Tax Planning Strategies for End-of-Year 2020

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With the year-end fast approaching, it is time to develop effective strategies for tax savings or deferrals. Strategic planning can help taxpayers reduce their overall tax burden, putting them in a better financial position moving forward.

This year has been a unique one. The outcome of the Presidential election has potential to change tax laws in the near future. Taxpayers may want to consider taking an opposite approach with regards to their 2020 and 2021 income and deductions. Deferring income and accelerating deductions was traditionally a good strategy for year-end planning; however, it may not hold true for 2020.

Since each taxpayer's individual tax situation is unique, taking a one-size-fits-all approach will not be beneficial for all taxpayers. Windes can tailor an individual or business tax planning strategy to fit your specific situation and needs. The following are techniques that should be considered.

Which Techniques Should You Consider?

Income Acceleration (delay these actions to postpone income until 2021):

- Selling outstanding installment notes
- Receiving bonuses that are due before January 2021
- Selling appreciated assets or investments
- Redeeming U.S. savings bonds
- Accelerating income from debt forgiveness
- Accelerating collections and billing
- Declaring a special dividend
- Maximizing retirement distributions
- Completing Roth IRA conversions
- Accelerating income, so you use all available carryforward losses
- Taking any corporate liquidation distributions in 2020

Credit Acceleration/Deductions (take contrary action for deferral):

- Bunch all itemized deductions in 2020, then take standard deductions in 2021
- Ensure you have paid all outstanding bills in 2020
- Accelerate your economic performance
- Watch your AGI (adjusted gross income) limitations on credits/deductions
- Match your passive activity losses and income to maximize your deductions

- Watch your net investment interest limitations
- Think about disposing of passive activities to deduct suspended passive activity losses
- Increase the basis in pass-through business entities so you can deduct current year losses
- Analyze the collectability of any account receivables outstanding while considering write-offs as a bad debt

End-of-year Tax Planning for Individuals

The following are the best strategies for individuals for 2020 end-of year tax planning:

Unearned Income Surtaxes for High Earners

If you are a high earner, you will face surtaxes on certain types of unearned income. This surtax represents 3.8% of either your NII (Net Investment Income) or your MAGI (Modified Adjusted Gross Income). It will apply only over a specified threshold amount to whichever of these is the lowest.

At present, the threshold figure for surviving spouses or joint filers is $250,000. It is $125,000 for married individuals who file separately. In every other case, the threshold figure is $200,000.

The taxpayer's approach to eliminating or minimalizing their surtax on unearned income will vary, depending on the person’s estimated NII and MAGI for that year. Some taxpayers should consider ways to minimize additional NII for the remainder of the year, while others should attempt to reduce MAGI instead. Some individuals should consider ways to minimize both NII and MAGI in their tax plan strategies.

Tax Rate for Medicare

An extra 0.9% Medicare tax will apply to high-income earners. This applies if the sum of your received wages from self-employment or employment is over a certain amount. For joint filers, this threshold figure is $250,000 and $125,000 for married couples who file separately. It is $200,000 for all other cases. Employers must withhold the Medicare Tax from all wages over $200,000, regardless of the individual’s other income or filing status.

Capital Gains Taxation

Long-term capital gains taxation applies when taxpayers sell assets that they held for more than a year. Depending on the taxpayer's taxable income, the tax rate is 20%, 15%, or 0%.

Generally, a taxpayer pays the 0% rate when there is an excess of long-term capital gains over short-term capital losses. When added to the individual’s standard taxable income, this amount cannot be over the “maximum zero rate amount” (e.g. $80,000 for married couples filing jointly and $40,000 for single taxpayers).

For example: The rate of 0% applies to a joint filing taxpayer who has made profits of $5,000 on selling stock purchased before 2019, and their other 2020 taxable income is $75,000. This taxpayer should not try to sell assets that would yield capital losses before the end of the year. This is because the first $5,000 of those losses would yield no benefits this year.

Consider Roth IRAs

Taxpayers that have traditional IRAs invested in low-performing mutual funds and stocks may benefit from converting the traditional IRA to a Roth IRA in 2020. Bear in mind that this conversion increases your AGI in 2020 and may also reduce your tax breaks relating to a modified AGI or an AGI.

