November 19, 2020

Dear Clients and Friends,

I think we all can agree that this has been an unforgettable 2020 and have a shared anticipation of it ending. There is a good chance the phrase "hindsight is 2020" will take on an entirely new meaning. We are grateful to have spent the last several months navigating it with you.

Now, as year-end approaches, is a good time to think about planning moves that may help lower your tax bill for this year and possibly next. Year-end planning for 2020 takes place during the COVID-19 pandemic. New tax rules have been enacted to help mitigate the financial impact of the disease, some of which should be considered as part of this year's planning.

Here is a summary of some of the items that remain and new changes resulting from the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

For Individuals:

- Economic Impact Payment (stimulus checks) of $1,200 per individual plus $500 for each qualifying child do not need to be included in gross income on your tax return.
- Refundable Recovery Rebate Credit. If you did not receive an economic impact payment, or you did and it was less than $1,200, you may qualify for a rebate credit based upon 2020 tax information.
- The Tax Cuts and Jobs Act (2018-2015) is still in effect and retains lower income tax rates, a boosted standard deduction, severely limited itemized deductions, no personal exemptions, an increased child tax credit, and a watered-down alternative minimum tax (AMT).
- There is a one year $300 partial above-the-line (pre-taxable) charitable contribution deduction for individuals taking the standard deduction and expands the limit on charitable contributions for itemizers.
- Waiving the 10% early-withdrawal penalty on retirement account distributions for individuals facing virus-related challenges.

For Businesses:

- Paycheck Protection Program (PPP) loan forgiveness may be excluded from gross income by an eligible recipient by the CARES Act. Currently, expenses associated with the tax-free income are nondeductible.
- Excluding from an employee's taxable income certain employer payments of student loans on behalf of employees.
- Allowing businesses, a five-year carryback of net operating losses (NOLs) earned in 2018, 2019, or 2020. The NOL limit of 80% percent of taxable income is also suspended, so businesses may use NOLs they have to fully offset their taxable income in carryover years.

Below is a checklist of items that may benefit you if you act before year-end. We can better identify the actions you can take if we meet with you to tailor a particular plan. Meanwhile, please review the following list. Contact us at your earliest convenience so that we can advise you on which tax-saving moves to make.

Year-End Tax Planning Moves for Individuals

- **Economic Impact Payments**
  Your EIP payment was based upon 2019 (or 2018) tax return information, it is considered an advance refund of 2020 taxes, with some exceptions. An EIP is not taxable income to you and it will not reduce the amount of your refund or increase the amount owed on your 2020 tax return. If you received too large of an EIP (e.g., you had income below the phase-out threshold in 2019, but above the threshold in 2020), you will not be required to return the excess amount.

- **Recovery Rebate Credit**
  For 2020, if you did not receive an Economic Impact Payment you may be allowed a refundable income tax credit of $1,200 ($2,400 for joint filers) plus $500 for each qualifying child under age 17 ("recovery rebate credit"). The credit is reduced by 5% of the amount by which the taxpayer's 2020 adjusted gross income exceeds $75,000 ($150,000 for joint filers; $112,500 for heads of household), but not below zero.

- **$300 Above-the-Line Deduction for Cash Charitable Contributions**. You may claim a $300 above-the-line deduction for cash charitable contributions on top of your standard deduction; and the percentage limit on charitable contributions has been raised from 60% of modified adjusted gross income (MAGI) to 100%.

- **Surtax on Unearned Income for Higher Income Earners**
  The surtax is 3.8% of the lesser of:

  (1) Net Investment Income (NII) (eg – bonds, stocks, mutual funds, etc.)

  or

  (2) The excess of modified adjusted gross income (MAGI) over a threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case).

  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 NII, and other individuals will need to consider ways to minimize both NII and other types of MAGI.

- **An additional Medicare Tax for Higher-Income Earners**
  This applies to individuals for whom the sum of their wages received with respect to employment and their self-employment income is in excess of $250,000 for joint filers, $125,000 for married couples filing separately, and $200,000 in any other case.

Employers must withhold the additional Medicare tax from wages in excess of $200,000 regardless of filing status or other income.

Self-employed persons must take it into account in figuring estimated tax.

There could be situations where an employee may need to have more withheld toward the end of the year to cover the tax. For example, if you earn $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, you would owe the additional Medicare tax, but there would be no withholding by either employer for the additional Medicare tax since wages from each employer don't exceed $200,000.

- **Long-term Capital Gain**
  Long term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%, depending on your taxable income. The 0% rate generally applies to the excess of long-term capital gain over any short-term capital loss to the extent that it, when added to regular taxable income, is not more than the "maximum zero rate amount" (e.g. - $78,750 for a married couple).

- **Postpone income until 2021 and accelerate deductions into 2020**
  Deferring income and accelerating deduction may enable you to claim larger deductions, credits, and other tax breaks for 2020 that are phased out over varying levels of adjusted gross income (AGI). These include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income is also desirable for those of you who anticipate being in a lower tax bracket next year due to changed financial circumstances.

