2021 TAXES: UPCOMING CHANGES IN TAX LAWS

FROM TURBO TAX

1. The Consolidated Appropriations Act, 2021

At the end of 2020, the Consolidated Appropriations Act, 2021 became law. With its passage, several included tax provisions will affect how Americans prepare their taxes for at least one more year.

The package includes many extensions of expiring deductions and credits, extensions, and expansions of certain tax relief provisions provided as part of the national response to the pandemic and various disaster tax relief provisions.

Among the many included items, the law provides:

- $600 advance payments of a tax credit per taxpayer ($1,200 for married filing jointly) plus $600 for each qualifying child. The credit, like the first stimulus checks, phases out starting at $75,000 of modified adjusted gross income ($112,500 for heads of household and $150,000 for married filing jointly)
- an extension of the ability for businesses to deduct 100% of certain meal expenses
- a clarification that personal protective equipment is a deductible expense for qualified teachers as part of the $250 qualified educator tax deduction
- an extension of the $300 deduction for cash charitable deductions if you claim the standard deduction. For 2021, the deduction is increased to $600 for joint filers.
- clarification that gross-income will not include an amount equal to any forgiven amount of a Paycheck Protection Program (PPP) loan and that expenses paid with forgiven PPP loans are fully deductible.

2. Adjustments for inflation

As the prices of the goods and services we buy gradually go up over time, typically, so do our incomes. If the income tax system did not account for this expected change, income taxes would often grow at a faster rate than incomes, likely causing unexpected financial stress. The income taxes assessed in 2021 are no different. Income tax brackets, eligibility for certain tax deductions and credits, and the standard deduction will all adjust to reflect inflation.

For most married couples filing jointly their standard deduction will rise to $25,100, up $300 from the prior year. For most single taxpayers and married individuals filing separately, the standard deduction rises to $12,550, or half that of married filers. Most taxpayers filing as head of household will see their standard deduction increase to $18,800.

3. Planned tax increases for 2021

As mentioned previously, income tax brackets, eligibility for certain deductions and credits, and the standard deduction will all see increases in 2021 on account of inflation. One change made since the Tax Cuts and Jobs Act became law, though, is how the tax code calculates inflation.

Namely, instead of tying inflation to the traditional consumer price index, tax reform now measures inflation using something called "chained" CPI.

Essentially, this new figure measures inflation in a different, often slower way that accounts for consumers' tendency to shy away from items that undergo a large price increase. For taxpayers, this means they could more easily get pushed into a higher marginal tax bracket than before tax reform because of cost-of-living paycheck increases or annual raises that outpace the chained CPI.

4. Deductions and credits phaseout adjustments

In line with the adjustments for inflation, many tax deductions and tax credits will have their phaseouts adjusted to account for these changes. Some phaseout changes to note are:

The first, called Pandemic Unemployment Assistance, provided support for workers who usually don't receive unemployment coverage: self-employed individuals including those who work in the gig economy or freelance. The second program, called the Pandemic Emergency Unemployment Compensation program, extended unemployment benefits received through traditional state programs from 26 weeks to 39 weeks.

Other programs included in the legislation have already expired, though some have been extended after passage of the Consolidated Appropriations Act at the end of 2020. This includes allowing employees to avoid taxes on student loan payments made by their employer until December 31, 2021. The portion of the act that provided subsidies for employers to offer leave under the Family and Medical Leave Act has been extended to 2025. The CARES Act originally provided assistance through banning evictions, pausing federal student loan payments and offering paid sick leave.

On December 22, 2021, the Biden Administration extended the pause on student loan payments, accrual of interest, and delinquency collections through May 1, 2022.

Taxes 2021: Start planning now

With these tax changes in 2021, you can take advantage by planning now. Don't let opportunities like contributing more toward your retirement plan or participating in a health savings account pass you by. Contributing to these accounts can save you money for needs you have down the road and lower your tax bill today, no matter what 2021 brings.

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- **Earned Income Tax Credit**: The maximum credit for filing jointly as a married couple and claiming three or more qualifying dependents amounts to $6,728 in 2021, with the credit completely phased out at $57,414 of adjusted gross income (AGI). If you are a single filer with no dependents, you can receive a maximum credit of $1,502 with your phaseout beginning at $11,610 of AGI
- **The Alternative Minimum Tax:** Higher exemptions and income phaseouts will occur in 2021.
- **IRA contributions:** Contribution amounts remain the same in 2021, but phaseout levels for taking deductions for these contributions increase as follows:
  - For active participants in employer retirement plans, phaseout for making individual retirement account (IRA) contributions will occur at AGIs between $66,000 and $76,000 for single and head of household filers, $105,000 and $125,000 for joint returns
  - For those with IRAs who do not actively participate in another plan but their spouse does, phaseout will now range from $198,000 to $208,000 for those that are married and filing a joint return. For a married individual filing separately, the phase-out range is not subject to an annual cost-of-living adjustment and remains between $0 to $10,000.
  - Phaseouts do not apply if neither the taxpayer nor the spouse has a workplace retirement plan

5. Planned changes to the alternative minimum tax

Congress designed the Alternative Minimum Tax (AMT) to keep wealthy taxpayers from using too many tax credits, deductions, and other loopholes to avoid paying taxes.

Because the AMT's exemptions did not automatically update for inflation, an increasing number of middle-income taxpayers got hit with the AMT until a permanent, annual update got put in place starting in 2013. Now, the AMT exemption amount automatically adjusts with inflation, allowing many taxpayers to avoid the tax.

In 2020, the exemption amount came to $72,900 and began to phase out at $518,400 ($113,400 for married couples filing jointly for whom the exemption began to phase out at $1,036,800).

In 2021, these amounts will change to $73,600 with phase out beginning at $523,600 ($114,600 for married couples filing jointly with a phase out beginning at $1,047,200), respectively.

6. Changes to retirement plan distributions

Taxpayers should be aware that provisions in the CARES Act allowed individuals impacted by COVID-19 to take out up to $100,000 of retirement funds without incurring the customary 10% early withdrawal penalty. Further, the legislation also loosened requirements for retirees to take required minimum distributions (RMDs) from their retirement plans.

This penalty waiver and the relaxed rules around RMDs only applies to 2020 unless reenacted by new legislation from Congress.

7. CARES Act provisions that expired in 2020

The CARES Act provided a significant amount of financial relief meant to last only a short amount of time. Some provisions received extensions, though some major components expired in 2020.

This legislation provided unemployment assistance for millions of workers who lost their jobs as a result of COVID-19's economic impact. In addition to $600 weekly payments made to unemployed individuals, the CARES Act also established two other programs to provide relief to affected workers.