CORDASCO
& COMPANY P.C.

Certified Public Accountants

2020

YEAR-END INCOME TAX PLANNING
FOR CORPORATE AND NON-CORPORATE BUSINESSES

Detailed Overview

UPDATED November 19, 2020

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2020 YEAR-END INCOME TAX PLANNING FOR INDIVIDUALS

INTRODUCTION

With year-end approaching, this is the time of year we suggest possible year-end tax strategies for our clients. However, there has never been a year quite like 2020. We think it is safe to say that year-end tax planning for 2020 is proving to be the trickiest in recent memory. In response to the Coronavirus, Congress and the IRS have been exceedingly busy enacting and issuing never-seen-before tax relief. Many of these new tax relief provisions are temporary and expire after 2020. Moreover, for well over a decade, we have been faced with the off-and-on expiration of a long list of popular tax breaks. Historically, Congress has temporarily extended the majority of these tax breaks every few years. Unfortunately, several of these traditional tax breaks are currently scheduled to expire after the end of 2020.

This letter is designed to bring you up to date on the most significant tax provisions that could impact your year-end planning. We start this letter with a listing of selected historic tax breaks scheduled to expire at the end of 2020. We then discuss selected legislative changes (including COVID-related tax provisions) that are most likely to impact your year-end tax planning. We conclude this letter by highlighting certain time-honored, year-end tax planning techniques that remain relevant notwithstanding the recent COVID-related tax changes.

Caution! It is entirely possible that Congress could enact additional COVID-related tax legislation before the end of this year. In addition, the IRS continues releasing guidance on various important tax provisions (particularly on COVID-related tax provisions that have already been enacted). We closely monitor new tax legislation and IRS releases on an ongoing basis. Please call our firm if you want an update on the latest tax legislation IRS notifications, announcements, and guidance or **if you need additional information concerning any item discussed in this letter.**

Be Careful! We suggest you call our firm before implementing any tax planning technique discussed in this letter. You cannot properly evaluate a particular planning strategy without calculating your overall tax liability with and without that strategy. This letter contains ideas for Federal income tax planning only. **State income tax issues are not addressed.**

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2020 MAY BE OUR LAST CHANCE TO TAKE ADVANTAGE OF THESE TRADITIONAL TAX BREAKS

For well over a decade, we have been faced with the off-and-on expiration of a long list of popular tax breaks. Historically, Congress has temporarily extended the majority of these tax breaks every few years. However, several popular tax breaks for individuals **are scheduled to expire at the end of 2020,** and Congress has yet to extend them. Some of the more popular tax breaks scheduled to expire at the end of 2020 include: Deduction (up to $4,000) for Qualified Higher Education Expenses; Deduction for Mortgage Insurance Premiums as Qualified Residence Interest; Income Exclusion For Discharge Of Qualified Principal Residence Indebtedness; and the 10% Credit (with a lifetime cap of $500) for Qualified Energy-Efficient Home Improvements (e.g., qualified energy-efficient windows, storm doors, roofing). As we send this letter, it has been reported that some members of Congress are still pushing for these tax breaks to be extended beyond 2020. However, only time will tell whether these tax breaks will be extended. Please call our office if you would like a status report on any of these expiring provisions.

Planning Alert! Although not expiring, the credit for "Qualified Fuel Cell Property," "Qualified Small Wind Energy Property," "Qualified Solar Electric Property," "Qualified Solar Water Heating Property," And "Qualified Geothermal Heat Pump Property" is to be reduced from 26% to 22% for property installed after 2020. Also, for **"2020 only,"** volunteer firefighters and volunteer EMS personnel may exclude from income up to $50 per month of expense reimbursements made by the State or political subdivision.

HIGHLIGHTS OF CHANGES TO IRAs AND QUALIFIED RETIREMENT PLANS MADE BY THE CONSOLIDATED APPROPRIATIONS ACT AND THE CARES ACT

In late December 2019, Congress passed the *Consolidated Appropriations Act of 2020* (the "Appropriations Act") which pre-dated the more recent flurry of COVID-related legislation. The Appropriations Act included significant changes to various IRA and qualified retirement plan rules. Most of these changes are first effective in 2020. In addition, the more recently enacted "CARES Act" provided temporary relief relating to loans and distributions from IRAs and qualified retirement plans. The following are highlights of selected changes from both of those pieces of legislation that we feel will have the greatest impact on tax planning for individuals:

Required Beginning Date For Required Minimum Distributions (RMDs) Delayed To Age 72.

Before this change, you were required to begin taking "*Required Minimum Distributions*" (RMDs) from your IRA or qualified retirement plan account no later than April 1st following the year you reached age 70½ (i.e., the required beginning date). For individuals who **reach age 70½ after 2019**, the *Appropriations Act* changed the age of the required beginning date for RMDs from 70½ to age 72. So, if you reach age 70½ **after 2019**, you will not be required to take your first RMD until the April 1st following the year in which you reach age 72! **Planning Alert!** Individuals who reached age 70½ during 2019 were still generally required to take their first RMD no later than April 1st of 2020 and were also required to take their second RMD no later than December 31, 2020. However, as discussed in the next paragraph, the more recently enacted Coronavirus Aid, Relief And Economic Security Act (the "CARES Act") suspended all RMDs for 2020.

- **CARES Act Suspends All RMDs Otherwise Due In 2020.** The CARES Act generally suspends all RMDs from an IRA or employer-sponsored defined contribution retirement plan that are otherwise required in 2020. This suspension applies to owners of IRAs and beneficiaries of inherited IRAs. **Planning Alert!** An RMD generally may not be rolled over into another IRA or qualified retirement plan. However, the IRS says that an individual who actually received an RMD during 2020, may roll over that RMD into an IRA or qualified retirement plan provided the rollover occurred by the **later of: 1)** August 31, 2020, or **2)** 60 days after the receipt of the RMD.

Age Limit On Contributing To An IRA Removed.

Before 2020, an individual who reached age 70½ during the year could not contribute to a traditional IRA for that year, or any later year. For contributions made for tax years beginning after 2019, the Appropriations Act removed all age limits for contributing to an IRA. Stated more simply, for contributions made for tax years beginning **after 2019,** there is **no age limit** on contributions to a traditional or Roth IRA! **Planning Alert!** Regardless of your age, you must have "earned income" (e.g., W-2 wages; Income subject to self-employment tax) at least equal to the amount of your contribution to a traditional or Roth IRA. **Caution!** As discussed in the immediately following segment, making a deductible contribution to your IRA after reaching age 70½ could have a negative tax impact on any "Qualified Charitable Distributions" you are planning to make from your IRA.

Changes To "Qualified Charitable Distributions" (QCDs) For IRA Owners.

If you have reached **age 70½** and you are planning to make charitable contributions before the end of 2020, there is a long-standing tax break known as a "Qualified Charitable Distribution" (QCD) that could apply to you. This popular provision generally allows taxpayers, who **have reached age 70½,** to have their IRA trustee transfer **up to $100,000** from **their IRAs "directly" to a qualified charity and exclude the IRA transfer from income.** The IRA transfer to the charity also counts toward the IRA owner's "Required Minimum Distributions" (RMDs) for the year.

- **Changes To QCDs Under The Appropriations Act.** Although the Appropriations Act increased the required beginning date for RMDs from age 70½ to age 72, the minimum age for making a QCD remains at age 70½. **Caution!** Starting in 2020, the Appropriations Act generally reduces the tax-free portion of a QCD by the amount of any deductible contributions made to an IRA after reaching age 70½. If you are planning to make a QCD for 2020 and you also plan to make a deductible IRA contribution for 2020, please call our firm first. We will gladly advise you on the impact of this new rule on your decision.

New 10-Year Pay-Out Requirement For Those Who Inherit An IRA Or Qualified Plan Account.

If an individual died before 2020 and someone other than the surviving spouse was named as the beneficiary of the decedent's IRA or qualified plan account, RMDs to the named beneficiary were required to begin by December 31 of the year following the year of death, and could be paid over the life expectancy of the named beneficiary. For example, if an individual died in 2019 and a child (regardless of age) was the beneficiary of the individual's IRA, the child could take RMDs over the child's life expectancy.

