

YEAR END 2020 TAX GUIDE



TAXGURU L.L.C.

As year-end approaches, it is a good time to think about planning moves that may help lower your tax bill for this year and possibly next. Year-end planning for 2020 takes place during the COVID-19 pandemic, which in addition to its devastating health and mortality impact has widely affected personal and business finances.

New tax rules have been enacted to help mitigate the financial impact of the disease, some of which should be considered as part of this year's planning, most notably elimination of required retirement plan distributions, and liberalized charitable deduction rules.

Tax Guru's year-end tax planning checklist of additional action items may help you save tax dollars if you act before year-end.

Major tax changes from recent years generally remain in place, including lower income tax rates, larger standard deductions, limited itemized deductions, elimination of personal exemptions, an increased child tax credit, and a lessened alternative minimum tax (AMT) for individuals; and a major corporate tax rate reduction and elimination of the corporate AMT, limits on interest deductions, and generous expensing and depreciation rules for businesses. Non-corporate taxpayers with certain income from pass-through entities may still be entitled to a valuable deduction.

Despite the lack of major year-over-year tax changes, the time-tested approach of deferring income and accelerating deductions to minimize taxes still works for many taxpayers, as does the bunching of expenses into this year or next to avoid restrictions and maximize deductions.



The Coronavirus Aid, Relief, and Economic Security (CARES) Act contains the most significant changes designed to deliver relief to businesses and individuals struggling due to the COVID-19 pandemic. The changes include:

For businesses, net operating losses from 2018, 2019, and 2020 tax years can now be carried back 5 years.

Relief was delivered to individuals and businesses through payroll tax deferrals and credits. Employer payroll taxes may be deferred into 2021 and 2022. Employers providing certain sick pay and FMLA paid leave are entitled to payroll tax credits to offset this cost. Additionally, employers may be entitled to an employee retention credit if the business had significantly declined as compared to 2019.

For individuals, the excess business loss rules have been suspended temporarily and net operating losses can be carried back.

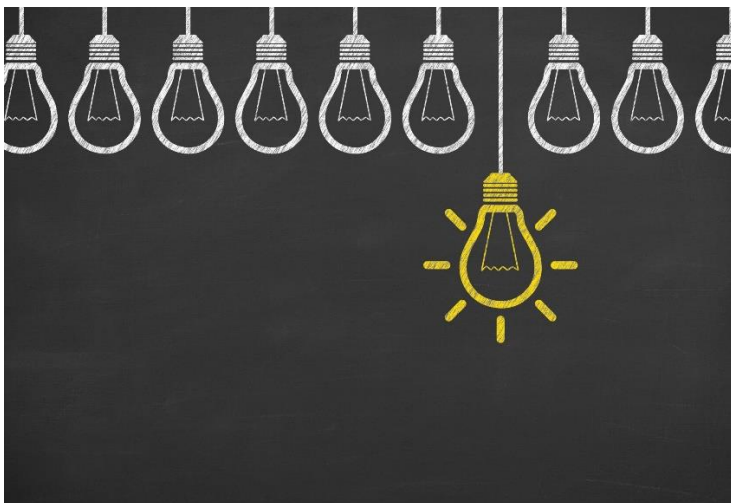
There is an up to \$300 above-the-line deduction for cash charitable contributions for individuals taking the standard deduction, and if itemizing as an individual, one can deduct up to 100% of adjusted gross income as charitable donations.

10% penalty on an early withdrawal from retirement accounts is waived if the withdrawal is coronavirus related.

