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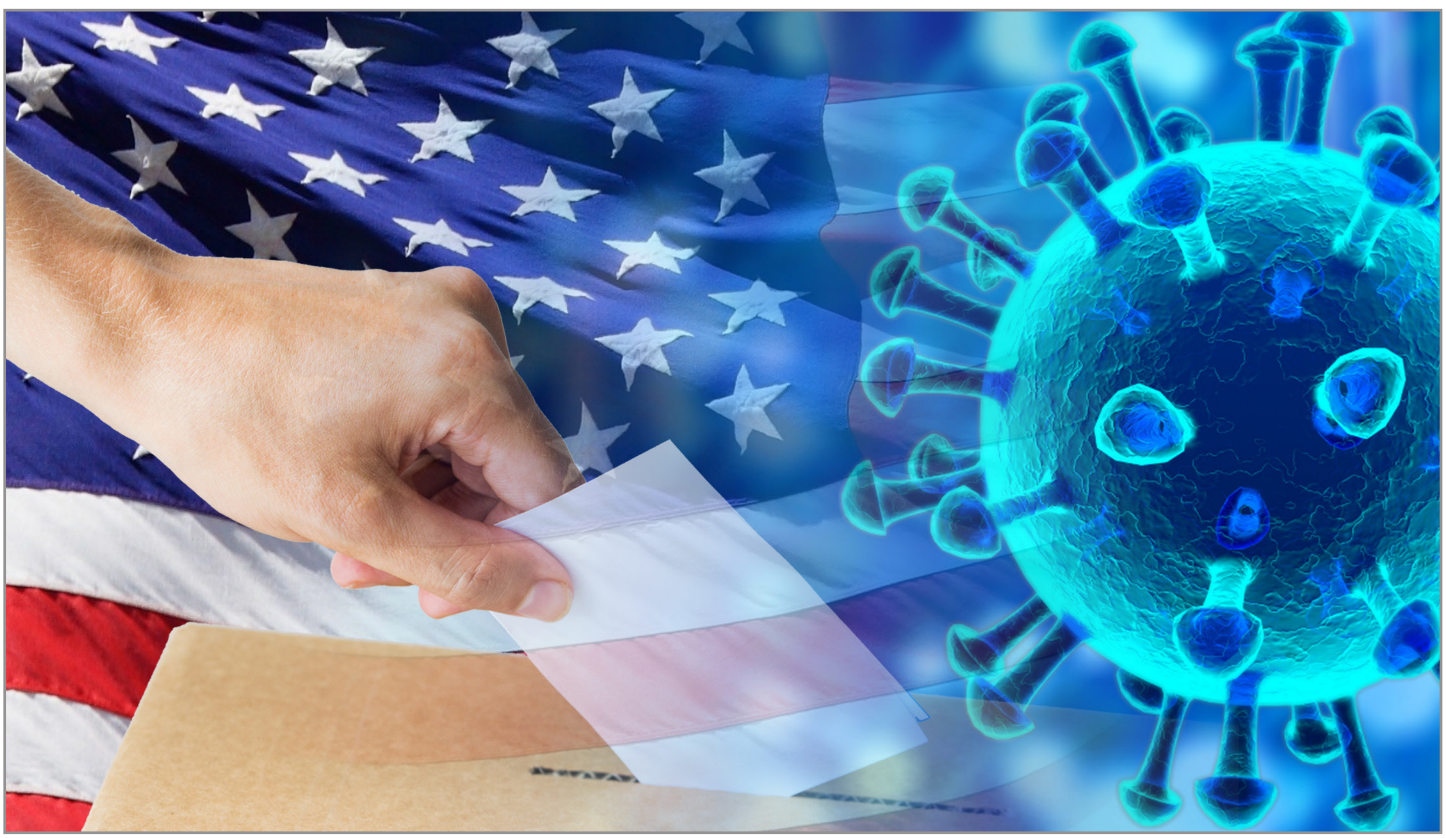
Trusted Tax Advisors

2020 Year-End Tax Planning Guide



INTRODUCTION

Tax planning in an election year is always a challenge as taxpayers and their advisors must discern the realistic tax proposals from the political bluster while contemplating tax and financial decisions. The 2020 election year was no different in terms of the grandiose tax policy visions from both candidates but with the added challenge of not knowing before year-end which, if any, of those policies have a realistic possibility of enactment. Additionally, the economic devastation from the coronavirus has added a new and unexpected challenge to the planning process.

