

2020/2021 INCOME TAX UPDATE

Chicago Volunteer Legal Services Foundation

Chicago, Illinois

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The logo consists of the word "WIPFLI" in a bold, white, serif font, centered within a solid blue rectangular background.

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LAWRENCE R. KRUPP, C.P.A., J.D.

Lawrence R. Krupp is a Director at Wipfli, LLP. He has extensive experience in tax consulting for individuals, private foundations, associations and charitable not-for-profit organizations. He has been engaged in many consulting assignments in the areas of securing and maintaining tax-exempt status and minimizing the tax on unrelated business income. Accomplishments include the merger of two business associations; securing public charity status for a private school, a youth counselling organization, and a request to convert a private foundation into a public charity. In addition, he has successfully negotiated settlements with the Internal Revenue Service and United States Tax Court on various tax related issues.

Larry earned a B.S. degree in Accounting from the University of Illinois-Urbana/Champaign and a law degree from Loyola University of Chicago. He is both a licensed CPA and attorney and a member of the American Institute of Certified Public Accountants, the Illinois CPA Society, the Illinois State Bar Association and the Decalogue Society of Lawyers. He is admitted to practice before the U.S. Tax Court.

Larry serves on the University of Illinois Foundation Library Board of Advocates and is a Trustee and Treasurer of The Decalogue Foundation. He is the past Chairman of the Federal Tax Section Council and of the Employee Benefits Section Council of the Illinois State Bar Association. He also is the Chair of the First Folio Theatre Board of Directors. Larry frequently speaks on tax and related topics for professional, charitable and business organizations including the annual tax updates for the Decalogue Society of Lawyers and the Chicago Volunteer Legal Services Foundation.

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I. Coronavirus Aid, Relief, and Economic Security Act – “CARES Act” (PL 116-136, March 27, 2020)

A. Retirement Provisions

1. No 10% penalty for COVID related distribution in 2020
 - a. Up to \$100,000 distribution
 - b. Contribute back within 3 years from distribution date
 - c. Include income over 3 years starting with year of distribution
2. RMD suspended only for 2020

B. Charitable Provisions

1. \$300/\$600 above line deduction for non-itemizers in 2021
 - a. Cash
 - b. Public Charity
 - c. Not to Donor Advised Fund
2. 100% of AGI for cash contribution to public charity
3. 25% of net income for corporations

C. Miscellaneous Provisions

1. \$10,000 lifetime for Section 529 plan withdrawal for student loan payments
2. Health Savings Account
 - a. Non-prescription drugs qualify for reimbursement
 - b. Menstrual products qualify for reimbursement

3. Rebates

- a. Non-taxable
- b. Current information www.irs.gov/coronavirus

II. Consolidated Appropriation Act (December 27, 2020)

- A. 100% meals deduction for 2021 and 2022
- B. 7½% limit on medical expense made permanent
- C. Mortgage forgiveness up to \$750,000
- D. Educators can deduct COVID supplies

III. Appropriation Act of 2020 (PL116-94, December 20, 2019)

A. Individual Provisions

- 1. IRA Contributions allowed after 70 ½
- 2. RMD Raised to age 72
 - a. After December 31, 2019
 - b. If age 70 ½ before January 1, 2020 old rules apply
- 3. Non-spouse inherited IRA must be withdrawn by end of 10th calendar year after death
 - a. Exception for minor child and
 - b. Beneficiary not more than 10 years younger than decedent
- 4. 529 Plans
 - a. Apprenticeship program applies
 - b. \$10,000 lifetime to pay student loan
- 5. Kiddie Tax
 - a. Investment and unearned income
 - b. Form 8815
- 6. \$5,000 penalty free IRA withdrawal for adoption purposes (\$10,000 for married couples)

B. Retirement Provisions

1. 401(K) eligibility
 - a. 500 hours for 3 consecutive years
 - b. Elective deferrals only, not employer contributions
 - c. Effective for plan years after December 31, 2020
2. Cannot use credit/debit card for plan loans
3. Can adopt plan by due date of tax return

C. Extenders

1. Mortgage Insurance Premium deduction
2. \$4,000 tuition expense
3. 3-year depreciation on racehorses two years old and younger
4. 7-year depreciation on motor sport facilities
5. Credit for home energy improvements

D. Tax Exempt Provisions

1. Private Foundation
 - a. 1.39% Excise tax
 - b. Years beginning after December 31, 2019

IV. Tax Cuts and Job Act (PL 115-197, December 22, 2017)

A. Individual Provisions

1. Standard Deductions 2021
 - a. \$25,100 Married Filing Jointly
 - b. \$12,550 Single, Married Filing Separately
 - c. \$18,800 Head of Household
 - d. Elderly/Blind – (married) \$1,350; (unmarried) \$1,700
 - e. Indexed for Inflation

