Kramer & Jensen LLC
Certified Public Accountants

Contact Us:

Kramer & Jensen LLC
7430 E. Caley Ave. Suite 300E
Centennial, CO 80111
T 303-741-2253
F 855-330-4215
sjensen@kramerjensen.com

Newsletter December 2021

President Biden's Build Back Better Act Passed by The House; Fate Now in the Senate's Hands

On November 19, 2021, the House of Representatives passed their proposed version of President Biden's Build Back Better Act, which was substantially pared down from the original version. The Senate will now take up the legislation, and without question we fully expect there will be changes.

Then the Senate-altered version will have to go back to the House and a compromised version negotiated before a final bill can go to the President's Desk for his signature. Reliable sources indicate a final bill will not be available until towards the end of the year.

Here are some of the tax provisions included in the House version, but there's no guarantee any of them will make it through to the final legislation.

- Adding surtaxes on high-income taxpayers:
  - 5% tax on individuals with modified adjusted gross incomes more than $10 million and more than $200,000 for estates and trusts.
  - An additional 3% tax on income in excess of $25 million ($500,000 for estates and trusts).
- Applying the Net Investment Tax to business income for married taxpayers filing jointly with a MAGI more than $500,000 ($400,000 for single and $250,000 for married filing separate taxpayers).
- Extending the increased Child Tax Credit and advance credit payments for one additional year, 2022. Thus for 2022 the credit would be $3,000 per qualifying child, up from $2,000 in 2020. The credit for a child under age 6 would be $3,600.
- Under prior law as enacted in the TCJA the state and local tax (SALT) deduction was limited to $10,000. The SALT limitation would be increased to $80,000, effective for 2021.
- Extending and enhancing green energy credits, including home energy savings, solar credit, and electric vehicle credits.

Not included in this version of the bill are the following provisions that were included in the original:

- High-income taxpayer limits on IRAs.
- Increased capital gains tax rates;
- Increased corporate income tax rates; and

- Increased income limits for the 20% deduction for business pass-through income.

Remember, there is no certainty any of the above will be reflected in the final legislation.

Avoiding IRS Underpayment Penalties

Congress considers our tax system a “pay-as-you-go” system. To facilitate that concept, the government has provided several means of assisting taxpayers in meeting the “pay-as-you-go” 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 nondeductible interest penalty is higher than what might be earned from a bank. The penalty is applied quarterly, so making a fourth-quarter estimated payment only reduces the fourth-quarter penalty. However, withholding is treated as paid ratably throughout the year, so increasing withholding at the end of the year can reduce the penalties for the earlier quarters. This can be accomplished with cooperative employers or by taking an unqualified distribution from a pension plan, which will be subject to 20% withholding, and then returning the gross amount of the distribution to the plan within the 60-day statutory rollover limit (but check with this office before using the latter strategy).

Federal law and most states have so-called safe harbor rules, meaning if you comply with the rules, you won’t be penalized. There are two Federal safe harbor amounts that apply when the payments are made evenly throughout the year.

1. The first safe harbor is based on the tax owed in the current year. If your payments equal or exceed 90% of your current year’s tax liability, you can escape a penalty.
2. The second safe harbor—and the one taxpayers rely on most often—is based on your tax in the immediately preceding tax year. If your current year’s payments equal or exceed 100% of the amount of your prior year’s tax, you can escape a penalty, regardless of the amount of tax you may owe when you file your current year’s return. If your prior year’s adjusted gross income was more than $150,000 ($75,000 if you file married separate status), then your payments for the current year must be **110%** of the prior year’s tax to meet the safe harbor amount.

Where taxpayers get into trouble is when their income goes up or their withholding goes down for the current year versus the prior year. Examples are having a substantial increase in income, such as when investments are cashed in, thereby increasing income but without any corresponding withholding or estimated payments. Another frequently encountered situation is when a taxpayer retires and their payroll income is replaced with pension and Social Security income without adequate withholding. Taxpayers who don’t recognize these types of situations often find themselves substantially underpaid and subject to the underpayment penalty when tax time comes around.

The bottom line is that **100%** (or **110%** for upper-income taxpayers) **of your prior year’s total tax** is the only true safe harbor because it is based on the prior year’s tax (a known amount), whereas the 90% of the current year’s tax amount is a variable based on the income for the current year, and often that amount isn’t determined until it is too late to adjust the prepayment amounts.

That being said, there are times when using the 100%/110% safe harbor method doesn’t make a lot of financial sense. For example, let’s say that in the prior year, you had a large one-time payment of income that boosted up your tax to $25,000, which is $10,000 more than you normally pay. You know that you won’t have that extra income in the current year. Rather than rely on the 100%/110% of prior tax safe harbor, where you’d be prepaying $10,000 more than your current year’s tax is likely to be, it may be appropriate to use the 90% current-year tax safe harbor, determined by making a projection of your current year tax, and as the year goes along, monitoring your income and the tax paid in to be sure you are on track to reach the 90% goal.

Please contact this office promptly if you have a substantial increase in income, so that withholding or estimated tax payments can be adjusted to avoid a penalty.

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

VISIT OUR WEBSITE

SPREAD THE WORD
SHARE THIS EMAIL

Kramer & Jensen, LLC
sjensen@kramerjensen.com

Share This Email as Webpage

KEEP UP ON THE LATEST
SIGN UP FOR OUR EMAILS