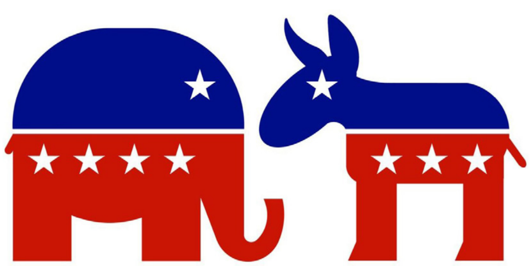
Though not yet official, it appears that we will have a Democratic President and a Democratic majority in the House. Control of the Senate will not be decided until January but most analysts believe the Republicans will retain the majority. In this context, it is important to remember that tax laws are written by Congress and require a majority vote from both the House and the Senate before they can be approved by the President. Therefore, this split government generally ensures that there will be no significant tax legislation over the next two years. In other words, if the Republicans control the Senate it is best to plan based on the tax laws as currently written and not based on campaign proposals that may never materialize.

If you believe that the Republicans will retain their majority in the Senate, thereby establishing a split Congress for the next two years, then you can generally disregard the following tax proposals from Presiden-elect Biden. While Mr. Biden proposed a number of large tax increases to taxpayers earning over $400,000, the chance that any of those proposals making it through a split Congress are slim to none. However, if you believe that the Democrats will win control of the Senate and thereby hold both the Presidency and Congress, then the following tax proposals are much more likely to become reality. Some of the more significant tax proposals include:

- Increase top ordinary income tax bracket back to 39.6%.
- Impose 12.4% Social Security payroll tax for wages above $400,000.
- Eliminate the 20% Qualified Business Income (QBI) deduction for business owners with over $400,000 of income.
- Increase the maximum Child and Dependent Care Tax Credit to $8,000 for a single child and $16,000 for two or more children.
- Limit itemized deductions to 28% of Adjusted Gross Income (AGI) for those earning more than $400,000.
- Tax long-term capital gains and qualified dividends at the ordinary income tax rate of 39.6% for income in excess of $1 million.
- Replace pre-tax deductions for retirement account contributions with a 26% tax credit.
- The lifetime exemption for estate and gift tax will revert to 2009 exemption levels of $3.5 million adjusted for inflation.
- Eliminate the basis step-up at death.

While there is some uncertainty regarding Mr. Biden's tax proposals, Congress did create some definite planning opportunities as a direct result of the coronavirus's impact on the economy. One of the most impactful to individuals was the Cares Act and specifically, the economic stimulus payment. Most taxpayers qualified for a payment of $1,200 plus another $500 per dependent. Payments were intended to be disbursed over the course of 2020, but taxpayers with 2019 income over $75,000 single/$150,000 married were phased-out of the benefit. The stimulus payment received during the year was actually an advance of the 2020 tax return credit so taxpayers that should have received a payment but did not will be able to claim the credit on their 2020 return. Taxpayers that received a payment will not have to repay the amount even if 2020 income exceeds the phase-out threshold. There are discussions in Congress to authorize another round of payments though it is far from certain.

Additionally, Congress established the Paycheck Protection Program (PPP) to benefit businesses. If certain conditions were met relating to payroll, businesses could receive a loan from the Small Business Administration (SBA). If the loan proceeds were then used appropriately, some or all of the PPP loan could be forgiven with an added bonus that the forgiven loan would be considered tax-free income. Unfortunately, the IRS isn't in agreement relative to this tax-free treatment; though Congress is in discussions to change that outcome. While the SBA is no longer issuing PPP loans, Congress is considering another round of funding so business owners will want to stay tuned to this constantly evolving topic.



To ensure you are able to maximize the benefits created under the Cares Act, it's important to discuss your specific situation in detail with Jenny, Ryan, or Stephanie. Furthermore, many of the tried and true planning strategies are still beneficial. Your particular situation changes from year to year so we encourage you to read through the guide and identify any areas that might apply and then give us a call to discuss your situation.

