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Newsletter September 2021

September 2021 Due Dates

September 15 - S Corporations

File a 2020 calendar year income tax return (Form 1120-S) and pay any tax due. This due date applies only if you requested an automatic 6-month extension. Provide each shareholder with a copy of their Schedule K-1 (Form 1120-S) or a substitute Schedule K-1.

September 15 - Corporations

Deposit the third installment of estimated income tax for 2021 for calendar year.

September 15 - Partnerships

File a 2020 calendar year return (Form 1065). This due date applies only if you were given an additional 5-month extension. Provide each partner with a copy of K-1 (Form 1065) or a substitute Schedule K-1.

September 30 - Fiduciaries of Estates and Trusts

File a 2020 calendar year return (Form 1041). This due date applies only if you were given an extension of 5 1/2 months. If applicable, provide each beneficiary with a copy of K-1 (Form 1041) or a substitute Schedule K-1.

September 15 - 3rd Quarter Estimated Tax Payment Due

The third installment of 2021 individual estimated taxes is due. Our tax system is a “pay-as-you-earn” system. To facilitate that concept, the government has provided several means of assisting taxpayers in meeting the “pay-as-you-earn” requirement. These include:

- Payroll withholding for employees;
- Pension withholding for retirees; and
- Estimated tax payments for self-employed individuals and those with other sources of income not covered by withholding.

When a taxpayer fails to prepay a safe harbor (minimum) amount, they can be subject to the underpayment penalty. This penalty is equal to the federal short-term rate plus 3 percentage points, and the penalty is computed on a quarter-by-quarter basis.

Federal tax law does provide ways to avoid the underpayment penalty. If the underpayment is less than $1,000 (the de *minimis* amount), no penalty is assessed. In addition, the law provides "safe harbor" prepayments. There are two safe harbors:

- The first safe harbor is based on the tax owed in the current year. If your payments equal or exceed 90% of what is owed in the current year, you can escape a penalty.
- The second safe harbor is based on the tax owed in the immediately preceding tax year. This safe harbor is generally 100% of the prior year's tax liability. However, for taxpayers whose AGI exceeds $150,000 ($75,000 for married taxpayers filing separately), the prior year's safe harbor is 110%.

CAUTION: Some state de *minimis* amounts and safe harbor estimate rules are different than those for the Federal estimates. Please call this office for particular state safe harbor rules.

Should You Opt Out of the Advance Child Tax Credit?

If you have children under the age of 18, by now you likely have gotten your first advance child tax credit payment, either by check or by direct deposit. Be aware, this is money you would have gotten credit for on your 2021 tax return when you file it next year anyway. You are just receiving it in advance, meaning you may not get as much as expected when you file your tax return.

The Government is touting the advance child tax credit as a major step toward reducing child poverty and sustaining families during the pandemic. However, paying it in advance and in small monthly amounts may spell trouble for those who traditionally rely on large tax refunds to fund their IRAs, property taxes, vacation, etc., since their 2021 refunds may not be what they'd planned on. Others, who deliberately cut back on tax withholding during the year and use the tax credit to make up for the under-withholding when they file their return, may be surprised next spring to find they owe tax and may even have an underpayment penalty. The list goes on of taxpayers for whom the advance credit payments aren't going to be very helpful. Small monthly payments can easily be used up on frivolous items and result in unpleasant surprises at tax time.

The American Rescue Plan Act of 2021 authorized the advance payments for one year only (2021), and the monthly payments are being made automatically to all qualifying individuals unless they go to the **IRS website** and opt out. The Biden Administration estimates that 39 million families are qualified for the advance payment and about 2.6% had opted out of the first payment (July 15, 2021).

The payments are estimated based on a taxpayer's family makeup (children and filing status) and taxpayer income, since the credit phases out for higher income taxpayers. The IRS is basing the advance credits on the income taxpayers reported on their 2020 returns (or 2019 if the 2020 return hasn't yet been filed). Some taxpayers may be in for an unpleasant surprise when they discover they were not qualified for the advance payments they received either because the number of their qualified children changed, or the children's ages disqualify them for the credit. On top of that, many may not have been working in 2019 or 2020 and the income the advance credit was based on was lower than their actual 2021 income, which may be above the 2021 credit phaseout threshold, thereby reducing or eliminating the credit.

