HARPER | PEARSON

Tax Newsletter

**Seven Timely Tax Tips for Individuals**
**Tax-saving opportunities in 2020**

As this turbulent year draws to a close, individuals may be able to reduce their federal income tax liability by making some timely moves. Taking the new Coronavirus Aid, Relief, and Economic Security (CARES) Act into account, following are seven tax-saving opportunities.

**1. Capital gains and losses:** Under current law, investors continue to offset capital gains and losses against each other. As a result, you might realize capital gains from sales of securities to absorb capital losses from earlier in the year or realize losses to offset capital gains plus up to $3,000 of ordinary income in 2020.

The maximum tax rate on long-term capital gain for assets held longer than a year remains at 15% (20% for high-income taxpayers). Also, certain low-income taxpayers (e.g., your children) may benefit from a 0% rate.

**2. Charitable donations:** If you itemize, you can boost your charitable deduction by giving gifts at year-end. (Special rule: A non-itemizer may claim a $300 deduction for monetary gifts made in 2020.) Under the CARES Act, you can deduct monetary gifts equal to 100% of your adjusted gross income (AGI) in 2020, up from of 60% of AGI.

Furthermore, charitable gifts made by credit card in December are still deductible on your 2020 return, even if you do not pay the credit charge until next year.

**3. Medical expenses:** An itemizer can deduct unreimbursed medical expenses above an annual threshold. Previously, the limit was 10% of AGI, but the Tax Cuts and Jobs Act (TCJA) passed in 2017 lowered it to 7.5% of AGI. Currently, this lower threshold expires after 2020.

This may be your best chance to qualify for a medical deduction for several years. When it makes sense, accelerate non-emergency expenses, such as medical exams or dental cleanings, from 2021 into 2020.

**4. Mortgage interest:** The TCJA modified the deduction for mortgage interest expenses by lowering the deduction threshold for acquisition debt from $1 million to $750,000. (Deductions for qualified prior debts are “grandfathered.”) In addition, for 2018 through 2025, the law suspended the deduction available for interest paid on the first $100,000 of home equity debt.

However, if you use a home equity loan to substantially improve a qualified residence, the debt is treated as an acquisition debt. Accordingly, if you take out a home equity loan in 2020 and use the proceeds for home improvements, the interest may be deductible within the usual limits.

**5. Required minimum distributions:** Normally, if you are age 72 or older (increased from age 70½ by legislation in 2020), you must take annual required minimum distributions (RMDs) from traditional IRAs and qualified plans like a 401(k). Otherwise, you are hit with a 50% tax penalty in addition to regular income tax liability. RMDs are based on life expectancy tables and the balance in your account on December 31 of the prior year.

However, the CARES Act suspends the RMD rules for 2020. Unless you need the money, keep it in your account and continue to benefit from tax-deferred compounding of funds.

**6. Installment sales:** When you sell real estate or other capital assets, you generally owe the full amount of capital gains tax in the year of the sale. However, you can benefit from installment sale reporting if you receive payments over two or more years. Essentially, you are taxed on a pro-rata basis on the amount received from the sale each year.

Not only do you defer part of the tax, you might lower your overall tax liability. Note: If it suits your purposes (e.g., you are experiencing a low tax year), you can "elect out of" installment sale reporting on your 2020 return.

**7. Estimated tax:** If you underpay income tax during the year through any combination of withholding and installment payments, you could be liable for an estimated tax penalty. When it is appropriate, make adjustments to qualify for one of two "safe harbor" exceptions.

Generally, you can avoid the penalty by paying at least 90% of your current tax liability or 100% of the prior year's tax liability (110% if your AGI for 2019 exceeded $150,000). A third safe-harbor rule provides flexibility for workers who earn most of their income during the holiday season.

**In summary:** These are just seven possibilities to consider. Develop a year-end tax plan for your personal situation.

**Seven Year-End Tax Moves for Businesses**
**Salvage key tax breaks for 2020**

This year has been a struggle for many small businesses. At least you may be able to reduce your tax liability through smart year-end tax planning, including several tax breaks included in the new Coronavirus Aid, Relief, and Economic Security (CARES) Act. Following are seven popular ideas to consider.

**1. Business assets:** If your business is ramping operations back up, you may need to acquire business assets. Thanks to the generous Section 179 deduction, as amended by the Tax Cuts and Jobs Act (TCJA) of 2017, your business can currently deduct the cost of up to $1 million of assets ($1.04 million in 2020) placed in service anytime during the year, subject to a phase-out threshold of $2.5 million ($2.59 million in 2020).

In addition, a business may be able to claim a first-year "bonus depreciation" deduction on any remaining cost. The bonus depreciation deduction, which was doubled from 50% to 100% by the TCJA, is scheduled to begin to phase out in 2023.

**2. Business interest:** Under the CARES Act, the annual deduction for the net interest of a business is limited to 50% of its income, up from 30%. But your small business may be eligible for an exception. The 50% net interest limit does not apply to a qualified small business with average gross receipts of $25 million or less ($26 million in 2020) for the three prior tax years. Your business might defer income to 2021 to qualify for the exception.