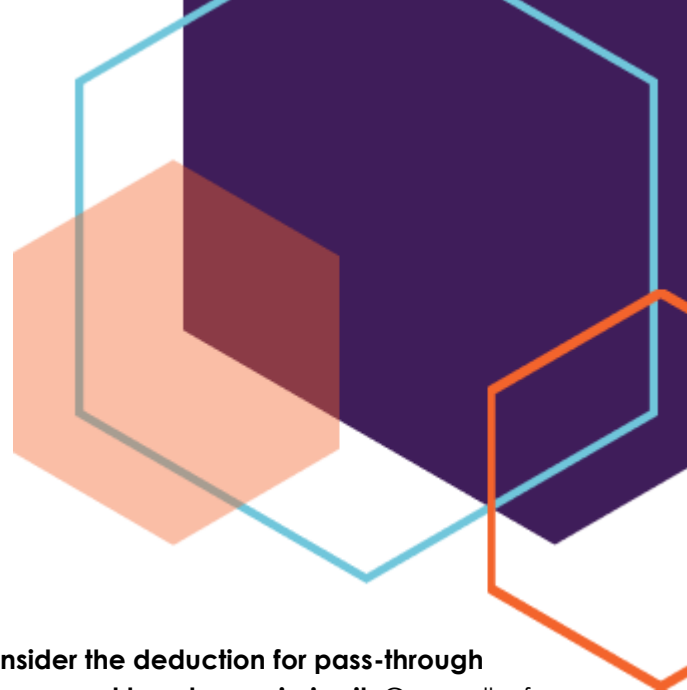
Employees can exclude student loan repayments from income if made by their employer.

Tax Guru's year-end tax planning checklist of additional action items may help you save tax dollars if you act before year-end.

We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you (or a family member) will likely benefit from many of them. We can narrow down the specific actions you can take once we meet with you to tailor a particular plan.



YEAR-END PLANNING BUSINESSES AND OWNERS



The Coronavirus Aid, Relief, and Economic Security (CARES) Act allows the employer's share of the 6.2% Social Security tax on wages paid from March 27, 2020 through December 31, 2020 to be deferred, with 50% due on December 31, 2021 and 50% due December 31, 2022. A similar rule applies to 50% of self-employment tax liability of partners and sole proprietors.

The CARES Act added a refundable payroll tax credit equal to 50% of qualified wages (wages, including qualified health plan expenses allocable to the wages) paid by eligible employers from March 13, 2020 to December 31, 2020. To be an eligible employer, your operations must have been fully or partially suspended due to a COVID-19 shutdown order, or gross receipts declined by more than 50% when compared with the same quarter in the prior year (the employer remains eligible in subsequent quarters until its gross receipts exceed 80% of gross receipts compared with the same quarter for the prior year). This credit is subject to limits if there are more than 100 employees, and the employer is not eligible if they received a small business interruption loan under the PPP.

Expanded credit for retirement plan startup costs. The employer credit for retirement plan start-up costs has been expanded to 50% of the eligible start-up costs capped at \$500 or \$250 per non highly compensated employee up to \$5,000, whichever is greater. The credit is available for three years for a potential total credit of \$15,000.

Consider the deduction for pass-through income and how to maximize it. Generally, for tax years beginning after December 31, 2017, a non-corporate taxpayer, including a trust or estate, who has qualified business income (QBI) from a partnership, S corporation, or sole proprietorship is generally allowed a deduction equal to:

-The lesser of 20% of QBI (not including net capital gains), or

-50% of W-2 wages paid by the partnership, S corporation, or sole proprietorship (or 25% of W-2 wages paid plus 2.5% of the unadjusted cost basis of the business's assets, subject to limitations).

The deduction can't exceed the taxpayer's taxable income, reduced by net capital gain. The calculation for this deduction is complicated and some planning before year-end is required to maximum the benefit.

