CPA CONSULTING GROUP
THE CRITICAL ELEMENT

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Year End Tax Plan Letter 2020

Dear Clients and Friends:

This year has been unlike any other in recent memory. Front and center, the COVID-19 pandemic has touched virtually every aspect of daily living and business activity in 2020. In addition to other financial consequences, the resulting fallout is likely to have a significant impact on year-end tax planning for both individuals and small businesses.

Furthermore, the national elections are expected to affect tax issues for the rest of the year and beyond.

In response to the pandemic, Congress authorized economic stimulus payments and favorable business loans as part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The CARES Act also features key changes relating to income and payroll taxes. This new law follows close on the heels of the massive Tax Cuts and Jobs Act (TCJA) of 2017. The TCJA revised whole sections of the tax code and includes notable provisions for both individuals and businesses.

This is the time to paint your overall tax picture for 2020. By developing a year-end plan, you can maximize the tax breaks currently on the books and avoid potential pitfalls.

Keeping all that in mind, we have prepared the following 2020 Year-End Tax Letter. For your convenience, the letter is divided into three sections:

* Individual Tax Planning
* Business Tax Planning
* Financial Tax Planning

Be aware that the concepts discussed in this letter are intended to provide only a general overview of year-end tax planning. It is recommended that you review your personal situation with a tax professional.

Sincerely,

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INDIVIDUAL TAX PLANNING

Charitable Donations

Generally, itemizers can deduct amounts donated to qualified charitable organizations, as long as substantiation requirements are met. Be aware that the TCJA increased the annual deduction limit on monetary contributions from 50% of adjusted gross income (AGI) to 60% for 2018 through 2025. Even better, the CARES Act raises the threshold to 100% for 2020.

In addition, the CARES Act authorizes an above-the-line deduction of up to $300 for monetary contributions made by a non-itemizer in 2020 ($600 for a married couple).

YEAR-END MOVE: In most cases, you should try to "bunch" charitable donations in the year they will do you the most tax good. For instance, if you will be itemizing in 2020, boost your gift giving at the end of the year. Conversely, if you expect to claim the standard deduction this year, you may decide to postpone contributions to 2021.

For donations of appreciated property that you have owned longer than one year, you can generally deduct an amount equal to the property's fair market value (FMV). Otherwise, the deduction is typically limited to your initial cost. Also, other special rules may apply to gifts of property. Notably, the annual deduction for property donations generally cannot exceed 30% of AGI.

Note: If you donate to a charity by credit card in December—for example, you make an online contribution—you can still write off the donation on your 2020 return, even if you do not actually pay the credit card charge until January.

Family Income-Splitting

The time-tested technique of family income-splitting still works. Currently, the top ordinary income tax rate is 37%, while the rate for taxpayers in the lowest income tax bracket is only 10%. Thus, the tax rate differential between you and a low-taxed family member, such as a child or grandchild, could be as much as 27%—not even counting the 3.8% net investment income tax (more on this later).

YEAR-END MOVE: Shift income-producing property, such as securities, to family members in low tax brackets through direct gifts or trusts. This will lower the overall family tax bill. But remember that you are giving up control over those assets. In other words, you no longer have any legal claim to the property.

Also, be aware of potential complications caused by the "kiddie tax." Generally, unearned income above $2,200 received in 2020 by a child younger than age 19, or a child who is a full-time student younger than age 24, is taxed at the top marginal tax rate of the child's parents. (Recent legislation reverses a TCJA change on the tax treatment.) The kiddie tax could affect family income-splitting strategies at the end of the year

Note: If there is a danger that the kiddie tax could be triggered in 2020, some of the same income deferral strategies that are available to adults may be used for dependent children. For example, you may arrange for a child to postpone a large capital gain from a securities sale to 2021 or realize a capital loss at year-end to offset previous capital gains (see Capital Gains and Losses under Financial Planning).

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Higher Education Expenses

The tax law provides tax breaks to parents of children in college, subject to certain limits. This often includes a choice between one of two higher education credits and a tuition-and-fees deduction.

YEAR-END MOVE: When appropriate, pay qualified expenses for next semester by the end of this year. Generally, the costs will be eligible for a credit or deduction in 2020, even if the semester does not begin until 2021.

Typically, you can claim either the American Opportunity Tax Credit (AOTC) or the Lifetime Learning Credit (LLC). The maximum AOTC of $2,500 is available for qualified expenses of each student, while the maximum $2,000 LLC is claimed on a per-family basis. Thus, the AOTC is usually preferable. Both credits are phased out based on modified adjusted gross income (MAGI).

