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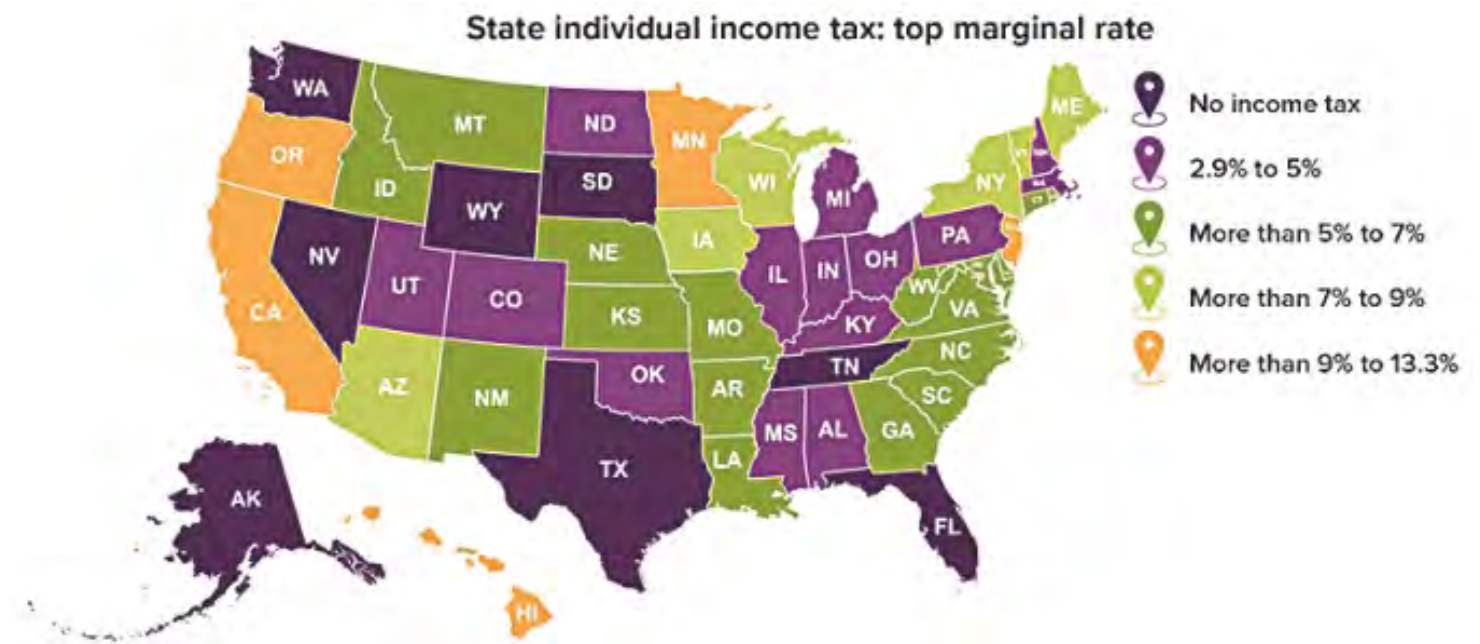
Quarterly Tax Newsletter

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State Income Tax: Depends on Where You Live or Work

Eight states have no state income tax. Of the 42 states with a state income tax (and the District of Columbia), the top marginal income tax rate ranges from 2.9% to 13.3%. Most states (and D.C.) with an income tax have multiple tax brackets with graduated rates; nine states have only a single tax rate.



Source: Tax Foundation, *Fiscal Fact No. 750*, February 2021

Following the Inflation Debate

During the 12 months ending in June 2021, consumer prices shot up 5.4%, the highest inflation rate since 2008.¹ The annual increase in the Consumer Price Index for All Urban Consumers (CPI-U) — often called headline inflation — was due in part to the "base effect." This statistical term means the 12-month comparison was based on an unusual low point for prices in the second quarter of 2020, when consumer demand and inflation dropped after the onset of the pandemic.

