Certified Public Accountants

Gatto McFerson

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Dear Friends and Colleagues,

There has been panic in the streets over the proposed Biden tax increases, specifically the steep jump in the capital gains rate.

Before jumping to any conclusions, we thought it would be helpful to review what we know and what we don't know about these proposed tax increases:

What We Know

- Currently, the long-term (held more than one year) capital gain tax rate is 20%. If the taxpayer's income is high enough, there is an additional 3.8% Medicare surtax on his/her net investment income;
- That's it.

What's Been Rumored

- The Biden proposal would tax capital gains at a 39.6% rate for the highest earning taxpayers. The 3.8% Medicare surtax would remain in place for these upper-end taxpayers, making the total tax rate 43.4%;
- That tax rate would apply to returns on assets held in taxable accounts and sold after more than a year. This increase would not apply to gains in retirement accounts.

What We Can Speculate On

- Would this apply to the sale of a business? <u>Some experts believe that the sale of a business – a once-in-a-lifetime type event for most taxpayers – could be excluded from this rate increase.</u> This exception gains traction when you consider that the 3.8% Medicare surtax on investment income already <u>does exclude the sale of a business;</u>

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- Would this apply to the sale of a personal residence? Currently, the first $500,000 in gain is excluded from capital gain taxes for joint filers. For most taxpayers throughout the country, that exclusion is more than enough. But what about residents of states with high-priced real estate, like California or New York? Would their senators and representatives fight for additional protection from these increased rates?
- Will this bill pass in 2021 or 2022? It seems that the infrastructure/corporate tax increase bill is first on deck. Would getting two massive tax bills through Congress in the next eight months be possible?
- Would this increase be retroactive? Typically, when a new tax law is passed, increases take effect the day it is passed, while benefits can be retroactive back to a specific date;
- How much will change during the process? With a razor-thin majority and at least two Democratic senators already balking at the increases, could this proposal get watered-down?

President Biden is supposed to unveil his new tax plan this week. Let's read the fine print and gauge the reaction before jumping to any conclusions.

New Individual Tax Deadline

The IRS has postponed the filing and payment deadline for all individual tax returns to Monday, May 17, 2021.

No late payment interest or penalties will accrue for those choosing to use the deadline postponement of May 17, 2021.

If taxpayers wish to request an automatic extension to October 15, 2021, they may still do so, but any taxes owed would be due May 17, 2021.

California, and most other states, have conformed to the IRS filing and payment extension date of May 17, 2021.

Other Affected Deadlines

You also now have until May 17, 2021 to contribute to your Traditional IRA, ROTH IRA, and Health Savings Accounts.

E-Filing and Direct Deposits Highly Recommended

According to the IRS, tax returns that are paper filed, and/or refunds using paper checks will take much longer to process this year. Filing electronically and opting to receive refunds via direct deposit will significantly decrease the processing time.

PPP Second Draw Application Deadline Extension

The application deadline for the 2nd PPP loans has been extended until May 31, 2021. The bill extends the filing deadline for PPP loans by 60 days and gives an additional 30 days to the SBA to process the applications received by May 31.

California PPP Deductibility

For Federal taxes purposes, Paycheck Protection Program (PPP) loans, when forgiven, will not be taxable. The expenses those funds were spent on will be deductible, so it is the best of both worlds.

For California tax purposes, however, these issues remain murky. The forgiven PPP loan will not be taxable, but there are questions regarding the deductibility of the PPP funds spent on payroll and other business expenses.

AB 80 is the California legislation that is supposed to address all of this, but as of mid-week, the Governor's office announced that AB 80 had been put on hold. AB 80, as initially drafted, would provide at least partial conformity to the federal provision allowing PPP borrowers to deduct expenses paid with forgiven loan amounts.

The state is awaiting additional guidance from the U.S. Treasury Department to see if AB 80 can be enacted.

Deadline to Apply for Forgiveness

There has been some confusion as to when the deadline is to submit the PPP Forgiveness Application. As long as the borrower submits its loan forgiveness application within 10 months of the completion of the Covered Period, the borrower will not be required to make any principal or interest payments to the SBA. So, as an example, if your Covered Period ended August 31, 2020, then your deadline is June 30, 2021.

Should you have any questions about the above, please feel free to contact our office at any time.

Sincerely,

Tom A. McFerson, CPA, ABV
Gatto McFerson, CPAs