Alternatively, you may claim the tuition-and-fees deduction, which is either $4,000 or $2,000 before it is phased out based on MAGI, as shown below:

Filing Status	MAGI	Tuition-and-Fees Deduction
Single	Up to $65,000	$4,000
Single	$65,001 – $80,000	$2,000
Married filing jointly	Up to $130,000	$4,000
Married filing jointly	$130,001 – $160,000	$2,000

Note: The tuition-and-fees deduction, which has expired and been revived several times, is scheduled to end after 2020, but could be reinstated again by Congress.

Medical and Dental Expenses

Previously, taxpayers could only deduct unreimbursed medical and dental expenses above 10% of their AGI. But the TCJA temporarily lowered the threshold to 7.5% of AGI for 2017 and 2018. Subsequent legislation extended this tax break through 2020.

YEAR-END MOVE: When it is possible, accelerate non-emergency expenses into this year to benefit from the lower threshold. For instance, if you expect to itemize deductions and have already surpassed the 7.5%-of-AGI threshold this year, or you expect to clear it soon, accelerate elective expenses into 2020. Of course, the 7.5%-of-AGI threshold may be extended again, but you should maximize the tax deduction when you can.

To qualify for a deduction, the expense must be for the diagnosis, cure, mitigation, treatment or prevention of disease or payments for treatments affecting any structure or function of the body. But any costs for your general health or well-being are nondeductible.

Note: Don't forget to count unreimbursed medical and dental expenses you have paid for your immediate family members, as well as other tax dependents such as an elderly parent or in-law. These extra expenses can push you over the 7.5%-of-AGI mark for the year or boost an existing deduction.

Estimated Tax Payments

The IRS requires you to pay federal income tax through any combination of quarterly installments and tax withholding. Otherwise, it may impose an "estimated tax" penalty.

YEAR-END MOVE: No estimated tax penalty is assessed if you meet one of these three "safe harbor" exceptions under the tax law.

1. Your annual payments equal at least 90% of your current liability;

2. Your annual payments equal at least 100% of the prior year's tax liability (110% if your AGI for the prior year exceeded $150,000); or

3. You make installment payments under an "annualized income" method. This option may be available to taxpayers who receive most of their income during the holiday season.

Note: If you have received unemployment benefits in 2020—for example, if you lost your job due to the COVID-19 pandemic—remember that those benefits are subject to income tax. Factor this into your estimated tax calculations for the year.

Miscellaneous

* Watch out for the alternative minimum tax (AMT). The AMT applies if a separate complex calculation involving "tax preference items" and certain adjustments exceeds your regular tax liability. Have an assessment of your AMT liability made to determine your year-end approach.

* Make home improvements that qualify for mortgage interest deductions as acquisition debt. This includes loans made to substantially improve your principal residence or one other home. Note that the TCJA suspended deductions for home equity debt for 2018 through 2025.

* With a Section 529 plan, you can set up an account for a child's college education that can grow without any current tax erosion. Distributions used to pay for qualified expenses are exempt from tax. Beginning in 2018, the TCJA expanded the use of 529 plans for tuition payments of up to $10,000 a year for a child's kindergarten, elementary or secondary school education.

* Consider the tax impact of a divorce or separation. The TCJA repealed the deduction for alimony expenses for payers and the corresponding inclusion in income for recipients, for divorce and separation agreements executed after 2018. Note that deductions may still be available for pre-2019 agreements that are modified after 2018.

* Meet student loan obligations. Under the CARES Act, payment on many student loans was suspended tax-free until September 30 and then through December 31 by an executive order. Barring any further developments, you must resume required payments in 2021.

* If you own property that was damaged in a federal disaster area in 2020, you may qualify for quick casualty loss relief by filing an amended 2019 return. The TCJA suspended the deduction for casualty losses for 2018 through 2025, but retained a current deduction for disaster-area losses.

BUSINESS TAX PLANNING

Depreciation-Related Deductions

Under current law, a business may benefit from a combination of three depreciation-based tax breaks: (1) The Section 179 deduction, (2) "bonus" depreciation and (3) regular depreciation.

YEAR-END MOVE: Place qualified property in service before the end of the year. Typically, a small business can write off most, if not all, of the cost in 2020 as shown below.

1. Section 179 deductions: This tax code section allows you to "expense" (i.e., currently deduct) the cost of qualified property placed in service anytime during the year. The maximum annual deduction is phased out on a dollar-for-dollar basis above a specified threshold.

The maximum Section 179 allowance has been gradually raised over the last decade since it was doubled to $500,000 in 2010. As shown below, the TCJA increased the amount again in 2018.

