2020 Year-end Planning

The good, the bad, and the unknown

December 17, 2020

Business Tips / Ideas

Consider bonus depreciation for 2020 asset purchases

- 100% write off for Federal purposes for new and used property
- Remember addback for Virginia returns and other states
- Can make election up to the time your return is filed, waiting to see if law changes will happen in 2021 in case tax rates increase

CARES Act corrected the TCJA error and now allows 100% bonus depreciation on 15-year qualified improvement property (QIP)

- This applies to QIP placed in service in 2018 through 2022.
- QIP property must be put in service after the date the building was first placed in service.
- QIP property is an improvement to an interior portion of a non-residential building that is not an internal structural framework of a building, enlarging the building, or any elevator or escalator.
- Like above consider not taking bonus if it looks like tax rates will increase in future years.

Retroactive refund for bonus depreciation

- QIP bonus depreciation for property placed in service in 2018 or 2019 can be captured by amending returns for those years
- Or you can reflect the additional retroactive deduction entirely in the 2020 year with an accounting method change

Bonus depreciation for a heavy SUV, Pickup, or Van

- Vehicle must be used more than 50% for business
- Vehicle must have gross vehicle weight rating (GVWR) over 6,000 pounds
- The GVWR can be verified by looking at the manufacturer’s label found on the inside edge of the driver’s side door.

Take advantage of more-generous Section 179 deduction rules

- Maximum deduction for 2020 is $1.04 million
- No addback for Virginia returns
- TCJA allows 179 expense for personal property used to furnish lodging (example furniture, kitchen appliances, living quarters equipment).
- Hotels, motels, rental condos, apartment houses, and single-family rental homes are examples of a lodging facility.
- TCJA also expanded 179 expense for certain equipment related to real property… applies to nonresidential buildings.
- Examples include qualified expenditures to roofs, HVAC equipment, fire protection and alarm systems, and security systems. Like the QIP rules, these assets must be placed in service after the date the building was first placed in service.
- Be careful of Section 179 expense limitations for pass-through entities.

Cost Segregation Benefits

- Cost segregation studies allocate building costs to tangible personal property to accelerate depreciation lives versus the longer lives for commercial real estate (39 years) and residential real estate (27.5 years).
- Tangible personal property can be depreciated over 5, 7 and 15 years and is eligible for bonus depreciation.
- Warning… tangible personal property related to real estate no longer qualifies as part of a Section 1031 tax-free exchange.

Time income and deductions for tax savings

- Unless the tax rates increase in 2021, deferring income and accelerating expenses makes sense if you will be in the same or lower tax bracket in 2021

- Accelerate income and delay deductions if you think you will be in a higher tax bracket in 2021

- The CARES Act increased the charitable contribution limit to 25% of taxable income for regular C corporations in 2020

Deferring taxable income

- If entity uses the cash basis method of accounting, you can manage the business taxable income over the 2020-2021 period
- Use a credit card to charge expenses… you claim the deduction in 2020 but will not pay the bill until 2021
- Mail checks for bills a few days before year end… expenses are deducted in the year you mail the bills, but they won't clear the bank until next year
- Prepay expenses for the next year as long as the economic benefit from the prepayment doesn't extend past 12 months or the end of next year
- Consider waiting until the last few days of the year to send out invoices to customers thus delaying payments received until 2021
- Reverse and send bills out early if you think your tax rate will be higher in 2021

Creating or increasing a net operating loss (NOL)

- NOL’s incurred in 2020, 2019 and 2018 can be carried back 5 years.
- If you expect your tax rate to be higher in future years, make the election to carry forward the NOL to future years.
- You can get your refund quicker by filing a tentative refund claim, but it must be filed by 12/31/2020 for the 2019 calendar year.
- If you anticipate a loss for 2020 plan on filing the return early because you can’t claim an NOL carryback refund until you file your tax return for the year.