- **The Act Imposes A New 10-Year Pay-Out Requirement.** Effective for **individuals dying after 2019**, the Appropriations Act generally requires a decedent's entire remaining IRA or qualified account balance

to be distributed to a named beneficiary **by December 31 of the 10th year following** the year of the decedent's death. This required 10-year payout does not apply if the named beneficiary is the decedent's spouse, has a qualified disability, is chronically ill, or is no more than 10 years younger than the decedent. If the named beneficiary is a minor, the 10-year pay-out requirement does not kick in until the beneficiary reaches majority (age 18 in many jurisdictions). **Planning Alert!** If you currently have an estate plan based on the assumption that the non-spouse beneficiaries of your IRAs or qualified retirement plan accounts will be able to take RMDs over their life expectancies, it might be a good time to review and possibly update your estate plan. We will gladly assist you with this review.

- **Planning For Rollovers By Surviving Spouses.** The new 10-year payout requirement does not apply to a surviving spouse who is the named beneficiary of the decedent's IRA or qualified retirement plan. In that event, the surviving spouse would generally treat the IRA as an "inherited" IRA and be required to take RMDs over the surviving spouse's *"single life expectancy"* (with no 10-year payout requirement). However, it is generally advisable for the surviving spouse to convert the decedent's IRA into the name of the surviving spouse (i.e., convert it into a "spousal IRA"). This is generally advisable because, once the decedent's IRA is converted to a spousal IRA: **1)** The surviving spouse will not be required to begin taking RMDs until the April 1st following the year the surviving spouse reaches age 72, and **2)** When the RMDS begin, the surviving spouse's RMDs will be determined using the "*Uniform Lifetime Distributions Table"* (with no 10-year payout requirement), which will result in a smaller annual required payout than under the "single life expectancy" computation that would otherwise be required had the surviving spouse not converted the decedent's IRA into a spousal IRA. **Caution!** If you (as surviving spouse) are not yet 59½, leaving the IRA or qualified plan account in the name of your deceased spouse (and not converting it to a spousal IRA) may actually be the better option if you think you will need to withdraw amounts from the retirement account before you reach age 59½. Otherwise, if your deceased spouse's account is transferred into your name as a spousal IRA and you take a distribution before reaching age 59½, the distribution could be subject to a 10% early distribution penalty.

New Option For Penalty-Free Withdrawals For Adoption Or Birth Of A Child.

Effective for distributions made after 2019, the Appropriations Act allows you to withdraw funds from your IRA or qualified retirement plan of up to $5,000 per child without a 10% early distribution penalty because of the birth or adoption of a child. To qualify, the withdrawal must occur within one year following the date the child is born or the adoption is finalized. For a married couple, **each spouse** may receive a **maximum aggregate amount** of $5,000 for a qualified birth or adoption from retirement plans in which each spouse participates or holds accounts. For a distribution because of an adoption to qualify, the child must be under age 18 or physically or mentally incapable of self-support. **Planning Alert!** Although the qualifying withdrawal is exempt from the 10% penalty, it is still **taxable.** However, the Appropriations Act does provide that a qualifying withdrawal may avoid taxation if it is later re-contributed to an IRA or qualified retirement plan. The IRS says that it plans to issue guidance in the future regarding the timing and procedures for this re-contribution rule.

Temporary Tax Relief For "Coronavirus-Related Distributions" From An IRA Or Qualified Retirement Plan.

The CARES Act allows an individual to take a *"Coronavirus-Related Distribution"* of up to $100,000 (in the aggregate) from an IRA and/or a qualified retirement plan without being subject to the 10% early distribution penalty. Although this distribution is **taxable,** the taxpayer may report the income ratably over a 3-year period. Also, a person receiving a *Coronavirus-Related Distribution* is allowed to roll all or a portion of the distribution back into an IRA or qualified retirement plan within three years (rather than the normal 60 days) of the distribution. To qualify for this special tax treatment, the distribution must be made **on or after January 1, 2020 and before December 31, 2020 and** must be made to a *"qualified individual."* A ***"qualified individual"*** is generally a person who has been diagnosed with COVID-19, whose dependent or spouse has been so diagnosed, or who has experienced one of the specifically listed adverse financial consequences as a result of the coronavirus. **Planning Alert!** The IRS says, "*Any coronavirus-related distribution (whether from an employer retirement plan or an IRA) paid to a qualified individual as a beneficiary of an employee or IRA owner (other than the surviving spouse of the employee or IRA owner) cannot be recontributed*." This presumably means, for example, that a "qualified individual" who receives a *Coronavirus-Related Distribution* as the beneficiary of an "inherited IRA," will not be allowed to later roll the distribution back into an IRA or qualified retirement plan.

- **Relief On The Payback Of Qualifying Retirement Plan Loans.** The CARES Act also provides that, if a "qualified individual" (described above) had an outstanding loan from a qualified employer retirement plan **on or after March 27, 2020,** payments on the loan that are otherwise due on March 27, 2020 through December 31, 2020 are delayed for one year!

For Some - 2020 May Be A Good Year To Consider A Roth Conversion.

If you have been considering converting your traditional IRA into a Roth IRA, it is best to convert in a low-income year, so your Roth conversion income is taxed at the lower tax rates. Therefore, if you are in a situation where, due to COVID (or for any other reason), your 2020 income is significantly lower than the income you expect in 2021 and later years, it may be a good idea to consider converting all or a portion of your traditional IRA into a Roth IRA before the end of 2020. **Planning Alert!** If you want a Roth conversion to be **effective for 2020,** you must transfer the amount from the regular IRA to the Roth IRA **no later than December 31, 2020** (you do not have until the due date of your 2020 tax return). Moreover, you are not allowed to later "re-characterize" that converted Roth IRA back to a traditional IRA. In other words, your conversion of an IRA to a Roth IRA cannot be undone. The IRS says that this prohibition applies to the conversion from a traditional, SEP, or SIMPLE IRA to a Roth IRA, as well as amounts rolled over into a Roth IRA from other retirement plans such as 401(k) or 403(b) plans. **Caution!** Whether you should convert your traditional IRA to a Roth IRA can be an exceedingly complicated issue. Your tax rate in the year of conversion is just one of many factors that you should consider. **Please call our Firm** if you need help in deciding whether to convert to a Roth IRA.

HIGHLIGHTS OF OTHER SELECTED TAX-RELIEF PROVISIONS UNDER THE CARES ACT

Largely in response to government-mandated shutdowns caused by COVID-19 (COVID), Congress enacted a series of tax-relief measures for individuals, including: The **Families First Coronavirus Response Act ("Families First Act")** and the **Coronavirus Aid, Relief and Economic Security Act ("CARES Act").** It is well beyond the scope of this letter to provide a detailed discussion of the many tax relief provisions contained in this voluminous legislation. Instead, the following are *selected* highlights that could have an impact on tax planning for individuals. **Caution!** Congress passed most of this recent COVID-Related legislation in a hurried fashion, without time to address the many uncertainties that would inevitably arise. As a result, over the last several months we have experienced a stream of piecemeal guidance from the IRS attempting to respond to some of these uncertainties. As we finish this letter, we are still waiting for guidance on many unanswered questions. Our firm continues to monitor the developments in this area, so please call our firm if you need additional information regarding any of the provisions listed below:

Economic Impact Payments.

By now, the vast majority of individuals qualifying for an "economic impact payment" (EIP) under the CARES Act of up to $1,200 per qualifying individual (and $500 per qualifying dependent) have received the payment. If you haven't received the payment (or you think your payment was less than it should have been), you can obtain detailed information on economic impact payments at www.irs.gov by accessing the link - ***"Economic Impact Payment Information Center: EIP Eligibility and General Information."*** **Planning Alert!** Technically, the EIP is an advance payment of a 2020 refundable tax credit. A **"refundable"** credit generally means to the extent the credit exceeds the taxes you would otherwise owe with your individual income tax return without the credit, the IRS will send you a check for the excess. The rebate is phased out as your adjusted gross income (AGI) exceeds certain levels. If for some reason you did not get the EIP (or the amount you received was too low), the credit will be re-computed when you file your 2020 income tax return based on your 2020 AGI. You will be entitled to a refundable credit for the amount of the credit computed on your 2020 income tax return in excess (if any) of the advance payment you previously received. If the credit computed on your 2020 return is less than the EIP you received, generally you will not have to pay back the excess.

Temporary *"Above-The-Line"* Deduction Of Up To $300 For Charitable Contributions For Individuals Who Do Not Itemize Deductions.

