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PRODUCT & SERVICE GUIDE

Do Your Clients Need a Mid-Year Tax Checkup?

CPA tax advisors are in a unique position as financial physicians. Now is an ideal time to be proactive and contact clients who might be in need of a mid-year financial check-up. With potentially significant changes to the tax landscape looming, we ...

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By Jim Guarino, CPA, PFS, CFP, MST.

Health and wealth. A lot more connects these two ideas than the simple fact that they happen to rhyme. Just as we need to regularly monitor our physical health, it is important to manage our financial health as well. As we age, both demand much more of our attention. As a tax and financial professional and an aging baby-boomer, I speak from experience on both.

The Covid-19 pandemic caused all of us to pause and survey our personal and financial well-being. The health ramifications were obvious; the wealth implications were just as diverse and indiscriminate.

Just as people need a medical physician to monitor their physical health, individuals should have a trusted professional to advise them with their financial health, a financial physician; CPAs frequently assume this role for their clients.

Financial Physicians

CPAs had the opportunity to exhibit their skillset in a multitude of ways this past year, helping clients navigate the financial turbulence that accompanied the pandemic. Whether it involved guiding them with the Paycheck Protection Program, determining eligibility for the Recovery Rebate Credit or simply responding to tax and financial inquiries, CPAs provided vital support to their clients when it was needed most.

Financial transactions can be negatively impacted by “tax drag” if appropriate tax planning isn’t conducted beforehand. As the midpoint of 2021 approaches, it is a crucial time for “financial physicians” to consult with their patients for a mid-year tax checkup.

2021 Tax Planning – Taxes on Sale?

High-income taxpayers might view current tax rates as being “on sale” for the remainder of 2021, considering potential tax rate increases advocated by President Biden for high-income earners. To a certain extent, the lower tax rates currently in place might be equated to “sale prices” and taxpayers would be wise to take advantage of them before they are gone next year.

President Biden’s plan would return the top marginal income tax rate to nearly 40%, reversing a key component of President Trump’s Tax Cuts and Jobs Act of 2017. It would also require households earning more than $1 million annually to pay higher taxes on capital gains, which sometimes make up the largest share of taxable income for the wealthy. Tax advisors should be discussing planning strategies with their high-income earners as part of their mid-year check-up.

2021 Tax Planning Version 2.0

President Biden made it clear during his presidential campaign that he would raise taxes for certain high-income individuals. Upon winning the White House, taxpayers were put on notice that the President's campaign tax proposals were moving closer to reality. Although tax professionals were aware of the possibility for a retroactive implementation of any future 2021 tax legislation, tax planning until now focused on strategies under the current 2021 tax law. In April, President Biden formalized his tax law change proposals as part of The American Families Plan announcement. Much of the tax proposals included in his plan were consistent with his campaign proposals.

However, President Biden fired a shot across the bow with his May 28th announcement, indicating his higher tax rate proposals would in fact be *retroactive,* effective to the date of announcement. This possibility changes the stakes for 2021 tax planning. At this point, tax advisors are going into triage mode. It is important that we evaluate all our clients to determine which ones are most in need of urgent assistance.

I've decided to categorize my clients into three camps based on their historical tax reporting and projected 2021 taxable income: critical; monitor; and stable. Working backwards, the category three "stable" clients are the ones who will generally not be impacted by any of the President's tax proposals or income tax rate hikes. Unless an unusual transaction occurs, we do not anticipate needing to make any planning changes with these clients.

Next are the "monitor" clients who are on the cusp of being impacted by the higher rates or have a pending 2021 investment or business transaction. These are the folks who need to know whether certain taxable income transactions will cause their income to spike high enough to be impacted. The financial implications of paying an additional tax would need to be factored into their decision before they decide to finalize the transaction.

Finally, the "critical" clients. These are the ones most at-risk. These higher income folks are in the crosshairs of President Biden's plan. They will ultimately pay more in taxes on both their ordinary income as well as their investment income under the proposed tax rate increases.

Time for Action

CPA tax advisors are in a unique position as financial physicians. Now is an ideal time to be proactive and contact clients who might be in need of a mid-year financial check-up. With potentially significant changes to the tax landscape looming, we want to take stock of our clients' financial wealth and health now, especially for those who are most at-risk and may not realize it quite yet.

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Jim Guarino, CPA, PFS, CFP, MST, is Managing Director at the top 100-ranked public accounting firm Baker Newman Noyes.

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