Selling Qualified Small Business Corporation (QSBC) stock

- QSBC stock acquired after 9/27/2010 and held more than 5 years qualifies for a 100% gain exclusion

- QSBC stock definitions are hard to meet so not many corporations may benefit from this tax break

- This benefit is not available to C corporations that own QSBC stock.

Maximize QBI deduction for pass-through entities

- Deduction currently allowed through 2025.
- Deduction can be up to 20% of a pass-through owner’s QBI.
- Deduction phases out at higher income levels and based on the owner’s taxable income.
- Note that tax strategies that lower taxable income have a negative side-effect of reducing the QBI deduction.

Establish a tax-favored retirement plan

- Current retirement plan rules allow for significant deductible contributions.
- For self-employed individuals, set up a SEP-IRA and contribute up to 20% of your self-employment earnings.
- If employed by your own corporation, up to 25% of your salary can be contributed to a SEP-IRA ($57,000 maximum for 2020).
- Other plans are available… 401(k) plans, defined benefit pension plans, and a SIMPLE-IRA.
- Depending on your circumstances, these plans may allow for larger deductible contributions.
- Plans must be established by 12/31/2020 (SIMPLE-IRA must have been set up by 10/1/2020).
- The contribution deadline for putting funds into these retirement plans is the extended due date for your 2020 tax return.

Accelerate AMT refunds

- The TCJA eliminated the corporate AMT and allows entities to claim their unused credit on 2018-2021 tax returns
- The CARES Act allows corporations to claim all remaining credits in either 2018 or 2019
- Corporations must file Form 1139 by 12/21/2020 to claim AMT credit this way

Business interest deduction

- Make sure that interest expense is paid up by year-end; the business interest expense allowance for 2020 is 50%

- The allowance reverts to 30% for calendar year 2021

De Minimis Safe Harbor Election

- Be sure to make this election for new businesses and any older ones that have not already done so

- Business can deduct small dollar items (up to $2,500 per invoice without audited financial statements) that would otherwise have to be capitalized

Nexus Based on COVID-19 Telecommuting

- Certain states have issued specific guidance on whether telecommuting employees temporarily working in a state due to the impact of the pandemic creates corporate income tax nexus for an employer who does not operate in that state. Currently Alaska, Colorado, Michigan, and Montana are the only states that will impose nexus.

Disaster Loss Refunds

- President Trump declared all 50 states, DC and the five territories as disaster areas due to COVID-19.
- This means that every U.S. business is covered and may be eligible for refunds from certain types of disasters.
- The provision may potentially affect losses arising in a variety of circumstances, including the loss of inventory, supplies or the closure of offices, stores or plants.
- To qualify, the loss must actually be attributable to or caused by COVID-19 and satisfy several other requirements.

Individual Tips / Ideas

Above-the-line charitable deduction

- Taxpayers that used the standard deduction can claim a $300 charitable deduction

- Contributions must be in cash and made before 12/31/2020

Stimulus Checks

- Checks were issued to some taxpayers for $1,200 per taxpayer and $500 per qualified child dependent under age 17.
- Payments were based on 2018 and 2019 return information so the amount may not match what is calculated on the 2020 return.
- If the 2020 credit calculation is less than the check amount, there is no credit claw back.
- If you received less than the credit calculated on the 2020 return, it can be claimed as an additional refund.

Income Tax withholding shortfalls

- Due to COVID-19 you will need to make sure that withholdings and estimated taxes align with what tax you expect to pay
- Shortfalls can be made up through additional withholdings on year-end salary and/or bonus checks
- Withholdings are considered made ratably throughout the year thus helping to reduce underpayment penalties

Opportunity Zone Investments

- There are more than 8,000 opportunity zones and many types of investment, development and business activities qualify
- In some scenarios not only can you defer paying tax on gains invested in an opportunity zone until as late as 2026, but you only recognize 90% of the gain if you hold the investment five years
- If you hold the investment for ten years and satisfy the rules, there is no tax on the appreciation of the opportunity zone itself
- See KLS for assistance

Capital Gains

- Take advantage of the 0% long-term capital gains bracket.
- Can shelter up to $40,000 for singles, up to $80,000 for married couples, and up to $53,600 for heads of households.
- If you have investments with losses to recognize in 2020, consider selling investments with capital gains to offset the losses (and vice-versa).
- Gain stocks sold can then be repurchased without being subject to the wash sale rules.
- Keep in mind that the exchange of one cryptocurrency for another is also treated as a sale, unlike currencies.
- Virtual currency exchanges may not provide investors with documentation to substantiate sales, gains and losses therefore the investor should keep detailed records of all transactions.