For the ***2020 tax year only,*** the CARES Act allows individuals who do not elect to itemize their deductions, to take a so-called *"above-the-line"* deduction of up to $300 for **cash contributions** to a qualifying charity. Therefore, an individual may deduct this $300 amount in addition to the standard deduction for 2020. **Caution!** Contributions to a donor advised fund do not qualify for this special *"above-the-line"* deduction.

Temporary Increase In Charitable Contribution Limit For Individuals Who Do Itemized Deductions.

Traditionally, for those who itemize their deductions, the deduction for charitable contributions made in cash to qualifying charities has been limited to 60% (through 2025) of an individual's adjusted gross income (AGI), and to 30% of AGI for certain "property" contributions. For the ***2020 tax year only,*** the CARES Act allows an individual to deduct *"cash"* contributions to qualifying charities up to ***100% of the individual's AGI*** (as reduced by the amount of all other charitable contributions allowed to the individual under the traditional charitable contribution limits). **Caution!** A qualifying charity does not include a donor-advised fund.

HIGHLIGHTS OF TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

TAKING ADVANTAGE OF CHILD AND FAMILY TAX CREDITS

- **Child Tax Credit. Starting in 2018 and through 2025,** the Tax Cuts And Jobs Act (TCJA) enacted in late 2017 doubled the previous $1,000 Child Tax Credit for each **"Qualifying Child"** under age 17 to **$2,000,** while also significantly increasing the income level where the credit begins phasing out. A **"Qualifying Child"** must meet the familiar residency, age, relationship, and support tests that were not changed by TCJA. The $2,000 Child Tax Credit begins phasing out as modified adjusted gross income (MAGI) **exceeds $400,000** on a **Joint Return or exceeds $200,000 for Singles.** Because of these TCJA changes, it has been reported that the number of individuals claiming the Child Tax Credit for 2018 and 2019 increased by more than 60% from previous years. **Caution!** In order to claim the Child Tax Credit of up to $2,000, TCJA requires that the Qualifying Child have a **qualified Social Security Number (SSN) before the return's filing due date.** The child's ITIN or ATIN will not satisfy this requirement.

    - **"Refundable" Child Tax Credit. Up to $1,400** of the Child Tax Credit is "refundable" to the extent of 15% of the taxpayer's earned income in excess of $2,500. Thus, for 2020, a taxpayer with only one Qualifying Child would need "earned income" of only $11,833 to get the full $1,400 refundable Child Tax Credit (i.e., [$11,833 less $2,500 = $9,333] x 15% = $1,400). **Please note** that, as previously discussed, a **"refundable"** credit generally means to the extent the credit exceeds the taxes you would otherwise owe with your individual income tax return without the credit, the IRS will send you a check for the excess. **Planning Alert!** If certain conditions are met, a divorced or separated parent that has custody of a "Qualifying Child" may complete Form 8332 and transfer the Child Tax Credit to the non-custodial parent. With the recent increases in the amount of the Child Tax Credit and the refundable portion, transferring the Child Tax Credit to the noncustodial parent has become more costly to the custodial parent.

- **$500 Family Tax Credit.** A non-refundable "Family Tax Credit" of up to $500 is available for each person the taxpayer could have claimed as a dependent under prior law but who does not qualify for the $2,000 Child Tax Credit. This credit will generally be available for: **1)** A "Qualifying Child" who does not qualify for the $2,000 Child Tax Credit because the child is 17 or older, and **2)** A "Qualifying Relative." Generally, **a "Qualifying Relative"** is a person who is not a Qualifying Child but who meets the familiar residency, gross income, support, and relationship tests that were not changed by TCJA. This $500 Family Tax Credit is added to any other Child Tax Credits, and the total credits begin phasing out once a taxpayer's MAGI **exceed $400,000 on a joint return** or **$200,000 for singles. Planning Alert!** One of the requirements for being classified as a "Qualifying Relative" is that the individual cannot have "Gross Income" in excess of the "Personal Exemption" deduction amount (which is zero after TCJA through 2025). However, the IRS has announced that, solely for purposes of determining whether an individual meets the gross income requirement of a "Qualifying Relative," the personal exemption deduction amount for 2020 will be deemed to be $4,300. In other words, an individual who otherwise satisfies the requirements of a "Qualifying Relative" cannot have gross income in excess of $4,300 for 2020.

BE PREPARED FOR THE 20% 199A DEDUCTION FOR "QUALIFIED BUSINESS INCOME"

Overview:

Don't overlook the **20% Deduction** under **Section 199A ("20% 199A Deduction")** with respect to **"Qualified Business Income," "Qualified REIT Dividends,"** and **"Publicly-Traded Partnership Income."** The 20% 199A deduction does not reduce your adjusted gross income (AGI) or impact your calculation of self-employment tax. Instead, the deduction simply reduces your Taxable Income (regardless of whether you itemized deductions or claim the standard deduction). In other words, the 20% 199A Deduction is allowed ***in addition to*** your itemized deductions or your standard deduction. **Caution!** The 20% 199A Deduction **expires after 2025!**

- **What Type Of Income Qualifies For The 20% 199A Deduction?** Generally, the following types of income are eligible for the 20% 199A Deduction: *Qualified REIT Dividends*, *Qualified Publicly Traded Partnership Income*, and *Qualified Business Income*. The rules for determining the 20% 199A Deduction for Qualified REIT Dividends and Publicly Traded Partnership Income are relatively straightforward. However, the 20% 199A Deduction for **"Qualified Business Income"** (QBI) is by far having the biggest impact on the greatest number of individual taxpayers and can be complicated and tricky. Consequently, the following discussion addresses the 20% 199A Deduction only as it relates to QBI.

- **Who Can Qualify For The 20% 199A Deduction For "Qualified Business Income" (QBI)?** Taxpayers who may qualify for the 20% 199A Deduction generally include taxpayers who report "Qualified Business Income" such as: Individual owners of S corporations and partnerships; Sole Proprietors; Trusts and Estates; and Certain beneficiaries of trusts and estates.

  Planning Alert! It is not feasible to provide a thorough discussion of the 20% 199A Deduction with respect to **Qualified Business Income (QBI)** in this letter. However, if you own an interest in a business as a sole proprietor, an S corporation shareholder, or a partner in a partnership, you are a very good candidate for the 20% 199A Deduction. Moreover, although taxpayers at all income levels may qualify for the 20% 199A Deduction, it is easier for sole proprietors, S corporation shareholders, or partners in a partnership to qualify for the deduction if their 2020 "Taxable Income" (before the 20% 199A Deduction) is **$163,300 or below** (**$326,600 or below** if filing a joint return). Consequently, if you own an interest in one of the businesses listed above and you expect your taxable income (before the 20% 199A Deduction) to be over $163,300 or $326,600 if filing a joint return, you may have an additional tax incentive to defer taxable income and/or increase deductions to reduce your **Taxable Income for 2020 to $163,300** or less, or to **$326,600 or less if filing jointly.** If you believe you would benefit by lowering your 2020 "Taxable Income" (before the 20% 199A Deduction) to **$163,300** or **$326,600,** you should consider taking certain actions before the end of 2020. In the immediately following segment, we discuss traditional year-end planning techniques designed to reduce your anticipated 2020 Taxable Income by deferring income and/or accelerating deductions. **Planning Alert!** Regardless of your anticipated Taxable Income for 2020, if you want more information on this new 20% 199A Deduction, please call our Firm and we will be glad to provide you with more details.

PAY SPECIAL ATTENTION TO "TIMING" ISSUES!

From a tax-planning standpoint, 2020 has been anything but a "normal" year for most. The pandemic has caused many individuals to incur significant losses in income. While at the same time, some individuals have actually experienced an increase in their expected income during this difficult time. Consequently, for 2020, there is clearly no single year-end tax planning strategy that will necessarily apply to all (or even a majority) of individuals. In normal times, a traditional year-end tax planning strategy would include reducing your current year taxable income by deferring taxable income into later years and accelerating deductions into the current year. This strategy is particularly beneficial where your income tax rate in the following year is expected to be the same or lower than the current year. Consequently, in the following discussion we include traditional year-end tax planning strategies that would allow you to accelerate your deductions into 2020, while deferring your income into 2021. **Caution!** For individuals who expect their taxable income to be much lower in 2020 than in 2021, the opposite strategy might be more advisable. That is, for individuals who have experienced a significant drop in income during 2020, a better year-end planning strategy might include accelerating income into 2020 (to be taxed at lower rates), while deferring deductions to 2021 (to be taken against income that is expected to be taxed at higher rates). As we discuss the planning methods that involve the "timing" of income or deductions, please keep in mind that you might want to consider taking the precise opposite steps recommended, if you decide it would be better to defer deductions into 2021, while accelerating income into 2020.