Tax year	Deduction limit	Phase-out threshold
2010–2015	$500,000	$2 million
2016	$500,000	$2.01 million
2017	$510,000	$2.03 million
2018	$1 million	$2.50 million
2019	$1.02 million	$2.55 million
2020	$1.04 million	$2.59 million

However, be aware that the Section 179 deduction cannot exceed the taxable income from all your business activities this year. This could limit your deduction for 2020.

2. Bonus depreciation: The TCJA doubled the 50% first-year bonus depreciation deduction to 100% for property placed in service after September 27, 2017 and expanded the definition of qualified property to include used, not just new, property. However, the TCJA gradually phases out bonus depreciation after 2022.

3. Regular depreciation: Finally, if there is any remaining acquisition cost, the balance may be deducted over time under the Modified Accelerated Cost Recovery System (MACRS).

Note: The CARES Act fixes a glitch in the TCJA relating to "qualified improvement property" (QIP). Under the new law, QIP is eligible for bonus depreciation, retroactive to 2018. Therefore, your business may choose to file an amended return for the appropriate tax year.

Payroll Tax Deferral

Normally, employers must deposit payroll taxes with the IRS under a schedule based on the size of the company revenue. Most small businesses are on a monthly schedule.

YEAR-END MOVE: Take advantage of a payroll tax deferral break. Under the CARES Act, an employer can defer payment of the 6.2% Social Security tax portion of payroll taxes for the period spanning March 27, 2020, through December 31, 2020.

Half of the deferred amount is due at the end of 2021. The employer must pay the other half by the end of 2022. If you choose this approach, make sure you will have the funds needed to meet your company's obligations in the future.

Note: Don't confuse the payroll tax deferral with the "payroll tax holiday" for employees created by an executive order in August. The payroll tax deferral discussed above refers to a separate provision in the CARES Act applying to employers.

Business Interest

Prior to 2018, business interest was fully deductible. But the TCJA generally limited the deduction for business interest to 30% of adjusted taxable income (ATI). Now the CARES Act raises the deduction to 50% of ATI, but only for 2019 and 2020.

YEAR-END MOVE: Determine if you qualify for a special exception. The 50%-of-ATI limit does not apply to a business with average gross receipts of $25 million (indexed for inflation) or less for the three prior years. The threshold for 2020 is $26 million.

For these purposes, ATI is defined as your business income without regard to any income, deduction, gain or loss not properly allocable to a business; business interest income and expense; net operating losses (NOLs); the 20% qualified business income (QBI) deduction; and, for tax years beginning before 2022, depreciation, amortization or depletion.

Note: If the business interest limit applies, you can carry forward the excess indefinitely until it is exhausted.

Employee Retention Credit

Many small businesses have been unable to continue regular operations during the COVID-19 pandemic. Frequently, they are facing difficult decisions concerning employment of workers.

YEAR-END MOVE: Keep employees on the books, if you can, through the end of 2020. The CARES Act authorizes an employee retention credit (ERC) to offset some of the cost.

The ERC equals 50% of the qualified wages an employer pays to employees after March 12, 2020 and before January 1, 2021. For these purposes, "qualified wages" are limited to the first $10,000 of wages paid to each worker during this time period.

Your business qualifies for the credit if it fully or partially suspended operation during any calendar quarter in 2020 due to government orders relating to the COVID-19 outbreak or if it experienced a significant decline in gross receipts (i.e., gross receipts equal to less than 50% of the gross receipts for the same calendar quarter in 2019).

Note: The Families First Coronavirus Response Act (FFCRA), which followed soon after the CARES Act, also provides a tax credit to certain small businesses that have provided emergency paid leave due to the COVID-19 pandemic. The FFCRA provision initially offsets the Social Security tax component of payroll tax. Any excess credit is refundable.

Bad Debt Deduction

During this turbulent year, many small businesses are struggling to stay afloat, resulting in large numbers of outstanding receivables and collectibles.

YEAR-END MOVE: Increase your collection activities now. For instance, you may issue a series of dunning letters to debtors asking for payment. Then, if you are still unable to collect the unpaid amount, you can generally write off the debt as a business bad debt in 2020.

Generally, business bad debts are claimed in the year they become worthless. To qualify as a business bad debt, a loan or advance must have been created or acquired in connection with your business operation and result in a loss to the business entity if it cannot be repaid.

Note: Keep detailed records of all your collection activities—including letters, telephone calls, e-mails and efforts of collection agencies—in your files. This documentation can help support your position claiming worthlessness of the debt if the IRS ever challenges the bad debt deduction.