- **Roth IRA**
  If you believe a Roth IRA is better than a traditional IRA consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA if eligible to do so. Keep in mind, however, that such a conversion will increase your AGI for 2020 and possibly reduce tax breaks.

  As a reminder, a Roth IRA is one in which you fund with after-tax dollars. As a result, your money grows tax free and remains tax free when you withdraw in retirement.

- **Payroll Bonuses**
  If you have a bonus coming your way at the end of 2020, it may be of benefit to have your employer defer it until 2021. This change could lower, as well as defer your tax.

- **Itemized Deductions**
  Similar to last year, if you routinely claimed itemized deductions you were no longer able to do so on your Federal return. That is because the basic standard deduction was increased. For the 2020 tax year, it is as follows:
  - $24,800 for joint filers,
  - $12,400 for singles,

- $18,650 for heads of household
- $12,400 for married filing separately

Many itemized deductions remain either cut back or abolished.
For example:

(1) No more than $10,000 of state and local taxes may be deducted.

(2) Miscellaneous itemized deductions (eg – investment advisory fees) and unreimbursed employee expenses are no longer deductible.

(3) Personal casualty and theft losses are deductible only if they're attributable to a federally declared disaster and only to the extent the $100-per-casualty and 10%-of-AGI limits are met.

You can still itemize medical expenses to the extent they exceed 10% of your adjusted gross income, state and local taxes up to $10,000, your charitable contributions, and interest deductions on a restricted amount of qualifying residence debt. But, payments of those items will not save taxes if they do not cumulatively exceed the new, higher standard deduction.

For those filing Oregon returns, itemizing is still beneficial to many. Be sure to still hang on to required documentation to support your itemized deductions.

Here are some possibly strategies to help with these limitations that remain in effect.

- Some of you may be able to work around these deduction restrictions by applying a bunching strategy to pull or push discretionary medical expenses and charitable contributions into the year where they will do some tax good. For example, if you will be able to itemize deductions this year but not next will benefit by making two years' worth of charitable contributions this year, instead of spreading out donations over 2020 and 2021. The COVID-related increase for 2020 in the income-based charitable deduction limit for cash contributions from 60% to 100% of MAGI assists in this bunching strategy, especially for higher income individuals with the means and disposition to make large charitable contributions.

- Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your 2020 deductions even if you don't pay your credit card bill until after the end of the year.

- If you expect to owe state and local income taxes when you file your return next year and you will be itemizing in 2020, consider asking your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2020. But remember that state and local tax deductions are limited to $10,000 per year, so this strategy is not good to the extent it causes your 2020 state and local tax payments to exceed $10,000.

- Required minimum distributions (RMDs) that usually must be taken from an IRA or 401(k) plan (or other employer-sponsored retirement plan) have been waived for 2020. This includes RMDs that would have been required by April 1 if you hit age 70½ during 2019 (and for non-5% company owners over age 70½ who retired during 2019 after having deferred taking RMDs until April 1 following their year of retirement). So, if you don't have a financial need to take a distribution in 2020, you don't have to. Note that because of a recent law change, plan participants who turn 70½ in 2020 or later needn't take required distributions for any year before the year in which they reach age 72.

  If you are age 70½ or older by the end of 2020, have traditional IRAs, and especially if you are unable to itemize your deductions, consider making 2020 charitable donations via qualified charitable distributions from your IRAs. These distributions are made directly to charities from your IRAs, and the amount of the contribution is neither included in your gross income nor deductible on Schedule A, Form 1040. However, you are still entitled to claim the entire standard deduction. (Previously, those who reached reach age 70½ during a year weren't permitted to make contributions to a traditional IRA for that year or any later year. While that restriction no longer applies, the qualified charitable distribution amount must be reduced by contributions to an IRA that were deducted for any year in which the contributor was age 70½ or older, unless a previous qualified charitable distribution exclusion was reduced by that post-age 70½ contribution.)

- If you are younger than age 70½ at the end of 2020, you anticipate that you will not itemize your deductions in later years when you are 70½ or older, and you don't now have any traditional IRAs, establish and contribute as much as you can to one or more traditional IRAs in 2020. If these circumstances apply to you, except that you already have one or more traditional IRAs, make maximum contributions to one or more traditional IRAs in 2020. Then, in the year you reach age 70½, make your charitable donations by way of qualified charitable distributions from your IRA. Doing this will allow you, in effect, to convert nondeductible charitable contributions that you make in the year you turn 70½ and later years, into deductible-in-2020 IRA contributions and reductions of gross income from later year distributions from the IRAs.

- Take an eligible rollover distribution from a qualified retirement plan before the end of 2020 if you are facing a penalty for underpayment of estimated tax and having your employer increase your withholding is unavailable or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2020. You can then timely roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2020, but the withheld tax will be applied pro rata over the full 2020 tax year to reduce previous underpayments of estimated tax.

- Consider increasing the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year and anticipate similar medical costs next year.

