Greetings,

As year-end approaches, it is wise to think of planning moves that will help lower your tax obligations and provide financial relief.

Year-end planning for 2020 takes place against the backdrop of the 2017 Tax Cuts and Jobs Act (TCJA) and the 2020 CARES ACT. The TCJA had major changes in the tax rules for individuals. There were new, lower income tax rates, a substantially increased standard deduction, severely limited itemized deductions and elimination of personal exemptions, an increased child tax credit, and a watered-down alternative minimum tax (AMT), among many other changes.

In response to these changes, our office can help you prepare an effective strategy to lower your tax bill. The earlier we get started, the greater the potential maximization of benefits. We have compiled a checklist of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you (or a family member) will likely benefit from many of them. We can narrow down the specific actions you can take, and once we meet with you, we can tailor a particular plan. Please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving strategies may be beneficial to you.

Download the following letter here

Itemized Deductions

- Medical – Taxpayers can deduct certain unreimbursed medical expenses that exceed 7.5% of 2020 AGI.
- State and Local Taxes – Taxes are still capped at $10,000; this includes income taxes paid to the state government, state and local real property taxes, and state and local personal property taxes (such as driver's license fees). Taxes paid for property held for investment is still deductible in full and does not fall within the $10,000 overall limitation.
- Temporary Suspension of Limits on Charitable Contributions – This creates an opportunity for individuals to deduct their entire adjusted gross income through charitable contributions. In most cases, the amount of charitable cash contributions taxpayers can deduct is limited to a percentage (usually 60 percent) of the taxpayer's adjusted gross income (AGI). Qualified

contributions are not subject to this limitation. Individuals may deduct qualified contributions of up to 100 percent of their adjusted gross income. Contributions that exceed that amount can carry over to the next tax year. To qualify, the contribution must be:

  - a cash contribution;
  - made to a qualifying organization;
  - made during the calendar year 2020

- Above-the-line Charitable Deductions – Individual taxpayers who do not itemize can take an above-the-line deduction of up to $300 for cash donations made in 2020 to organizations describe in IRC 170(b)(1)(A) as charities. Donations made to donor advised funds, and certain private foundations do not qualify.
- Donor Advised Funds (DAF) – This is a charitable giving vehicle administered by a public charity created to manage charitable donations on behalf of organizations, families, or individuals. A donor advised fund allows the taxpayer to receive an immediate tax deduction with the benefit of not having to immediately decide which charities to support. Although the taxpayer surrenders ownership of the assets contributed to the donor advised funds, he/she retains advisory privileges over how the assets are invested and distributed to charities.

The phaseout of itemized deductions is still temporarily repealed, which means taxpayer's itemized deductions are no longer limited if their adjusted gross income reaches over a certain amount.

Stimulus Check

The stimulus check recovery rebate for individuals is an advance refund of credit against 2020 taxes. Whether the check you received was $1,200 for single filers, $2,400 for married couples, or more if you have dependents, each rebate's amount is phased out by $5 for every $100 in excess of a threshold amount.

The threshold brackets are the following:

- $75,000 - $99,000 for single filers
- $112,500 - $136,500 for head of household filers
- $150,000 - $198,000 for joint filers

Retirement Plans

- CARES Act waived the 10% penalty on early withdrawals for up to $100,000 from a qualified retirement plan. The distribution must be made in 2020, and the individual must have been either diagnosed with COVID or experienced financial distress due to COVID, which includes business closure, layoff, or reduced hours.
- The Act also waived all required minimum distributions for the year 2020. This is a benefit for all individuals regardless if they were impacted by COVID or not.

Qualified Opportunity Zones

A taxpayer can elect to exclude capital gain from a sale or exchange of any property from their income if they reinvest the gain in a qualified opportunity zone within 180 days of the sale or exchange. The deferred gain is then recognized on the earlier of the date which the qualified opportunity investment is disposed or December 31, 2026. If the investment is held for 10 years, the taxpayer may elect to treat his basis on the date of sale as the fair market value of the qualified opportunity fund on the date of sale or exchange.

New Deduction for Pass-through Entities (“199A Deduction”)

An individual, trust, and estate may deduct up to 20 percent of certain domestic qualified business income (QBI) from a sole proprietorship, partnership, and S corporation for tax years beginning after December 31, 2017, and before January 1, 2026. The QBI deduction, also known as the "pass-through deduction," is generally the lesser of combined QBI or 20 percent of the excess (if any) of taxable income over net capital gain.

