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Dear Client:

Now, as year-end approaches, is a good time to think about planning moves that may help lower your tax bill for this year and possibly next. Year-end planning for 2020 takes place during the COVID-19 pandemic, which in addition to its devastating health and mortality impact has widely affected personal and business finances. New tax rules have been enacted to help mitigate the financial impact of the disease, some of which should be considered as part of this years' planning, most notably elimination of required retirement plan distributions, and liberalized charitable deduction rules.

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

One item of note due to the Coronavirus Aid, Relief, and Economic Security (CARES) Act passed early in the spring is still causing concern for businesses who received funding from the Small Business Administration (SBA) under the Payroll Protection Program (PPP). The funds, if used to pay payroll, and certain rent and utility expenses are eligible for loan forgiveness, and the forgiveness is excluded from income. While the cancellation is excluded from gross income for federal tax purposes, in August the Treasury Department issued Notice 2020-32, which ruled that expenses funded by the PPP are not deductible to the extent of the loan forgiveness. (In essence making the loan taxable, which many members of Congress have indicated was not the intent of the bill). However, in guidance issued November 18, 2020, the IRS essentially doubled down on this ruling, requiring that if a business believes they will qualify for relief in the future, they may not deduct the expenses in 2020. Therefore, if you received a PPP loan, at this point, pending any relief from Congress, the "forgivable amount" of the loan is going to add to your taxable income in 2020.

Another surprise for many taxpayers this year will be the taxability of their unemployment benefits. Both the state and the federal benefits authorized under the CARES Act are subject to federal income tax.

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

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We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you (or a family member) will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make:

Year-End Tax Planning Moves for Individuals

... The Setting Every Community Up for Retirement Enhancement Act (SECURE) made changes to retirement rules, including allowing those over 70 ½ to make IRA contributions as long as they have earned income (W-2 wages or self-employment income). Also, the required minimum distribution age was raised from 70 ½ to 72. (Note the CARES Act waived the requirement to take an RMD in 2020.)

... Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%, depending on the taxpayer's taxable income. If you hold long-term appreciated-in-value assets, consider selling enough of them to generate long-term capital gains that can be sheltered by the 0% rate. The 0% rate generally applies to the excess of long-term capital gain over any short-term capital loss to the extent that, when added to regular taxable income, it is not more than the maximum zero rate amount (e.g., $80,000 for a married couple, $40,000 single). The 15% rate goes from $80,001 to $496,600 for marrieds, and $40,001 to $441,450 for singles). After that the 20% rate kicks in.

... Postpone income until 2021 and accelerate deductions into 2020 if doing so will enable you to claim larger deductions, credits, and other tax breaks for 2020 that are phased out over varying levels of adjusted gross income (AGI). These include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may pay to actually accelerate income into 2020. For example, that may be the case for a person who will have a more favorable filing status this year than next (e.g., head of household versus individual filing status), or who expects to be in a higher tax bracket next year.

... If you believe a Roth IRA is better than a traditional IRA, consider converting traditional-IRA money invested in any beaten-down stocks (or mutual funds) into a Roth IRA in 2020 if eligible to do so. Keep in mind, however, that such a conversion will increase your AGI for 2020, and possibly reduce tax breaks geared to AGI (or modified AGI).

... It may be advantageous to try to arrange with your employer to defer, until early 2021, a bonus that may be coming your way. This could cut as well as defer your tax.

... Many taxpayers won't be able to itemize because of the high basic standard deduction amounts that apply for 2020 ($24,800 for joint filers, $12,400 for singles and for marrieds filing separately, $18,650 for heads of household), and because many itemized deductions have been reduced or abolished. Like last year, no more than $10,000 of state and local taxes may be deducted; miscellaneous itemized deductions (e.g., tax preparation fees and unreimbursed employee expenses) are not deductible; and personal casualty and theft losses are deductible only if they're attributable to a federally declared disaster. You can still itemize medical expenses but only to the extent they exceed 7.5% of your adjusted gross income, state and local taxes up to $10,000, your charitable contributions, plus interest deductions on qualifying residence debt, but payments of those items won't save taxes if they don't cumulatively exceed the standard deduction for your filing status.

Two COVID-related changes for 2020 may be relevant here: (1) Individuals may claim a $300 above-the-line deduction for cash charitable contributions on top of their standard deduction; and the percentage limit on charitable contributions has been raised from 60% of modified adjusted gross income (MAGI) to 100%.