- If you become eligible in December of 2020 to make health savings account (HSA) contributions, you can make a full year's worth of deductible HSA contributions for 2020.

- Make gifts sheltered by the annual gift tax exclusion before the end of the year if doing so may save gift and estate taxes. The exclusion applies to gifts of up to $15,000 made in 2020 to each of an unlimited number of individuals. You cannot carry over unused exclusions from one year to the next. Such transfers may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

- If you were in federally declared disaster area, and you suffered uninsured or unreimbursed disaster-related losses, keep in mind you can choose to claim them either on the return for the year the loss occurred (in this instance, the 2020 return normally filed next year), or on the return for the prior year (2019), generating a quicker refund.

- If you were in a federally declared disaster area, you may want to settle an insurance or damage claim in 2020 in order to maximize your casualty loss deduction this year.

Year-End Tax-Planning Moves for Businesses & Business Owners

- **Paycheck Protection Program (PPP) Loan Forgiveness**
  For Federal purposes, PPP loan forgiveness may be excluded from gross income under the Coronavirus Aid, Relief, and Economic Security (CARES) Act. However, in May, the IRS released Notice 20-32 stating that expenses associated with the tax-free income are nondeductible. While the IRS guidance does not appear to align with Congress' original intent, there is nothing in law yet to rectify it. Most borrowers are not likely to receive final forgiveness until 2021. This leaves some uncertainly about claiming deduction of expenses in 2020. As we receive additional guidance, we will be sure to update you.

- **Qualified Business Income (QBI)**
  Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income (QBI).

  For 2020, if taxable income exceeds $326,600 for a married couple filing jointly, $163,300 for singles, marrieds filing separately, and heads of household, the deduction may be limited based on whether you are engaged in a service-type trade or business (such as law, accounting, health, or consulting), the amount of W-2 wages paid by the trade or business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the trade or business. The limitations are phased in; for example, the phase-in applies to joint filers with taxable income between $326,600 and $426,600, and to all other filers with taxable income between $163,300 and $213,300.

You may be able to achieve significant savings with respect to this deduction, by deferring income or accelerating deductions so as to come under the dollar thresholds (or be subject to a smaller phaseout of the deduction) for 2020. Depending on their business model, taxpayers also may be able increase the new deduction by increasing W-2 wages before year-end. The rules are quite complex, so don't make a move in this area without consulting your tax adviser.

- **Cash Method of Accounting**

  More small businesses are able to use the cash (as opposed to accrual) method of accounting in than were allowed to do so in earlier years. To qualify as a small business a taxpayer must, among other things, satisfy a gross receipts test. For 2020, the gross-receipts test is satisfied if, during a three-year testing period, average annual gross receipts don't exceed $26 million (the dollar amount was $25 million for 2018, and for earlier years it was $1 million for most businesses). Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings till next year or by accelerating expenses, for example, paying bills early or by making certain prepayments.

- **Business Property Expensing**
  Businesses should consider making expenditures that qualify for the liberalized business property expensing option. For tax years beginning in 2020, the expensing limit is $1,040,000, and the investment ceiling limit is $2,590,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. It is also available for qualified improvement property (generally, any interior improvement to a building's interior, but not for enlargement of a building, elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems. The generous dollar ceilings mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. The fact that the expensing deduction may be claimed in full (if you are otherwise eligible to take it) regardless of how long the property is in service during the year can be a potent tool for year-end tax planning. Thus, property acquired and placed in service in the last days of 2020, rather than at the beginning of 2021, can result in a full expensing deduction for 2020.

- **Bonus Depreciation**
  Businesses also can claim a 100% bonus first year depreciation deduction for machinery and equipment bought used (with some exceptions) or new if purchased

and placed in service this year, and for qualified improvement property, described above as related to the expensing deduction. The 100% write-off is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the 100% bonus first-year write-off is available even if qualifying assets are in service for only a few days in 2020.

- **De Minimis Safe Harbor Election**
  Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies, assuming the costs don't have to be capitalized under the Code Sec. 263A uniform capitalization (UNICAP) rules. To qualify for the election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS; e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed $2,500. Where the UNICAP rules aren't an issue, consider purchasing such qualifying items before the end of 2020.

- **Net Operating Loss (NOL)**
  A corporation (other than a large corporation) that anticipates a small net operating loss (NOL) for 2020 (and substantial net income in 2021) may find it worthwhile to accelerate just enough of its 2021 income (or to defer just enough of its 2020 deductions) to create a small amount of net income for 2020. This will permit the corporation to base its 2021 estimated tax installments on the relatively small amount of income shown on its 2020 return, rather than having to pay estimated taxes based on 100% of its much larger 2021 taxable income.

- **Other Ideas to reduce 2019 taxable income**
  - To reduce 2020 taxable income, consider deferring a debt-cancellation event until 2021.
  - To reduce 2020 taxable income, consider disposing of a passive activity in 2020 if doing so will allow you to deduct suspended passive activity losses.

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

Cheers to a safe and peaceful rest of 2020.

Sincerely,

HMW CPAs & Associates, LLC