Kalvig & Associates
EST. 1974
Bookkeeping and Tax Service

Open Monday – Friday
Weekends by Appointment
(218) 835-4546   TOLL FREE (888) 888-6735
(218) 835-6590 – FAX
kalvigandassoc@paulbunyan.net
359 MAIN STREET, BLACKDUCK, MN 56630

2021 YEAR-END TAX LETTER

INSIDE THIS ISSUE:

IT'S TAX TIME AGAIN...

Your mailbox should be filling up with the information you will need to get the job done.

This letter is full of information designed to help you prepare your tax documents so you will pay only the tax that you rightfully owe.

Time to get organized:

The following checklist will help you collect the documents needed to file your tax return.

☐ **Your last 3 years' tax returns** *(new clients).*

☐ **Social Security numbers and dates of birth** for taxpayers, spouses and dependents.

☐ **Copy of Driver's License** for taxpayer and spouse.

☐ **W-2 Forms.**

☐ Amount of 3rd **Economic Impact Payment** ('stimulus'). Bring IRS Form 1444-C.

☐ **Advance payments of the Child Tax Credit** received in 2021 (bring IRS Letter 6419).

☐ **Your last paycheck stub of the year** (for each job).

☐ **1099 Forms** for interest, dividends, sales, retirement, Social Security, self-employment, and unemployment. ★ *Remember to download and print statements from online accounts that don't send paper tax forms.*

☐ **Property tax statements.**

☐ **Forms 1098 for mortgage interest.**

☐ **Foreign accounts.** Bring statements. Such assets must be disclosed even if they do not generate income.

☐ **Purchase and sale information,** including dates, relating to anything sold.

☐ **Stock options.** Form 1099-B and 'supplemental' brokerage statements showing amounts already reported as income on form W-2.

☐ **Cryptocurrency.** Bring details including dates, proceeds, and original cost.

☐ **Child care provider information** (name, address, SS#, amount paid). *Required even if you have a daycare flex account at work.*

☐ **Names, addresses, and Social Security numbers** from whom you received interest, or to whom you paid interest.

☐ **Bankruptcy or divorce papers** (if applicable).

☐ **If you paid an individual $600 or more for services in connection with your business,** please provide their name, address, and tax ID#.

☐ **Records showing income and expense for business and/or rental property you own.** Records of business and personal mileage are required for automobile deductions.

☐ **Form K-1** if you have an interest in a Partnership, S-Corporation, Estate or Trust.

☐ **IRA year-end statements.**

☐ **Bring details for all other income,** whether you think it's taxable or not. Examples may include foreign income, barter, hobby, settlements, awards/prizes, gambling, etc.

☐ **Forms 1098-T** for post-secondary tuition payments are sent to the student. If the student is your dependent you must get it from them.

☐ **Forms 1099-Q** for education savings plan distributions.

☐ **Estimated taxes paid** (including amount and date of each separate payment).

☐ **Student loan interest forms 1098-E.**

☐ **Adoption costs** if applicable. Also bring the legal adoption documents.

☐ **Form 1098-C** for donations of automobiles or boats.

☐ **Details for charitable donations.** Bring receipts. For noncash donations totaling over $500 include date, place, fair market value, and original cost.

☐ **If you purchased a new electric plug-in vehicle,** bring the year, make and purchase date.

☐ **If you installed solar or geothermal systems** for your home or cabin bring receipts.

☐ **Noncustodial parents claiming children** need a signed IRS Form 8332 to claim the child.

☐ **If debts were forgiven,** bring Form 1099-C or 1099-A.

☐ **If you bought, sold, or refinanced a home** bring the closing papers.

☐ **Forms 1099-K for internet or credit card sales.**

☐ **Health Savings Account (HSA) contributions and distributions.** Bring forms 5498-SA and 1099-SA.

☐ **Form(s) 1095** for health insurance.

☐ **Out of pocket medical expenses** may be deductible (if large). Bring details.

☐ **Form 1099-LTC** for long-term care policy benefits paid.

☐ **Pandemic related business assistance.** Bring details related to PPP loans and/or Employee Retention Credits.

☐ **Bring a voided check for direct deposit** of any refunds you expect to receive.

Caution: the IRS is very attentive to taxpayers who write off local travel costs.

A daily log of business use is essential. Also, don't forget to record the beginning and the year-end odometer readings.

Need help? There are plenty of smartphone apps that can help with tracking mileage.

DEDUCTING MILEAGE?

Did you drive for charity? If so, you can deduct **14¢** for every mile you drove.