TAKING ADVANTAGE OF DEDUCTIONS

"Above-The-Line" Deductions Can Generate Multiple Tax Benefits.

Traditional year-end planning includes accelerating deductible expenses into the current tax year. So-called **"above-the-line"** deductions reduce both your "adjusted gross income" (AGI) and your "modified adjusted gross income" (MAGI), while **"itemized"** deductions (i.e., below-the-line deductions) do **not** reduce either AGI or MAGI. Deductions that reduce your AGI (or MAGI) can generate multiple tax benefits by: **1)** Reducing your taxable income and allowing you to be taxed in a lower tax bracket; **2)** Potentially freeing up other deductions (and tax credits) that phase out as your AGI (or MAGI) increases (e.g., Certain IRA Contributions, Certain Education Credits, Adoption Credit, Child and Family Tax Credits, etc.); **3)** Potentially reducing your MAGI below the income thresholds for the 3.8% Net Investment Income Tax (i.e., 3.8% NIIT only applies if MAGI exceeds $250,000 if married filing jointly; $200,000 if single); **4)** Possibly reducing your household income to a level that allows you to qualify for a "refundable" Premium Tax Credit for health insurance purchased on a government Exchange, **or 5)** As discussed previously, potentially reducing your taxable income to a level that could maximize your 20% 199A Deduction (i.e., individuals reporting Qualified Business Income will generally find it much easier to qualify for the new 20% 199A Deduction with respect to that Qualified Business Income if their 2020 taxable income does not exceed $326,600 if filing a joint return or $163,300 if single.

If you think that you could benefit from accelerating ***"above-the-line"*** deductions into 2020, consider the following:

- **Identifying "Above-The-Line" Deductions:** **"Above-the-line"** deductions include: Deductions for IRA or Health Savings Account (HSA) Contributions; Health Insurance Premiums for Self-Employed Individuals; Qualified Student Loan Interest; Qualifying Alimony Payments (if the divorce or separation instrument was **executed before 2019);** and, Business Expenses for a Self-Employed Individual. **Caution!** As discussed in more detail below, un-reimbursed employee business expenses are not deductible at all **for 2018 through 2025.** However, employee business expenses that are reimbursed under an employer's accountable plan are excluded altogether from the employee's taxable income. Moreover, there have been changes to the above-the-line deductions for **"Moving Expenses,"** and **"Alimony Payments,"** as follows:

  Moving Expenses: Historically, the deduction for qualified **business-related "Moving Expenses"** was an above-the-line deduction. However, **for 2018 through 2025,** the deduction for **"Moving Expenses"** has been suspended altogether. **Planning Alert! ** Generally, active members of the Armed Forces who move pursuant to a military order because of a permanent change of station may still deduct un-reimbursed qualified moving expenses as above-the-line deductions and may exclude the employer reimbursements of those moving expenses. For 2020, an **Armed Forces Member** may use the standard rate of **17 cents per mile** to determine the deductible moving expense.

  Alimony Payments: Historically, an individual making qualified alimony payments was allowed an "above-the-line" deduction for the payments and the recipient of the payments was required to include the payments in income. **However, effective for "Divorce or Separation Instruments" executed after 2018,** the **deduction for alimony payments has been repealed altogether.** The good news, however, is that these alimony payments **are no longer taxable to the recipient.** Alimony paid under a divorce instrument **executed before 2019** will generally be grandfathered under the previous rules. **Planning Alert!** If you are currently paying or receiving alimony pursuant to a divorce or separation instrument ***executed before 2019,*** the tax treatment of the alimony payments does not change. That is, if your alimony payments were deductible before 2019, they should continue to be deductible (and includible in the recipient's income). **Caution!** Form 1040 requires individuals who ***receive*** taxable alimony to disclose the "*Date Of Original Divorce Or Separation Agreement,"* and the individuals deducting alimony must provide the same information on Form 1040.

- **Accelerating "Above-The-Line" Deductions:** As a cash method taxpayer, you can generally accelerate a 2021 deduction into 2020 by *"paying"* it in 2020. *"Payment"* typically occurs in 2020 if, **before the end of 2020:**
  1) A check is delivered to the post office.
  2) Your electronic payment is debited to your account.
  3) **OR** an item is charged on a *third-party credit card* (e.g., Visa, MasterCard, Discover, American Express).

  Caution! If you post-date the check to 2021 or if your check is rejected, no payment has been made in 2020 even if the check is delivered in 2020.

  Planning Alert! The IRS says that prepayments of expenses applicable to periods beyond 12

months after the payments are not deductible in 2020.

- **Deductions For Business Expenses Paid By Partners:** Generally, the IRS allows a partner in a partnership (or owner of an LLC) to take an "above-the-line" deduction for business expenses the owner **pays on behalf** of the partnership (or an LLC taxed as a partnership) **only if** there is an agreement (preferably in writing) between the partner and the partnership providing that those expenses are to be paid by the partner, and that the expenses will not be reimbursed by the partnership. **Tax Tip.** If you are a partner or LLC owner paying unreimbursed business expenses on behalf of your partnership or LLC, to be safe, you should have a written agreement in place with the entity stipulating that those expenses are to be paid by you, and that the expenses will not be reimbursed by the partnership or LLC.

- **Interest Paid By Purchasers Of Partnership Interests Or S Corporation Stock.** If you have borrowed funds to purchase a partnership interest or S corporation stock, the interest you pay on that loan will generally be deductible. If and to the extent the partnership or S corporation operates a trade or business, you will generally be able to deduct the interest as an "above-the-line" deduction (which is generally reported on Schedule E of Form 1040). **Planning Alert!** If you are in this situation and your interest on the debt is in arrears, **paying** the accrued interest no **later than December 31, 2020** will accelerate the interest deduction into 2020.

- **Be Careful With "Employee" Business Expenses. Starting in 2018 and through 2025, *"un-reimbursed"*** employee business expenses are not deductible at all. For example, you **will not be able to deduct** any of the following business expenses **you incur as an "employee," even if the expenses are necessary for your work: Automobile expenses** (including auto mileage, vehicle depreciation); **Costs of travel, transportation, lodging, and meals; Union dues** and expenses; **Work clothes and uniforms;** Otherwise qualifying **home office expenses; Dues** to a chamber of commerce; **Professional dues; Work-Related education expenses; Job search expenses; Licenses and regulatory fees; Malpractice insurance premiums; Subscriptions** to professional journals and trade magazines; and **Tools and supplies** used in your work.

Good News! - An Employer's Qualified Reimbursement Of An Employee's Business Expenses Is Deductible By The Employer And Tax Free To The Employee. Generally, employee business expenses that are reimbursed under an employer's qualified **"Accountable Reimbursement Arrangement" are deductible by the employer** (subject to the 50% limit on business meals), and the reimbursements are **not taxable to the employee.** However, reimbursements under an arrangement that is not a qualified "Accountable Reimbursement Arrangement" generally must be treated as compensation and included in the employee's W-2, and the employee would get no offsetting deduction for the business expense. **Planning Alert!** Generally, in order for an employer to have a qualified **"Accountable Reimbursement Arrangement" - 1)** The employer must maintain a reimbursement arrangement that requires the employee to substantiate covered expenses, **2)** The reimbursement arrangement must require the return of amounts paid to the employee that are in excess of the amounts substantiated, and **3)** There must be a business connection between the reimbursement (or advance) and anticipated business expenses. **Please call our Firm if you need assistance.** We can help you establish a qualifying **Accountable Reimbursement Arrangement** with your employer.

- **Be Careful If You Are Working For Your Own S Corporation.** If you operate your business as an S corporation and you also work for your S corporation as its "employee," then it is particularly important that you have your S corporation (i.e., your employer) reimburse all of your employee business expenses under an accountable plan. Under this arrangement, the reimbursement will be deductible by your S corporation, the deduction from the reimbursement will pass through to you as the S corporation shareholder, and your S corporation/employer will be able to exclude the reimbursement from your W-2 wages.

