TaxBrief

Keeping you informed November 2021

SEANA RAU
CERTIFIED PUBLIC ACCOUNTANT

2101 Overland Ave
Billings, MT 59102
(406) 855-2847
seana@seanarau.com

As 2021 comes to a close, we've highlighted a few key issues to watch for as you get ready to have your 2021 tax return prepared.

Required minimum distributions

Required minimum distribution (RMDs) were waived for tax year 2020 only, so don't forget to take your RMD for 2021 by Dec. 31, 2021.

If you turn 70½ after 2019, you must begin taking RMDs from your traditional IRA by April 1 of the year following the year you reach age 72. For example, if you turned 72 in September 2021, you can either take your 2021 RMD in 2021 or you can wait until April 1, 2022. However, you must take your 2022 RMD by Dec. 31, 2022, which means you'll have two RMDs to report on your 2022 return if you wait.

If you fail to take your RMD, you're subject to a 50% excise tax on the amount not distributed. Don't panic though. You can ask the IRS to waive the tax due to reasonable error if you take steps to remedy the shortfall. Contact our office and we'll explain what needs to be done and prepare the necessary paperwork.

Charitable contributions

Ordinarily, if you choose to claim the standard deduction, you cannot deduct your charitable contributions. Good news though, if you don't itemize deductions for 2021, you may deduct up to $300 ($600 if MFJ) on your 2021 tax return for cash contributions made to most charitable organizations.

If it's better for you to itemize deductions, you can elect to apply a 100%-of-AGI deduction limit for cash contributions made to most charitable organizations during 2021. Without this election, the usual percentage limit applies (normally 60%), and the nondeductible amount carries over up to five years. We can discuss which AGI limit is best for you based on your specific facts and circumstances.

Remember to obtain an acknowledgment letter from the charity before filing your return and retain a canceled check or credit card receipt for contributions of cash.

Child and dependent care credit

For 2021 only, the child and dependent care credit increased significantly and is fully refundable even if you have no tax liability, so don't forget to keep track of your work-related child care expenses. The dollar limit for eligible expenses is $8,000 for one child and $16,000 for two or more qualifying children. If your income is $125,000 or less, you get the maximum 50% credit rate. Otherwise, if your income is more than $125,000, the 50% rate decreases as your income rises. The credit becomes unavailable when your income exceeds $438,000.

In addition, you may be eligible to exclude up to $10,500 ($5,250 if MFS) of employer-provided dependent care benefits from gross income for 2021. However, you cannot use any child care expenses paid with these tax-free benefits for the child and dependent care credit.

Child tax credit

For 2021 only, the child tax credit (CTC) increased from $2,000 to $3,000 for each child under age 18, or $3,600 for each child under age 6. Unfortunately, the extra amount ($1,000 or $1,600, respectively) is reduced when income exceeds $150,000 for married taxpayers filing a joint return (MFJ) and qualifying widow(er)s (QW), $112,500 for heads of household (HOH) and $75,000 for single taxpayers. Good news though: the normal $2,000 credit amount phases out as usual at $400,000 for MFJ and $200,000 for all others. Thus, higher income taxpayers may lose some of the credit but not all of it. It's also fully refundable if you have no tax liability.

You also probably noticed that advance CTC payments were made monthly from July through December 2021. These payments were estimates of your 2021 CTC, generally based on your 2020 tax return. If you received advance payments in excess of the CTC allowed on your 2021 return due to a change in circumstances, you may have to repay some or all of the excess amount. For example, you may have a 2021 repayment in a shared custody arrangement if you claim your child only in even-numbered years. There is some repayment protection depending on your income level. However, if your income equals or exceeds $120,000 for MFJ or QW, $100,000 for HOH or $80,000 for single or MFS, plan on repaying the entire excess amount as additional income tax on your 2021 return.

In January 2022, the IRS will send Letter 6419, which provides the total amount of advance CTC payments that were disbursed to you during 2021. Keep this letter to give to us when we prepare your 2021 tax return.

Education tax benefits

For 2021, the tuition and fees deduction is gone, but you might benefit from the lifetime learning credit if your income is below $90,000 ($180,000 if MFJ), which matches the income limitations for the American opportunity tax credit. Furthermore, COVID-19 emergency financial aid grants under the CARES Act are excluded from gross income, but qualified education expenses paid with these tax-free grants can still be used to claim an education credit. Bring in your tuition statements at tax time so we can claim the maximum credit using all eligible expenses.

There's also a special rule for student loans discharged in 2021 through 2025. For certain types of loans, you can exclude the debt discharge from gross income. Contact our office so we can determine if your student loan qualifies for this exclusion.

Qualified principal residence debt exclusion

If the home acquisition debt on your principal residence was canceled after 2017, you may exclude up to $2 million ($1 million if MFS) from gross income for tax years 2018 through 2020. This exclusion was set to expire on Dec. 31, 2017, but was retroactively extended through Dec. 31, 2020. Give us a call if your 2018 or 2019 tax return included forgiven principal residence debt as taxable income. We can file an amended return. The 2018 amended return must be filed by April 15, 2022, so let us know as soon as possible.

This exclusion was extended again through Dec. 31, 2025. However, for discharges after 2020, you can only exclude up to $750,000 ($375,000 if MFS).

Premium tax credit

In general, if you purchase health insurance through the Marketplace, you don't qualify for any premium assistance when your income is too high. However, for 2021 and 2022, if your household income is more than 400% of the federal poverty line (FPL), you may be eligible to claim the premium tax credit (PTC) and will not pay more than 8.5% of your income for coverage.

Also, if you were unemployed and received, or were approved to receive, unemployment compensation for any week during 2021, you may be eligible for the PTC as if your household income was only 133% of the FPL, which means more premium assistance regardless of the level of your household income. If this special rule applies to you, be prepared to provide self-attestation and documentation that demonstrates the receipt of such unemployment compensation or approval.

Earned income credit

If your 2019 earned income was more than your 2021 earned income, you can use your 2019 earned income to determine the earned income credit (EIC) on your 2021 tax return. You may benefit from this provision if your income went down after 2019 due to the pandemic, or any other reason for that matter, and you're eligible for the EIC. Be prepared to provide the amount of your 2019 earned income at tax time if we don't already have it.

Last but not least, for 2021 only, the minimum age to claim the EIC without any children decreased from age 25 to age 19 for most taxpayers (age 24 for certain students), and the maximum age limit was eliminated. Thus, if you're a recent high school graduate or retirement age, you might qualify for the childless EIC for 2021, assuming you meet all the other requirements.

We hope this year-end newsletter answered some questions you may have had. As always, please reach out if you have any additional questions before your annual appointment. Happy Holidays!