Donating IRA Distributions to Charity

The PATH Act made permanent the ability of individuals of 70-1/2 years or older to exclude from gross income qualified charitable distribution from IRAs of up to $100,000 per year. On the other hand, no donation deduction is allowed. This is an extremely useful tool under the TCJA as lesser taxpayers will be itemizing due to an increase of standard deductions and various limitations put on itemized deductions.

Conversion from Traditional IRA to Roth IRA

Taxpayers can no longer recharacterize a conversion from a traditional IRA, SEP, or SIMPLE to a Roth IRA. The new law also prohibits recharacterizing amounts rolled over to a Roth IRA from other retirement plans, such as 401(k) or 403(b) plans. You can still treat a regular contribution made to a Roth IRA or to a traditional IRA as having been made to the other type of IRA.

Net Investment Income Tax

A 3.8% surtax applies to the lesser of (1) net investment income or (2) the excess of modified adjusted gross income (MAGI) over the threshold

Modified adjusted gross income thresholds				
Single	Married filing jointly	Married filing separately	Head of Household	Window(er) with dependent child
$ 200,000	$ 250,000	$ 125,000	$ 200,000	$ 250,000

MAGI is adjusted gross income (AGI) increased by the amount excluded from income as foreign earned income (net of the deductions and exclusions disallowed with respect to the foreign earned income). The 3.8% surtax applies to gross income from interest, dividends, annuities, royalties, and rents unless those items are derived in the ordinary course of a trade or business to which the tax doesn't apply. The tax also applies to income generated from a trade or business if it is a passive activity of the taxpayer. Hence, the tax doesn't apply to active businesses conducted by a sole proprietor, partnership, or S corporation. Investment income does not include any amount subject to the self-employment tax and doesn't include amounts distributed from retirement plans. As year-end nears, a taxpayer's approach to minimizing or eliminating the 3.8% surtax will depend on his or her estimated MAGI and net investment income (NII) for the year. Some taxpayers should consider ways to minimize (e.g., through deferral) additional NII for the balance of the year, others should try to see if they can reduce MAGI other than unearned income, and others will need to consider ways to minimize both NII and other types of MAGI. One way to reduce NII is to recognize losses on stocks and use them to offset other gains taken earlier this year. In addition, taxpayers that own interests in several passive activities also should reexamine the way they group their activities. Taxpayers expecting significant gains on sale of property may want to consider using the installment method to spread out the taxable gain on sale if applicable.

Alternative Minimum Tax

Like the NII tax, the alternative minimum tax (AMT) also requires personalized attention. There are steps that taxpayers subject to AMT can take to reduce its effect on their tax liability. For instance, taxpayers can undertake to eliminate certain tax preferences. Certain deductions, including the accelerated depreciation deduction on real property, as well expensed research and development costs, and expensed mining exploration and development costs, are tax preference items only to the extent that they exceed an otherwise allowable deduction. However, with State and Local Tax Deductions being capped at $10,000, we are expecting much fewer taxpayers being subject to AMT. For 2020 exemption and phaseout amounts, please refer to the table above.

Additional Medicare Tax

The 0.9% additional Medicare tax also may require higher-income earners to take year-end actions. It applies to individuals for whom the sum of their employment wages and their self-employment income is in excess of an unindexed threshold amount. The threshold amounts are:

Income threshold for additional medicare tax				
Single	Married filing jointly	Married filing separately	Head of Household	Window(er) with dependent child
$ 200,000	$ 250,000	$ 125,000	$ 200,000	$ 200,000

There could be situations where an employee may need to have more taxes withheld toward the end of the year to cover the tax. For example, if an individual earns $200,000 from one employer during the first half of the year and a like amount from another employer during the balance of the year, he or she would owe the additional Medicare tax, but there would be no withholding be either employer for the additional Medicare tax since wages from each employer don't exceed $200,000. If you feel you do not have enough income tax withholding to cover this tax, you may request that your employer process additional withholding from your income.

Gift Tax

The annual exclusion for gifts remained $15,000 in 2020. Make gifts sheltered by the annual gift tax exclusion before the end of the year, thereby saving gift taxes. The exclusion applies to gifts of up to $15,000 made in 2020 to each of an unlimited number of individuals. You can't carry over unused exclusions from one year to the next. The transfers also may save family income taxes where income-earning property is gifted to family members in lower income tax brackets who are not subject to the kiddie tax.