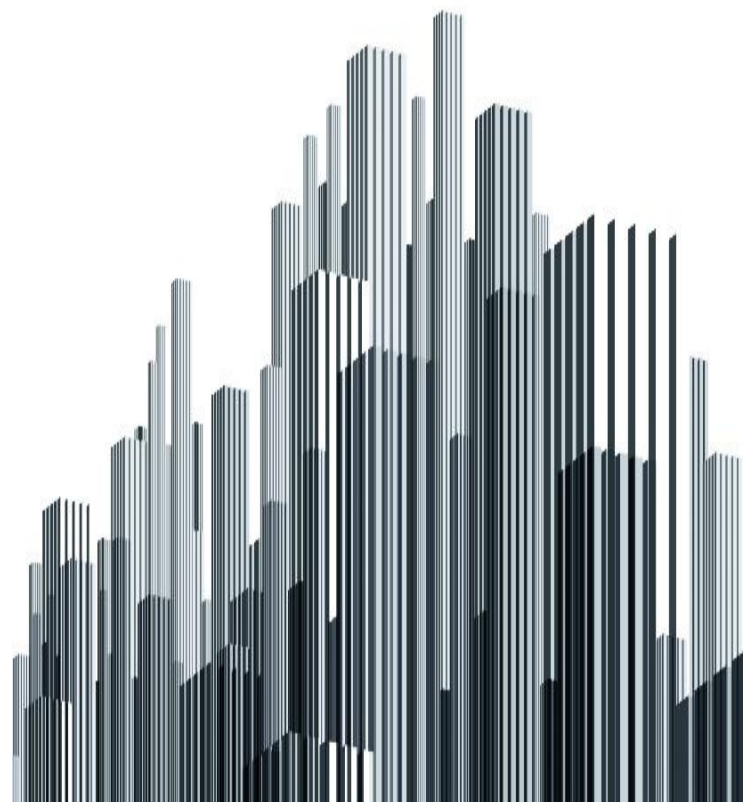
Remember to keep your entertainment and meals expenses separate. The TCJA disallowed deductions for entertainment, amusement, or recreation that are directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business. There are a few exceptions to this rule, such as an office outing. Business meals, however, are still eligible for a 50% deduction. Therefore, it continues to be important to keep your entertainment and meals expenses separate so that you do not miss the 50% deduction for the meals.



It also includes any other building improvements that are not elevators or escalators, do not enlarge the structure, and are not attributable to internal structural framework.

Businesses may be able to **take advantage of the “de minimis safe harbor election” to expense the costs of inexpensive assets, materials and supplies**, assuming the costs do not have to be capitalized under the Code Sec. 263A uniform capitalization rules. To qualify for the election, the cost of an expensed unit of property cannot exceed \$5,000 if the taxpayer has an applicable financial statement, e.g., a certified audited financial statement. If there is no applicable financial statement, the cost of an expensed unit of property cannot exceed \$2,500. Where appropriate, purchase such qualifying items before the end of 2020.

A corporation, other than a “large” corporation, that anticipates a small net operating loss (NOL) for 2020 and substantial net income in 2021 may find it worthwhile to **accelerate just enough of its 2021 income or to defer just enough of its 2020 deductions** to create a small amount of net income for 2020. This will permit the corporation to base its 2021 estimated tax installments on the relatively small amount of income tax shown on its 2020 return, rather than having to pay estimated taxes based on 100% of its much larger 2021 taxable income. To reduce 2020 taxable income, consider deferring a debt-cancellation event until 2021 and consider disposing of a passive activity in 2020 if doing so will allow you to deduct suspended passive activity losses.



YEAR-END PLANNING INDIVIDUALS



The CARES Act suspended the business loss limitation under Section 461. The limitation on the deduction of business losses to \$250,000 (single) or \$500,000 (married) has been suspended for 2018, 2019 and 2020.

Postpone income until 2021 and accelerate deductions into 2020 to lower your 2020 tax bill. This strategy was available in 2019 as well and may enable you to claim larger deductions, credits, and other tax breaks for 2020 that are phased out over varying levels of adjusted gross income. These include child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. However, in some cases it may pay to accelerate income into 2020. For example, this may be the case when a person's marginal tax rate is much lower this year than it will be next year.