- **Deducting Entertainment Expenses.** The Tax Cuts And Jobs Act generally repealed business deductions with respect to entertainment, amusement or recreation activities **after** 2017. **Planning Alert!** Fortunately, the IRS says that taxpayers can still generally deduct 50% of the cost of meals with a business associate (e.g., a current or potential business customer, client, supplier, employee, agent, partner, professional advisor). The IRS also says that a taxpayer can deduct 50% of the cost of food and beverages provided during a nondeductible entertainment activity with a business associate provided the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. **Caution!** If an employer reimburses an employee's deductible business meal and beverage expense under an Accountable Reimbursement Arrangement, the employer could deduct 50% of the reimbursement. This same rule applies if you are employed by your own S corporation.

  However, as discussed previously, an employee who is not reimbursed by the employer for the business meal would get no deduction because un-reimbursed employee business expenses are not deductible.

"ITEMIZED" DEDUCTIONS

Background:

Although **"itemized"** deductions (i.e., below-the-line deductions) do **not** reduce your AGI or MAGI, they still may provide valuable tax savings. **Starting in 2018 and through 2025,** recent legislation **substantially** increased the Standard Deduction. For 2020, the Standard Deduction is: Joint Return - $24,800; Single - $12,400; and Head-of-Household - $18,650. Recent legislation has also made certain changes to the following popular itemized deductions:

- **Charitable Contributions. Starting in 2018** (with no sunset date), a charitable contribution deduction is not allowed for contributions made to colleges and universities in exchange for the contributor's right to purchase tickets or seating at an athletic event (prior law allowed the taxpayer to deduct 80% as a charitable contribution). **Planning Alert!** As discussed previously in this letter, recent COVID-related tax legislation made several enhancements to the charitable deduction rules **for 2020 only.** Please see our discussion of those changes above.

Planning Alert! If you think your itemized deductions this year could likely exceed your Standard Deduction of $24,800 if filing jointly ($12,400 if single) and you want to accelerate your charitable deduction into 2020, please note that a charitable contribution deduction is allowed for 2020 if the check is **"mailed" on or before December 31, 2020,** or the contribution is made by a credit card charge in 2020. However, if you merely give a note or a pledge to a charity, no deduction is allowed until you pay the note or pledge. In addition, if you are considering a significant 2020 contribution to a qualified charity (e.g., church, synagogue, or college), it will generally save you taxes if you contribute *appreciated* long-term capital gain property, rather than selling the property and contributing the cash proceeds to the charity. By contributing capital gain property held more than one year (e.g., appreciated stock, real estate, etc.), a deduction is generally allowed for the full value of the property, but no tax is due on the appreciation. If instead you intend to use *"loss"* stocks to fund a charitable contribution, you should sell the stock first and then contribute the cash proceeds. This will allow you to deduct the capital loss from the sale, while preserving your charitable contribution deduction. **Caution!** As discussed previously, for **2020 only,** the CARES Act allows a taxpayer to deduct charitable contributions of up to 100% of the individual's AGI if made in **"cash."** Contributions of **"property"** (e.g., stock, real estate) **do not qualify** for this temporary 100% of AGI rule.

- **Casualty Losses. From 2018 through 2025,** the itemized deduction for personal casualty losses and theft losses has been suspended. However, personal casualty losses attributable to a Federally declared disaster continue to be deductible. **Planning Alert!** Personal casualty losses generally continue to be deductible to the extent the taxpayer has personal casualty "gains" for the same year. In addition, casualty losses with respect to property held in a trade or business or for investment are still allowed.

- **Medical Expense Deductions.** If you think your itemized deductions this year could likely exceed your standard deduction of $24,800 if filing jointly ($12,400 if single), but you do not expect your itemized deductions to exceed your Standard Deduction next year, you could save taxes in the long run by accelerating elective medical expenses (e.g., braces, new eye glasses, etc.) into 2020. **Planning Alert!** For 2020, you are allowed to take a medical expense itemized deduction only to the extent your aggregate medical expenses exceed 7.5% of your AGI. This 7.5% threshold is scheduled to increase to 10% after 2020.

- **$10,000 Cap On State And Local Taxes. From 2018 through 2025,** your aggregate itemized deduction for state and local real property taxes, state and local personal property taxes, and state and local income taxes (or sales taxes if elected) is **limited to $10,000** ($5,000 for married filing separately). Foreign real property taxes are not deductible at all unless the taxes are paid in connection with a business or in an activity for the production of income. **Planning Alert!** You are still allowed a full deduction (i.e., an above-the-line deduction) for state, local, and foreign **"property"** or **"sales"** taxes paid or incurred in carrying on your **trade or business** (e.g., your Schedule C, Schedule E, or Schedule F operations). ***Tax Tip!*** You are also allowed to fully deduct state and local property taxes (without a dollar cap) paid with respect to "*an activity described in section 212."* One of the activities described in section 212 is "*the management, conservation, or maintenance of property held for the production of income."* Consequently, you should be able to fully deduct property taxes paid on real estate if you can establish that you held the real estate for *"investment"* purposes (as opposed to holding it for

"personal" purposes). Moreover, the regulations under section 212 state: "*Expenses paid or incurred in managing, conserving, or maintaining property held for investment may be deductible under section 212 even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto.*" **Caution!** It is difficult to convince the IRS that real estate used as a vacation home is held for investment. The IRS generally contends that vacation homes and principal residences are personal-use property.

- **Limitations On The Deduction For Interest Paid On Home Mortgage "Acquisition Indebtedness."** Before the Tax Cuts And Jobs Act (TCJA), individuals were generally allowed an *itemized* deduction for home mortgage interest paid on up to $1,000,000 ($500,000 for married individuals filing separately) of **"Acquisition Indebtedness"** (i.e., funds borrowed to purchase, construct, or substantially improve your principal or second residence and secured by that residence). Subject to certain transition rules, TCJA reduced the dollar cap for **Acquisition Indebtedness incurred after December 15, 2017 from $1,000,000 to $750,000** ($375,000 for married filing separately) for **2018 through 2025.** Generally, any Acquisition Indebtedness incurred on or before December 15, 2017 is "grandfathered" and will still carry the $1,000,000 cap. Moreover, subject to limited exceptions, if you incurred *Acquisition Indebtedness* on or before December 15, 2017 (i.e., grandfathered Acquisition Indebtedness), the refinancing of that indebtedness after December 15, 2017 will still be entitled to the $1,000,000 cap (to the extent of the outstanding balance of the original *Acquisition Indebtedness* on the date of the refinancing). **Caution!** The $750,000 cap that generally applies to "*Acquisition Indebtedness"* incurred after December 15, 2017, is reduced by the outstanding balance of any grandfathered "Acquisition Indebtedness." **Planning Alert!** If you think your itemized deductions this year could likely exceed your *Standard Deduction*, paying your January 2021 qualifying home mortgage payment **before 2021** should shift the deduction on the interest portion of that payment **into 2020.**

- **"Home Equity Indebtedness" Suspended For 2018 through 2025.** TCJA suspended the deduction for **interest** with respect to **"Home Equity Indebtedness"** (i.e., up to $100,000 of funds borrowed that do not qualify as "Acquisition Indebtedness" but are secured by your principal or second residence). **Caution!** Unlike the interest deduction for "Acquisition Indebtedness," TCJA **did not grandfather** any interest deduction for **"Home Equity Indebtedness"** that was **outstanding before 2018. Planning Alert!** A loan that has been labeled by your lender as a home equity loan, home equity line of credit (HELOC), or second mortgage on a Qualified Residence may, in certain situations, actually be classified as **"Acquisition Indebtedness."** This would be the case where the borrowed funds were used to **"substantially improve"** your Qualified Residence that secures the loan. For example, assuming you have not exceeded the dollar caps on Acquisition Indebtedness, you will still be able to deduct the interest on a second mortgage taken out as a home improvement loan so long as the improvement: **1) Adds to the value** of your home that secures the second mortgage, **2) Prolongs** your **home's useful life,** or **3) Adapts** your home to **new uses. Caution!** These new rules can be tricky. We suggest that you talk with us before you sign off on a new mortgage: to buy your main house, to buy a second home, to place a second mortgage on your existing home, or to refinance your existing home mortgage. We will be glad to review your situation and determine if there are ways to structure the loan or refinance that maximizes your interest deduction.