2. Personal Exemptions
 - a. Zero
 - b. Eliminated
3. Alternative Minimum Tax
 - a. Retained
 - b. Exemption and phase out level increased
 - c. Index for inflation
4. State and Local Taxes
 - a. \$10,000 limit for MFJ, Single, H of H
 - b. \$5,000 limit for MFS
5. Mortgage Interest
 - a. Limited to interest on \$750,000 beginning December 15, 2017
 - b. \$100,000 home equity loans eliminated unless for improvements, additions, etc.
6. Alimony – Agreements executed after December 31, 2018
 - a. Not deductible by payor
 - b. Not taxable by recipient
7. Miscellaneous Itemized Deductions no longer allowed
 - a. Investment fees
 - b. Tax preparation and planning
 - c. Unreimbursed employee expenses
 - d. Applies to trusts/estate returns
8. Moving Expenses
 - a. Taxable if employer reimburses employee
 - b. Not deductible if paid by taxpayer
 - c. Exception for active-duty military.

9. Casualty and Theft Losses only for Federally declared disaster areas

10. Section 529 Plan withdrawals for elementary and secondary school

d. Private, Public, Religious school

e. \$10,000 limit per year

B. Estate and Gift Tax Provisions

1. \$12,060,000 for 2022 and \$11,700,000 for 2021

2. \$16,000 for 2022 and \$15,000 gift exclusion for 2021

C. Recharacterization from Roth to Traditional repealed

D. Exempt Organization Provisions

1. 21% excise tax on compensation over \$1,000,000

2. 1.4% excise tax on certain private college endowments

3. Unrelated business income/losses no longer netted against each other

V. Rates, Deductions, and Other

A. Individual Tax Rates for 2021

1. 10%, 12%, 22%, 24%, 32%, 35%, and 37%

2. 2021 Qualified Dividends and Long-Term Capital Gains

a. 0% if income below \$80,800 (MFJ)/\$40,400 (S)

b. 15% if income below \$501,600 (MFJ)/\$445,850 (S)

c. 20% if income above \$501,600 (MFJ)/\$445,850 (S)

B. Individual Deductions

1. Personal Exemptions are gone

2. Itemized Deductions

a. Income or Sales Tax election has been made permanent

b. Standard deduction - See IV.A.1

C. Child/Dependent Care

1. \$3,000 per child/dependent; maximum \$6,000
2. Reduced for Dependent Care Plan amounts

D. Education

1. American Opportunity Tax Credit made permanent
 - a. 100% of first \$2,000 and 25% of next \$2,000
 - b. First four years of post high school education
 - c. Tuition, fees, course materials qualify
 - d. Phase-out \$160,000-\$180,000 (MFJ)/\$80,000-\$90,000 (S)
 - e. Up to \$1,000 refundable
2. Lifetime Learning Credit
 - a. 20% of first \$10,000
 - b. Any post high school education
 - c. Tuition, fees, course materials qualify
 - d. Phase-out \$118,000-\$138,000 (MFJ)/\$59,000-\$69,000 (S)
 - e. Limited \$2,000 per return
3. Coverdell/Education IRA Accounts
 - a. \$2,000 per year per beneficiary
 - b. Elementary/Secondary School expense qualify
 - c. Can be used with credits

VI. Additional Medicare Tax

- A. .9% on Excess Wages and Self-Employment income
1. Employee, not employer, subject to tax
 2. \$250,000 (MFJ)/\$200,000 (S)

3. Combined earnings of couples
4. Withholding requirement for salary over \$200,000

B. 3.8% on Net Investment Income

1. Excess over Modified Adjusted Gross Income
2. \$250,000 (MFJ)/\$200,000 (S)
3. Net Investment Income
 - i. Interest, Dividends, Royalties, Rents
 - ii. Passive Activity
 - iii. Capital transactions
 - iv. Not IRA, Pension, Social Security

VII. Employee Benefits

A. Transit, Van Pooling and Parking Exclusions for 2022

1. \$280 per month for parking
2. \$280 per month for transit and van pooling
3. Can receive both parking and transit benefit
4. Not deductible by employer

B. Flexible Spending Arrangements

1. \$2,850 for 2022 and \$2,750 for 2021
2. 2021 must be used by March 15, 2022

VIII. Health Savings Accounts

A. Contributions not linked to deductible

1. Family Coverage
 - a. \$7,200 for 2021
 - b. \$7,300 for 2022

2. Individual Coverage

- a. \$3,600 for 2021
- b. \$3,650 for 2022

B. Catch-up Contributions

- 1. 55 years old by year-end
- 2. \$1,000 for 2021 and 2022

C. Contribute up to April 18, 2022 for 2021

IX. Standard Mileage Deduction

A. Business

- 1. 56¢ for 2021
- 2. 58.5¢ for 2022

B. Charity - 14¢ for 2021 and 2022

C. Medical and Moving

- 1. 16¢ for 2021
- 2. 18¢ for 2022

X. Retirement Savings

A. Individual Retirement Accounts

1. Contribution Level

- a. \$6,000 for 2022 and 2021
- b. \$1,000 catchup if age 50 at year end

2. Non-active spouse can deduct if joint AGI

- a. Less than \$198,000 (Phase-out \$208,000) – 2021
- b. Less than \$204,000 (Phase-out \$214,000) – 2022

