Freddi Eberhart & Associates Inc.
CERTIFIED PUBLIC ACCOUNTANTS

Newsletter

JULY 2021

Freddi Eberhart & Associates Inc. would like to 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. Also, thank you for recommending us to your family, friends, and associates. We truly appreciate your referrals.

This Month:

Upcoming dates:

July 20

- The 50th Anniversary of the Apollo 11 Lunar Landing

July 26

- Anniversary of the Americans with Disabilities Act

In this month's edition please read about the PPP loan forgiveness deadline. Now that 2021 is more than half-way in the books, it's time to take a look at higher taxes you may face in the future. Included in this month's newsletter are several ideas to help you make the most of your 401(k) plan. There is also an article about the common tax mistakes when selling a home and some information about good debt and bad debt.

Please call if you would like to discuss how this information could impact your situation. If you know someone who could benefit from this newsletter, feel free to send it to them.

Act Now for PPP Loan Forgiveness

Businesses that took Paycheck Protection Program (PPP) loans in 2020 need to apply for loan forgiveness soon to avoid unnecessary costs. If businesses do not act quickly, the loans will become permanent, and businesses would need to start making loan payments with interest.

These businesses that do not apply for forgiveness within 10 months of the end of the covered period under which they had to spend the money, will have their PPP loan automatically convert to a standard loan at 1% interest. There was initially an eight-week covered period for some businesses when it launched in April 2020 that was revised to a 24-week covered period after multiple regulatory law revisions. This would put that deadline as early as mid-July 2021. Most loans are operating under the 24-week covered period, which would mean a loan forgiveness application deadline sometime between mid-July and the end of September 2021.

Many small businesses are deliberately delaying the submission of the PPP forgiveness applications awaiting final regulations relating to the application parameters as well as maximizing the Employee Retention Credit eligibility in concert with the PPP forgiveness, but it is not recommended to wait any

~ Continued on Page 2 ~

Act Now for PPP Loan Forgiveness (Cont'd)

longer at this point. If businesses miss the application deadline, they must immediately begin making payments on their loans to their lenders, including interest. Even though a 1% interest rate is favorable, small businesses would have debt on their books that could have been forgiven.

PPP loans made prior to June 5, 2020, will have a loan term of two years and loans made after June 5, 2020, will have a loan term of five years. If the loan's term is shorter, businesses can work with their lender to extend the maturity date of their loan.

Recently it was announced that the Small Business Administration is making changes to the process and intends to withdraw the use of the loan necessity questionnaire and streamline loan forgiveness for loans from $150,000 up to $2 million.

Higher Taxes May Be in Your Future

Here's what to think about now.

There's little question the tides are moving towards a higher tax environment with multiple trillion dollar spending bills, a new administration, and deficits as far as the eye can see. Instead of feeling helpless, here is a quick look at what might be on the horizon and some thoughts on how to be prepared.

- **Self-employment tax risk.** Social Security and Medicare fund collections took a hit during the pandemic. This is because of high unemployment and new federal benefits allowing employers to receive a credit on these taxes to help continue paying employees to take leave due to COVID-19. Over the next few years, there will be tremendous pressure to add funds back into these programs. This might be done by increasing the taxability of benefits or dramatically increasing the income subject to Social Security taxes.

  Potential action: Continue to work on a retirement plan that is not as dependent on Social Security benefits. If you are a small business owner, and your business income is subject to self-employment tax (SE tax) now is a good time to consider reorganizing your business to shield some of your business income by moving to an S corporation.

- **Capital gains tax rate increases.** In 2021, the highest long-term capital gains tax rate is 23.8% (20% capital gains tax rate plus a 3.8% surtax as part of the Affordable Care Act) but if planned correctly, you could pay either nothing or 15% federal tax on long-term capital gains. Congress could see the sales of long-term securities and other assets as a valuable source of tax revenue by eliminating this preferential tax rate and instead using ordinary income tax rates (currently as high as 37%).

