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Unusual Year Steers Year-End Tax Strategies – 2020 Year-End Tax Planning

By Richard Morris, CPA, MST, Tax Practice Director
Councilor, Buchanan & Mitchell, P.C. – CPAs & Business Advisors

As the end of 2020 approaches, we can all agree that this year is unlike any other. The coronavirus pandemic and natural disasters have had a significant impact on the tax situation for many taxpayers. In response to the health and economic impacts of the coronavirus pandemic, Congress passed two major pieces of legislation – the Family First Coronavirus Response Act and the Coronavirus Aid, Relief, and Economic Security (CARES) Act. More relief may be forthcoming. In addition, we might expect future tax law changes as a result of the election. As such, each individual taxpayer should consider the unique challenges and opportunities that this year presents. Planning during the final weeks of this year involves much more- both in terms of traditional year-end strategies and strategies developed in response the developments over this last year. Here are some points to consider:

Data gathering. Year-end planning should start with data collection and a review of prior year returns. This includes information on losses or other carryovers, estimated tax installments, and

items that were unusual. Conversations regarding next year should include discussions of any plans for significant purchases or dispositions, as well as any possible life cycle events.

Stimulus payments. Many of you received an Economic Impact Payment or "Stimulus Check" earlier this year. If an individual missed the extension for non-filers, the credit may be taken on the 2020 Form 1040 for the full amount in which they were entitled and do not have to repay excess amounts unless they were not eligible to receive it in the first place, i.e. deceased individuals or non-resident aliens. In many instances the check was less than what you were owed, and we can only determine any additional amount if you let us know the amount received. The IRS informed you of that amount with Notice 1444 which, if you received it, we will need to reconcile.

Investments. Taxpayers holding investments, whether in the form of securities, real estate, collectibles, or other assets, often have an opportunity to reduce their overall tax bill by some strategic buying and selling toward the end of the year, as well as, exchanging appreciated assets for like-kind property in order to defer gains. Tax rates on investments are also impacted by the total amount of your income, so a determination should be made of the best time to sell investments. Balancing tax considerations with other factors is part of the challenge in dealing with investments, including: the ordinary income tax rates, the net investment income tax rate, the capital gain rates, and the alternative minimum tax (AMT).

Income caps on benefits. Monitoring adjusted gross income (AGI) at year-end can also pay dividends in qualifying for a number of tax benefits. Often tax savings can be realized by lowering income in one year at the expense of realizing a bit more in another year.

Life events. The biggest variables for many taxpayers impacting their year-end tax planning surrounds life events such as marriage, divorce, birth or adoption of a child, a new job or the loss of a job, and retirement. These life events may, for instance, result in a change in filing status that will affect tax liability. The possibility of significant changes and/or significant or unusual items of income or loss should also be part of a year-end tax strategy. Additionally, taxpayers need to take a look into the future and predict, if possible, any events that could trigger significant income, losses, or deductions.

UNUSUAL YEAR STEERS YEAR-END TAX STRATEGIES – 2020 YEAR-END TAX PLANNING FOR INDIVIDUALS

Tax Cuts and Jobs Act of 2017. Remember that the below significant changes came into effect in 2018 under TCJA and are still having significant impacts on taxpayers:

- ***State and local taxes.*** TCJA limits the deduction for state and local taxes to $10,000 per year.
- ***Increased standard deduction.*** One of the most broadly impactful provisions of TCJA was the near doubling of the standard deduction for all taxpayers. For 2020, the standard deduction amounts are $24,800 for joint filers, $18,650 for heads of households, and $12,400 for all other individual filers. This increased amount makes it less likely that it is more advantageous for individuals to itemize deductions.
- ***Miscellaneous itemized deductions.*** TCJA eliminated miscellaneous itemized deductions for individuals. This includes deductions for unreimbursed employee expenses.

Telecommuting because of coronavirus. Many states have issued guidance related to personal income taxes during the pandemic for telecommuting employees. States are literally all over the map on this issue depending upon whether they were 'losing' or 'gaining' workers. We may need to review your residency risk depending upon your telecommuting location during the pandemic. Consider reviewing and updating your calendar and records by year end.

Paycheck Protection Program (PPP). Under the Cares Act, a recipient of a covered loan can receive forgiveness of indebtedness on a PPP loan in an amount equal to the sum of payments made for qualified expenses. According to IRS guidance, the business expenses related to forgivable PPP loans are not deductible. However, lawmakers state that this was not their intent. Congress will need to address the deductibility of these expenses in future legislation to clearly make these expenses deductible. This is potentially the most significant unknown at this time.

Retirement. The CARES Act allows penalty free distributions made during the 2020 calendar year of up to $100,000 for COVID-related expenses. Any income attributable to an early withdrawal is subject to tax over a three-year period, and taxpayers may recontribute the withdrawn amounts to a qualified retirement plan without regard to annual caps on contributions if made within three years.

The maximum loan amount from a retirement account is increased from the lesser of $50,000 or 50% of vested balance to the lesser of $100,000 or 100% of vested balance for qualified individuals. This increase applies to loans made between March 27, 2020 and December 31,

2020. In addition, qualified individuals may delay loan payments due after March 27, 2020 and before December 31, 2020 for one year. A qualified individual is an individual (or the spouse of an individual) diagnosed with COVID-19 with a CDC-approved test, or who experiences adverse financial consequences as a result of quarantine, business closure, layoff, or reduced hours due to the virus.

