CARES = Coronavirus, Aid, Relief, and Economic Security Act
SECURE = Setting Every Community Up for Retirement Enhancement Act
TCJA = Tax Cuts and Jobs Act

2020 TAX PLANNING TIPS

Last minute strategies to reduce your 2020 tax bill

RETIREMENT CONTRIBUTION PLANNING:

- **IRA:** Remember to plan your cash flow to make an IRA contribution by April 15, 2021. The maximum 2020 IRA contribution is $6,000 ($6,000 in 2021). If you are age 50 or older by December 31, 2020, the maximum amount is $7,000. Roth IRA contributions are restricted to adjusted gross income phaseout amounts, with complete phaseout at $139,000 for single taxpayers and $206,000 for married taxpayers. IRA plans can be set up as late as April 15, 2021. If you are not eligible for a deductible IRA or Roth contribution due to income limitation, you can make a non-deductible IRA contribution and then (ideally) an immediate Roth conversion. Depending on the other IRA's you own, there may be reduced or no tax consequences. Contact us for specific details.

- **<u>*NEW* Contributions after age 70 ½:</u>** For taxable years beginning after 12/31/19, the SECURE Act removed the age restriction for taxpayers to contribute to a traditional IRA. Roth IRA contributions had no age limit prior to the SECURE Act and this remains the same.

- **<u>401K:</u>** The maximum 2020 contribution to your 401K is $19,500 ($19,500 in 2021). If you are age 50 or older by December 31, 2020 and your plan has been amended to allow it, the maximum amount is $26,000.

- **<u>SEP:</u>** The maximum 2020 SEP contribution is $57,000 ($58,000 in 2021). You have until the due date of your tax returns, including extensions, in which to make the 2020 contribution and to set up the plan.

- **<u>All retirement plan contributions:</u>** Due to the complexity on limitations for contributions, we recommend that you consider waiting to make contributions until we have determined the allowable amount based on your actual tax return OR contact us to discuss an appropriate amount before you make the contribution. [You must have "earned income" to qualify for <u>any</u> type of IRA contribution.]

- **<u>Roth IRA rollover:</u>** There is no adjusted gross income limitation that restricts the rollover of a regular IRA into a Roth IRA. Funds rolled over from a regular IRA to a Roth IRA will be taxed under the regular IRA distribution rules, but no penalties will apply. A Roth conversion can no longer be recharacterized (enacted with the TCJA). This means that any type of plan converted to a Roth IRA (including a traditional IRA, SEP, SIMPLE, 401(k) or 403(b)) cannot be undone.

- **<u>IRA One-Rollover-Per-Year Rule</u>:** You are allowed only one rollover from an IRA to another (or the same) IRA in any 12-month period, regardless of the number of IRAs you own. This applies to all IRAs including SEP and SIMPLE IRAs and traditional or Roth IRAs. Transfers that are <u>not</u> limited include trustee-to-trustee transfers between IRAs and rollovers from traditional IRAs to Roth IRAs.

- **<u>Required minimum distribution (RMD):</u>** The CARES Act waived required minimum distributions in 2020. If you had already taken your RMD prior to the passage of the Act in March, you had until August 31, 2020 to roll back those funds. The 2020 RMD suspension also includes taxpayers who turned 70 ½ in 2019 and would have had to take their first RMD by April 1, 2020. It is unknown at this time whether a taxpayer in such a situation who did waive their first RMD will have to take an extra RMD in 2021.

- **<u>*NEW* RMD age change:</u>** The SECURE Act increased the age at which taxpayers must begin taking RMD's from age 70 ½ to age 72, but only for taxpayers who turned age 70 ½ after 12/31/19. Taxpayers who turned age 70 ½ in 2019 (or earlier) must continue taking RMD's each year, even for those years before they turn age 72 (excluding 2020).

- **<u>Tax-free distributions for charity:</u>** Taxpayers over age 70 ½ are allowed to exclude IRA distributions from their gross income if they are donated to a qualified charity (up to $100,000 per year) as a direct transfer from an IRA account. This is now a permanent provision of the law.

<u>Standard deduction</u>

The TCJA dramatically increased the standard deduction. Additionally, the $10,000 SALT (state/local/property taxes) cap reduced many taxpayers' total itemized deductions. The combination of these two factors resulted in <u>substantially more</u> taxpayers claiming the higher standard deduction. Deductible expenses such as medical expenses or charitable contributions may not have an impact on your federal tax returns for 2020 and beyond. <u>Many states, including California, did not conform to these changes</u> which resulted in itemizing for state only, however, the record keeping involved may not be worth itemizing for your state alone. Feel free to contact us if you would like our advice regarding continued record keeping of itemized deductions.

