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Greetings!

We hope you had a great year and an even better holiday season. Unlike last year's newsletter, there weren't nearly as many pieces of legislation affecting taxes in 2021 as there were in 2020. Two bills passed in 2021 with notable tax provisions, and we will discussthose provisions at length in this newsletter. Please note that many of the provisions passed for tax year 2021 are not extended into future years as of the date of this letter. However, drafts of the Build Back Better Act that is circulating in Congress right now contain extensions to some items, so we'll have to wait to see what is extended and what is cut.

Additionally, Washington passed two notable pieces of legislation that we will discuss at length as well. Those measures include a publicly funded long-term care program called the CARES fund, as well as a 7% tax on long-term capital gains. Both measures currently face legal and implementation issues, which we will discuss.

Changes to Our Firm

Many of you are probably familiar with our office manager, Melissa Solen, by now. Melissa is in her third year with the firm and has developed into a very knowledgeable resource. This tax season we also have two additional staff – Shelley Marshall and Alex Phillips. Shelley is an experienced bookkeeper, and Alex is a returning intern from two tax seasons ago.

This year we are implementing a policy that no return preparation will begin until your engagement letter and organizer are filled out and signed. Please see the dates and deadline section below for more information on those forms.

Lastly, we are trying to catch up with the times and move toward electronic delivery as much as possible. Beginning this year, we will not print physical copies of returns unless you indicate otherwise in your tax organizer. It came to our attention in the past couple of years that many clients do not want physical copies printed, even though that was our default delivery method for finished tax returns. We're more than happy to print paper copies if that is your preference, and you can even request to receive both a paper and electronic copy if you wish.

Please note the following dates and deadlines

January 2022: Be on the lookout for a tax organizer and engagement letter in the mail. You will receive both documents in a single package. The engagement letter and the first three pages of the organizer must be completed and signed before we can start preparing your return. These pages contain the general information page and two pages of yes or no questions. If you wish to fill out the organizer pages past page 3, please do so, but note that it is not a requirement and is simply there to help you get organized.

Businesses will also receive a packet in the mail with a business checklist and engagement letter. These forms must be signed and returned to us we can begin preparing your return.

January 31, 2022: Form 1099-MISC and 1099-NEC

March 15, 2022: Form 1065 (Partnerships) and Form 1120S (S Corporations)

April 18, 2022: Form 1040, Form 1041 (Estates and Trusts), Form 1120 (Corporations), IRA contributions, HSA contributions, and foreign asset reporting

In the remaining pages of this newsletter are updates, general reminders, and strategies. We look forward to hearing from you this tax season!

Sincerely,

GEHRING & FARRWOOD

Tim Gehring

Bo Farrwood

UPDATES, REMINDERS, STRATEGIES – FOR INDIVIDUALS

Key Changes & General Reminders

- As many of you are probably aware, dealing with the IRS since March of 2020 has been a challenge. The service is millions of pieces of mail behind, and their phone lines are very difficult to reach. While there are noticeable improvements in the past few months, we are still advising clients to expect any mail correspondence to take at least three months from the date of mailing. IRS phone lines are also down regularly due to staffing issues, so expect long delays if you attempt to call.
- If you take the standard deduction in 2021 you also qualify to take a special deduction for charitable contributions made in 2021 to 501(c)(3) entities. The limits are $300 for single filers and $600 for joint filers.
- Fill out a new W-4 with your employer if your tax situation has changed, such as a change in income, marital status, or dependents.
- The new overtime exempt threshold for qualified Washington employees is $52,474. Qualified employees include those in administrative, executive, professional, computer-related (such as a systems analyst or software engineer), and outside sales. The United States Department of Labor has very similar standards, though the current threshold is lower at $35,568.
- The deadline for contributing to your HSA for the 2021 tax year is April 18, 2022. We recommend you contribute via a payroll deduction to save an additional 7.65% on FICA taxes.
- The $10,200 unemployment income exclusion for 2020 is not available for 2021.
- Student loans discharged under the American Rescue Plan act will not be included in taxable income for 2021.
- The annual gifting limit is increased from $15,000 to $16,000 per individual or trust in 2021. The amount gifted to an individual or trust in excess of this amount is required to be reported on an annual gift tax return.
- The annual threshold for issuing Form 1099-K is $600 in 2021, down from $20,000 in prior years. 1099-K forms are typically issued by electronic payment processors but will also include cryptocurrency platforms such as Coinbase.
- Cryptocurrency (digital assets) remains a hot topic with the IRS. The tax code treats these assets similarly to stocks or other financial securities, meaning gain is recognized when the asset is sold or exchanged for another digital asset. We recommend anyone who owns digital assets to diligently track their purchases, sales, and transfers for each digital asset on each platform used to hold or trade cryptocurrency. Most platforms do not track cost basis for these assets, which means the requirement to track basis falls on you.
- Filers who obtain health insurance through a state exchange were not required to pay back the premium advance if their income was too high on their tax return. This provision is not in effect for 2021; however, the income requirements for paying back the advance are less strict in 2021 and 2022 than they have been in prior years.
- The Paid Family & Medical Leave tax in Washington has increased to 0.6%, up from 0.4% under the prior law. Additionally, the employee withholding rate has increased from 63.33% of the total premium up to 73.22%.