POSTPONING TAXABLE INCOME MAY SAVE TAXES

Generally, deferring taxable income from 2020 to 2021 may also reduce your income taxes, particularly if your effective income tax rate for 2021 will be lower than your effective income tax rate for 2020. Moreover, deferring income from 2020 to 2021 may provide you with the same possible tax benefits listed previously with respect to accelerating deductions into 2020 (i.e., Freeing up other deductions and tax credits that phase out as your AGI (or MAGI) increases; Reducing your MAGI below the income thresholds for the 3.8% Net Investment Income Tax; Reducing your household income to a level that allows a

"refundable" Premium Tax Credit; or, reducing your taxable income to a level that could maximize your 20% 199A Deduction). **Planning Alert!** If, after considering all factors, you believe deferring taxable income into 2021 will save you taxes, consider the following:

Planning For Tax Rates.

The deferral of income could cause your 2020 taxable income to fall below the thresholds for the highest 37% tax bracket (i.e., $622,050 for joint returns; $518,400 if single). In addition, if you have income subject to the 3.8% Net Investment Income Tax (3.8% NIIT) and the income deferral reduces your 2020 modified adjusted gross income (MAGI) below the thresholds for the 3.8% NIIT (i.e., $250,000 for joint returns; $200,000 if single), you may avoid this additional 3.8% tax on your investment income.

Deferring Self-Employment Income.

If you are a self-employed individual using the cash method of accounting, consider delaying year-end billings to defer income until 2021. **Planning Alert!** If you have already received the check in 2020, deferring the deposit of the check does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.

Using Installment Sales To Defer Taxable Gain.

If you plan to sell certain appreciated property in 2020, you might be able to defer the gain until later years by taking back a promissory note instead of cash. By taking a promissory note, you may qualify for the "installment method" which allows you to pay tax on the gain only as you collect payments on the note. Qualifying for the *installment method* not only defers the time you must pay the tax on the gain but could also defer all or a portion of the gain into later years when your expected tax rate is less than your 2020 tax rate. For example, spreading the gain over several years could reduce the seller's income tax in the year of sale (and possibly subsequent years) by reducing the tax rates on long-term capital gains below the current top effective rate of 23.8% (including the 3.8% net investment income tax). This could also prevent the seller's income from exceeding the thresholds for the 3.8% NIIT (discussed in more detail below). **Planning Alert!** Although the sale of real estate and closely held stock generally qualifies for installment sale treatment, some sales do not. For example, even if you are a cash-method taxpayer, ***you cannot use*** the installment method gain-deferral technique if:

1) You sell publicly traded stock or securities.
2) You sell real estate that is *held primarily for sale to customers* (as opposed to holding it for investment).
3) **OR** you sell a partnership or LLC interest to the extent the partnership or LLC owns certain appreciated disqualifying property (e.g., property producing depreciation recapture, property held primarily for sale to customers, unrealized receivables).

Caution! You may not want to take back a promissory note in lieu of cash if you believe this reduces your chances of getting paid. Moreover, since TCJA's lower tax rates are currently scheduled to expire after 2025, you should pay careful attention to an installment sale arrangement that would defer gain beyond 2025 when your rates might be higher.

Postponing Cancellation Of Debt Income.

If you negotiate or arrange a reduction or cancellation of a debt you owe to others, unless you meet certain exceptions, you will generally have to report *"cancellation of debt"* (COD) income. For example, you could have COD income where: Your creditor, such as a credit card company, agrees to accept as full payment an amount which is less than the amount you owe; You own real estate subject to a mortgage and the lender forecloses on the property (or, you enter into a short sale of the mortgaged property); You own an interest in a partnership (or LLC) or "S" corporation and the partnership or S corporation has COD income. **Planning Alert!** If you are in the process of negotiating an agreement with your creditors that involves a debt reduction that would trigger COD income, consider postponing the action ***until after 2020*** to defer any debt cancellation income into 2021.

Gain Deferral Opportunities By Investing In "Qualified Opportunity Funds."

Caution! The requirements for satisfying this new gain deferral provision are far too technical to address in detail in this letter. However, the following is a general description of how this new provision works:

- **General Tax Benefits Of Investing A Capital Gain In A "Qualified Opportunity Fund."** Generally, section 1400Z allows taxpayers to defer capital gains (long-term or short-term) to the extent the gains are re-invested in a QOF ***within 180 days*** of realizing the capital gain. In addition, if the investment in the QOF is held for at least 5 years - then 10% of the original deferred capital gain is essentially eliminated. If the QOF investment is held at least 7 years - then 15% of the original deferred capital gain is eliminated. Moreover, for qualified investments in a QOF held for at least 10 years, the taxpayer may elect to exclude any gain that arose after the taxpayer initially purchased the QOF investment. ***Observation!*** All remaining deferred gain reflected in the investment in a QOF must be fully recognized on the **earlier of 1)** The date the taxpayer sells the QOF investment, or **2)** December 31, 2026. Thus, the remaining deferred gain **must be fully recognized** no **later than December 31, 2026,** even if the taxpayer still holds the QOF investment on December 31, 2026. **Planning Alert!** Even in the best-case scenario, generally 85% of the original deferred capital gain will be taxed ***no later than December 31, 2026*** at whatever capital gains rates exist in 2026. For example, if the current effective maximum long-term capital gain rate of 23.8% (including the 3.8% Net Investment Income Tax) is increased between now and 2026, the increase in the capital gains rates could dilute the tax benefit of the tax deferral. In addition, if a short-term capital gain is invested in a QOF, any gain triggered on that investment in 2026 will be taxed at the ordinary income tax rates in 2026. **Planning Alert!** If you would like additional details regarding this new provision, please call us.

TAX PLANNING FOR INVESTMENT INCOME (INCLUDING CAPITAL GAINS AND THE 3.8% NIIT)

Planning With The 3.8% Net Investment Income Tax (3.8% NIIT).

The **3.8% Net Investment Income Tax (3.8% NIIT)** applies to the Net Investment Income of higher-income individuals. This tax applies to individuals with modified adjusted gross income (MAGI) exceeding the following **thresholds: $250,000** for **married filing jointly; $200,000** if **single;** and **$125,000** if **married filing separately.**

The 3.8% NIIT is imposed upon the ***lesser of an individual's***:

1) Modified adjusted gross income (MAGI) in excess of the threshold
2) **OR** net investment income.

Trusts and estates are also subject to the **3.8% NIIT** on the **lesser of:**

1) The adjusted gross income of the trust or estate in excess of $12,950 (for 2020)
2) **OR t**he undistributed net investment income of the trust or estate.

The 3.8% NIIT not only applies to traditional types of investment income (i.e., interest, dividends, annuities, royalties, and capital gains), it also applies to "business" income that is taxed to a "passive" owner (as discussed in more detail below) unless the "passive" income is subject to S/E taxes. If you believe that the 3.8% NIIT may apply to you, consider the following planning techniques:

- **Shifting To Investments That Generate Income Exempt From The 3.8% NIIT.** Fortunately, the following types of income are **not subject** to the 3.8% NIIT: **tax-exempt bond interest;** gain on the sale of a principal residence otherwise excluded from income under the **home-sale exclusion** rules (i.e., up to $250,000 on a single return, up to $500,000 on a joint return); and **distributions from qualified retirement plans** (e.g., 401(k) plans, IRAs, §403(b) annuities, etc.). ***Tax Tip!*** Investments that generate tax-exempt income (e.g., tax exempt municipal bonds) potentially provide higher-income individuals with a double benefit: **1)** The interest will not be included in the individual's MAGI, thus reducing the chance that the individual will exceed the income thresholds for the 3.8% NIIT, and **2)** The tax-exempt interest itself is exempt from the 3.8% NIIT as well as from Federal income taxes. **Planning Alert!** Although taxable distributions from qualified retirement plans (e.g., IRAs, 401(k) plans, etc.) are exempt from the 3.8% NIIT, the taxable distributions will increase your "modified adjusted gross income" (MAGI). Therefore, to the extent the taxable distributions cause your MAGI to exceed the thresholds for the 3.8% NIIT (e.g., $250,000 for joint returns; $200,000 for singles), the distributions could cause your other "net investment income" (e.g., dividends, interest, capital gains, rents, passive income) to be hit with the 3.8% NIIT.