DEDUCTION AND CREDIT PLANNING:

- **<u>Medical expenses:</u>** The 7.5% medical expense threshold has been extended through 2020 for all filers. The medical expense threshold for all filers will return to 10% of adjusted gross income in 2021. Expenses must be paid or charged on a credit card by December 31, 2020 to be eligible.

- **<u>*NEW* Charitable contributions:</u> The CARES Act provides that an individual who doesn't itemize may still take an "above-the-line" charitable deduction of up to $300 (per return) for 2020.** Be sure to ask for receipts to substantiate all amounts for both non-cash donations and cash donations. Cash donations can also be substantiated by canceled checks or bank statements that verify the charity's name, date and amount. Donations charged on a credit card by December 31, 2020 are eligible as a deduction for 2020, even if you don't pay the credit card balance until 2021. Charitable contributions have varied limitations based on your adjusted gross income (temporarily suspended by the CARES Act for contributions made in 2020 only). Any amounts not eligible due to these limitations can be carried forward for five years. Any donation deduction amount for cars, boats and airplanes of more than $500 requires your tax return to include a statement from the charity identifying the vehicle and stating the amount for which it was sold. Be sure to obtain these statements from the charity and include them with your organizer package.

- **<u>Health savings accounts:</u>** Health Savings Account (HSA) contribution limits for 2020 are $3,550 if single ($3,600 in 2021) or $7,100 for a family ($7,200 in 2020). For taxpayers aged 55 or older, the limits are $4,550 if single and $8,100 for a family.

- **<u>Taxes:</u>** State taxes are deductible on your federal tax return. State estimated income tax payments and property taxes that are due in 2021 can be paid in 2020. *CAUTION*: If you are subject to AMT (alternative minimum tax), there is no tax benefit by prepaying these taxes in 2020. Additionally, TCJA limits the total deduction of state and local income taxes, property taxes and personal property taxes to a combined total of $10,000. For many taxpayers, there is no longer an advantage to pre-paying your state or property taxes. NOTE - For rental property owners, there is NO limit to the amount of property taxes that can be deducted as a rental expense (however, overall rental losses could still be limited based on passive loss rules).

<u>Deduction "bunching"</u>

By applying a "bunching strategy", taxpayers can accelerate or defer their discretionary medical expenses and/or charitable contributions into the tax year where it might actually create a tax benefit. For example, if you know that you will be able to itemize in 2020 but not in 2021, it would be more beneficial to do two years' worth of charitable contributions in 2020, instead of spreading out the donations over the two years.

- **Mortgage interest:** Mortgage interest is deductible to the extent the proceeds were used to acquire, construct or improve your personal residence(s) to a maximum principal amount of $750,000 ($1,000,000 for debts acquired prior to December 15, 2017). Interest paid on home equity loans for which the proceeds were **not** used to acquire, construct or improve your personal residence is no longer deductible after the passage of the TCJA, even if the loan was acquired prior to December 15, 2017. Previously, you were allowed to deduct interest on a home equity loan up to $100,000 regardless of what the proceeds were used for. Refinancing a mortgage and taking cash proceeds may impact the amount of interest that is deductible. No part of a home equity loan is deductible for AMT purposes to the extent that it is not used to acquire, construct or improve a residence.

- **Miscellaneous itemized deductions:** From the passage of the TCJA, there is no longer a deduction for miscellaneous itemized deductions which were formerly deductible to the extend they exceeded 2% of your adjusted gross income. This category included tax preparation costs, investment/broker fees, union dues, unreimbursed employee expenses and safety deposit boxes. For taxpayers that incur high broker fees, consider discussing alternative options with your broker. For taxpayers with unreimbursed employee business expenses, consider discussing reimbursement options with your employer.

- **Residential Energy Efficient (Solar) Property Credit**: 2019 was the final year to receive the 30% credit for installing property such as solar electric panels or solar water heaters to your primary residence (excluding solar heaters installed for heating a swimming pool or hot tub). This credit is available through 12/31/2021, but is reduced to 26% in 2020 and 22% in 2021. To receive the credit in 2020, the solar property must be placed in service before 1/1/21 (even if the project is financed or paid in future years).

- **Nonbusiness Energy Property Credit**: The Further Consolidated Appropriations Act of 2020, signed into Law 12/20/19, retroactively extended this credit, which provides a credit of 10% of qualifying energy efficient improvements to your principal residence. This includes energy efficient windows, doors, skylights and other items. The credit has a lifetime cap of $500 or $200 depending on the property type.