Itemizing Your Deductions

Many taxpayers will be unable to itemize their deductions during this tax year because of the high 2020 standard deduction amounts. These amounts equate to $12,400 for singles and married couples filing separately and $24,800 in the case of joint filers. Heads of households have deduction amounts for 2020 of $18,650.

Individuals cannot deduct more than $10,000 of local and state taxes. No deduction is allowed for miscellaneous itemized deductions, such as unreimbursed employee expenses and tax preparation fees. Taxpayers can only deduct theft and personal casualty losses if they can attribute them to federally declared disasters. Also, the taxpayer must meet the 10% of AGI limit and $100 per casualty limit.

It is still possible to itemize medical expenses only to the extent that they are more than 7.5% of your AGI. It is also possible to itemize local and state taxes up to a total of $10,000. Taxpayers can still itemize charitable contributions and interest deductions, but only on restricted amounts of qualifying residence debt. Nevertheless, paying for these items will not save on taxation in every situation. If they do not exceed the standard deduction amounts applicable to your filing status cumulatively, you will save nothing.

Some taxpayers can work around such deduction restrictions by applying bunching strategies to move discretionary charitable contributions and medical expenses into the most beneficial tax year. As an example, you can itemize deductions this year, but you cannot itemize them next year. If you make two years' of charitable contributions in 2020, you can benefit from itemizing the 2021 contribution in 2020 that would otherwise yield no benefit in 2021.

In 2020, two rules apply to your charitable contributions. The first is a $300 above-the-line deduction on top of the available standard deduction available for taxpayers who do not itemize deductions. However, it applies only to cash gifts made to a public charity. Taxpayers who itemize their deductions can benefit from increasing their AGI deduction limits for public charity cash gifts. The standard AGI deductions limit of 60% will increase for 2020 to 100%.

Making charitable contributions with your credit card before the end of 2020 is a suitable strategy if you do not need to pay the bill until 2021. Mere pledges to make donations are not deductible unless you have paid them by the end of the year.

If you are claiming deductions for a car donation, boat, or airplane of over $500, the available deduction varies. The available amount will depend on how the charity uses the donated vehicle. It does not just depend on the donated vehicle's fair market value. Should the organization sell the property with no material improvement or significant use, the available deduction is lower. The amount of deduction for the charitable contribution cannot exceed the gross proceeds you received from selling the property.

Adjusting Employer Withholdings

Do you believe you will owe local and state income taxes next year when filing your tax return? Are you going to itemize in 2020? If so, you may want to think about increasing the amount of local and state taxes you withhold. Alternatively, you may wish to make estimated tax payments for local and state taxes before the end of the year. This pulls the deduction for those taxes into 2020. Remember, this strategy could be disadvantageous if it causes your local and state tax payments for 2020 to go above $10,000.

Planning for Retirement

Are you planning for your retirement? If so, your first step should be contributing savings via an elective salary deferral plan sponsored by your employer, including 457 plans, 403(b) plans, and 401(k) plans. The option available depends on the kind of employment you have. In 2020, there is an elective salary deferral limit that has adjustments for inflation for the 457, 403(b), and 401(k) plans. This stands at either 100% of the compensation or $19,500 – whichever is lower. If your employer currently makes contributions, there is a cap of $57,000 for 2020's total contributions. This includes the contributions made by both the employer and employee. This does not include the extra $6,500 relating to catch-up contributions. All participants should speak to the administrator of their plans regarding their options for increases to year-end contributions.

Taking Required Minimum Distributions

You may have to take a Required Minimum Distribution (RMD) from your IRA or company's retirement plan when you turn 72 (70½ before 2020). Non-owner employees who continue to work can defer their RMDs until April 1, after the year they retire. You will pay a penalty if you fail to take the required withdrawal. This penalty amounts to half the total amount of non-withdrawn RMD. The RMD for 2020 has been waived (except for defined benefit pension plans) and you will not be penalized if you choose to forgo the 2020 RMD.