Itemized Deductions

- Medical expenses allowed only to the extent they exceed 7.5% of AGI.
- State and local taxes still limited to no more than $10,000.
- Mortgage interest deductible up to the extent of $750,000 home mortgage debt unless grandfathered (limit is then $1,000,000).
- No deduction for home equity loan unless used for purchase, improvements or addition to principal residence. Equity line must be secured by the principal residence.
- Miscellaneous itemized deductions still not deductible.
- Personal casualty and theft losses are deductible only if they are attributable to a federally declared disaster, then subject to a $100 and 10% AGI thresholds.

Charitable Contributions

- Consider a Qualified Charitable Distribution (QCD) from an IRA. For taxpayers over 70½; can give up to $100,000 per year to a public charity other than a DAF. The distribution is not taxable, and contribution is not deductible.
- Consider bunching charitable gifts to allow for itemized deductions in one year as opposed to being stuck with the standard deduction each year.
- Giving to a Donor Advised Fund (DAF) allows you to take a charitable deduction in the current year for the entire amount, yet you can delay actual gift giving out of the DAF for later years.
- CARES Act allows for charitable contributions up to 100% of AGI for 2020. Contributions must be made in cash and an election is required.

Retirement accounts

- No required minimum distributions (RMDs)for calendar year 2020 under the CARES Act.
- If a taxpayer had taken an RMD prior to the CARES Act passage, they were allowed to roll over this distribution (including any withholding).
- The SECURE Act increased the RMD from 70½ to 72 for individuals born on or after 7/1/1949.
- SECURE Act also allows for contributions to traditional retirement accounts to continue after age 70½. Good planning tools for individuals who are still working.
- Consider maxing out deferrals on 401(k) and any other retirement plans to reduce taxable income and maximize retirement income.
- Some plans allow for a catchup contribution for those ages 50 and over.

Use of retirement funds for COVID costs

- CARES Act allows individuals under 59½ to withdraw up to $100,000 from retirement funds for COVID costs without incurring 10% penalty.
- If funds are paid back within 3 years, income tax can be avoided.
- If funds cannot be paid back, tax on withdraw can be spread over 3 years beginning with 2020 tax return.
- This should be considered a last resort after all other options have been exhausted in order to maximize growth for retirement distributions.

Net operating losses

- Like business returns, an NOL generated in 2018, 2019 or 2020 can be carried back for five years

- Consider making the election to waive the carryback period if you anticipate income in 2021 to be higher or if tax rates might increase

- The CARES Act also eliminated the 80% limitation on such losses

Depreciation planning

- Refer to business planning ideas for bonus depreciation, Section 179 expense election, and qualified improvement property.

Disposition of passive activities

- Consider getting rid of passive activities with suspended passive losses to reduce current year taxable income
- Losses in the year of disposition can exceed any other passive income for the year since they are no longer considered passive

Kiddie Tax changes

- The SECURE Act reinstated the kiddie tax rules previously suspended by the TCJA
- Unearned income of a child is no longer taxed at the same rates as estates and trusts
- Taxpayers can amend their 2018 and 2019 returns… may be a good planning opportunity if the tax was significant in those years

529 Plans

- Consider maxing out contributions to state 529 plans.
- Contributions to Virginia plans are allowed as a deduction on the state income tax return subject to limits.
- For taxpayers over 70, there is no limit to the amount that can be deducted on the Virginia for a 529 plan.
- Remember, up to $10,000 can be used for educational purposes for a beneficiary that is enrolled at a public, private, or religious elementary or secondary school.