However, some obvious inflationary pressures entered the picture in the first half of 2021. As vaccination rates climbed, pent-up consumer demand for goods and services was unleashed, fueled by stimulus payments and healthy savings accounts built by those with little opportunity to spend their earnings. Many businesses that shut down or cut back when the economy was closed could not ramp up quickly enough to meet surging demand. Supply-chain bottlenecks, along with higher costs for raw materials, fuel, and labor, resulted in some troubling price spikes.²

Monitoring Inflation

CPI-U measures the price of a fixed market basket of goods and services. As such, it is a good measure of the prices consumers pay if they buy the same items over time, but it does not reflect changes in consumer behavior and can be unduly influenced by extreme increases in one or more categories. In June 2021, for example, used-car prices increased 10.5% from the previous month and 45.2% year-over-year, accounting for more than one-third of the increase in CPI. Core CPI, which strips out volatile food and energy prices, rose 4.5% year-over-year.³

In setting economic policy, the Federal Reserve prefers a different inflation measure called the Personal Consumption Expenditures (PCE) Price Index, which is even broader than the CPI and adjusts for changes in consumer behavior — i.e., when consumers shift to purchase a different item because the preferred item is too expensive. More specifically, the Fed looks at core PCE, which rose 3.5% through the 12 months ending in June 2021.⁴

Competing Viewpoints

The perspective held by many economic policymakers, including Federal Reserve Chair Jerome Powell and Treasury Secretary Janet Yellen, was that the spring rise in inflation was due primarily to base effects and temporary supply-and-demand mismatches, so the impact would be mostly "transitory."⁵ Regardless, some prices won't fall back to their former levels once they have risen, and even short-lived bursts of inflation can be painful for consumers.



Source: U.S. Bureau of Labor Statistics, 2021

Some economists fear that inflation may last longer, with more serious consequences, and could become difficult to control. This camp believes that loose monetary policies by the central bank and trillions of dollars in government stimulus have pumped an excess supply of money into the economy. In this scenario, a booming economy and persistent and/or substantial inflation could result in a self-reinforcing feedback loop in which businesses, faced with less competition and expecting higher costs in the future, raise their prices preemptively, prompting workers to demand higher wages.⁶

Until recently, inflation had consistently lagged the Fed's 2% target, which it considers a healthy rate for a growing economy, for more than a decade. In August 2020, the Federal Open Market Committee (FOMC) announced that it would allow inflation to rise moderately above 2% for some time in order to create a 2% *average* rate over the longer term. This signaled that economists anticipated short-term price swings and assured investors that Fed officials would not overreact by raising interest rates before the economy has fully healed.⁷

In mid-June 2021, the FOMC projected core PCE inflation to be 3.0% in 2021 and 2.1% in 2022. The benchmark federal funds range was expected to remain at 0.0% to 0.25% until 2023.⁸ However, Fed officials have also said they are watching the data closely and could raise interest rates sooner, if needed, to cool the economy and curb inflation.

Projections are based on current conditions, are subject to change, and may not come to pass.

1, 3) U.S. Bureau of Labor Statistics, 2021; 2) *The Wall Street Journal*, April 13, 2021; 4) U.S. Bureau of Economic Analysis, 2021; 5-6) Bloomberg.com, May 2, 2021; 7-8) Federal Reserve, 2020-2021

Child Tax Credit for 2021: Will You Get More?

If you have qualifying children under the age of 18, you may be able to claim a child tax credit. (You may also be able to claim a partial credit for certain other dependents who are not qualifying children.) The American Rescue Plan Act of 2021 makes substantial, temporary improvements to the child tax credit for 2021, which may increase the amount you might receive.

Ages of Qualifying Children

The legislation makes 17-year-olds eligible as qualifying children in 2021. Thus, children ages 17 and younger are eligible as qualifying children in 2021.

Increase in Credit Amount

For 2021, the child tax credit amount increases from \$2,000 to \$3,000 per qualifying child (\$3,600 per qualifying child under age 6). The partial credit for other dependents who are not qualifying children remains at \$500 per dependent.

Refundable Credit

The aggregate amount of nonrefundable credits allowed is limited to tax liability. With refundable credits, a taxpayer may receive a refund at tax time if they exceed tax liability. For most taxpayers, the child tax credit is fully refundable for 2021. To qualify for a full refund, the taxpayer (or either spouse for joint returns) must generally reside in the United States for more than one-half of the taxable year. Otherwise, under the pre-existing rules, a partial refund of up to \$1,400 per qualifying child may be available. The credit for other dependents is not refundable.