Miscellaneous

* Maximize the QBI deduction that is available for pass-through entities and self-employed individuals. Be aware you must observe special rules if you're in a "specified service trade or business" (SSTB).

* If you buy a heavy-duty SUV or van for business, you may claim a first-year Section 179 deduction of up to $25,000. The "luxury car" limits do not apply to certain heavy-duty vehicles.

* If you pay year-end bonuses to employees in 2020, the bonuses are generally deductible by your company and taxable to the employees in 2020. A calendar-year company operating on the accrual basis may be able to deduct bonuses paid as late as March 15, 2021, on its 2020 return.

* Generally, repairs are currently deductible, while capital improvements must be depreciated over time. Therefore, make minor repairs before 2021 to increase your 2020 deduction.

* Switch to cash accounting. Under a TCJA provision, a C corporation may use this simplified method if average gross receipts for last year exceeded $26 million (up from $5 million).

* Hire disadvantaged workers eligible for the Work Opportunity Tax Credit (WOTC). The WOTC, which is generally a maximum of $2,400 per worker, is scheduled to expire after 2020.

* Get a new business up-and-running to qualify for a maximum first-year deduction of $5,000 in start-up costs. Any remainder is amortized over 180 months.

* An employer can claim a refundable credit for certain family and medical leaves provided to employees. The credit is currently scheduled to expire after 2020.

* Investigate Paycheck Protection Program (PPP) forgiveness. Under the CARES Act, PPP loans may be fully or partially forgiven without tax being imposed. Despite recent guidance, this remains a complex procedure, so consult with your professional tax advisor about the details.

FINANCIAL TAX PLANNING

Capital Gains and Losses

Frequently, investors time sales of assets like securities at year-end to produce optimal tax results. For starters, capital gains and losses offset each other. If you show an excess loss for the year, it offsets up to $3,000 of ordinary income before being carried over to the next year. Long-term capital gains from sales of securities owned longer than one year are taxed at a maximum rate of 15% or 20% for certain high-income investors. Conversely, short-term capital gains are taxed at ordinary income rates reaching up to 37% in 2020.

YEAR-END MOVE: Review your investment portfolio. Depending on your situation, you may harvest capital losses to offset gains realized earlier in the year or cherry-pick capital gains that will be partially or wholly absorbed by prior losses.

Be aware of even more favorable tax treatment for certain long-term capital gains. Notably, a 0% rate applies to taxpayers below certain income levels, such as a young child. Furthermore, some taxpayers who ultimately pay ordinary income tax at higher rates due to their investments may qualify for the 0% tax rate on a portion of their long-term capital gains.

However, watch out for the "wash sale rule." If you sell securities at a loss and reacquire substantially identical securities within 30 days of the sale, the tax loss is disallowed. A simple way to avoid this harsh result is to wait at least 31 days to reacquire substantially identical securities.

Note: The 0%/15%/20% rate structure for long-term capital gains also applies to qualified dividends you have received in 2020. These are dividends paid by U.S. companies or qualified foreign companies.

Net Investment Income Tax

In addition to capital gains tax, a special 3.8% tax applies to the lesser of your "net investment income" (NII) or the amount by which your modified adjusted gross income (MAGI) for the year exceeds $200,000 for single filers or $250,000 for joint filers. (These thresholds are not indexed for inflation.) The definition of NII includes interest, dividends, capital gains and income from passive activities, but not Social Security benefits, tax-exempt interest and distributions from qualified retirement plans and IRAs.

YEAR-END MOVE: Assess the amount of your NII and your MAGI at the end of the year. When it is possible, reduce your NII tax liability in 2020 or avoid it altogether.

For example, you might add municipal bonds ("munis") to your portfolio. Interest income generated by munis does not count as NII, nor is it included in the calculation of MAGI. Similarly, if you turn a passive activity into an active business, the resulting income may be exempt from the NII tax. These rules are complex, so obtain professional assistance.

Note: When you add the NII tax to your regular tax plus any applicable state income tax, the overall tax rate may approach or even exceed 50%. Factor this into your investment decisions.

Required Minimum Distributions

As a general rule, you must receive "required minimum distributions" (RMDs) from qualified retirement plans and IRAs after reaching age 72 (70½ for taxpayers affected prior to 2020). The amount of the RMD is based on IRS life expectancy tables and your account balance at the end of last year. If you do not meet this obligation, you owe a tax penalty equal to 50% of the required amount (less any amount you have received) on top of your regular tax liability.