  Potential action: Actively manage investment profits, netting your gains against your losses. If you have any assets that have appreciated over time and intend to sell in the near future, consider trading in 2021 to avoid a potential increase in the capital gains tax rates.

~ Continued on Page 3 ~

Higher Taxes May Be In Your Future (Cont'd)

- **Tax planning problems for your estate.** There are several considerations to take into account when looking at your estate's tax plan. First, under current law, say for example your parents bought one share of stock in 1980 for $10 and you inherit the share of stock when it's worth $100 and immediately sell it for the same $100. You would not owe any federal taxes on the $90 difference. In the future, this feature, called stepped-up cost basis, may become limited or removed to increase tax revenue. Second, the estate tax rate currently set at 40% is under pressure to be increased. This is entirely possible when you consider that this tax rate was 55% in 2001.

  Potential action: Consider gifting money or securities to family, friends or a foundation during your lifetime. Individual gifts in 2021 of $15,000 or less ($30,000 for married couples) don't count against the lifetime gift-giving limit.

- **Tax rate volatility.** With huge federal deficits that are now beyond the scope of imagination, what will happen next? Just the latest legislation adds a whopping $1.9 trillion to what must be paid back. While interest rates are being held at historic lows to help lower the cost of this added debt, it cannot continue unabated. And the meteoric rise in home prices is just one of the costs of this low interest approach. The current proposals in Washington suggest an increase in tax rates is not too far in the distant future.

  Potential action: Do a forecast of your future income and tax rates. If you think tax rates and your taxable income will be increasing in the next few years, you will want to move as much money as possible into tax-advantaged accounts like Roth IRAs. You should also understand any state tax ramifications to help with your tax planning.

While Congress is debating what to do with your tax rates, now is the time to create a strategy so that if or when tax rates do increase, you will be prepared.

Make the Most of Your 401(k) Plan

With the future of Social Security uncertain and company pension plans being cut back, careful management of your 401(k) becomes very important. Here are some basic guidelines to help you make the most of your 401(k) investments:

- **Start early.** A 25-year-old employee who saves $300 a month will accumulate over $1 million by age 65 (assuming an 8% annual rate of return). By waiting ten years and still investing the same amount ($300 a month), that employee would accumulate less than $500,000 by age 65.

- **Be willing to take some risks.** Over the long term, you aren't likely to beat inflation by placing all your money in ultra-conservative investments. If you are more than five years from retirement,

~ Continued on Page 4 ~

Make the Most of Your 401(k) Plan (Cont'd)

consider putting at least a portion of your money into stock funds. A fund that mirrors the overall stock market, for example, is likely to beat inflation.

- **Don't invest too much in your own company's stock.** Even if you're confident that your company will be profitable for years to come, it's seldom a good idea to tie your financial future to one firm. In some cases, employees are locked into their employer's stock, but if you have a choice, consider diversifying your 401(k) funds.

- **Don't be quick to borrow from your 401(k).** Although you can repay principal and interest to yourself, dipping into your 401(k) will reduce its earning power. If it's available, a home-equity loan may be a better alternative, especially since the interest is generally tax-deductible.

- **Don't raid your 401(k) when you change jobs.** Resist the temptation to deplete your retirement savings when you change employers. If it's allowed, leave what you have in your old plan or roll the money into your new employer's 401(k). Another option is to roll the funds into an IRA.

- **Review your portfolio at least once a year.** If you've decided to keep 60% of your 401(k) in stock funds, a bull market can push the stock portion of your portfolio beyond the limits you've set. By readjusting your portfolio annually, you'll maintain the desired mix.

Common Tax Mistakes When Selling a Home

With home sales booming throughout much of the country, you may decide that now's the right time to put your abode on the market. If you do put your primary residence up for sale, try to steer clear of the following mistakes.

- **Not qualifying for the home sale exclusion.** If you've owned and used your home as your principal residence at least two out of the last five years, you can exclude from your taxable income the first $250,000 of gain if you're single and $500,000 if you're married.