Complex Trusts and Estates

There is a special election available for estates and complex trusts for distributions made to a beneficiary within 65 days following the end of a tax year. The fiduciary can elect to treat any such distribution or part of a distribution as having been made in the prior year. The effect of this election is that the deduction for the distribution can be taken by the estate or trust in the year before the distribution was made. However, the beneficiary receiving the distribution must also be taxed on the distribution in the year before the distribution was received.

The amount covered by the 65-day election is limited to the greater of:

- the amount of the estate's or trust's income; or
- the estate's or trust's DNI, reduced by amounts paid or required to be distributed during the tax year, other than amounts subject to the 65-day election.

This election is made on Form 1041. Once made, the election is irrevocable, but is binding only for that year. The 65-day election is not available for accumulation distributions.

Residential Energy Efficient Property Credit

A nonrefundable tax credit is available to an individual for residential energy efficient property placed in service before January 1, 2022, and installed on, or in connection with, a dwelling unit located in the United States and used as a residence by the taxpayer. The credit is available for qualified solar electric property, qualified solar water heating property, qualified fuel cell property, qualified small wind energy property, and geothermal heat pump property. Cooperative and condominium dwellers can claim the credit by splitting the cost of installing equipment with other unit owners.

The credit is 30 percent of the cost of eligible property placed in service in 2017, 2018, or 2019; 26 percent of the cost of eligible property placed in service in 2020; and 22 percent of the cost of eligible property placed in service in 2021. There is also a $500 credit limit with respect to each 0.5 kilowatts of capacity of qualified fuel cell property expenditures for each tax year.

Student Loan Repayment Paid by Employer Excluded from Income

Employer-provided education payments can be excluded from an employee’s gross income up to $5,250 per year. The CARES Act expands the definition of such education payments to include student loan repayment made before January 1, 2021. However, the total annual limit stays at $5,250. Deduction of student loan interest is not allowed for amounts excluded from income under such provision.

Tentative Claims of Refunds

Under the new Coronavirus Aid, Relief, and Economic Security Act (CARES Act), net operating losses which are generated in 2018, 2019, or 2020 can now be carried back five years. NOLs generated in tax years beginning December 31, 2017 and before January 1, 2021 can be carried back to each of the five-preceding taxable by filing a tentative refund claim on Form 1045, but these must be filed by December 31, 2020.

Modification of Limitation of Losses for Noncorporate Taxpayers

Previously, noncorporate taxpayers were not allowed to deduct excess business losses for tax years beginning after December 31, 2017 and ending before January 1, 2026. Excess business loss is defined as the excess of (1) the taxpayer’s aggregate business deductions for the year over (2) the sum of the taxpayer’s aggregate business gross income or gain plus $250,000 (adjusted for inflation). The CARES Act temporarily removes the excess business loss limitations for noncorporate taxpayers for tax years beginning after December 31, 2017, and before January 1, 2021.

The CARES Act also made a technical amendment to IRC 461(l)(3) thereby allowing capital gains attributable to a trade or business to be included in business income in determining excess business loss limitation. This will have an impact when the temporary lift of excess business loss limitation expires for tax year beginning after December 31, 2020.

California Proposition 19: Property Tax Transfers, Exemptions, and Revenue for Wildfire Agencies and Counties Amendment

With the passing of Proposition 19, Californians will soon be losing a valuable estate planning tool effective February 16, 2021. Currently, when property ownership changes, the assessed value for property tax purposes is set as the fair market value as of the transfer date. Under current special exemption rules, there is a parent-to-child exclusion, which allows parents to transfer of a family home or family farm to their children without the property being subject to a property tax reassessment. This exclusion also applies to $1M of other real property.

Under Proposition 19, additional restrictions apply. The beneficiary is required to use the property as their primary home or farm within one year of the inheritance. A cap of $1M is also imposed on the increase in fair market value of the property that may avoid reassessment. The additional $1M of other real property will no longer be eligible for exclusion. Before the end of 2020, individuals may want to consider gifting real estate to their children to avoid property tax reassessment, but also to protect against a possible decrease in lifetime exemptions under the Biden administration.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a plan that will work best for you.

Sincerely,

KROST CPAs & Consultants

Contact us and we will tailor a plan that is specific to you and your needs

CONTACT US