TAX PLANNING CHECKLIST FOR INDIVIDUALS

Income Planning

- [ ] Income Deferral – When possible, consider recognizing income after year-end to defer the tax. For example, defer bonuses or delay stock option exercises and asset sales, or utilize installment sales, when possible.

- [ ] Income Acceleration – If 2020 income is temporarily low or if a substantial increase in income is expected in future years, consider accelerating income by taking retirement account distributions, converting an IRA to a Roth IRA, selling assets, or deferring deductions.

- [ ] Tax-Exempt Income – Review investment portfolios to consider exposure to municipal bonds. Not only is the interest tax-exempt, but it's also not subject to the 3.8% Net Investment Income Tax (NIIT) that might apply to other taxable income.

- [ ] Capital Gain Deferral – Realized capital gains from the sale of an investment can be deferred into future years if a portion of the sale proceeds are invested in a Qualified Opportunity Zone Fund (QOF) within certain time periods. The QOF investment could even generate tax-free gain when sold.

- [ ] 0% Tax Rate Income – For some taxpayers in the 10% or 12% income tax brackets, long-term capital gains and qualified dividend income is taxed at 0%. So if you are in one of these tax brackets, consider capital gain harvesting before year-end to increase basis within a portfolio. Note that wash sale rules that limit capital losses do not apply to gains so the asset can be immediately repurchased.

- [ ] Like-Kind Exchange – Consider using a like-kind exchange on the sale of rental or business property to defer taxable gains.

- [ ] Capital Loss Harvesting – Review your portfolio and consider selling any unrealized capital losses (when appropriate) to offset other realized capital gains. Capital losses can be used to offset capital gains, and unused losses are carried forward to offset future capital gains. However, the wash sale rules will eliminate the benefit if the same asset is reacquired within a specified time period.

2020 TAX RATES			
Single	Married Filing Jointly	Marginal Rate	Long-Term Capital Gain & Qualified Dividends Tax Rates
$0 to $9,875	$0 to $19,750	10%	0%
$9,876 to $40,000	$19,751 to $80,000	12%	0%
$40,001 to $40,125	$80,001 to $80,250	12%	15%
$40,126 to $85,525	$80,251 to $171,050	22%	15%
$85,526 to $163,300	$171,051 to $326,600	24%	15%
$163,301 to $207,350	$326,601 to $414,700	32%	15%
$207,351 to $441,450	$414,701 to $496,600	35%	15%
$441,451 to $518,400	$496,601 to $622,050	35%	20%
Over $518,400	Over $622,050	37%	20%

TAX PLANNING CHECKLIST FOR INDIVIDUALS (CONTINUED)

Income Planning (continued)

- ☐ Suspended Passive Losses – Consider disposing of passive real estate or business interests to recognize any suspended passive losses. Losses from a passive activity that are not allowed to offset current income due to the passive loss rules are suspended and carried forward. Disposing of a passive activity with suspended losses allows both the current year losses and suspended losses to offset current year income.

- ☐ Passive Income – Explore ways to increase the level of participation with passive entities or rental properties to avoid the additional NIIT. Income from passive activities may be subject to the NIIT 3.8% surtax in addition to income tax. However, this can be mitigated if taxpayers can meet one of the tests for material participation.

- ☐ Roth IRA Conversion – Evaluate your IRA and anticipated income level for 2020 to determine if a portion of your IRA should be converted to a Roth IRA. This conversion will create additional taxable income in the current year, at a potentially lower tax rate, but the distributions from the converted account will be income tax free in future years.

- ☐ Early Retirement Plan Distributions – For 2020 only, taxpayers under age 59.5 can take up to $100,000 in coronavirus-related distributions from retirement plans without incurring the 10% early distribution penalty.

- ☐ Retirement Plan Distributions – Coronavirus-related distributions from retirement accounts may be repaid within three years and, for amounts not repaid, income can be spread over three years. Eligible taxpayers must have been impacted by the coronavirus.

- ☐ Required Minimum Distributions (RMD) – The 2020 RMD for defined contribution retirement plans, including 401(k)s and IRAs, has been suspended. RMDs will resume in 2021.

- ☐ Child's Income – Transfer income-producing assets, or appreciated property to kids to utilize their (generally) lower tax bracket. However, the Kiddie Tax could eliminate a majority of the tax savings if the child is under age 18, or under age 24 and a full-time student.