Washington Long-Term Care (LTC)

- Starting in 2022, Washington has a publicly funded long-term care plan that will function similarly to the Paid Family & Medical Leave plan that started in 2019. The payroll tax is supposed to start on January 1, 2022, but it is expected that this date will be retroactively delayed when the Washington legislature returns on January 10, 2022. It is unclear how long the delay will be, but we anticipate it will last at least until the second quarter of 2022.
- The plan provides LTC benefits to Washington residents who are vested in the plan and is funded by a 0.58% payroll tax.
- Those subject to the tax could opt out of the program by obtaining a private LTC policy and applying for an exemption by November 1, 2021. It is unclear whether the anticipated delay of the program will also extend the exemption request deadline.
- Benefits can be applied for starting in 2025 with a maximum lifetime benefit of $36,500, which will be inflation-adjusted.
- Employees vest by working in Washington for at least 500 hours per year for three to ten years depending on how many breaks in employment they had. Once vested, employees can apply for benefits.
- To apply for benefits you must be vested in the program and be a Washington resident.
- Unlike private LTC policies, you do not need to continue to pay into the program to receive benefits once you stop working.
- Generally, highly compensated employees, out-of-state employees, and employees who do not intend to retire in Washington won't find the program attractive, while low-wage earners living in Washington will find the program more suitable.
- To illustrate the above example, a wage earner making $10,000 per year will pay $2,320 in premiums during a 40-year career, while a wage earner making $100,000 per year will pay $23,200 in premiums during the same working period. However, both employees are entitled to receive the same lifetime benefit.

Washington Long-Term Capital Gains Tax (LTCG)

- Beginning in 2022, Washington has a 7% capital gains tax in place on LTCG of individuals.
- Washington LTCG results from the sale of capital assets held for more than one year that are attributable to Washington.
- LTCG attributable to Washington includes gains from the sale of assets located in Washington, and gains from sales made by Washington residents.
- Capital assets generally include investments, real estate, business interests, and tangible assets such as automobiles or equipment.