There is a temporary waiver of required minimum distributions for the 2020 calendar year. However, because of recent changes to retirement accounts, such as the increased age to begin RMDs, the end to the 70 ½ age limit for contributions to an IRA, and the shortened distribution period for non-spouse inherited IRAs, taxpayers are encouraged to review strategies for continuing to make IRA contributions and to reevaluate their beneficiary designations.

Charitable deductions. For 85% of taxpayers who do not itemize, a $300 above-the-line deduction for cash contributions is available for 2020. However, the law is unclear if the $300 amount applies for both individual and joint returns or whether it is available beyond 2020.

For 2020 only, the limit for itemized charitable deductions is increased from 60% to 100% of adjusted gross income for cash contributions. The non-cash contribution rules are unchanged.

Although the CARES Act eliminated the required minimum distribution for 2020, taxpayers over age 70 ½ may still make a direct contribution to a charity from their IRA of up to $100,000 in 2020 and thereby reduce their adjusted gross income.

Student Loans. For payments made before January 1, 2021, employers may reimburse employees for principal and interest on student loans of up to $5,250 as part of an education reimbursement program.

Kiddie Tax. Changes under the Tax Cuts and Jobs Act (TCJA), that were meant to simplify the application of the kiddie tax, had the unintended consequence of increasing the tax on the unearned income, such as military death benefits, of children in low-income families. As a result, the kiddie tax reverts to rules prior to TCJA, using the parents' tax rate for tax years after 2019. However, a taxpayer may elect to apply the parent's tax rate to 2018 and 2019 thereby providing an opportunity to amend a prior year's return.

Disaster Relief. Several tax law provisions may help taxpayers recover financially from the impact of a disaster, especially when the federal government declares their location to be a major disaster area. Depending on the circumstances, the IRS may grant additional time to file returns and pay taxes. Both individuals and businesses can elect to claim casualty losses related to a disaster on the tax return for the previous year and thereby receive needed funds more quickly. Although the Covid-19 pandemic is a federally declared disaster and qualifies for a casualty loss deduction in 2020 (or the prior year, if elected) the IRS must provide further clarification on what losses qualify and for what time period.

Protective Claims. In addition to the individual mandate tax penalty, the Affordable Care Act introduced the 3.8 percent net investment income tax and the .09 percent Medicare tax. If the Supreme Court determines the ACA to be unconstitutional, there is a potential for a refund for taxpayers' subject to these taxes. Taxpayers with considerable investment income should consider filing a protective claim for any open tax years.

Expiring Provisions. Taxpayers might consider taking advantage of these tax benefits in 2020 before they expire. In some cases, these benefits were retroactively applied. In which case, it might be useful to amend prior year's returns if the savings are significant enough.

- ***Exclusion from income for the forgiveness of debt on a principal residence.*** The exclusion now applies to discharges of qualified principal residence indebtedness occurring before January 1, 2021, or discharges that are subject to an arrangement that is entered into and evidenced in writing before January 1, 2021.
- ***Mortgage insurance premium deduction.*** Premiums paid or accrued after January 1, 2018, for qualified mortgage insurance in connection with acquisition indebtedness are deductible as home mortgage interest (qualified residence interest). The deduction is subject to the taxpayers adjusted gross income (AGI) limits.
- ***Above-the-line deduction for tuition and fees.*** The tuition and fees deduction may be claimed for qualified tuition and related expenses paid for the enrollment or attendance at an eligible education institution. The student may be the taxpayer, the taxpayer's spouse, or the taxpayer's dependent.
- ***Nonbusiness energy property credit.*** The nonrefundable nonbusiness energy property credit is available for qualified energy efficient improvements or property placed in service before January 1, 2021. Qualified energy efficiency improvements include energy-efficient exterior windows, doors and skylights; roofs (metal and asphalt) and roof products; and insulation. Residential energy property includes energy-efficient heating

and air conditioning systems; water heaters (natural gas, propane or oil); and biomass stoves.

- ***Reduced 7.5 percent threshold for medical expense.*** If it is possible and the expenses are significant, accelerate the payment of medical expenses into 2020. The threshold rises to 10% of adjusted gross income in 2021.
- ***Health coverage tax credit (HCTC).*** Eligible individuals can receive a tax credit to offset the cost of their monthly health insurance premiums for 2020 if they have qualified health coverage for the HCTC.

Timing rules. Timing, and the skilled use of timing rules to accelerate and defer certain income or deductions, is the linchpin of year-end tax planning. For example, timing year-end bonuses or year-end tax payments, or timing sales of investment properties to maximize capital gains benefits should be considered. So, too, sometimes fairly sophisticated "like-kind exchange," "installment sale" or "placed in service" rules for business or investment properties come into play. In other situations, however, implementation of more basic concepts is just as useful.

For example, taxpayers can write a check or can charge an item by credit card and treat these actions as payments. It often does not matter for tax purposes when the recipient receives a check mailed by the payor, when a bank honors the check, or when the taxpayer pays the credit card bill, as long as done or delivered "in due course."

With all of this in mind, please call our offices if you have any questions about how year-end tax planning might help you save taxes and develop a customized plan for you. Our tax laws operate largely within the confines of "the tax year." Once 2020 is over, tax savings that are specific to this year may be gone forever. Whether it's working toward retirement or getting answers to your tax and financial questions, we're here for you. Please contact our office today at 301.986.0600 to set up your year-end review. As always, planning can help you minimize your tax bill and position you for greater success.

Please contact CBM Tax Practice Director Richard Morris with any question about your tax situation at 301.986.0600 or via email at rmorris@cbmcpa.com.