The 2020 tax year provides a unique opportunity for taxpayers to take distributions from IRAs and retirement plans due to the COVID-19 pandemic. Should taxpayers meet certain coronavirus-related requirements, they can withdrawal up to a $100,000 aggregate limit from all IRAs and plans. The coronavirus-related distribution amount will be recognized in the taxpayer's income evenly over three years, beginning in the year the distribution is received. A withdrawal for such purposes will not be subject to the 10% early withdrawal penalty, including the additional 25% tax levied on specific SIMLE IRA distributions. Such penalties would otherwise apply to withdrawals taken before the age of 59½. These distributions do not fall under mandatory tax withholding rules. Taxpayers may repay them to workplace retirement plans or IRAs within three years. This applies if the taxpayer meets the eligibility criteria for the tax-free rollover treatment.

Individuals can only receive loans or withdrawals relating to coronavirus if:

The individual (or individual's dependent or spouse) receives a diagnosis of coronavirus disease 2019 or SARS-Cov-2 (known as COVID-19). The individual must have received this diagnosis after a CDC-approved testing process. This includes tests authorized under the Federal Food, Drug, and Cosmetics Act.

The individual must also have experienced negative financial consequences. These must have occurred because the individual's company furloughed or laid them off. It also must have occurred because of a quarantine. The individual may also have had their working hours reduced or was unable to attend work because of no childcare. Other applicable circumstances include having an offer of employment rescinded or a delay to a job's starting date. A reduction of self-employment income or pay because of COVID-19 is also an applicable circumstance. Alternatively, someone within the individual's household or their spouse must have met at least one of the above criteria. One further eligibility criterion that applies is if a business, owned by the individual, their spouse, or household member, closed or reduced its hours because of COVID-19.

Be aware that you can recontribute some or all the specific coronavirus-related distributions, including IRAs, to eligible retirement plans. This must occur within three years, starting on the date following the day the individual received the distribution. The IRS will treat the repayments as if they were direct eligible rollovers. There will be no rollover or contribution limits placed on the amounts repaid.

There is also a special provision that allows taxpayers to distribute up to $100,000 to charity tax-free. This can be from a Roth, or traditional IRA maintained for someone who is already 70½ years or over.

IRA Charitable Distributions

Are you, or will you be, 70½ years old or older by the end of 2020? Do you have a traditional IRA and cannot itemize deductions? Then making charitable donations for 2020 directly from your IRA to charities could be a good tactic. You do not have to include the contribution amount as part of your overall gross income. It also will not be deductible on Form 1040 Schedule A. The total amount of qualified charitable distributions will reduce the required minimum distribution amount, therefore, lowering your taxes.

Are you under 70½ years old? Do you anticipate that you will not itemize deductions in the year when you reach this age or in future years? Do you have no traditional IRAs? You can then establish and contribute the maximum possible amount in 2020 to traditional IRAs. Should these circumstances apply to you, and you already have a traditional IRA, you should maximize your 2020 contributions. Then, once you have reached the age of 70½, you can make charitable donations from your IRA and convert the nondeductible charitable contributions into an IRA deductible in 2020. These apply to those made during the year in which you turned 70½, as well as beyond. You can also convert them into gross income reductions from 70½ years and later-year IRA distributions.

Rolling Over Any Distributions

Do you face penalties for underpaying your estimated tax? Can your employer not increase your withholdings by the end of the year to keep you from incurring this penalty? If so, you can take eligible rollover distributions before the 2020 year-end from a qualified retirement plan. The IRS will withhold the income tax from your distribution and apply it toward the tax you owe for 2020.

It is possible to rollover your gross amount of distributions together with the withheld tax amount to your traditional IRA. While you cannot include any of those distributions in your 2020 income, you can apply the amount of withheld tax on a pro-rata basis across the entire tax year for 2020. The IRS will use it to reduce your previous estimated tax underpayments.

Flexible Spending Accounts (FSAs)

You should think about increasing the sum you are setting aside in your FSA for the next year. This applies if you are not setting aside enough this year for your employer's health flexible spending account.

Health Spending Accounts (HSAs)

Are you becoming eligible in December 2020 for HSA (health savings account) contributions? Then, it is possible to make your entire years' worth of HSA deductible contributions for the tax year 2020.