- There are several exemptions available, including gains from real estate, assets in retirement accounts, livestock related to agriculture, depreciable assets used by a business, and gains from the sale of a small family-owned business.
- There are also deductions available. Each taxpayer (individual or married couple) will receive a $250,000 standard deduction. Additionally, charitable contributions more than $250,000 per year qualify for a standard deduction, up to a maximum deduction of $100,000. For example, a married couple with LTCG of $800,000, charitable contributions of $500,000, and no qualifying exemptions would receive $350,000 of deductions, resulting in $450,000 of LTCG income.
- An additional deduction will be available to gains that are also taxed by another jurisdiction, such as the sale of a capital asset located in Idaho by a Washington owner.
- LTCGs will be reported on a capital gains tax return. The due date will be the same as the federal individual income tax return, and a six-month extension will be available. Similar to federal returns, Washington tax will be due on the original due date of the return, not including extensions. The first return will be due on April 15, 2023.
- Individuals will have to include LTCGs from their interests in all federal passthrough entities, such as trusts, estates, partnerships, and corporations, as well as their interests in entities disregarded for federal tax purposes, such as such proprietorships. This will in effect prevent individuals from dodging long-term capital gain income by transferring assets to an entity in which they have a financial interest.
- There have been many pieces of legislation introduced in Washington over the years trying to implement a similar tax, and most have been rejected because Washington statutes declaring there shall not be an income tax. This is the first time a measure like this has passed, and there are already several lawsuits challenging the legality of the tax. The bill codifies the tax as an excise tax, and challengers claim the tax is an income tax. At this point, it's in the Washington court's hands.
- If the legal basis for this tax holds up in court, few individuals will be affected by the tax. The most common occurrences we anticipate are from the sale of non-family-owned businesses and sales of financial securities by wealthy investors.

Economic Impact Payments (EIP) – Also referred to as stimulus payments

- In April 2021 congress passed the American Rescue Plan Act, which included $1,400 EIP for each qualifying adult and child.
- Like the two EIP payments in 2020, the 2021 payments were paid in advance based on the prior year's income and are subject to limitations.
- Like the previous EIP payments, 2021 payments are reconciled on your 2021 income tax return. If your EIP was too small due to adding a dependent or income going down, you will receive the difference as a refundable tax credit in 2021. If you were overpaid due to losing a dependent or income increasing, you do not have to pay back the overpaid amount.
- The Treasury Department sent EIPs on prepaid debit cards to many individuals. If you did not receive your debit card there are remedies available via the IRS website.
- We received many questions last year about what to do if a taxpayer received an EIP but passed away before they filed their 2020 income tax return. If the taxpayer was alive when the payment was issued, they are entitled to keep the money. If the taxpayer passed away before the EIP was made, the moneyneeds to be returned to the IRS. Published guidance provides several ways to return the funds to the IRS depending on whether the EIP was originally received via check, direct deposit, or prepaid debit card.

Child Tax Credits (CTC) – Changes for 2021 only

- The Child Tax Credit was greatly expanded for 2021 under the American Rescue Plan act.
- Credits are increased from $2,000 to $3,000 for dependents over six years and under eighteen, and $3,600 for dependents six and under.
- The increase is subject to income limitations, starting at $75,000 for single filers and $150,000 for joint filers.
- Half of the total child tax credit was paid in advance in six monthly installments, using information from prior returns to calculate the credit. Recipients of the advance payments could opt out via an online portal if they didn't wish to receive the payments in advance.
- Credits are reconciled on your 2021 income tax return. If you were paid too much in advance, you must repay that amount on your tax return unless you qualify for repayment protection. Repayment protection is available for single filers with Adjusted Gross Incomes of $80,000 or less, and joint filers with Adjusted Gross Incomes of $120,000 or less.

Dependent Care – Changes for 2021 only

- The Dependent Care Credit for 2021 was also expanded under the American Rescue Plan.
- Eligible taxpayers may receive up to a 50% credit on qualifying expenses paid that enable them to work while their dependent is cared for.
- The maximum credit is now $8,000, up from $3,000 under the prior law.
- The credit is now refundable, unlike prior versions of the credit.
- Like prior versions, the credit is limited to both spouse's earned income unless an exception applies.
- The credit begins to be reduced at Adjusted Gross Incomes of $125,000.
- The maximum that can be excluded from income under a Dependent Care Assistance Plan through an employer is $10,500 for 2021.