If your medical expenses are substantial, you may want to calculate a mileage deduction. Medical miles for 2021 are calculated at **16¢ per mile.**

If you drove for business purposes, the situation is a little more complicated: First decide which miles qualify.

Use the following three scenarios to determine how many miles you can deduct:

*Keep in mind the following statement: **In general, commuting is not deductible.***

Scenario #1: If you have an office or regular place of business outside your home, you may not deduct miles commuting to and from work or to your first or from your last stop, but you may deduct mileage to drive to a *temporary work place* (less than one year's duration) and mileage to and from different work locations during the day.

Scenario #2: If you have an office in your home that qualifies for a home office deduction, all of your business-related mileage is deductible (see below for home office deduction qualifiers).

Scenario #3: If you work out of your home but do not qualify for the home office deduction, the distance between home and your first stop and between your last stop and home are nondeductible commuting miles. You should carefully plan to have your first and last stops close to home to maximize the mileage deduction. A trip to the bank, post office, or a supplier can help increase deductible business miles.

Once you have determined which miles to count, you need to decide whether to use the *standard mileage* rate or actual expenses.

The ***standard mileage rate*** *for qualified business use* for 2021 is **56¢ per mile** (down 1.5 cent from 2020).

Which method is best? In general, the standard method works best if your business miles are high or your vehicle is economical to run.

The actual expense method works best if your vehicle weighs over 6000 pounds, is costly to run, or you do not have that many miles in total.

DO YOU WORK AT HOME?

If you are self-employed, you may qualify for the home office deduction if you use a portion of your home **exclusively** as your principal place of business, to store inventory, or to conduct substantial management or administrative activities. There can be no other fixed location where the above activities can be done.

The office space still needs to be **used regularly and exclusively for business.** You can not have any other usage of the area whatsoever. Using your office for personal or investment reasons eliminates the deduction as far as the IRS is concerned, so be careful to keep your office space all business.

Having a deductible home office means you can deduct all of your local business travel as described earlier.

If your office qualifies, you will need additional information: Measure the business space and the total space. You will also need your mortgage interest, taxes, insurance, association fees, repairs, maintenance, utilities, garbage, security, and rent paid. Also, provide an accounting of the total investment in your home.

The IRS has provided a simplified home office deduction, if you choose. Instead of calculating all of the above information, $5 per square foot can be deducted (maximum $1,500). The IRS estimates that the new calculation will save taxpayers 1.6 million hours per year.

To avail yourself of tax deductions, you need to be organized and well documented.

Save proof of all tax deductible purchases.

COMPUTER & CELLPHONE GUIDELINES

Did you buy a computer that you would like to deduct? You can use the following guidelines to determine what is deductible.

If you are self-employed, the business percentage of computer usage, measured by time, is deductible. ***If you are a student,*** the use of a computer is not deductible, but you can tap your 529 plan for a computer purchase.

Keep a log of computer usage to support your deduction.

Cell phone deductions are as follows:

Employers providing cell phones do not have to require records of use to provide tax-free cell phones to employees.

Self employed individuals can deduct business cell phone usage. The IRS, however, still has a hard time believing a cell phone is 100% for business. It's wise to keep a log of use.

EMPLOYEE BUSINESS EXPENSE DEDUCTIONS ARE NOT ALLOWED ON THE FEDERAL RETURN

The Tax Cuts & Jobs Act eliminated federal deductions for employee work expenses. As such, the deductions discussed on this page are for <u>business owners</u> only.

WHAT'S NEW FOR 2021?

It's been a big year for tax changes, mostly due to the American Rescue Plan Act (ARPA).

Did you get the 3rd Economic Impact Payment?
The EIP (a.k.a. "stimulus") is not taxable income, but you still need to remember how much you got. That's because if your stimulus was too small you can claim the balance as a 2021 tax credit. However, don't worry about having to pay-back the stimulus. The IRS says you can keep it even if you don't qualify based on 2021 income.

Did you get advance payments of the Child Tax Credit (CTC)?
In short, ARPA enhanced the CTC by:

- Increasing the CTC for low/middle income taxpayers.
- Expanding eligibility to children age 17 (previously the CTC was for ages 0-16).
- Allowing taxpayers to receive 50% of their CTC in advance monthly payments.
- Low income taxpayers can claim the CTC regardless of income level or tax liability (a.k.a. "fully refundable").

The CTC is not taxable income, but you still need to remember how much you got. In January 2022 the IRS will send letters (Letter 6419) to the millions of taxpayers that received advance CTC payments. Save this letter. It reports the total received and you will need that for your 2021 tax return.