Mortgage Interest Rates

- Consider refinancing while interest rates are low due to current economic trends.
- 30-year loan rates are around 2.5% to 2.875%.
- 15-year loan rates are around 2.3% to 2.525%.
- Other factors to be considered such as closing costs, cash out, etc.

Gift and Estate Taxes

- The prevailing view is that the current lifetime exemption amount is as good as it gets, using it up before it's gone might be your best bet.
- For 2020, you can give each person $15,000 (unlimited number of persons) without having to file a gift tax return.
- The amount increases to $30,000 per person if gift-splitting with the spouse, but that requires a gift tax return to be filed.
- The lifetime gift exemption amount for 2020 is $11.58 million per individual.
- Consider accelerating gifts in 2020 to take advantage of lower valuations due to the pandemic thus preserving some of the lifetime gift exemption for future years.

State Conformity

- Some states (and the number is growing) do not conform to the most recent SECURE and CARES Acts as well as earlier legislation.
- Some provisions of the CARES Act apply retroactively for Federal tax purposes, but may not at the state level.
- Refer to the BNA and RIA state conformity charts.

2020 Tax Planning Under President-elect Biden

Obviously, one cannot predict what will actually happen with the new congress, but here are some highlights of what has been proposed during the campaign…

- The corporate income tax rate would increase to 28% from 21%.

- There would be a new form of corporate AMT that would require corporations to pay the greater of their regular corporate income tax or a new 15% minimum tax on worldwide book income of $100 million or more but paid no federal income tax.

- FICA Taxes: There is a proposal to remove the cap on the wage base for Social Security tax for individuals making over $400,000. This would mean there is a "donut hole" between $142,800 (wage base for 2021) and $400,000 before the higher rate kicks in.

- Biden proposes a 10% "Made in America" tax credit for companies that create jobs for American workers. It would be available for revitalizing closed or nearly closed facilities, retooling or expanding facilities, and bringing production or service jobs back to the U.S. and creating U.S. jobs.

- Estate Taxes: Biden wants to reduce the lifetime exemption to $3.5 million per taxpayer and increase the top estate tax rate to 45%. He also wants to eliminate the basis step-up on the date of death or alternate valuation date. Finally, the lifetime gift exemption would be reduced to $1 million. Both exemptions are currently at $11.58 million.

- The top individual tax rate would revert to 39.6% for taxable incomes above $400,000.

- Capital Gains Rate: The tax rate would increase to 39.6% for taxpayers with taxable income of $1 million or more.

- Biden would eliminate the carried interest rules and the 3-year holding period requirement for long-term capital gain and loss for certain service-based partnership interests.
- The Qualified Business Income (QBI) deduction would be phased out for individuals making over $400,000. He would also end special qualifying rules including those for real estate investors (no QBI deduction).
- Itemized deductions for individuals earning more than $400,000 would have a cap of 28% of value.
- The Pease limitation (3%) on itemized deductions would be restored for individuals with taxable incomes over $400,000.

- The state and local tax limitation of $10,000 would go away.
- Expand the child and dependent care credit from a maximum of $3,000 in qualified expenses to $8,000 ($16,000 for multiple dependents) for children under 13. The credit would become refundable. Reimbursement rate increases from 35% to 50% for families making less than $125,000 a year.
- The child tax credit would increase from $2,000 to $3,000 for children 6 to 17 and would allow an additional $600 bonus credit for children under 6. The credit would also become fully refundable. Additional credit would start in 2021 and go for as long as economic conditions require.
- Reestablish the first-time homebuyer's tax credit for up to $15,000. The credit would be paid upon the purchase instead of when filing the tax return.

- Expand the earned income tax credit to older workers.
- Student loans would be cancelled, tax free, after borrowers have been enrolled in the income-based repayment plan for 20 years.
- For retirement plans, Biden wants to create “automatic 401(k)” plans for workers without access to pension or 401(k) plans. He also wants to offer tax credits to small businesses to offset much of the cost of starting and maintaining retirement plans.

Questions

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