Retirement

- Traditional and Roth IRA contribution limits remain at $6,000 plus a $1,000 catch-up for those 50 and older. The deadline for contributing for the 2021 tax year is April 18, 2022.
- The requirement to take minimum distributions from retirement accounts is back in effect for tax years 2021 and after.
- Taxpayers can now make deductible Traditional IRA contributions at any age if they meet the income thresholds to do so.
- Inherited IRAs from original account owners who passed away after December 31, 2019, must be distributed within ten years after the death of the account owner unless an exception applies. If the original account owner passed away before this date, the RMD is based either on the inheritor's lifetime or the original account holder's lifetime.
- The 10% penalty for early withdrawal is waived for distributions up to $5,000 for qualified births and adoptions.
- Recipients of Coronavirus-related distributions in 2020 must include 1/3 of the distribution in their incomes in 2021 and 2022, assuming an election was made to split the income over three years. Recipients may pay back up to the entire amount of the distribution before December 31, 2022. An amended incometax return for prior years should be filed if any repayment is made after the original return was filed.

UPDATES, REMINDERS, STRATEGIES – FOR BUSINESS OWNERS & EMPLOYERS

Reminders & Key Changes

- Minimum Wage is now $14.49 in Washington state. This affects all wages earned after December 31, 2021.
- Keep a mileage log for all business automobile use. Your log should include dates, locations, and a description of the business purpose for each trip. Logs should be kept for each vehicle used.
- We recommend that you take a picture of the odometer on January 1 each year for all vehicles in which an automobile expense deduction is taken. This helps substantiate business mileage upon audit.
- If you deferred some your self-employment tax in 2020, half was due on December 31, 2021, and half is due on December 31, 2022.
- 2021 SEP IRA contributions are due on March 15, 2022, for businesses and April 18, 2022, for individuals. Your contribution deadline can be extended by six months by filing a federal income tax extension.
- Business meal expenses paid to a restaurant qualify for a 100% deduction in 2021, up from the usual 50% deduction. Meal deductions calculated as a Per Diem qualify for the 100% deduction rate.
- National Paid Sick Leave (NPSL) ended on September 30, 2021. NSPL provides reimbursement for 80 hours of wages to employers who paid employees who stayed home while quarantining, either for themselves or for family members. Wages paid to employees who were able to work remotely do not qualify. Employers can apply for a refund by amending the payroll tax return in which these wages were paid.
- National Paid Sick Leave is also available to self-employed individuals who were unable to work because of quarantine.
- Your business must register with the Washington Department of Revenue if you collect sales tax, owe use tax, or collect more than $12,000 in gross revenue per year. Other jurisdictions have similar licensing and registration requirements, so check with your local authority.

Employee Retention Credit (ERC)

- The ERC was extended through September 30, 2021, for qualifying employers (December 31, 2021, for Recovery Startup Businesses).
- The rules are complicated and vary depending on what year wages were paid, whether the wages went to owners or family members, how many other businesses share common ownership, and whether the business also received a PPP loan that was or will be forgiven.
- Businesses qualify if they were fully or partially shut down due to government restriction, or by showing a certain percentage revenue loss for any quarter in 2020 or 2021 compared to the same quarter in 2019. For 2020 quarters the loss must be 50% or more, and for 2021 quarters the loss must be 20% or more.
- Wages paid by a forgiven PPP loan do not qualify for the ERC, nor do wages paid to owners or their family members.
- The 2021 ERC calculation provides a more favorable credit percentage, as well as a higher qualifying wage base per employee than the 2020 ERC calculation.
- For businesses that were not in operation until after February 15, 2020, who do not qualify for the standard ERC may qualify as a Recovery Startup Business (RSB). RSBs are eligible for the ERC in the 3rd and 4th quarters of 2021 and follow the 2021 ERC calculation rules with a maximum credit of $50,000 per quarter. Note that RSBs are the only employers who may receive an ERC in the 4th quarter of 2021.
- Unlike wages paid by forgiven PPP loans, taxpayers must reduce their wage deduction on their income tax return for ERCs in the period the ERC was earned. If an employer files for an ERC refund after their income tax return is filed, they must amend their respective income tax return for that period.
- Amended payroll returns must be filed on paper, which means it will take at least 3-6 months for refunds to be processed.

Personal Property Tax

- Similar to real property tax, personal property tax is levied and collected by many counties.
- Personal property includes all tangible assets that are not real property, such as furniture, equipment, and supplies.
- Personal property not used in a business is typically exempt. Examples include your personal automobile or living room television.
- Whitman County personal property returns are due by April 30 each year.