Some taxpayers may be able to work around these deduction restrictions by applying a bunching strategy to pull or push discretionary medical expenses and charitable contributions into the year where they will do some tax good. For example, a taxpayer who will be able to itemize deductions this year but not next will benefit by making two years' worth of charitable contributions this year, instead of spreading out donations over 2020 and 2021. The COVID-related increase for 2020 in the income-based charitable deduction limit for cash contributions from 60% to 100% of MAGI assists in this bunching strategy, especially for higher income individuals with the means and disposition to make large charitable contributions.

... Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2020 deductions even if you don't pay your credit card bill until after the end of the year.

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

... Consider increasing the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year and anticipate similar medical costs next year.

... If you become eligible in December of 2020 to make health savings account (HSA) contributions, you can make a full year's worth of deductible HSA contributions for 2020.

... Make gifts sheltered by the annual gift tax exclusion before the end of the year if doing so may save gift and estate taxes. The exclusion applies to gifts of up to $15,000 made in 2020 to each of an unlimited number of individuals. You can't carry over unused exclusions from one year to the next. Such transfers may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

... If you were in federally declared disaster area, and you suffered uninsured or unreimbursed disaster-related losses, keep in mind you can choose to claim them either on the return for the year the loss occurred (in this instance, the 2020 return normally filed next year), or on the return for the prior year (2019), generating a quicker refund.

... The CARES act allows net operating losses for 2018, 2019 and 2020 to be carried back for five years to refund taxes paid in prior years.

... Maximize retirement plan contributions – 2020 401(k) amounts are $19,500, plus $6,500 for those over 50. The IRA contribution limit remains $6,000, with an additional $1,000 catch-up for people over 50.

Year-End Tax-Planning Moves for Businesses & Business Owners

... Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income. For 2020, if taxable income exceeds $326,600 for a married couple filing jointly, $163,300 for singles, marrieds filing separately, and heads of household, the deduction may be limited based on whether the taxpayer is engaged in a service-type trade or business (such as law, accounting, health, or consulting), the amount of W-2 wages paid by the trade or business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the trade or business. The limitations are phased in; for example, the phase-in applies to joint filers with taxable income between $326,600 and $426,600, and to all other filers with taxable income between $163,300 and $213,300.

Taxpayers may be able to achieve significant savings with respect to this deduction, by deferring income or accelerating deductions so as to come under the dollar thresholds (or be subject to a smaller phaseout of the deduction) for 2020. Depending on their business model, taxpayers also may be able increase the new deduction by increasing W-2 wages before year-end. The rules are quite complex, so don't make a move in this area without consulting your tax adviser.

... More small businesses are able to use the cash (as opposed to accrual) method of accounting than were allowed to do so in earlier years. To qualify as a small business a taxpayer must, among other things, satisfy a gross receipts test. For 2020, the gross-receipts test is satisfied if, during a three-year testing period, average annual gross receipts don't exceed $26 million (the dollar amount was $25 million for 2018, and for earlier years it was $1 million for most businesses). Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings until next year or by accelerating expenses, for example, paying bills early or by making certain prepayments.

... Businesses should consider making expenditures that qualify for the liberalized business property expensing option. For tax years beginning in 2020, the expensing limit is $1,040,000, and the investment ceiling limit is $2,590,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. It is also available for qualified improvement property (generally, any interior improvement to a building's interior, but not for enlargement of a building, elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems. The generous dollar ceilings mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. The fact that the expensing deduction may be claimed in full (if you are otherwise eligible to take it) regardless of how long the property is in service during the year can be a potent tool for year-end tax planning. Thus, property acquired and placed in service in the last days of 2020, rather than at the beginning of 2021, can result in a full expensing deduction for 2020.

... Businesses also can claim a 100% bonus first year depreciation deduction for machinery and equipment bought used (with some exceptions) or new if purchased and placed in service this year, and for qualified improvement property, described above as related to the expensing deduction. The 100% writeoff is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the 100% bonus first-year writeoff is available even if qualifying assets are in service for only a few days in 2020.

... Businesses may be able to take advantage of the de minimis safe harbor election to expense the costs of lower-cost assets and materials and supplies, assuming the costs don't have to be capitalized under the Code Sec. 263A uniform capitalization (UNICAP) rules. To qualify for the election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS; e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed $2,500. Where the UNICAP rules aren't an issue, consider purchasing such qualifying items before the end of 2020.

... To reduce 2020 taxable income, consider deferring a debt-cancellation event until 2021.

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

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

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