Making Gifts

Gifts made before the year-end that are protected by annual gift tax exclusions can reduce estate and gift taxes. This exclusion will apply to any gifts made during 2020 up to a maximum of $15,000. This figure applies to each one of an unlimited number of individuals. Unused exclusions cannot be carried over to a future tax year. If you transfer income-earning properties to a family member in a lower income tax bracket, you can save on family income tax. This will save you money as long as they are not contingent on the kiddie tax.

Exemption Gifting of Estate Tax – Use It or Lose It!

Is your estate large enough that your family members would have to pay the estate tax when you die? At present, estate tax exemptions are $11,580,000 for an individual, while married couples in California, have estate tax exemptions of $23,160,000. For the majority of taxpayers, this will eliminate the estate tax. However, under current legislation, the exemption will return to $5 million in 2026 (adjusting for inflation). There will likely be additional revisions due to the administration change in Washington. One existing proposal would reduce estate tax exemptions to just $3.5 million per individual.

Therefore, if your estate is large, you might want to think about gifting some or all of the $11,580,000 exemption prior to the end of 2020 to help reduce future estate tax bills.

Estate Tax Planning vs. Income Tax Basis Planning

You may think estate taxes are not a concern because of your estate size. However, you will find income tax plans are a vital component of estate planning. This is especially true when considering inherited or gifted assets' income tax basis.

The Internal Revenue Code states that assets gifted during an individual's lifetime retain the donor's income tax basis. However, the gifted basis amount cannot exceed the asset's fair market value on the date the donor made the gift. Assets that an individual inherits upon the owner's death will receive a different tax basis. The inherited basis equals the assets' fair market value as it stood on the day of the donor's death. This is referred to as a "step-up." An example in point – an asset costs $100, but its fair market value is $1,000. Therefore, it would have a tax basis of $100 if received as a gift by the donor. If received as an inheritance, its tax basis would be $1,000.

With these income tax rules in mind, below are several helpful tax planning tips:

- Is your potential estate materially under the applicable estate tax exemption? Then it rarely makes sense to gift appreciated assets while you are alive. In the majority of cases, gifting causes a loss in the basis step-up.
- You should make all appropriate gifting when possible with your high basis assets.
- Is your potential estate big enough to make it likely that estate tax will be due? Then you should think about gifting those assets that have the highest potential to appreciate in the future.
- You should consider undoing any trusts previously created to maximize your benefit from a basis step-up. One such example is a trust created when a decedent died for the benefit of his or her surviving spouse. Known as a “B” trust, credit equivalent trust, or bypass trust, this trust may hold appreciated assets. This may allow the surviving spouse who receives the principal distributions to retain them until his or her death, allowing a basis step-up for such assets.
- Certain irrevocable trusts treated as if owned by the grantor for income tax purposes have their own rules. They can have lower basis assets within the trust swapped for those with a higher basis in the grantor’s hands. This could be very advantageous.
- Does your existing estate plan include a trust you created at the time of the first death? Will it benefit the surviving spouse under the rules discussed above? You must decide whether revised documents eliminating the trust could be advantageous.

Using a Non-Grantor Trust for the Avoidance of State Income Tax

The majority of tax plans focus on minimalizing federal tax liability. However, rates for state income taxes are very high – as much as 13.3%. Therefore, it is easy to see why strategies to reduce these taxes are becoming more popular.

One strategy that has recently become popular uses non-grantor trusts when portfolio assets may generate significant income. An individual can contribute assets to a trust within a state that has no state income tax. This shifts tax exposure to the tax rate of 0% in that state. This avoids exposure to the high tax rate in the settlor’s home state. As a result, it is possible to make significant savings in state income tax. If you have considerable income and assets, as well as investments that have significant exposure to taxation, then a trust structured properly may generate substantial savings in state income taxes.

End-of-Year Tax Planning for Businesses

If you are running a company, business tax planning is a key element of your year-end considerations. The following are some effective tax planning strategies for companies.

