding the proposals. Your tax and financial advisors closely monitor these proposals to determine the impact on clients' businesses, but active discussions regarding this proposals are beneficial.
·Subscribe to newsletters from tax and financial advisors and consider viewing webinars on these topics. Most substantial new tax legislations are immediately analyzed and summarized either in email newsletters or webinars.
·Base your planning on the best possible information, but be mindful of possible changes as plans can quickly change.
·Communicate impactful business decisions with advisors so that influences of tax policy changes can be considered.

What are some tax planning questions companies and individuals should be asking their accountants, but often don't?

From a company standpoint, there a number of general and tax planning questions that many times are not asked:

• Do we have the most effective retirement plan that works best for both the employees and the owners? Many times as companies grow, the retirement plan that worked well for a smaller company might not be the best plan for a larger company. As companies grow, regular discussions should occur with the retirement plan provider to ensure that the plan is still the most effective for the needs of the owners and employees.
• Do we have a workable plan in the event of an unexpected termination of a key employee or even an owner? While this is not an issue anyone prefers to discuss, it is important for businesses to plan for the unexpected departure of key employees or owners and determine not only how the job duties will be distributed, but also how ownership might be affected.
• What is the current plan for transitioning the business to the next generation in the most tax efficient manner? As business owners continue to age and as the next generations rise in businesses, owners should begin to consider the most tax efficient manner for transitioning the ownership to the next generation. There are planning techniques available that best accomplish this goal. Moreover, there are several non-tax factors to consider, such as depth of internal management along with customer and vendor relationships

From an individual standpoint, there also a number of general and tax planning questions that many times are not asked:

• Are my income tax withholdings sufficient? I know this is also a recurring theme in my comments but many times this is not closely monitored since most individuals assume this is handled correctly. However, every annual submission of a W-4 and many incentive compensation payments can alter the amount of income tax withholdings.
• Am I saving enough for retirement? Many individuals begin their work careers deferring small amounts into their retirement plans in order to help maximize their take home pay. However, as careers progress and earnings increase, it might make sense to review these deferrals since there likely is greater ability to defer more into the plan.

How do investments, either by an individual or company, factor in to year-end tax planning?

Investments play a large role in year-end tax planning for both individuals and companies since the return from investments and realized gains and losses contribute to taxable income. In addition, particularly for individuals who hold investments either directly or indirectly through a pass-through entity, the income taxes associated with the income is generally not paid through withholdings, creating complexity. Both individuals and companies should review investment portfolios to determine the impact of the investment returns on current year income taxes. They should determine if it makes sense to utilize appreciated stocks to satisfy charitable giving desires and whether there are portfolio losses that could be realized to help offset realized gains.