

2020 Year-End Tax Planning



Highlights

- ✓ Election Uncertainty Promotes Wait and See Approach
- ✓ CARES Act Provisions Ending in 2020
- ✓ Bunching Itemized Deductions
- ✓ Possible Tax Increases in 2021

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SPECIAL REPORT

Planning Strategies and Techniques Available Through End of Year

Tax planning in 2018 and 2019, in the wake of the Tax Cuts and Jobs Act, was largely a settled issue. Tax rates have been stable at a low level, meaning that there hasn't exactly been much reason to act quickly at the end of the year to take advantage of a beneficial tax environment down the road. With no looming tax legislation or massive policy changes, one year has more or less been just like the year before it.

Of course, 2020 has changed all of that, throwing Major League curveballs into what had been batting practice. The biggest curveball is the ongoing COVID-19 (coronavirus) crisis. With an uncertain economic future because of the pandemic, there is major incentive to maximize all tax savings now. Additionally, the Coronavirus Aid, Relief, and Economic Security (CARES) Act enacted many taxpayer-friendly provisions, many of which have a 2020 expiration date. On top of that, 2020 sees a presidential election, which always means that major tax policy changes could be months away.

With so much going on in the world, the certainty of a logical and reasonable tax plan is very important, and can be instrumental in helping families and businesses get through a very difficult time.

ELECTION IMPACT

A great deal of year-end tax planning for 2020 is contingent on the outcome of the elections on November 3. At the time of publication, the election was about a week away. A win by former Vice President Biden (along with Democratic control of Congress), promises an increase in taxes on higher income individuals and corporations. However, a re-election of President Trump (with or without Democratic control of Congress) means a likely continuation of current tax policies through 2024.

Since year-end tax planning often means having to determine whether to accelerate or delay income or deductions between years, it may be wise to hold off on any decisions until the outcome of the election is clear. Unfortunately, if the election is close and subject to contention after November 3, there could be limited time to act once the results are official. Thus, it would be prudent to make a plan now for both contingencies, and get the pieces into place for quick action.



COVID-19 AND LEGISLATION

Another real world impact on year-end tax planning is the ongoing COVID-19 crisis. Clearly, tax considerations should take a back seat to any decisions being made for reasons related to health and medical care. However, the escalating crisis continues to impact the economy, and there is a great deal of demand for additional stimulus/relief legislation to follow up on the CARES Act.

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Again, the timing of any legislation largely hinges on the outcome of the election. Congressional Republicans have made it clear that a Biden win will not result in any lame duck legislation in 2020, as they would not be willing to hand the incoming administration a victory before even taking office. However, a Trump win could mean that legislation is back on the table for the end of 2020, as the economy continues to reel from the pandemic.

Thus, a wait and see approach may be best for now. How any legislation can impact various plans will be detailed below.

MINIMIZING INDIVIDUAL TAXES

The key to any year-end planning strategy is to minimize taxes. This is done by either reducing the amount of income received or increasing the amount of deductions, which is all easier said than done. However, there are a few simple things that can be done in the waning weeks of 2020 to accomplish this.

STRATEGY. *As discussed above, a Biden victory in the election could mean higher taxes in 2021, in which case an **acceleration** of income into 2020 might be the best option for reducing taxes*


Delaying/Reducing Income and Gains

Ordinary income is taxed at seven rates, depending upon the amount of income. Taxes on capital gains also apply at different rates depending upon the amount of taxable income. For 2020, the rates are as follows:

	0%	15%	20%
MFJ/SS	\$0 - \$80,000	\$80,001 - \$496,600	over \$496,600
MFS	\$0 - \$40,000	\$40,001 - \$248,300	over \$248,300
HoH	\$0 - \$53,600	\$53,601 - \$469,050	over \$469,050
Single	\$0 - \$40,000	\$40,001 - \$441,450	over \$441,450
E&T	\$0 - \$2,650	\$2,651 - \$13,150	over \$13,150

For taxpayers whose income tends to fluctuate from year to year, it would be wise to examine the impact of sales of investment items. For taxpayers who think they may have lower income in 2021, it would be smart to hold off on a sale of a capital item if their income is at or near a threshold for a higher capital gains bracket.

This type of consideration should not be limited to capital gain taxes, but also the net investment income (NII) tax. The 3.8% NII tax kicks in at \$200,000 of modified adjusted gross income for single and head-of-household filers, \$250,000 for joint filers, and \$125,000 for married taxpayers filing separately.

 **IMPACT.** *Since the NII thresholds fall right in the middle of the 15% capital gains bracket, a taxpayer to whom the NII applies because of a sale of a capital item would likely not be able to reduce the tax to 0%. But, a taxpayer who is barely in the 20% bracket could defer a sale and get into the 15% bracket, meaning a sale of a capital item would only be taxed at 18.8% instead of 23.8%.*


Maximizing Deductions

For 2020, the inflation adjusted standard deduction amounts are \$24,800 for joint filers, \$18,650 for heads of households, and \$12,400 for all other filers. With standard deduction amounts so high, coupled with the \$10,000 limitation on the deduction of state and local taxes, it is difficult for many taxpayers to claim enough deductions to make itemizing deductions beneficial. Thus, maximizing deductions may not be beneficial for all taxpayers.

One of the best ways to maximize the amount of deductions is to develop a bunching strategy. This involves accumulating charitable contributions, or even medical expenses (see below), from two or more years into one year. For example, a taxpayer may have not made any of his or her normal charitable contributions in 2019, and then made double the normal amount in 2020 in order to help surpass the standard deduction amount.