Most taxpayers will not have to pay-back the CTC on their 2021 tax return. This is especially true for folks whose 2021 situation (income, filing status, dependents, etc.) is similar to 2020. Those whose situation changed (significantly increased income, fewer dependents, etc.) might have to pay-back some (or all) of the advance payments. Taxpayers with 2021 income (AGI) less than $40,000/$50,000/$60,000 (single/HH/MFJ) are exempted from paying-back the advance regardless of situation changes.

Did you have kids in daycare?
ARPA also made bold enhancements to the Child and Dependent Care Credit (CDCC). In short, ARPA:

- Increased the maximum amount of qualifying daycare expenses from $3000 to $8000 per child under 13 years of age (maximum of 2 qualifying children).
- Increased the percentage of qualifying expenses that count for the credit (if your AGI is under $183,000).
- Decreased the percentage of qualifying expenses that count for the credit (if your AGI is over $400,000).
- Increased the maximum amount that you can contribute to pre-tax dependent care flexible spending accounts from $5000 up to $10,500.
- Allows low income taxpayers to claim the CDCC regardless of income level or tax liability (a.k.a. "fully refundable").

Combined together, the increased expense limit and credit percentage makes a BIG difference for low/middle income taxpayers with kids in daycare. For example, the credit jumps from $1200 to $8000 if you make less than $125,000 with two qualifying kids in daycare at a combined cost of over $16,000 (with no pre-tax daycare flex spending contributions).

Did you buy Affordable Care Act (ACA) health insurance?
The Premium Tax Credit (PTC), a type of health insurance subsidy, was also enhanced for tax year 2021. The amount of the credit was increased and taxpayers that make greater than 400% of the federal poverty level can now claim the PTC. As always, those that purchased ACA insurance will receive form 1095-A (you will need this form for your taxes).

The enhanced PTC is also available for 2022. Open enrollment for 2022 plans begins Nov. 1st, 2021. Visit www.healthcare.gov to get started (you may be redirected to your state's website if they manage their ACA marketplace).

Are you age 72 or older?
Don't forget to take your Required Minimum Distributions (RMDs) from retirement accounts. The IRS let taxpayers skip RMDs for 2020. However, RMDs are back for 2021.

Did you give to charity?
Even if you don't itemize you can deduct up to $300 ($600 for married filing jointly) in charitable contributions. This rule applies to monetary contributions only (not goods).

Did you receive unemployment compensation?
Unemployment compensation is taxable income for 2021. The ability to exclude up to $10,200 of unemployment compensation from taxable income was for tax year 2020 only.

Were you pursuing a graduate degree in 2021?
Unfortunately, the **Tuition and Fees** deduction was eliminated. However, the **Lifetime Learning Credit** still exists and more middle-income taxpayers can qualify due to increased income phase-out thresholds. Now you can make up to $90,000/$180,000 (single/MFJ) and claim the credit. Previously, it phased out completely once modified AGI exceeded $69,000/$138,000 (Single/MFJ). The amount of the credit did not change. It remains 20% of out-of-pocket tuition paid (max tuition $10,000).

Did you have student loan debt forgiven in 2021?
Good news! Student loans forgiven in 2021 are no longer taxable income. This provision will expire on 12/31/25. Student loans forgiven after that will go back to being taxable.

Did you have principal residence mortgage debt forgiven?
The amount of forgiven mortgage debt that can be excluded from taxable income went down from $2,000,000 to $750,000. You can still exclude the higher amount if you entered into a written agreement to forgive the debt during 2020.

Are you a business owner?
Business meals from restaurants are 100% deductible for 2021 and 2022. They go back to 50% deductible in 2023.

More taxpayers will get the Earned Income Tax Credit
ARPA reduced the age where 'childless' taxpayers can claim the EITC (from age 25 down to 19). ARPA also eliminated the upper age limit for 'childless' EITC claimants.

ARPA also allows some legally married taxpayers that file separately to claim the EITC. This is allowed only in the case where the married couple lives apart for the last half of the year and the qualifying child lives with the taxpayer claiming the EITC for greater than half the year.

Lastly, ARPA increases the investment income threshold for the EITC to $10,000. Previously, if your investment income was greater than $3650 you could not claim the EITC.

2021 was a year of bold tax changes, especially for low/middle income taxpayers with dependent children.

All of the following were enhanced for 2021:

- *Child Tax Credit*
- *Child and Dependent Care Credit*
- *Earned Income Tax Credit*
- *Premium Tax Credit*

These are only the highlights of the new laws affecting tax year 2021. Ask for help to determine how these (and other tax rules) apply to your specific situation.