  What you can do: *Consider a delay of selling your home until you meet the 2-out-of-5 year threshold. If you can't qualify for a full exclusion, you may qualify for a partial exclusion if your sale results from an employment change, a need for medical care or other IRS-approved circumstances.*

- **Forgetting to deduct points.** If you have points from your current mortgage that you haven't deducted on a previous tax return, include the balance of these points on your next tax return. Too many taxpayers forget to do this and lose thousands in deductions.

  What you can do: *Review your loan documents before selling your property. Identify all costs, including points, that are included in the loan. Save the document with your tax records to ensure the deduction is not forgotten.*

~ Continued on Page 5 ~

Common Tax Mistakes When Selling a Home (Cont'd)

- **Not double checking your settlement statement.** Closely review the closing statement. It is easy to assume all the numbers are correct and the math is done right. Often this is not the case! And a mistake here could be costly.

  What you can do: *Review the closing document multiple times. Have your Realtor and closing agent explain items you don't understand. Pay special attention to property taxes. The property tax bill will be allocated between the seller and the buyer. Only pay the share of the bill that covers the time period when you're the owner.*

Selling a home is full of tax implications. Since selling a home is not an everyday occurrence, it is easy to make a mistake. So if you need help with these or any other tax questions surrounding the sale of your house, please call...before you sell!

Good Debt Versus Bad Debt

How to tell the difference

Not all debt is created equal. Knowing the difference can change the way you look at your spending.

Good debt adds value

Good debt often leads to financial growth, because the product or service being purchased adds more value than the debt that comes with it. Student loans are usually an example of good debt because the related education allows you to earn more income.

Some purchases result in value more directly. Taking on a mortgage, for example, can be valuable simply by giving you access to a place to live all while building equity. Additionally, a mortgage is often considered good debt because your property can be used as collateral for other debt once you've made some payments on it, or your home has gained in market value. Even better, good debt often comes with a tax deduction on the interest you pay on things like your mortgage or student loans.

Bad debt adds expense

Credit card debt is almost always bad debt. Not only are interest rates on credit cards higher than most other types of debt, but most purchases made with credit cards are for things that do not contribute to personal financial growth. In fact, interest expense is so high that credit card companies are now legally required to display the cost of this debt directly on their billing statements. Auto loans are another example of bad debt, because cars usually lose value quickly, often leaving more money owed on the debt than the car is worth! But even good debt can turn bad if there is too much of it. Take out too large a mortgage and you may struggle to make payments!

~ Continued on Page 6 ~

Good Debt Versus Bad Debt (Cont'd)

Debt always means higher cost

Debt's big benefit is allowing you to pay for something over time. The cost of any purchase using debt MUST include the interest expense of taking on that debt. You can compare that with the option of saving up money and then making the purchase without interest. Is the extra interest worth the benefit? Comparing the cost of the purchase with interest, to the value you stand to gain by purchasing the asset, can help you determine whether using debt is a good or bad choice for you.

Final thoughts

Here are some ideas on how to manage good versus bad debt.

- Consider carefully what you can afford and make a plan for how you will pay off any debts before you take on the debt.
- Never carry a balance on a credit card unless it is an emergency. Pay the balance in full every month.
- Calculate the entire cost, including interest, of anything you purchase using debt. This is the REAL cost of an item.
- Use savings, whenever possible, to purchase goods and services that would otherwise be considered bad debt.
- Pay off high interest debt first.
- Financial growth is often the key measure for defining good versus bad debt, but not always. Other factors, like personal interest, growth, and well-being can also be measures for your debt decisions, as long as you can truly afford the payments.

Reach out for help if you aren't confident whether a potential debt will lead to more good or harm. Making the right choice could save you money.

As always, should you have any questions or concerns regarding your tax situation please feel free to call..

This newsletter provides business, financial, and tax information to clients and friends of our firm. This general information should not be acted upon without first determining its application to your specific situation. For further details on any article, please contact us.