- ☐ Qualified Charitable Distribution (QCD) – Taxpayers over age 70.5 with an RMD and who normally make charitable donations, should utilize a QCD to donate funds directly from the IRA to the charity up to $100,000. The amount donated through a QCD will not be included in Adjusted Gross Income which helps increase the tax benefit of the donation. This strategy works especially well if the taxpayer does not itemize deductions.

- ☐ Same-Sex Marriage – Guidance relating to same-sex marriage has changed tax return filing requirements for certain individuals and created opportunities to potentially reduce income taxes. Furthermore, these changes apply retroactively so it is important to consider prior-year tax returns in light of these changes.

- ☐ Incentive Stock Options (ISO) – Due to the changes with AMT resulting in an increased AMT income threshold, evaluate ISO exercise strategies and consider exercising ISOs in a qualified transaction.

- ☐ Foreign Bank Accounts – With some exceptions, bank accounts, securities, mutual funds, online poker accounts, or insurance policies with cash value that are physically located outside the U.S. must be disclosed to avoid penalties. This applies to employees with signature authority and foreign retirement accounts.

Top Tax Rates for 2020	
Ordinary earned income	37%
Net investment income and passive income(1)	40.8%(2)
Long-term capital gains	23.8%(2)
Qualified dividends	23.8%(2)
Estate and gift tax	40%

(1) Includes interest, dividends, royalties, net rental income, and other passive income

(2) Includes 3.8% surtax on the lesser of a) net investment income or b) adjusted gross income over the applicable threshold of $200,000 for single taxpayers, $250,000 for joint taxpayers, or $12,950 for estates and trusts

TAX PLANNING CHECKLIST FOR INDIVIDUALS (CONTINUED)

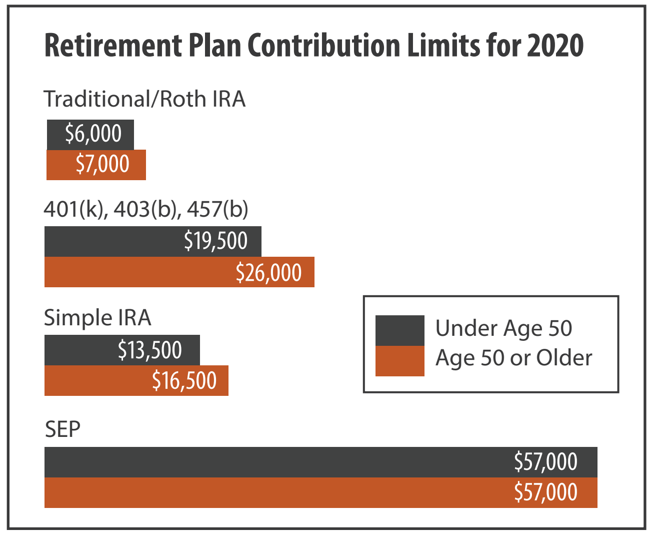
Deduction Planning

- ☐ Retirement Plan Contributions – Certain retirement plans, such as a 401(k) or Keogh must be established by year-end even though employer contributions are not due until the tax return due date.

- ☐ Over Age 50 Retirement Plan Contributions – If over age 50, be sure to utilize the "catch-up contribution" that allows for an additional $6,500 contribution to a 401(k) and a $1,000 contribution to an IRA in addition to the regular contribution limits. (See chart to the right)

- ☐ Health Savings Account (HSA) Contributions – If eligible, contributions to an HSA are tax-deductible and eligible distributions are tax-free.

- ☐ Bunch Deductions – With the new increased standard deduction making it harder to reach the threshold to itemize deductions, consider bunching two years of deductions into one year by accelerating or deferring deductions like medical expenses and charitable contributions to maximize the deduction benefit. The goal is to report itemized deductions greater than the standard deduction one year, and then utilize the standard deduction, which acts as a floor, in the next year.



- ☐ Charitable Contributions – For 2020 only, taxpayers who do not itemize can take an above-the-line charitable deduction of up to $300 for cash contributions to a 501(c)(3) charity.