The credit is reduced by $50 for each $1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income exceeds the thresholds illustrated below.

- $75,000 for single filers and married persons filing separate returns.
- $112,500 for heads of household.
- $150,000 for married couples filing a joint return and qualifying widows and widowers.

A taxpayer whose advance credit payments exceed what their actual credit turns out to be will need to repay the excess with their 2021 tax return.

If you've received advance child credit payments, in January 2022 the IRS will send you a letter recapping the amount of advance credit they sent you, this information will be needed for filing your tax returns and when reconciling the advance credit payments with the actual credit on your 2021 return. Just in case the letter goes astray, you should carefully keep track of the advance credit payments you received.

If you have questions related to how the advance payments may impact the outcome of your 2021 tax return and whether you should opt out of any additional advance payments, or perhaps adjust your withholding or estimated tax payments to account for the advance credits, please contact this office.

Don’t Have a Retirement Plan? Maybe a SEP Is the Answer

Like many small business owners, you probably find yourself very busy in the wake of the COVID slowdown and are getting back up to speed. But don’t forget about your future.

There are a number of retirement plans available, including Keogh plans and 401(k)s. However, a simplified employee pension plan (SEP) may be your best option.

The reason a SEP is “simplified” is that its retirement contributions are deposited into a traditional IRA account under the control of the SEP participant, thus eliminating most of the employer’s administrative duties. That is why these plans are sometimes referred to as SEP-IRAs.

SEPs function much like Keogh retirement plans, and they allow tax-deductible contributions for both employees and self-employed individuals. For an employee, the maximum contribution for 2021 is the lesser of 25% of that employee’s compensation or $58,000. These contributions are excluded from the employees’ wages and are not subject to withholding for income tax or FICA. A self-employed person can contribute 25% of his or her compensation after deducting the employer’s contribution, which boils down to the smaller of 20% of the business’ net profit or $58,000. Each year, the employer can specify a compensation amount between zero and 25% (not exceeding the maximums for the year).

SEPs are a great option for startups and other small businesses that have unpredictable income and that may be leery of the long-term contribution matches required with other types of retirement plans. SEPs are also a great option for self-employed individuals with no employees, as the contributions are based upon net profits, allowing the business owner to select the maximum percentage while knowing that the required contribution will be small in low-income years.

Except for when employees are covered by collective bargaining agreements, an employer that elects to make a SEP contribution for the year must contribute to an employee’s SEP-IRA if the employee is at least 21 years of age, has worked for the employer in at least three of the prior five calendar years, and for 2021 has compensation of at least $650. The compensation floor is subject to inflation adjustment annually and had been $600 from 2015 through 2020.

Another advantage of SEP plans is that contributions are allowed after the account owner has reached the age of 72 and must begin taking required minimum distributions from the plan.

As with all traditional IRAs and qualified plans, distributions from a SEP are taxable and subject to a 10% early withdrawal penalty if funds are withdrawn before age 59½.

A SEP-IRA must be set up by or for each eligible employee, and may be set up with banks, insurance companies or other qualified financial institutions. When setting up a SEP plan, you can adopt the IRS model plan by using Form 5305-SEP or you can adopt whatever plan is offered by the financial institution you’ll be dealing, with, the latter being the better option to ensure that all plan requirements are met. If using a financial institution’s plan, be sure to discuss the plan’s fees.
A SEP can be established and funded up to the due date of the business’ income tax return – even up to the extended due date.

A SEP may be the best option for your business’s retirement plan. Please call this office for more information on how a SEP plan might work for your particular business structure or to determine whether other options should be considered.

Thank you for selecting our firm for your tax and accounting needs. We appreciate the confidence you have shown in us, and we remain ready to assist you at any time.

Scott Jensen
Kramer & Jensen, LLC

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