Advance Payments

Taxpayers may receive periodic advance payments for up to one-half of the refundable child tax credit during 2021, generally based on 2020 tax returns. The U.S. Treasury will make the payments for periods between July 1 and December 31, 2021. For example, monthly payments could be up to \$250 per qualifying child (\$300 per qualifying child under age 6).

Phaseout of Credit

The combined child tax credit (the sum of your child tax credits and credits for other dependents) is subject to phaseout based on modified adjusted gross income (MAGI). Special rules start phasing out the increased portion of the child tax credit in 2021 at much lower thresholds than under pre-existing rules. The credit, as reduced under the special rules for 2021, is then subject to phaseout under the pre-existing phaseout rules.

Phaseout of Credit in 2021 Based on MAGI

Credit can be reduced to \$2,000 per qualifying child, or \$500 per other dependent, based on MAGI	
Single/Married filing separately	Over \$75,000 to \$200,000
Married filing jointly	Over \$150,000 to \$400,000
Head of household	Over \$112,500 to \$200,000

Credit can be reduced to \$0, based on MAGI	
Single/Married filing separately	More than \$200,000
Married filing jointly	More than \$400,000
Head of household	More than \$200,000

For 2021, there is no reduction in the credit if the taxpayer's MAGI does not exceed \$75,000 (\$150,000 for joint returns and surviving spouses, \$112,500 for heads of households). The credit is partially phased out for MAGI exceeding these income limits. At this stage, the credit is reduced by the lowest of the following three amounts:

- \$50 for each \$1,000 (or fraction thereof) of MAGI exceeding these thresholds
- The total increase in the credit amounts for 2021 [e.g., if 3 qualifying children (2 under the age of 6), then \$10,200 increased credit minus \$6,000 pre-existing credit = \$4,200 increase in credit]
- \$6,250 (\$12,500 for joint returns, \$4,375 for heads of households, \$2,500 for surviving spouses); these amounts are equal to 5% of the difference between the higher pre-existing phaseout thresholds and the special thresholds for 2021

The credit cannot be reduced below \$2,000 per qualifying child or \$500 per other dependent at this stage under this special rule for 2021.

However, the credit can be fully phased out for MAGI in excess of \$200,000 (\$400,000 for a joint return) under the pre-existing phaseout rules. The credit as reduced in the preceding stage is further reduced by \$50 for each \$1,000 (or fraction thereof) by which the taxpayer's MAGI exceeds these thresholds.

Three Reasons to Keep Your Personal and Business Finances Separate

If you are launching a new venture, you may wonder whether it's necessary to open a dedicated bank account for your business. Even if your company is established and already has separate checking and credit-card accounts, you may be tempted to pay business expenses from personal accounts on occasion — or vice versa — particularly during tough times.

The more your business and personal outlays become entwined, the harder it is to manage your company's cash flow, payroll, and taxes. It might also be difficult to keep tabs on the company's financial performance.

Here are three key reasons to draw a clear line between your business and personal finances — and do your best never to cross it.

To Increase Purchasing and Borrowing Power

To open a business bank account, you may be required to obtain an Employer Identification Number (EIN) from the Internal Revenue Service. Building a relationship with a bank that serves small businesses might provide access to other important financial services and resources, such as a merchant account, a line of credit, and a business credit card.

Using a business credit card responsibly is one way to establish the positive credit history that could help you qualify for larger business loans with better rates and terms, and without personal guarantees, in the future.

To Make Life Easier at Tax Time

Maintaining separate bank and credit accounts means you won't have to spend time sorting business purchases from personal ones.

As a small-business owner or independent contractor, you may be eligible for a long list of tax deductions that don't apply to regular wage earners. Careful tracking of your business expenses can help you and your tax professional take full advantage of deductions and reduce your tax burden.

To Protect Personal Assets

If your business struggles, it could pose a threat to your personal assets and credit. Paying business expenses directly from personal accounts might help substantiate a creditor's claim that your business was being run improperly.

Keeping your financial accounts separate may be especially critical if your business is incorporated as a C corp, an S corp, or a limited liability company (LLC). The corporate veil, which refers to the legal distinction between a corporation and its owners, is designed to protect the owners from liability related to the company's actions. However, commingling personal and business funds could pierce the corporate veil and leave your personal assets vulnerable to business debts, losses, and lawsuits.

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