- **Roth IRAs (Including Roth IRA Conversions).** Tax-free distributions from a Roth IRA are exempt from the 3.8% NIIT, and do not increase your MAGI (and, thus will not increase your exposure to the 3.8% tax). Therefore, these tax-favored features should be factored into any analysis of whether you should contribute to a Roth IRA. However, if you are considering converting a traditional IRA into a Roth, the income triggered in the year of conversion would increase your MAGI and, therefore, may increase your exposure to the 3.8% NIIT on your net investment income (e.g.,

dividends, interest, capital gains). **Planning Alert!** If you want a Roth conversion to be **effective for 2020,** you must transfer the amount from the regular IRA to the Roth IRA **no later than December 31, 2020** (you do not have until the due date of your 2020 tax return). **Caution!** Whether you should convert your traditional IRA to a Roth IRA can be an exceedingly complicated issue, and the 3.8% NIIT is just one of many factors that you should consider. **Please call our Firm** if you need help in deciding whether to convert to a Roth IRA.

- **"Tax-Deferred" Investments.** The 3.8% NIIT does not apply to earnings generated by a **tax-deferred annuity** (TDA) contract **until the income is distributed.** Thus, after first considering the economics, investing in a TDA in your higher-income years may allow you to defer the annuity income until later years when your MAGI is below the 3.8% NIIT thresholds.

- **"Passive" Income.** "Net Investment Income" for purposes of the 3.8% NIIT generally includes net income from a business activity if you are a "passive" owner (unless the income constitutes self-employment income that is subject to the 2.9% Medicare tax). You will generally be deemed a "passive" owner if you do not "materially participate" in the business as determined under the traditional "passive activity loss" rules. For example, under the passive activity loss rules, you may be a "passive" owner unless you spend more than 500 hours working in the business during the year or meet one of the other "material participation" tests. Furthermore, rental income is generally deemed to be "passive" income under the passive activity loss rules, regardless of how many hours you work in the rental activity. ***Tax Tip!*** In certain situations, real estate rentals may not be treated as "passive" income and could also be exempt from the 3.8% NIIT. For example, if you are a "qualified real estate professional," or you lease property to a business in which you "materially participate," the rental income may be exempt from the 3.8% NIIT. If you believe you may qualify for one of these rental real estate exemptions, or you otherwise believe you may have "passive" income from non-rental business activities, please contact our Firm. We will gladly evaluate your situation to determine whether there are steps you could take before the end of 2020 to avoid "passive" income classification, and thus, reduce your exposure to the 3.8% NIIT.

Traditional Year-End Planning With Capital Gains And Losses.

Generally, net capital gains (both short- term and long-term) are potentially subject to the 3.8% NIIT. This could result in an individual filing a joint return with taxable income for 2020 of $496,600 or more ($441,450 or more if single) paying tax on his or her **net long-term capital gains** at a **23.8%** rate (i.e., the maximum capital gains tax rate of 20% plus the 3.8% NIIT). In addition, this individual's **net short-term capital gains** could be taxed as high as **40.8%** (i.e., 37% plus 3.8%). Consequently, traditional planning strategies involving the timing of your year-end sales of stocks, bonds, or other securities continue to be as important as ever. The following are time-tested, year-end tax planning ideas for sales of capital assets. **Planning Alert!** Always consider the **economics of a sale or exchange first!**

- **Planning With Zero Percent Tax Rate For Capital Gains And Dividends.** For individuals filing a **joint return** with 2020 Taxable Income of **less than $80,000 (less than $40,000 if single),** their long-term capital gains and qualified dividends are taxed at a **zero percent rate.** ***Tax Tip!*** Individuals who have historically been in higher tax brackets but are now expecting a significant drop in their 2020 taxable income, may find themselves in the zero percent tax bracket for long-term capital gains and qualified

dividends for the first time. For example, a significant drop in 2020 taxable income could have occurred due to COVID-19; or because you are between jobs; or you recently retired; or you are expecting to report higher-than-normal business deductions in 2020. **Planning Alert!** If you are experiencing any of these situations, please call our Firm as soon as possible and we will help you determine whether you can take advantage of this zero percent tax rate for long-term capital gains and qualified dividends. If you wait too late to contact us, you may run out of time before the end of this year to take the recommended steps to maximize your tax savings.

- **Lower-Income Retirees:** The zero percent rate for long-term capital gains and qualified dividends is particularly important to lower-income retirees who rely largely on investment portfolios that generate dividends and long-term capital gains. Furthermore, gifts of appreciated securities to lower-income individuals who then sell the securities could reduce the tax on all or part of the gain from as high as 23.8% to as low as zero percent. **Caution!** If the lower-income individual is subject to the so-called kiddie tax, this planning technique will generally not work.

- **Timing Your Capital Gains And Losses:** If the value of some of your investments is less than your cost, it may be a good time to harvest some capital losses. For example, if you have already recognized capital gains in 2020, you should consider selling securities **prior to January 1, 2021** that would trigger a capital loss. These losses will be deductible on your 2020 return to the extent of your recognized capital gains, plus $3,000. ***Tax Tip!*** These losses may have the added benefit of reducing your income to a level that will qualify you for other tax breaks, such as: **1)** The $2,500 American Opportunity Tax Credit, **2)** The $2,000 Child Tax Credit, **3)** The Adoption Credit of $14,300, or **4)** Causing your taxable income to drop below the $326,600/$163,300 thresholds for purposes of the 20% 199A Deduction (discussed in more detail previously). **Planning Alert!** If, within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the "wash sale" rules (although the disallowed loss will increase the basis of the acquired stock). ***Tax Tip!*** If you are afraid of missing an upswing in the market during this 61-day period, consider buying shares of a different company in the same sector. Also, there is no wash sale rule for gains. Thus, if you decide to sell stock at a gain in order to take advantage of a zero capital gains rate, or to absorb capital losses, you may acquire the same securities within 30 days without impacting the recognition of the gain.

- **Planning With Capital Loss Carryforwards:** If you have substantial capital loss carryforwards coming into 2020, consider selling enough appreciated securities **before the end of 2020** to decrease your net capital loss to $3,000. Stocks that you think have reached their peak would be good candidates. All else being equal, you should sell the short-term gain (held 12 months or less) securities first. This will allow your net capital loss (in excess of $3,000) to offset your short-term capital gain, while preserving favorable long-term capital gain treatment for later years. **Planning Alert!** Your net short-term capital gains can be used to free up a deduction for any "investment interest" you have incurred (e.g., interest you have paid on your margin account). If you eliminate your short-term capital gains by recognizing your short-term capital losses, you may be restricting your ability to deduct your investment interest.

SELECTED MISCELLANEOUS YEAR-END PLANNING CONSIDERATIONS

The "Premium Tax Credit" Under The Affordable Care Act.

Although TCJA essentially eliminated the penalty for individuals who fail to purchase qualified health coverage by reducing the **"Shared Responsibility Tax"** (SR Tax) **to Zero, it did not repeal** the refundable **"Premium Tax Credit" or "PTC."** The PTC is still generally available for eligible low-and-middle income individuals who purchase health insurance through a State or Federal Exchange. The PTC is generally paid **in advance directly to the insurer** ("Advance Payments").

- **Who Qualifies For The "Premium Tax Credit" (PTC)?** An individual who bought health insurance on a government Exchange generally qualifies for the PTC **for 2020** only if the individual's "Household Income" for **2020** is **at least 100%** and **not more than 400%** of the applicable Federal Poverty Line (FPL) for the individual's family size. **For example,** a **family of four** could qualify for at least some PTC with "2020" Household Income **of up to $103,000.**

- **Certain Individuals May Be Required To Pay Back Some Or All Of Their "Advance Payments."** Any individual who received Advance Payments for 2020 **is required to file** a **2020 income tax return** to reconcile:
  1) The amount of the **"actual"** PTC (based on the individual's **"actual"** 2020 Household Income) with
  2) The **Advance Payments** of the PTC (which were determined by the Exchange based on the individual's **"projected"** 2020 Household Income). If an individual's Advance Payments for 2020 exceed the "actual" PTC, the **excess must be paid back** on the **2020 tax return** as an **"additional tax liability."**

     Caution! Recent Tax Court cases have held that this excess must be paid back as an additional tax liability even where the taxpayers made a good faith effort to comply with requirements for Advance Payments of the PTC, or even where the Exchange allegedly made a mistake.