STRATEGY. *Again, depending on the outcome of the election, it may be more beneficial to minimize*

deductions in 2020 to maximize them in 2021 if higher taxes are likely under a new administration.

 **COMMENT.** Note that the CARES Act does allow an above-the-line charitable contribution deduction up to \$300 for individuals who do not itemize deductions for 2020 **only**. This special deduction applies regardless of the individual's income level.

The same strategy can be employed for deductible medical expenses where the timing is somewhat flexible, such as for elective procedures (remember that purely cosmetic procedures are not deductible). However, the floor for deductible medical expenses in 2021 is 10%, whereas the floor is 7.5% in 2020.

STRATEGY. The increase in the floor for deductible medical expenses in 2021 causes a dilemma if planning is taking into account a potential tax increase in 2021, depending on the election. While generally pushing deductions to 2021 would take advantage of higher tax rates, the higher floor on the deduction for medical expenses in 2021 could undermine the benefits of a delay.

 **IMPACT.** Bunching can be a very effective strategy, but it has to be effectively used, and potentially planned out two or three years in advance to maximize the benefit, while also taking into account shifts in tax policies as a result of political change.

Stimulus Payments

The CARES Act included a \$1,200 credit for the 2020 tax year that was paid to individuals in advance during the spring of 2020 as economic income payments. The payments were meant to stimulate the economy during the early stages of the COVID-19 crisis. The amount of the credits was subject to phase-out based upon individual income amounts for 2019 (or 2018 if taxpayers had not yet filed returns for 2019).

As the crisis continues, politicians across the political spectrum have called for a second round of stimulus payments. In all likelihood, if legislation were to be passed now, the phase-out would be based on 2019 income amounts. However, it is conceivable that legislation could be delayed far enough into 2021 that the phase-out would be based on 2020 income amounts. Thus, it may be smart to delay income to 2021 in order to maximize the amount of a potential second round of economic income payments.

STRATEGY. While this strategy would seem to run counter to the theory that income should not be delayed to 2021 because taxes could increase in 2021, the reality is that taxes will likely only increase in the event of a Biden victory, and Biden has stated that he will only increase taxes on incomes above \$400,000. The first round of economic impact payments phased out well below this level, thus there would be no risk of higher taxes.

Other Year-End Strategies


A number of other traditional year-end strategies may apply. These include:

- Maximizing Education Credits and Deductions – Individuals can claim a credit or a deduction for tuition paid in 2020 even if the academic period begins in 2021, as long as the period begins by the end of March. This is especially important because, absent legislation, the tuition and fees deduction is not available in 2021.
- Increasing 401(k) Contributions – Adjusted gross income (AGI) can be reduced if individuals increase the amount of their 401(k) contributions.
- IRA Contributions – Individuals eligible for deductions for IRA contributions can claim deductions, and thus reduce AGI, for amounts contributed through April 15, 2021.
- Teacher deductions – Educators can claim a deduction for up to \$250 of classroom expenses (like books, supplies, computer equipment), and should maximize those expenses by year-end.


YEAR-END BUSINESS STRATEGIES

Depreciation and Expensing

The Tax Cuts and Jobs Act (TCJA) provided very generous depreciation and expensing limitations. Businesses may want to take advantage of 100-percent first-year depreciation on machinery and equipment purchased during the year. Additionally, Code Sec. 179 expensing has an investment limitation of \$2,590,000 for 2020, with a dollar limitation of \$1,040,000.

 **IMPACT.** These provisions do not apply to 2020 only, so there is time to take advantage of them in later years. However, if a business has been considering expanding capacity or acquiring new equipment, there has never been a better time to do so than in 2020, from a tax benefit standpoint.

Additionally, the CARES Act corrected a longstanding error from the TCJA by categorizing qualified improvement property as 15-year recovery property. The effective date of this fix to the so-called “retail glitch” is for property placed in service after 2017, thus it was retroactive for 2018 and 2019.


 **IMPACT.** *Again, these provisions do not apply to 2020 alone, so there is not necessarily an end-of-year deadline to implement any changes. Nevertheless, the opportunity is there in 2020. In order to take advantage of the retroactive nature of the provision, there are specific rules relating to amending returns and accounting method changes that must be followed.*

Charitable Contributions

The CARES Act also increased the limitation on corporations’ deduction for charitable contributions from 10 percent of taxable income to 25 percent of taxable income. However, this increase is limited to the 2020 tax year only.

Business Interest Deduction Limitation

The CARES Act also increased the business interest deduction limitation from 30 percent to 50 percent of adjusted taxable income for 2019 and 2020. The TCJA introduced the limitation for tax years after 2017. The increase does not apply to interest paid after 2020. Specific rules apply in the case of partnerships.

 **IMPACT.** *The increases of deduction limitations for both charitable contributions and business interest provide unique opportunities for businesses to reduce their tax bills, but action must be taken before the close of the year.*

GIFT TAXES AND RETIREMENT PLANNING

Required Minimum Distributions

Individuals who have reached age 72 during 2020 (70 ½ prior to 2020) and are retired generally need to make sure that they are making their required minimum distributions (RMDs) from IRAs. However, the CARES Act eliminated the need to take RMDs for 2020.

STRATEGY. *Despite the CARES Act waiver, it may still be worthwhile to take a distribution in 2020, thereby reducing the size of future RMDs, if it appears that tax rates will go up if Biden wins the election.*

Gift Taxes

The TCJA-increased unified exclusion amount for gift taxes is not scheduled to expire until 2026. However, if Biden wins, one possibility is that many of the provisions of TCJA could be rolled back sooner than that. It would be worth considering making any gifts before the end of 2020 to take advantage of the higher exclusion while it is still certain to be available.