VALUE	CHARITABLE CONTRIBUTION SUBSTANTIATION REQUIREMENTS		
	Cash Donations	Non-Cash Donations	Publicly Traded Stock Donations
$249 or less	Maintain records to support contribution	Maintain records to support contribution	Maintain records to support contribution
$250 - $500	Maintain written acknowledgement from the charitable organization	Maintain written acknowledgement from the charitable organization	Maintain written acknowledgement from the charitable organization
$501 - $5,000		In addition to maintaining acknowledgement letter, must report date that property was acquired, adjusted cost basis, and method of acquisition	In addition to maintaining acknowledgement letter, must report date that property was acquired, adjusted cost basis, and method of acquisition
More than $5,000		In addition to requirements above, must obtain an appraisal –from a qualified appraiser	
$500,000 or greater		Obtain an appraisal from a qualified appraiser for assets other than cash or publicly traded securities AND attach a copy of the appraisal to your return along with a confirmation letter from the charity	

TAX PLANNING CHECKLIST FOR INDIVIDUALS (CONTINUED)

Deduction Planning (continued)

- ☐ Charitable Miles – A deduction of $0.14 per mile is allowed when using a vehicle for charitable purposes, plus parking fees and tolls.

- ☐ Charitable Contributions of Appreciated Property – Consider giving appreciated property to a charity instead of cash to receive a deduction for the fair market value and avoid paying tax on the capital gain. Conversely, investment assets with unrealized losses should be sold first, and the cash donated to charity to receive the benefit of the capital loss.

- ☐ Charitable Contribution Threshold – For 2020 only, taxpayers can deduct cash gifts of up to 100% of their adjusted gross income, rather than the usual 60% limit. To qualify for this higher limit, the gifts must go directly to the charities, rather than to a donor-advised fund or private foundation.

- ☐ Timing of Charitable Contributions – Credit card charges and checks mailed on or before December 31, though not actually paid until 2021, are still considered deductions in 2020.

- ☐ Substantiation of Charitable Contributions – The IRS has been disallowing charitable contribution deductions when taxpayers are unable to completely meet the substantiation requirements. When giving over $250 to charity, be sure to get an acknowledgment letter from the charity. It would even be advisable to take a photo of non-cash items contributed.

- ☐ Home Equity Interest – For tax years 2019 through 2025, the deduction for interest from a home equity loan or line of credit is suspended if the proceeds were not used to acquire or substantially improve your primary or secondary home. The loss of deduction should be factored into the total financing cost for the purchase, and consider reducing the outstanding debt.

- ☐ Donor-Advised Funds - Taxpayers with charitable contributions might consider utilizing a Donor-Advised Fund (DAF) as part of a bunching strategy discussed above. The DAF allows taxpayers to make a large charitable contribution one year, but distribute the funds to charities in future years.

- ☐ Mortgage Interest – Interest from mortgage loans originating after December 15, 2017, is deductible on mortgage debt up to $750,000. Loans originating before that date are still able to use the previous $1 million limitation. Second mortgages are also deductible as long as the proceeds were used to acquire or improve the residence and the total mortgage debt is below the applicable threshold.

- ☐ Residential Energy Tax Credits – The tax credits for installing residential energy efficient property and personal energy property were reinstated through 2021. This includes an unlimited 26% credit for installing solar water heaters, solar panels, geothermal heat pumps, small wind turbines, and fuel cells; along with a limited 10% credit for items meeting specific energy efficiency requirements, including biomass stoves, central air conditioners, furnaces, insulation, roofs, hot water heaters, windows, doors, and skylights. The credit is scheduled to decrease to 22% in 2021 with no credit beyond 2021.

- ☐ Education Credits and Deductions – To be eligible for the American opportunity tax credit or the lifetime learning credit, taxpayers must have a Form 1098-T from the educational institution. Information from Form 1098-T is needed to claim the credits or deductions.

- ☐ School Teachers – Elementary and secondary school teachers are allowed to deduct up to $250 on books, supplies, and materials purchased for their classrooms.

TAX PLANNING CHECKLIST FOR INDIVIDUALS (CONTINUED)

Estate and Gift Planning

- ☐ Annual Exclusion – Every taxpayer has a $15,000 per-recipient annual exclusion from gift tax. Combined with a spouse's annual exclusion, a married couple can give $30,000 per recipient. Consider evaluating your gifting options before year-end.