  Possible Cap On The Amount That Must Be Paid Back! The amount of the 2020 excess payment that must be repaid as an additional tax liability **is capped if** the individual's actual 2020 Household Income is **less than 400%** of the Federal Poverty Line (FPL) for the individual's family size. For example, for 2020, as long as an individual's actual household income is **less than 400% of the FPL,** the maximum amount that must be repaid will not exceed **$1,350 for a single individual** and **$2,700 for others. Planning Alert!** In some cases, an individual whose **"actual"** 2020 Household Income is projected to be 400% or more of the FPL may be able to trigger these dollar caps by reducing his or her **"actual"** 2020 Household Income **below** 400% of the FPL. **For example,** an individual might make a contribution to an IRA (if eligible to do so) in order to reduce his or her 2020 Household Income to less than 400% of the 2020 FPL for the individual's family size. Taking this step would cap the amount of the individual's excess payments required to be paid back as an additional tax liability to **$1,350 for single individuals** and **$2,700 for others.** ***Tax Tip!*** If you think that you may have to pay back some or all of your 2020 excess payments, please call our Firm as soon as possible so we can determine whether you can take steps **before the end of 2020** to minimize the amount of the pay back.

- **Keep An Eye Out For IRS Form 1095-A.** Any individual who purchased health insurance for 2020 through the Exchange should receive a **Form 1095-A** ("Health Insurance Marketplace Statement") by January 31, 2021. Information on this Form will be used to complete **Form 8962** ("Premium Tax Credit") which reconciles an individual's Advanced Payments of the PTC with the "actual" PTC, as discussed above. If you, your spouse, or a dependent purchased health insurance through the Marketplace during 2020, **please bring us a copy of Form 1095-A along with your other tax information** when we prepare your 2020 tax return.

The Former 30% Credit For Qualified Energy-Efficient Property Began Dropping After 2019.

The former 30% tax credit for **"Qualified" Solar Electric Property, Solar Water Heating Property, Energy-Efficient Fuel Cell Property, Small Wind Energy Property,** and **Geothermal Heat Pump Property** began phasing out **after 2019. Caution!** This 30% credit is: reduced to 26% for qualified property installed in 2020; reduced to 22% if installed in 2021; and, expires altogether for property installed after 2021. Consequently, to qualify for the current 26% credit for 2020, the qualifying energy-efficient property must **actually be installed** no later than **December 31, 2020.**

- **Planning Alert!** The credit generally applies if you install the qualifying energy-efficient property in or on property located in the U.S. that you use as a residence. Except for the Energy-Efficient Fuel Cell Property, the residence does **not** have to be your **"principal residence."** So, installations (other than for **Energy-Efficient Fuel Cell Property**) for a second residence or vacation home may qualify.
- **Planning Alert!** If you are the initial purchaser of a newly-constructed residence that contains qualified energy-efficient property (e.g., a qualifying solar water heater, solar panels, a geothermal heat pump), you should ask the builder to provide you with a reasonable allocation of the cost of the home attributable to the qualified energy-efficient property (including labor costs for on-site preparation, assembly, and installation of the property).

Don't Miss Use-It-Or-Lose-It Deadline For Flex Plans.

If you participate in a cafeteria or flexible savings account plan (flex plans), you can generally elect to make a pre-tax salary reduction contribution to the plan. You can then access that account to reimburse yourself tax-free for qualified expenditures (e.g., medical expenses, dependent care assistance, adoption assistance). For most *calendar-year* plans, you must clean out your 2020 account by March 15, 2021, or forfeit any funds that aren't used for qualifying expenses.

Consider Contributing The Maximum Amount To Your Traditional IRA.

As your income rises and your marginal tax rate increases, deductible IRA contributions generally become more valuable. Also, making your deductible contribution to the plan as early as possible generally increases your retirement benefits. As you evaluate how much you should contribute to your IRA, consider the following limitations. If you are married, even if your spouse has no earnings, you can generally deduct in the aggregate up to $12,000 ($14,000 if you are both at least age 50 by the end of the year) for contributions to your and your spouse's traditional IRAs. You and your spouse must have *combined earned income* at least equal to the total contributions. However, no more than $6,000 ($7,000 if at least age 50) may be contributed to either your IRA account or your spouse's IRA account for 2020. If you are an active participant in your employer's retirement plan during 2020, your IRA deduction is reduced ratably as your adjusted gross income increases from **$104,000 to $124,000** on a joint return (**$65,000 to $75,000** on a

single return). However, if you file a joint return with your spouse and your spouse is an active participant in his or her employer's plan and you are not an active participant in a plan, your IRA deduction is reduced as the adjusted gross income on your joint return goes from **$196,000 to $206,000. Caution!** Every dollar you contribute to a deductible IRA reduces your allowable contribution to a nondeductible Roth IRA. The sum of your contributions for the year to your Roth IRA and to your traditional IRA may not exceed the $6,000/$7,000 limits discussed above. For 2020, your ability to contribute to a Roth IRA is phased out ratably as your adjusted gross income increases from **$196,000 to $206,000** on a joint return or from **$124,000 to $139,000** if you are single. **Planning Alert!** Unlike the rule for traditional IRA contributions, the amount you may contribute to a Roth IRA is reduced if your adjusted gross income falls within these phase-out ranges regardless of whether you or your spouse is a participant in another retirement plan. In addition, contributions to a Roth IRA are not deductible.

The Unified Exclusion Amount And GST Exemption Amount.

Effective for individuals dying and generation-skipping transfers after 2017 and before 2026, TCJA almost doubled the **Basic Unified Exclusion Amount** for gift & estate tax purposes and the generation-skipping exemption amount and indexed it for inflation. For 2020, the **Basic Unified Exclusion Amount** is **$11,580,000.** TCJA did not change the provision allowing a deceased spouse's estate to elect to transfer the deceased spouse's unused Exclusion Amount to the surviving spouse (i.e., the portability election). **Planning Alert!** Under current law, the Basic Unified Exclusion amount for estates is scheduled to drop back to $5,000,000 (as indexed for inflation) for individuals dying after December 31, 2025.

THE ALTERNATIVE MINIMUM TAX (AMT) IS HITTING FAR FEWER TAXPAYERS AFTER TCJA

Recent Legislative Changes Have Caused Far Fewer Individuals To Pay AMT.

Although TCJA **retained** the **"Alternative Minimum Tax"** (AMT) for individual taxpayers, **starting in 2018 and through 2025,** it also granted new relief by significantly:

1) Increasing the AMT exemption amounts.
2) Increasing the amount of alternative minimum taxable income where the AMT exemption amount begins to phase out.

Moreover, TCJA reduced or eliminated for regular tax purposes several common AMT adjustments, such as: Reducing the Personal Exemption Amount to Zero; Capping the Deduction for State and Local Taxes at $10,000; Suspending the Deduction for "Miscellaneous Itemized Deductions," and Suspending the Deduction for Interest paid on Home Equity indebtedness. **Planning Alert!** Due to these and other changes under TCJA, it was initially estimated that the number of individuals subject to AMT would drop from approximately 5 million down to a level closer to 200,000. More recent reports from the IRS indicate that the drop in individual taxpayers paying AMT on their 2018 and 2019 returns was even more significant than originally predicted. **Caution!** TCJA does retain certain adjustments that could potentially trigger AMT. For example, AMT adjustments and preference items that survived TCJA include: The Standard Deduction; the State and Local Tax (SALT) Deduction (to the extent allowed for regular tax purposes); Income from exercise of Incentive Stock Options; Interest on Private Activity Bonds; and Certain Accelerated Depreciation Adjustments.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our Firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note!** The information contained in this material should not be relied upon without an independent, professional analysis of how any of the items discussed may apply to a specific situation.

Disclaimer: *Any tax advice contained in the body of this material was not intended or written to be used, and cannot be used, by the recipient for the purpose of promoting, marketing, or recommending to another party any transaction or matter addressed herein. The preceding information is intended as a general discussion of the subject addressed and is not intended as a formal tax opinion. The recipient should not rely on any information contained herein without performing his or her own research verifying the conclusions reached. The conclusions reached should not be relied upon without an independent, professional analysis of the facts and law applicable to the situation.*