Noncorporate Business Entities

Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income. The deduction is subject to certain limitations when taxable income exceeds the following thresholds:

- Over $326,600 for jointly filing married couples
- $163,300 in the case of other taxpayers

There could be limitations on these deductions dependent upon:

- If the taxpayer engages in service type businesses or trades, such as law, health, consulting, or accounting
- How much the business or trade pays in W-2 wages
- The unadjusted basis of qualifying properties, such as equipment and machinery that the business or trade holds

Taxpayers can achieve some significant savings when they use this deduction. The individual has to accelerate deductions or defer income to come below the dollar threshold for 2020. Otherwise, certain limitations may begin to phase in. Depending on their business model, taxpayers may be able to increase the new deduction by increasing W-2 wages before year-end. The rules regarding this are fairly complex, therefore, you should not take any steps in this direction without speaking to a professional tax advisor.

Accrual vs. Cash Method

Many small businesses can use cash (rather than accrual) methods of accounting for this year. To meet the small business qualification, a key requirement that taxpayers must meet is the satisfaction of the gross receipts test. In 2020, a business can satisfy this test if, during the testing three-year period, its annual average gross receipts do not exceed $26,000,000. Taxpayers choosing the cash method can find it simpler to change their income by accelerating expenses or delaying billing until the next year. An example of this is making prepayments or paying bills early.

Expensing Business Property

Companies should think about purchasing equipment that qualifies for the expensing option for liberalized business properties under IRC §179. The limit for expensing in the tax years starting in 2020 is $1,040,000, and $2,590,000 is the limit for investment.

Generally, expensing is available for the majority of computer software available off the shelf, as well as for depreciable property and qualifying improvement property, including improvements to the interior of a building. This does not include enlargements of buildings, escalators, elevators, or internal framework structures. However, it does include roofs, fire protection, HVAC, security, and alarm systems.

With this year's generous dollar ceiling, many small- and medium-sized businesses making timely purchases can deduct virtually all their outlays. These outlays can be on equipment or machinery. It is also possible to claim this expensing deduction no matter how long the taxpayer has held the property in the year. This makes it a powerful tax planning tool for the end of the year.

Depreciation of Equipment and Machinery

A business can claim a 100% depreciation deduction in the first year for equipment and machinery. This will apply to either new or used equipment bought and put into service during this year. This write-off of 100% is available no matter how long the asset remains in service. Therefore, a business can use this write-off even if it used the assets in 2020 for just a few days.

Book Tax Conformity Election

A business can benefit from the book tax conformity election, also known as de minimis safe harbor election. Businesses can use this for expensing the cost of low-cost supplies, materials, and assets. This assumes a business does not need to capitalize those costs under Code Sec. 263A Uniform Capitalization (UNICAP) rules.

A property unit cannot cost more than $5,000 to qualify for this election. This applies if taxpayers have an applicable financial statement (AFS; e.g., a certified audited financial statement along with an independent CPA's report). If no AFS exists, a property unit's cost may not be greater than $2,500. If these UNICAP rules are not of concern, you should consider buying these qualified items before the end of 2020.

Net Operating Loss (NOL) Carryback and Carryforward

Should taxpayers expect to have net operating losses in 2020, they can generally carry this loss forward or back. If the NOL is carried forward, it can be carried forward indefinitely. However, if they carry it back, it is only for five years. Non-life insurance organizations that have net operating losses during 2020 can carry their losses backward five years; however, they can only carry the loss 20 years forward. REITs cannot carry back. They can carry their losses forward indefinitely. A taxpayer that carries back a 2020 NOL can file Form 1045 or 1139 to request a refund of prior year taxes.

A taxpayer may choose to waive the carryback period. Instead, the taxpayer may elect to carry the NOL forward. The taxpayer needs to know that there will be limits on deductions for any loss incurred after 2017 and carried forward into 2021 and later years. The limit will be a maximum of 80% of the taxpayer's taxable income.

Taxpayers expecting a loss during this tax year, and who have already paid their estimated taxes, need to think about looking for a refund quickly for overpayments. Corporations can file Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax. It allows the recovery of estimated tax overpayments for this tax year. The amount you can recover is any sum amounting to more than the expected final liability for income tax. If a corporation has suffered losses in 2020 and expects to be profitable during 2021, it must be prepared to make estimated tax payments for 2021.