Consider "bunching" your 2020 and 2021 charitable contributions in 2020. Due to the increase in the standard deduction and the limitation on deductible taxes in 2019 from the Tax Cuts and Jobs Act (TCJA), many taxpayers may find that they do not have enough deductions to itemize in 2020. If you are close to the maximum standard deduction,

you might want to make your 2021 charitable contributions in 2020. By doing this, you may be able to itemize and take a tax deduction for your contributions in 2020. Then in 2021, you would take the standard deduction. If you previously bunched your contributions in 2019, take the standard deduction in 2020 and plan to bunch your contributions again in 2021.

If you are unsure as to whom you will be making your 2021 charitable contributions, or you would like to maintain annual donations to your favorite charities, consider using a Donor Advised Fund (DAF). By using a DAF, you can receive the full deduction in 2020 for the amount you contributed, and then in 2021 (or a future year) decide to whom and when you would like the funds disbursed.

This year, under the CARES Act, an individual who takes the standard deduction can claim an above-the-line deduction of up to \$300 for cash contributions to charitable organizations. If an individual does itemize their deductions, deductible cash charitable contributions can now be equal to 100% of their adjusted gross income, as opposed to a 60% limit in previous years.

To reduce 2020 taxable income, consider disposing of a passive activity in 2020 if doing so will allow you to deduct suspended passive activity losses.

If you own an interest in a partnership or S Corporation, consider whether you need to **increase your basis in the entity so you can deduct a loss from it for this year.**

Increase withholding of state and local taxes, or make estimated tax payments. If you expect to owe state or local income taxes when you file your return next year, consider asking your employer to increase withholding of state and local taxes, or make estimated tax payments before year-end to pull the deduction of those taxes into 2020. Remember that due to tax reform, you are only allowed a maximum \$10,000 itemized tax deduction. This includes state and local income taxes, real estate tax, sales tax and personal property tax. Therefore, this strategy will be beneficial only if you are under the \$10,000 maximum state tax deduction and if you are going to itemize.

Make sure you have the correct amount of taxes withheld. The IRS has a tax withholding calculator at <https://www.irs.gov/payments/taxwithholding> that will help you with this process.

Increase the amount you set aside for next year in your employer's **health flexible spending account (FSA)** if you set aside too little for this year. The maximum annual contribution to an FSA that a cafeteria plan can allow is \$2,750 for tax year 2020.

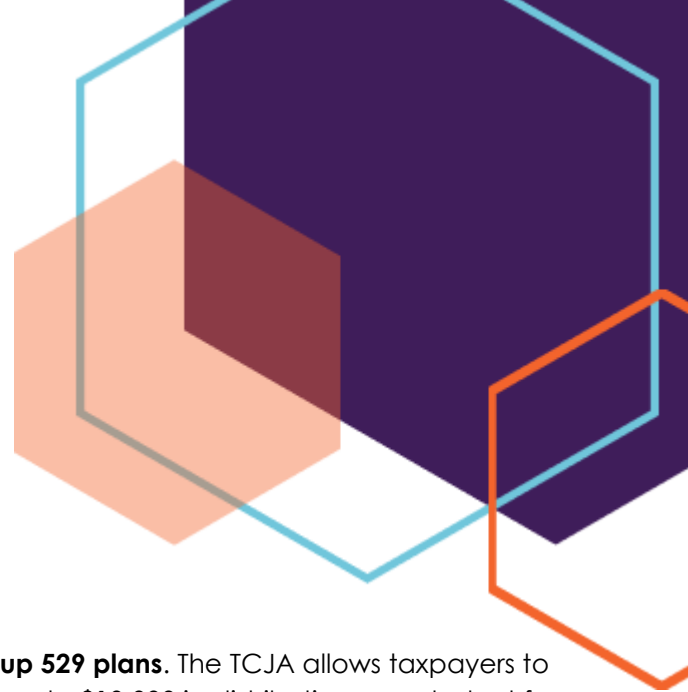
If you are eligible to make health savings account (HSA) contributions in December of this year, **you can make a full year's worth of deductible health savings account contributions for 2020.** This is so even if you first became eligible on December 1, 2019.

