To Our Clients and Friends:

2020 has been quite a challenge, to say the least. The COVID-19 crisis brought massive unemployment, business closures, and an enormous amount of uncertainty. All of this has made 2020 seem like the year that never ends. In fact, I'm sure some of us can't wait for it to be over. As we approach the end of the year, it's time to discuss steps that can be taken to help reduce your 2020 tax bill.

The past 12 months have seen several major tax law changes. In response to the COVID-19 emergency, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law in March. In addition, the Taxpayer Certainty and Disaster Tax Relief Act (Disaster Act) and the Setting Every Community Up for Retirement Enhancement (SECURE) Act were passed in December 2019. The Disaster Act extended many beneficial provisions that had expired or were set to expire. Barring additional extenders, many of these will expire again at the end of the year. The SECURE Act, on the other hand, made significant changes to the retirement rules. We'll highlight planning techniques stemming from these recent bills, as well as other year-end planning ideas.

Let's not forget that there is an election in November. While we don't anticipate significant tax law changes if President Trump is re-elected, a victory by Joe Biden would almost certainly lead to tax reform (with potentially higher tax rates). It's also possible that we'll see additional COVID-19 legislation. As always, we're paying close attention to the ever-changing tax environment to discover tax planning opportunities.

Year-end Planning Moves for Individuals

Take Advantage of Generous Standard Deduction Allowances. For 2020, the standard deduction amounts are $12,400 for singles and those who use married filing separate status, $24,800 for married joint filing couples, and $18,650 for heads of household. If your total annual itemizable deductions for 2020 will be close to your standard deduction amount, consider making additional expenditures before year-end to exceed your standard deduction. That will lower this year's tax bill. Next year, you can claim the standard deduction, which will be increased a bit to account for inflation.

The easiest deductible expense to accelerate is included in your house payment due on January 1. Accelerating that payment into this year will give you 13 months' worth of interest in 2020. Mortgage insurance premiums for eligible taxpayers also are deductible in 2020, but will once again be disallowed in 2021 barring extension.

Also, consider state and local income and property taxes that are due early next year. Prepaying those bills before year-end can decrease your 2020 federal income tax bill because your itemized deductions will be that much higher. However, the maximum amount you can deduct for state and local taxes is $10,000 ($5,000 if you use married filing separate status).

Warning: This can be a bad idea if you owe Alternative Minimum Tax (AMT) this year. That's because write-offs for state and local income and property taxes are completely disallowed under the AMT rules. Therefore, prepaying those expenses may do little or no good if you're an AMT victim. Contact us if you're unsure about your exposure to AMT.

Accelerating other expenditures could cause your itemized deductions to exceed your standard deduction in 2020. For example, consider making bigger charitable donations this year and smaller contributions next year to compensate. The CARES Act offers two unique opportunities for charitable minded taxpayers in 2020. Individuals who don't itemize will be allowed an "above the line" deduction of up to $300 in 2020. For those who do itemize, the CARES Act increases the limit on charitable deductions to 100% of the individual's Adjusted Gross Income (AGI) for cash contributions made to public charities in 2020. Note there is no requirement that the contributions be related to COVID-19.

Among the provisions of the Disaster Act set to expire in 2020 is the reduced threshold for the medical expense deduction. You might consider accelerating elective medical procedures, dental work, and vision care. For 2020, medical expenses are deductible to the extent they exceed 7.5% of AGI, but that threshold is set to increase to 10% in 2021.

Cancellation of Debt (COD) Relief. Individuals can exclude up to $2 million ($1 million if not married filing jointly) of COD income from qualified principal residence indebtedness that is cancelled in 2020 because of their financial condition or decline in value of the residence. Debt cancelled after 12/31/20 still qualifies, but only if discharged pursuant to a written binding agreement entered into prior to 1/1/21.

Traditional IRA Contributions for All. The SECURE Act removed the age restriction on making traditional IRA contributions. Individuals over the age of 70½ who are still working in 2020 are no longer prohibited from contributing to a traditional IRA. However, if you're over age 70½ and considering making a charitable donation directly from your IRA (known as a *Qualified Charitable Distribution* or *QCD*) in the future, making a deductible IRA contribution will affect your ability to exclude future QCDs from your income. Please contact us for further explanations of QCDs and how they can be an effective way to give to charity and reduce your income.

Carefully Manage Investment Gains and Losses in Taxable Accounts. If you hold investments in taxable brokerage firm accounts, consider the tax advantage of selling appreciated securities that have been held for over 12 months. The maximum federal income tax rate on long-term capital gains recognized in 2020 is only 15% for most folks, although it can reach a maximum of 20% at higher income levels. The 3.8% Net Investment Income Tax (NIIT) also can apply at higher income levels.