- **Plug-in vehicle credit:** The maximum federal credit for buying a plug-in vehicle is $7,500, with phaseout beginning once the automaker sells 200,000 qualifying vehicles. An updated list of vehicles that qualify for the credit and the actual amount of the credit can be found at https://www.irs.gov/businesses/irc-30d-new-qualified-plug-in-electric-drive-motor-vehicle-credit. Several automakers have met this limit and the credits have been reduced as follows:
    - There is no credit for Tesla vehicles delivered after 12/31/19.
    - The credit for GM electric vehicles (including the Chevrolet Bolt and Volt) is $1,875 for vehicles purchased through March 2020. After March 2020, there is no credit.

  California offers a rebate unrelated to your tax return that is applied for online at https://cleanvehiclerebate.org.

2020 Standard Mileage Rates
- Business: 57.5 cents/mile
- Charitable: 14 cents/mile
- Medical: 17 cents/mile

BUSINESS EXPENSE PLANNING:

- **Health insurance premiums:** As a self-employed person, you are able to deduct 100% of health insurance premiums paid for yourself, your spouse, and your dependents to the extent of your earned income. This also includes dental and vision insurance, plus limited amounts for long-term care insurance. It does not include disability or life insurance. **Health insurance paid for shareholders of an S-corporation must be reported on the shareholder's W-2 to be deductible. We will provide additional information to owners of S-corporations in a separate newsletter.**

- **Depreciation:**
    - *"Section 179 deduction"* Equipment purchases are eligible for a "Section 179 deduction" of up to $1,040,000 for 2020. The equipment must be "placed in service" by December 31, 2019.

Note that purchasing too much equipment (over $2,590,000) will restrict your total "Section 179 deduction".

- *Bonus depreciation* The TCJA increased bonus depreciation to a 100% first-year deduction for qualified new and used property placed in service after September 27, 2017 and before 2023. Qualified improvement property is now eligible for bonus depreciation.

INVESTMENT PLANNING:

- **Capital gains and losses:** Income that results from the sales of stock, investment property, and rental property (above depreciation recapture) is considered capital. Long-term gains result from sales that have been held over one year. The federal income tax rate on long-term capital gains is limited to 20% in 2020. The Medicare surtax of 3.8% on investment income for taxpayers with income exceeding certain thresholds is also still in effect. Losses are deductible to the extent of gains plus $3,000. Any excess loss is carried over to subsequent years for an unlimited amount of time. *CAUTION*: If you are subject to AMT (alternative minimum tax), the capital gains tax rate benefit may be partially offset by an increased AMT liability amount.

- **Sale of home:** When selling your principal residence, you may exclude up to $500,000 of capital gain if married or $250,000 of capital gain if single. A sale of a home in 2020 (and beyond) could trigger the increased capital gain rate and the 3.8% Medicare surtax if there is a taxable gain. Since there is no exclusion for the sale of a second home, vacation home, or rental property, the entire capital gain could be subject to these higher rates for sales in 2020 and beyond.

- **Gifts**: Amounts transferred up to $15,000 per person per year in 2020 are considered exempt from gift reporting and taxation. Amounts given above this amount require the "giver" to file a gift tax return and either elect to use part of their "life-time exclusion" or to pay a gift tax. This tax return is due April 15, 2021 or October 15, 2021 if an extension is filed. There are no requirements for the recipient of the gift. The 2021 limit is also $15,000.

- **Social security:** Up to 85% of social security benefits may be taxable depending on your modified adjusted gross income. For one-time events you should give consideration to the year of receipt. Please call us for an individualized analysis.

- **Net operating loss (NOL):** A net operating loss occurs if certain non-personal income and expenses create a negative amount. The TCJA repealed the net operating loss carryback (with limited exceptions), but is still allowed to be carried forward indefinitely (there is no longer a 20-year expiration). The TCJA also limited the amount of the NOL that is available for use to 80% of the taxpayer's taxable income. However, the CARES Act provided two major modifications. Five-year carrybacks *are allowed* for NOL's incurred in 2018-2020 and the 80% taxable income limitation for 2018-2020 is suspended.

ALTERNATIVE MINIMUM TAX:

- Some of the standard year-end planning ideas will not reduce tax liability if you are subject to the alternative minimum tax (AMT) because different rules apply. Because of the complexity of the AMT, we recommend a personalized analysis of your AMT exposure, which will include the preparation of a tax projection report.

HEALTHCARE MANDATE:

- It's back! But for California only. Beginning 1/1/20, California imposes penalties generally equal to $750 per adult against California residents who do not have minimum essential health coverage for the entire year. We will address this in the same manner we have in the past and the penalties will be calculated and reported on your 2020 California tax return.