- ☐ State Estate Tax – Some states, including Washington, Oregon, and Massachusetts, have state estate taxes. The state exemptions are lower than the federal exemption so it is important to consider state estate taxes in your estate plans.

- ☐ Stretch IRA – The recently enacted Secure Act eliminated the "stretch IRA" strategy for IRAs inherited after 2019 by requiring most non-spouse beneficiaries to withdraw the retirement account funds over 10 years. All taxpayers should revisit their estate plans in light of this change; however, taxpayers that have named a trust as beneficiary of their IRAs should reach out to legal counsel to possibly revise the trust terms in light of these changes.

- ☐ Charitable Gifts – Taxpayers with significant charitable intent may be able to receive both an income tax benefit and an estate tax benefit with proper planning.

- ☐ Same-Sex Marriage – New guidance relating to same-sex marriage has created opportunities for certain individuals. Wills and other estate planning documents should be updated to incorporate these new opportunities.

- ☐ Federal Lifetime Exemption – The federal lifetime exemptions for gift and estate tax is now $11.58 million (this is in addition to the $15,000 per-recipient annual exclusions for lifetime gifts referenced above). The gift and estate tax rate for transfers greater than $11.58 million is 40% for 2020.

- ☐ Interest Rates – Applicable federal rates (AFRs), minimum interest rates that are required to be charged by related parties, are at all-time lows. In some cases, it may be possible to refinance loans between related parties to reduce interest payments and implement other estate planning strategies that utilize the low rates.

- ☐ Valuation Discounts – Discounts have been an extremely valuable tool in the estate planning arena for decades. Proposed regulations from the Treasury to limit the application of these discounts have been withdrawn so this strategy is still available.

TAX PLANNING CHECKLIST FOR TRUSTS

Tax Planning Checklists for Trusts

- [ ] Distributions – Trusts have a low threshold of $12,950 for the Net Investment Income Tax (NIIT) so most undistributed income in a trust will be subject to the additional tax. Trustees should consider maximizing distributions to beneficiaries, and consider strategies to distribute capital gains.

- [ ] Passive Activities – IRS guidance has clarified the application of NIIT on a trust's business and/or real estate income. In light of this new guidance, consider the role of a trustee in the management of the trust assets and whether additional steps can be taken to mitigate this additional tax.

- [ ] Income Sources – Similar to the tax planning strategies for individuals, trustees should evaluate the role of tax-exempt income in the trust's investment portfolio given the 3.8% NIIT on taxable income.

Trust Taxable Income	Marginal Tax Rate
$0 to $2,600	10%
$2,601 to $9,450	24%
$9,451 to $12,950	35%
Over $12,950 *	37%

*Additional 3.8% tax on investment and passive income in excess of $12,950

TAX PLANNING CHECKLIST FOR BUSINESSES

Tax Planning Checklists for Businesses

- [ ] Coronavirus Sick Leave – Certain employers that paid qualified family leave wages and qualified sick leave wages can receive a tax credit of up to 100% of the amount paid.

- [ ] Entity Selection – With the corporate tax rate of 21%, consider evaluating the tax benefits of a C corporation compared to an S corporation.

- [ ] 20% Qualified Business Income Deduction – Non-corporate taxpayers with income from a pass-through entity or sole proprietorship are allowed a deduction of up to 20% of the Qualified Business Income (QBI). Service businesses are excluded from this benefit in some situations, but rental and other passive activities can be included.

- [ ] Form W-2 – The filing deadline for Forms W-2/W-3 is January 31. Employers are also required to disclose the annual cost of health plan or HRA coverage to an employee on the W-2.

- [ ] Health Insurance – Employers with 50 or more FTE employees must offer minimum essential coverage and report insurance coverage for employees on specified forms.

- [ ] Cash Method of Accounting and UNICAP – Taxpayers that satisfy a $25 million gross receipts test may use the cash method of accounting and are exempt from application of the uniform capitalization (UNICAP) rules. Consider evaluating your current reporting methods to determine if an accounting method change would be advantageous.

- [ ] Limitation on Health FSA Reimbursements - The maximum Health FSA reimbursement may not exceed $2,750 per year for 2020.