To the extent you have capital losses that were recognized earlier this year or capital loss carryovers from pre-2020 years, selling winners this year will not result in any tax hit. In particular, sheltering net short-term capital gains with capital losses is a sweet deal because net short-term gains would otherwise be taxed at higher ordinary income rates.

What if you have some loser investments that you would like to unload? Biting the bullet and taking the resulting capital losses this year would shelter capital gains, including high-taxed short-term gains, from other sales this year.

If selling a bunch of losers would cause your capital losses to exceed your capital gains, the result would be a net capital loss for the year. No problem! That net capital loss can be used to shelter up to $3,000 of 2020 ordinary income from salaries, bonuses, self-employment income, interest income, royalties, and whatever else ($1,500 if you use married filing separate status). Any excess net capital loss from this year is carried forward to next year and beyond.

In fact, having a capital loss carryover into next year and beyond could work to your advantage. The carryover can be used to shelter both short-term and long-term gains recognized next year and beyond. This can give you extra investing flexibility in those years because you won't have to hold appreciated securities for over a year to get a preferential tax rate. Since the top federal rates on net short-term capital gains recognized in 2021 could be higher than the 2020 top rates of 35% and 37% (plus the 3.8% NIIT, if applicable), having a capital loss carryover into next year to shelter short-term gains could be a very good thing.

Key Point: If you still have a capital loss carryover after 2020, it could come in handy if the presidential election results in increased tax rates for 2021 and beyond.

Take Advantage of 0% Tax Rate on Investment Income. A potential silver lining to a down year may be the ability to harvest some long-term capital gains at very favorable rates. For 2020, singles can take advantage of the 0% income tax rate on long-term capital gains and qualified dividends from securities held in taxable brokerage firm accounts if their taxable income is $40,000 or less. For heads of household and joint filers, that limit is increased to $53,600 and $80,000, respectively.

While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who will be in the 0% bracket. If so, consider giving them appreciated stock or mutual fund shares that they can sell and pay 0% tax on the resulting long-term gains. Gains will be long-term, as long as your ownership period plus the gift recipient's ownership period (before the sale) equals at least a year and a day.

Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 0% rate bracket, they will be federal-income-tax-free.

Warning: If securities are given to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting capital gains and dividends to be taxed at the higher rates that apply to the individual's parent. That would defeat the purpose. Please contact us if you have questions about the Kiddie Tax.

Convert Traditional IRAs into Roth Accounts. This may be the perfect time to make that Roth conversion you've been thinking about. The current tax rates are still relatively low compared to a couple of years ago, and while they are scheduled to remain that way until 2026, depending on the results of the November election, they could increase much sooner. Also, your income may be lower in 2020 due to the financial fallout of COVID-19. On the bright side, that means you're likely in a lower tax bracket than you normally find yourself. Since the CARES Act suspended Required Minimum Distributions (RMDs) for 2020, if you already budgeted to pay tax on your RMD, rolling that distribution to a Roth IRA could be a perfect move. No RMD for 2020 also means that 100% of the distribution can be classified as a rollover.

It's possible the overall value of your retirement account suffered as a result of the economic downturn. The depressed value in your IRA means a rollover distribution will contain more assets. Once in the Roth IRA, the recovery of value and ultimate withdrawal will be tax free.

Consider Intrafamily Loans. Interest rates are at a historic low and continue to decrease. This scenario creates an attractive opportunity for those interested in assisting family members financially and transferring assets in a tax-efficient manner.

Individuals who wish to lend money to relatives may do so at interest rates lower than what commercial lenders offer, thus allowing the lendee to save money on interest. There's a minimum rate that can be charged by the lender called the Applicable Federal Rate (AFR). Loans with interest rates below the AFR may be subject to gift tax rules. While it's generally advisable to stay above the AFR to avoid being caught by the gift tax rules, individuals can use the annual and lifetime gift exclusions to maximize the benefit to the lendee.

To ensure the loan is an arm's length transaction, follow these steps: (1) have a properly worded and signed document, (2) file the documents with the necessary authorities, (3) provide the lendee with a formal document that summarizes the amount of interest paid each year, and (4) either collect the loan payments or establish the payments will be gifted. Please contact us if you are interested in taking advantage of intrafamily loans.

Conclusion

This letter only covers some of the year-end tax planning moves that could potentially benefit you, your loved ones, and your business. Please contact us if you have questions, want more information, or would like us to help in designing a year-end planning package that delivers the best tax results for your particular circumstances.