3. Penalty-free withdrawal

- a. Qualified higher education expenses

- b. First-time home buyers
- c. Adoption expenses
- 4. Phase-out for contributions (see G below)
- 5. No age restriction on contribution

B. Roth IRA's

- 1. Same limits as Regular IRA
 - a. Non-deductible
 - b. Reduced by other IRA contribution
- 2. No tax on earnings
- 3. Tax-free withdrawals
 - a. Held at least 5 years
 - b. Over age 59 ½, death, disability
- 4. Phase-out for contributions (See F below)
- 5. No income limit on conversion from traditional IRA
- 6. No age restriction on contribution

C. Qualified Retirement Plans

- 1. 25% of compensation
- 2. Maximum compensation
 - a. \$290,000 for 2021
 - b. \$305,000 for 2022
- 3. Maximum contribution
 - a. \$58,000 for 2021
 - b. \$61,000 for 2022

D. 401(k) Plans

1. Contribution

a. \$19,500 for 2021

b. \$20,500 for 2022

2. \$6,500 catch up for those over 50 by year end for 2021 and 2022

3. Up to 100% of compensation

E. Social Security Wage Base –

a. \$142,800 for 2021

b. \$147,000 for 2022

F. Roth IRA Phase-out

1. Single

a. \$125,000 to \$140,000 for 2021

b. \$129,000 to \$144,000 for 2022

2. Married Filing Jointly

a. \$198,000 to \$208,000 for 2021

b. \$204,000 to \$214,000 for 2022

G. Traditional IRA Phase-out

1. Single

a. \$66,000 to \$76,000 for 2021

b. \$68,000 to \$78,000 for 2022

2. Married Filing

a. \$105,000 to \$125,000 for 2021

b. \$109,000 to \$129,000 for 2022

XI. Illinois Matters

- A. Individual Rate is 4.95%
- B. Replacement Tax remains at 1.5% for Trusts, Partnerships and S Corporations
- C. Corporation Rate (including 2.5% Replacement Tax) is 9.5%
- D. Safe Harbor Estimates for Individuals
 - 1. 100% of prior year liability
 - 2. 90% of current year liability
- E. Estate Tax
 - 1. \$4 million Exclusion
 - 2. Rate
 - a. Starts at .8% for \$90,000
 - b. Maximum at 16% for \$10,040,000
- F. Tax Credits
 - 1. Education Credit for Private or Public School
 - a. 25% of qualified expenses
 - i. Amount over \$250
 - ii. Tuition/fees
 - i. Regular school year
 - b. Qualified Student
 - i. Illinois resident
 - ii. Under age 21 at end of school year
 - i. Kindergarten through 12th grade
 - c. Maximum credit is \$750
 - d. Non-Refundable

2. Real Estate Tax
 - a. 5% of tax paid
 - b. Primary residence only
 - c. Not allowed if AGI above \$500,000 (MFJ) or \$250,000 (for other returns)
3. Taxes Paid to Other States
 - a. Limited to Illinois tax on income
 - b. Not gambling winnings
4. Educator - \$250 for supplies per taxpayer

G. Exemption

1. \$2,375 for 2021
2. \$1,000 for age 65 or blind
3. Not allowed if AGI above \$500,000 (MFJ) or \$250,000 (for other returns)

H. Deduct payments to Illinois College Saving Programs

1. Bright Start or College Illinois or Bright Directions
2. \$20,000 (MFJ)/\$10,000 (S)

XII. Interesting Cases

- A. *Pinkert v. Schwab Charitable Fund* (Case No. 20-cv-07657-LB) held that a donor to a donor advised fund (DAF) lacked standing to sue. Pinkert had attempted to raise the issue that the DAF should have negotiated better rates and fees with Charles Schwab & Company.
- B. *Giving Hearts, Inc. v. Commissioner* (TC Memo 2019-94) revoked exempt status because taxpayer was "not operated exclusively for exempt purposes" but was instead a front for a for profit window replacement company.
- C. *Chancellor v. Commissioner* (TC Memo 2021-50) disallowed \$6,000 of cash contributions. Taxpayer's testimony was that she "had * * * people that I was charitable to" including "helping with my family."