- [ ] Section 179 – The Section 179 depreciation deduction for qualifying assets acquired in 2020 is $1,040,000. This depreciation deduction begins to phase out once total depreciable assets purchased during the year exceed $2,590,000. The definition of qualifying assets has also been expanded to include roofs, heating systems, HVAC units, and other specific assets that are used in a trade or business.

- [ ] Bonus Depreciation – 100% bonus depreciation is allowed for qualified tangible personal property with a recovery period of 20 years or less, for both new and used assets.

- [ ] Automobile Depreciation – The maximum allowable first-year depreciation for passenger automobiles placed in services after 2018 increased to $10,100. The Tax Cuts and Jobs Act (TCJA) retained the $8,000 limit for bonus deprecation, so in 2020, the maximum first-year deduction for a passenger automobile is $18,100.

- [ ] Family Employees – Consider hiring your school-age child to work for your business part-time. Reasonable compensation is deductible, reducing your self-employment income. No Social Security or Medicare tax is due on the child's earnings if they are under age 18 and the business is not a corporation. Also, the child could make a contribution to a traditional or Roth IRA.

- [ ] Form 1099 – All businesses with payments to any vendor over $600 must issue the new Form 1099-NEC for non-employee compensation or Form 1099-MISC for all other payments including rent. Form 1099/1096 is due by January 31 and the penalty for late filing can be as high as $530 per Form 1099 with no maximum penalty. The IRS has emphasized greater enforcement of the Form 1099 compliance process.

TAX PLANNING CHECKLIST FOR BUSINESSES (CONTINUED)

Tax Planning Checklists for Businesses (continued)

- ☐ Small Business Health Care Tax Credit – Small employers, generally those with fewer than 25 full-time equivalent employees with average wages of $54,200 or less, are allowed a maximum credit for 50% of premiums paid for employees' health insurance. Insurance must be purchased through the Small Business Health Options Program (SHOP) or qualify for an exception to the requirement.

- ☐ Health Reimbursement Arrangement (HRA) – Employers with fewer than 50 employees and no company-provided health insurance can utilize an HRA to reimburse employees for healthcare expenditures. Annual reimbursements are limited to $5,250 for employee-only coverage and $10,600 for family coverage.

- ☐ Work Opportunity Tax Credit – Employers who hire and retain veterans and other qualified individuals, including long-term unemployment recipients, are eligible for a tax credit up to 40% of the employee's wages.

- ☐ Qualified Small Business Stock – Up to 100% of the gains from the sale of certain qualified small business stock can be excluded from income.

- ☐ Employer-Provided Child Care Credit – Employers can claim a credit of 10 to 25% up to $150,000 for supporting employee child care or child care resource and referral services.

- ☐ Research and Development Credit – Companies that develop new or improved products or processes may be able to benefit from research tax credit incentives. The research tax credit law was permanently extended.

- ☐ Family and Medical Leave Credit – Employers that provide paid family and medical leave to qualified employees not related to coronavirus during 2020 are eligible for a credit of 25% of wages paid for up to 12 weeks of pay.

MACRS Depreciation Asset Classes

3-Year	5-Year	7-Year	10-Year
			
Tractor units for over-the-road-use.	Autos, computers, and equipment	Office furniture and fixtures, farm machinery and equipment	Vessels, barges, tugs

15-Year	20-Year	27.5-Year	39-Year
			
Certain land improvements	Certain farm buildings	Residential rental property - apartment buildings, single family	Non-residential real property - office and commercial

IMPORTANT TAX DUE DATES		
TAX FORM	Filing Deadline	Extended Filing Deadline
Form W-2/W-3	January 31	N/A
Form 1099/1096	January 31	N/A
Individuals – Form 1040	April 15	October 15
FBAR – Form 114	April 15	October 15
Trusts – Form 1041	April 15	September 30
Partnerships – Form 1065	March 15	September 15
C Corporations – Form 1120	April 15	October 15
S Corporations – Form 1120S	March 15	September 15

For most taxpayers, 2020 has been a challenging year and they look forward to changing the calendar to 2021. However, it's important to address your year-end tax planning before 2020 ends.

Contact Jenny Keeney, Ryan Blume, or Stephanie Onzay for more information.

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