Turn the page for some great year-end tax tips

YEAR-END TAX TIPS

Consider the following before 2021 comes to an end:

Lower Your Taxable Income: Employees still have time to increase pre-tax deductions (e.g. 401(k), 403(b), etc.) from their paycheck (unless already maxed). Self-employed folks can lower their taxable income too by making business purchases before the end of the year or contributing to a SEP IRA before the filing deadline (including extensions).

Why consider this? Not only can it reduce tax, but there are plenty of credits and surtaxes that are sensitive to income levels. Each income threshold is calculated differently and there are other limiting factors, so ask for help if you need to figure out precisely how much extra to contribute. With that in mind, here are some of the most common examples:

Did you not get the 3rd stimulus because you made more than $160,000 in 2019/2020? Perhaps you can qualify by lowering your 2021 AGI below $160k?

Do you have kids in college? The American Opportunity Credit (first four years of college) begins to phase out at an income of $80,000 (single) and $160,000 (married).

Do you own a business? The QBI deduction begins to phase out for many businesses starting at a taxable income of $164,900 (single) and $329,800 (married).

Do you have a modest income? The Earned Income Credit phases out at varying income levels between $21,430 (single with no qualifying children) and $57,414 (Married with 3+ children).

Do you have a larger income? The final phase-out of the Child Tax Credit resumes at $200,000 (single) and $400,000 (married). Medicare and investment surtaxes begin at $200,000 (single) or $250,000 (married).

Do you put money in a Roth IRA? Contributions to a Roth IRA begin to phase-out at $125,000 (single) or $198,000 (married). Roth conversions, however, are still allowed at any income level.

Do you own rental property? Your ability to deduct most rental losses incurred during the current tax year phases out between $100,000 and $150,000 of income.

Are you paying student loans? Your ability to deduct the interest begins to phase out at $70,000 (single) and $140,000 (married).

Do you buy ACA health insurance on healthcare.gov (or state run exchange)? Your premium contribution is limited to 8.5% of household income. As such, lower incomes result in a higher Premium Tax Credit.

Charity:
Roughly 85%+ of taxpayers will not itemize this year. If that's you, consider the following charity tax strategies:

- **Give up to $300 anyway.** A new rule allows you to deduct up to $300 in monetary contributions even if you don't itemize ($600 for married filing jointly).
- **Plan ahead for a QCD:** Qualified Charitable Distributions (QCDs) from an IRA are allowed for taxpayers over age 70$^{1/2}$. The contribution must be made directly from the IRA to the charity. Seniors that use this strategy can take the deduction even if they don't itemize.

Selling investments?
If your taxable income is likely to fall below $40,525 (single) or $81,050 (married) consider selling long term investments that have gained in value. You will not pay any federal tax on the gain if you keep your taxable income below those thresholds.

Conversely, it might be wise to check your portfolio for losses. You can offset up to $3,000 of other income with investment losses. If you wish to repurchase the stock again, wait at least 31 days to avoid a wash-sale that disallows the loss.

If you are planning on deducting worthless stock, remember that it's not deductible until it's completely worthless.

Roth conversions:
The deadline to convert funds from a traditional IRA to a Roth IRA is 12/31/21. Remember, the amount converted is taxable income. Also remember that you can no longer undo Roth conversions at a later date.

Health insurance:
If you choose a health plan that is compatible with **Health Savings Accounts (HSA)** you should start funding your HSA right away. That's because medical expenses do not count as a "qualified" for tax free distributions if they occur before the HSA was funded. The maximum amount you can shelter per year is $3,600 (single) or $7,200 (married). You should contribute the maximum if you can afford to. That's because HSAs have three tax benefits;

1. Contributions are a tax deduction.
2. Distributions for qualified medical expenses are tax free.
3. You can invest the funds and reimburse yourself for qualified medical expenses after the account has grown in value.

Employee fringe benefits:
Aside from HSAs, look into other pre-tax spending options that your employer offers such as; insurance, daycare, commuting, parking, education, etc.

Looking to 2022...
Congress is still debating whether or not the generous 2021 tax provisions (see page 3 for details) will be further extended.

To pay for the low/middle income tax breaks Congress is also debating:

- Raising the highest tax bracket from 37% to 39.6%
- Increased capital gains tax rates for the wealthy.
- Increased tax rates for profitable corporations.
- Increased taxes for wealthy estates.

More audits in the future?
The Biden administration proposes to increase IRS funding by $80 billion (partially to fund more audits). This is just a proposal and funding has not been approved.

The basic strategy for year-end tax planning can be summed up in the following two statements:

- *Channel your income into the year where it will be taxed at a lower rate.*
- *Channel your deductions to the year where your income will be taxed at a higher rate.*

If you need year-end tax planning a consultation would be wise.