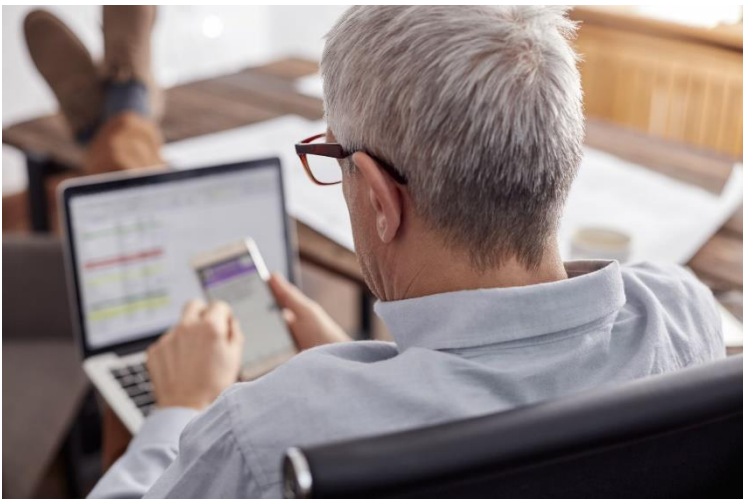
The maximum annual contribution to an HSA for 2020 is \$3,550 for self-only and \$7,100 for family coverage. If you are over the age of 55, you can contribute an additional \$1,000 to your HSA. The contribution limit increases in 2021 for self-only coverage to \$3,600 and family coverage to \$7,200.

Bulk up 529 plans. The TCJA allows taxpayers to take up to \$10,000 in distributions per student for public, private, or religious elementary and secondary school tuition costs. If you have young children or grandchildren, consider funding their 529 plans at a higher level to grow tax-free and cover a portion of the cost of elementary and secondary schools in addition to college tuition.

Make gifts sheltered by the annual gift tax exclusion before the end of the year and thereby save gift and estate taxes. You can give \$15,000 in 2020 to each of an unlimited number of individuals, but you cannot carry over unused exclusions from one year to the next. The transfers also may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

Maximize your 401(k) contributions. If you are a participant in a traditional employer-sponsored defined contribution plan, the 2020 contribution limit for a 401(k) is \$19,500, with an additional \$6,500 catch-up allowed for individuals 50 and older. Consider contributing from a year-end bonus to take advantage of the maximum contribution. Beginning in 2021, the contribution limit is set to remain the same at \$19,500. The catch-up contribution will be \$6,500, also remaining the same.





If you are self-employed and will not have employees, **you can establish a “one person” 401(k) plan.** Under this plan, you can make elective contributions of up to \$19,500 for 2020 (\$26,000 if you are over age 50) and can make profit-sharing contributions up to a maximum of \$57,000 counting both the employer and the elective contributions (not counting catch-up contributions). The plan must be established by the end of the year to claim a tax deduction for contributions for that year, although you do not need to make contributions until the due date (with extensions) of your return.

Contribute to an IRA. If your employer does not offer a retirement plan, consider a traditional or Roth IRA. The 2020 contribution limit on IRAs is \$6,000, with an additional \$1,000 catch-up for taxpayers 50 and older. With a traditional IRA you can likely deduct your contributions, though your deduction may be limited if your spouse participates in an employer-sponsored plan. For 2021, the contribution limit and the catch-up contribution amounts remain the same at \$6,000 and \$1,000, respectively.

Consider making contributions to Roth IRAs instead of traditional IRAs. Roth IRA payouts are tax-free and thus immune from the threat of higher tax rates, as long as they are made 1) after a five-year period, and 2) on or after attaining age 59½, after death or disability, or for a first-time home purchase.