YEAR-END MOVE: Take RMDs in 2020 if you need the cash. Otherwise, you can skip them this year, thanks to a suspension of the usual rules by the CARES Act. There is no requirement to demonstrate any hardship relating to the pandemic.

However, if you already received an RMD this year and did not return the money to a qualified plan or IRA by August 31, the distribution is generally taxable in 2020.

Typically, retirees wait until late in the year to arrange RMDs. If you still intend to take any of your RMDs in 2020, make sure you complete the arrangements in time to have this accommodated by the financial institution.

Note: RMDs are not treated as NII for purposes of the 3.8% tax. Nevertheless, an RMD may still increase your MAGI used in the NII tax calculation.

IRA Rollovers

If you receive a distribution from a qualified retirement plan or IRA, it is generally subject to tax unless you roll it over into another qualified plan or IRA within 60 days. In addition, you may owe a 10% tax penalty on taxable distributions received before age 59½. However, some taxpayers may have more leeway to avoid tax liability in 2020 under a special CARES Act provision.

YEAR-END MOVE: Take your time redepositing the funds if it qualifies as a COVID-19 related distribution. The CARES Act gives you three years, instead of the usual 60 days, to redeposit up to $100,000 of funds in a plan or IRA without owing any tax.

To qualify for this tax break, you (or your spouse, if you are married) must have been diagnosed with COVID-19 or experienced adverse financial consequences due to the virus (e.g., being laid off, having work hours reduced or being quarantined or furloughed). If you do not replace the funds, the resulting tax is spread evenly over three years.

Note: This may be a good time to consider a conversion of a traditional IRA to a Roth IRA. With a Roth, future payouts are generally exempt from tax, but you must pay current tax on the converted amount. Have a tax professional help you determine if this makes sense for your situation.

Estate and Gift Taxes

Since the turn of the century, Congress has gradually increased the federal estate tax exemption, while eventually establishing a top estate tax rate of 40%. At one point, the estate tax was repealed—but only for 2010—while the unified estate and gift tax exclusion was severed and then subsequently reunified.

Finally, the TCJA doubled the exemption from $5 million to $10 million for 2018 through 2025, inflation-indexed to $11.58 million in 2020. The following table shows the progression of the estate tax exemption and top estate tax rate during the last decade.

Tax year	Estate tax exemption	Top estate tax rate
2011	$5 million	35%
2012	$5.12 million	35%
2013	$5.25 million	40%
2014	$5.34 million	40%
2015	$5.43 million	40%
2016	$5.45 million	40%
2017	$5.49 million	40%
2018	$11.18 million	40%
2019	$11.40 million	40%
2020	$11.58 million	40%

YEAR-END MOVE: Update your estate plan to reflect current law. For instance, you may revise wills and trusts to accommodate the rule allowing portability of the estate tax exemption.

Under the "portability provision" for a married couple, the unused portion of the estate tax exemption of the first spouse to die may be carried over to the estate of the surviving spouse. This tax break is now permanent, so incorporate it into your estate planning decisions.

Note: With the gift tax exclusion, you can give each recipient, like a young family member, up to $15,000 in 2020 without paying any federal gift tax. This exclusion is effectively doubled to $30,000 for joint gifts made by a married couple. These gifts reduce the size of your taxable estate.

Miscellaneous

* Contribute up to $19,500 to a 401(k) in 2020 ($26,000 if you are age 50 or older). If you clear the 2020 Social Security wage base of $137,700 and promptly allocate the payroll tax savings to a 401(k), you can increase your deferral without any further reduction in your take-home pay.

* Sell real estate on an installment basis. For payments over two years or more, you can defer tax on a portion of the sales price. Also, this may effectively reduce your overall tax liability.

* Invest in passive income generators (PIGs). Generally, you can only use losses from passive activities (e.g., most real estate investments) to offset income from other passive activities, with limited exceptions. With a PIG, you can absorb more of your passive activity losses

* From a tax perspective, it is often beneficial to sell mutual fund shares before the fund declares dividends (the ex-dividend date) and buy shares after the date the fund declares dividends.

* Consider a qualified charitable distribution (QCD). If you are age 70½ or older, you can transfer up to $100,000 of IRA funds directly to a charity. Although the contribution is not deductible, the QCD is exempt from tax. This may benefit your overall tax picture.

CONCLUSION

This year-end tax-planning letter is based on the prevailing federal tax laws, rules and regulations. Of course, it is subject to change, especially if additional tax legislation is enacted by Congress before the end of the year.

Finally, remember that this letter is intended to serve only as a general guideline. Your personal circumstances will likely require careful examination. We would be glad to schedule a meeting with you to assist with all your tax-planning needs.

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