Entertainment, Meals, and Business Travel Expenses

Although there are significantly limited business deductions regarding entertainment and meal expenses, they remain available in specific circumstances. You will find an overview of the requirements and rules regarding the deductibility of these expenses in our 2020 Meals and Entertainment Expenses chart.

Making Charitable Contributions

Businesses, as well as individuals, can benefit from deductions for charitable contributions. Generally, corporations can deduct their charitable contributions to a maximum of 10% of their taxable income.

The CARES Act provides an increase of corporate limitation to 25% of a business's taxable income for all 2020 contributions. The IRS will allocate any contribution by a pass-through entity to an individual equity interest holder. This means an individual can place limitations on it. Individuals generally can deduct their charitable contributions to a maximum of 60% of their AGI, however this limitation has been expanded to 100% of AGI for 2020.

Disposing of Passive Activities

Taxpayers who have suspended passive activity losses can consider selling a passive activity to deduct the suspended losses attached to the activity. Suspended losses attached to an unrelated passive activity may also be deducted against taxable gain generated from the sale.

Key Changes in Your Life Cycle that Could Affect Your End-of-Year Tax Planning

Taxpayers must consider the changes in tax legislation, as well as changes in their circumstances during 2020, such as:

- A change in your filing status because of divorce, marriage, changes to the head of the household, or death
- A change in dependents, such as a grown or newborn child
- Changes to your medical expenses
- A change in your employer
- Higher education and college expenses
- Retirement
- Inheritance
- Personal bankruptcy
- Failures or successes in your business and your succession plan

Summarized in this guide are some of the year-end strategies you may use to save taxes for yourself and your business. If you wish to discuss how Windes can tailor a plan that will work best for your particular situation, or have questions regarding your year-end tax planning, please do not hesitate to contact us at taxalerts@windes.com or toll free at **844.4WINDES** (844.494.6337).

Sincerely,

WINDES

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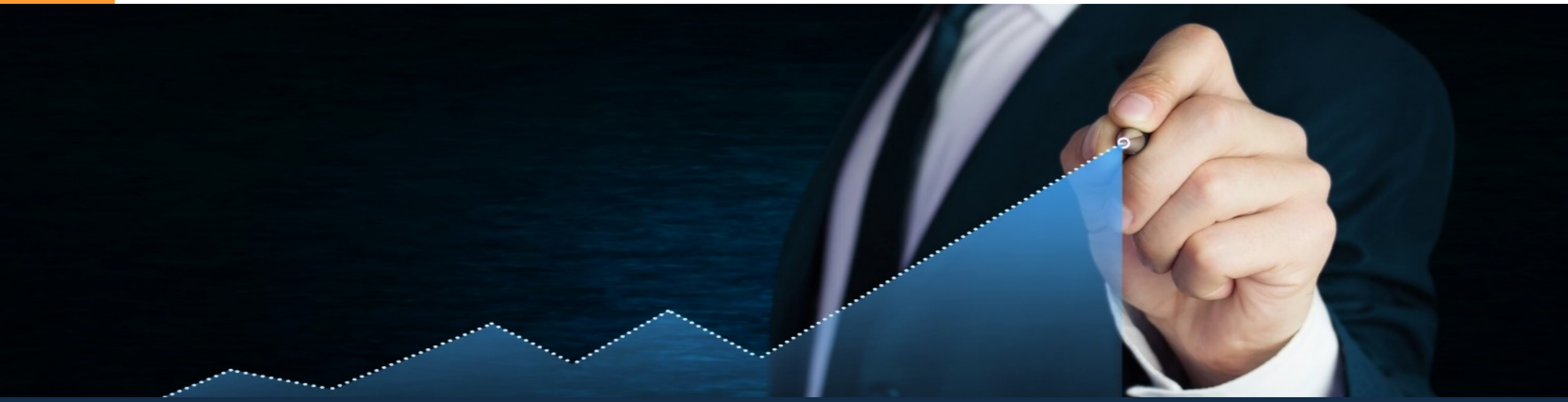

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