If you believe a Roth IRA is better than a traditional IRA, and want to remain in the market for the long term, **consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA if eligible to do so.** Keep in mind, however, that such a conversion will increase your adjusted gross income for 2020.

As a general rule, we advise our clients to pay any taxes resulting from a conversion with non-retirement funds to maximize the future benefit it will produce. Withholding federal and state taxes from a conversion would also generate an additional 10% penalty on the amounts withheld.

Required minimum distributions (RMDs) that usually must be taken from an IRA or 401(k) plan (or other employer-sponsored retirement plan) have been waived for 2020. This includes RMDs that would have been required by April 1 if you hit age 70½ during 2019 (and for non-5% company owners over age 70½ who retired during 2019 after having deferred taking RMDs until April 1 following their year of retirement). If you don't have a financial need to take a distribution in 2020, you don't have to. Note that because of a recent law change, plan participants who turn 70½ in 2020 or later needn't take required distributions for any year before the year in which they reach age 72.

The 10% penalty on an early-withdrawal from a retirement account is waived for up to \$100,000 of distributions for coronavirus-related purposes made on or after January 1, 2020. To be considered coronavirus-related, an individual, their spouse, or a dependent must have been diagnosed with SARS-CoV-2 or COVID-19 by a test approved by the Centers for Disease Control and Prevention. The penalty can also be waived if the individual experiences adverse financial consequences because of being quarantined, being furloughed or laid off, having work hours reduced, or being unable to work due to lack of child care or the closing or reduced hours of a business the individual owns or operates.



Employees can exclude up to \$5,250 from income for student loan repayments made by an employer after March 27, 2020 and on or before December 31, 2020. The exclusion is subject to the same restrictions as an educational assistance program (e.g., the payments need to be available on a nondiscriminatory basis to employees who meet criteria established by the employer, cannot be in lieu of other taxable compensation, etc.). The exclusion appears to be available regardless of whether the student loan repayment has any connection to COVID-19.

Higher-income earners must be wary of the 3.8% surtax on certain unearned income. The surtax is 3.8% of the lesser of: 1) net investment income (NII), or 2) the excess of modified adjusted gross income (MAGI) over a threshold amount (\$250,000 for joint filers or surviving spouses, \$125,000 for a married individual filing separate, and \$200,000 in any other case). Some taxpayers should consider ways to minimize (e.g., through deferral) additional NII for the balance of the year, others should try to see if they can reduce MAGI other than NII, and other individuals will need to consider ways to minimize both NII and other types of MAGI. An important exception is that NII does not include distributions for IRAs and most other retirement plans.

The 0.9% additional Medicare tax also may require higher-income earners to take year-end action. It applies to individuals whose employment wages and self-employment income total more than a threshold amount (\$250,000 for joint filers, \$125,000 for married couples filing separately, and \$200,000 in any other case). Employers must withhold the

additional Medicare tax from wages in excess of \$200,000 regardless of filing status or other income. Self-employed taxpayers must take it into account in figuring estimated tax as well.

Give appreciated stock as a charitable contribution. The value of your donation is the fair market value of the stock on the date of the contribution, and you will not have to pay any tax on the appreciation of the stock. This will also prevent the gain from being subject to the 3.8% tax on net investment income.

Consider realizing losses on the sale of stock to offset other investment gains while substantially preserving your investment position to minimize the burden of the 3.8% tax on net investment income. This is especially important if your taxable income exceeds \$425,800 (\$479,000 married filing joint), as the long-term capital gain rate increases from 15% to 20% for those individuals. There are several ways this can be done. For example, you can sell the original holding, then buy back the same securities at least 31 days later. It may be advisable for us to meet to discuss year-end trades you should consider making as there are limitations to the amount of capital losses that can be deducted in any given year.

We can assist with strategies to minimize or eliminate this additional tax.