If the business interest deduction limit still applies to your business in 2020, the excess may be carried forward indefinitely until it is used up.

**3. Payroll tax deferral:** Is your business having trouble meeting its payroll tax obligations this year due to the pandemic? Under the CARES Act, an employer can defer payment of the 6.2% Social Security tax portion of payroll tax incurred for the period of March 27, 2020, through December 31, 2020. This can give you more cash flow flexibility.

Be aware that the deferral is temporary. An employer must pay half of the deferred amount by the end of 2021 and the other half by the end of 2022.

**4. Cash accounting:** Generally, small business owners prefer to use the simplified cash method of accounting. However, prior to the TCJA, a C corporation that was not a personal service corporation generally could not use the cash method if its average gross receipts for the three prior tax years exceeded $5 million. The TCJA increased this limit to $25 million ($26 million in 2020).

Consider a switch to the cash accounting method. Review all the implications with your professional tax advisor.

**5. Employee Retention Credit:** If your business keeps workers on the books in 2020, it may claim the Employee Retention Credit (ERC). The ERC, authorized by the CARES Act, is equal to 50% of the first $10,000 of qualified wages paid to employees after March 12, 2020 and before January 1, 2021.

An employer qualifies for the ERC if it suspended operation during any calendar quarter due to government orders relating to the COVID-19 pandemic or it experienced a significant decline in gross receipts (i.e., gross receipts equal to less than 50% of the gross receipts for the same calendar quarter in 2019).

**6. Start-up costs:** During these uncertain economic times, your may have pivoted into a new business undertaking. The tax code provides a special write-off of up to $5,000 of qualified start-up expenses. This includes costs normally deductible by an active business. However, you must actually get the business going before 2021 to qualify for this tax break.

Start-up costs above $5,000 must be amortized over 180 months. In addition, the deduction begins to phase out for expenses above $50,000.

**7. Work Opportunity Tax Credit:** An employer looking to increase its staff at year-end can claim the Work Opportunity Tax Credit (WOTC) for hiring disadvantaged workers from one of several "target" groups. Generally, the WOTC equals 40% of the first-year wages of up to $6,000 per employee, for a maximum of $2,400. For disabled veterans, the credit is available for the first $24,000 of wages, for a maximum of $9,600.

The WOTC has expired and been reinstated numerous times in the past. Currently, it is scheduled to go off the books again after 2020.

**Final words:** Contact your professional tax advisor before the end of the year to design and implement a year-end plan for your business.

**Saving for Retirement at Different Stages**
**Prepare for your future now**

When should you start saving for retirement? The best answer is "right now!" It is not too early to begin nor is it generally too late, although the manner and method of savings will likely vary, depending on your stage of life. Here is a snapshot of what things may look like at different stages.

**The early years:** For most people, your first starting salary does not provide much room for savings. But it is still important to develop good savings habits. For instance, if you work at a company that provides matching contributions to your 401(k) account, be sure to take advantage of the company match. Otherwise, you are leaving money on the table that may provide valuable income in retirement. Plus, you might be surprised to find out how much of an impact tax-deferred compounding can have over a long period of time.

**The middle years:** When you are in the middle of your working career, other obligations—such as buying a home, raising your children and building up funds to help pay for their college education—often take priority. Nevertheless, do not take your eye off the ball. To the extent possible, continue utilizing company retirement plans, IRAs and other savings vehicles. Note that a Roth IRA may provide tax-free payouts in retirement for qualified distributions (e.g., those received after age 59½). If you are rewarded with a raise, try to allocate at least part of it to your retirement savings plan.

**The late years:** This time of life may provide more opportunity for saving if the house is paid off and the kids are out of school. Also, you may benefit from seniority and career advancement, so your earnings could be higher than ever or near their peak. If you have not been as diligent through the years as you would have liked (see above), it is still possible to build a sizeable nest egg for retirement. The basic principles of using retirement plans and IRAs for tax-deferred growth remain in place.

Finally, do not think that saving for retirement ends once you have retired. At this time, you must make some serious decisions and assess both your expected income and expenses. For instance, one major decision is when to take Social Security benefits, so you are able to maximize the payouts. The longer you wait, the bigger the monthly benefit (until the maximum is reached at age 70). Similarly, you might decide to keep working past the age for receiving full Social Security retirement benefits (currently, up to age 67 for the youngest workers).

**In summary:** Due to longer life expectancies, you may need more retirement income than you initially imagined. There is no time like the present to start building your nest egg.

**Watch Out for 529 Tax Trap**

If your child has a Section 529 plan account for higher education expenses, be aware of potential tax trap. If you withdraw funds from the account and do not use them for **qualified expenses**, you must return the money within 60 days. Otherwise, the withdrawal is treated as a taxable distribution.

For instance, this might occur if you take a distribution in anticipation of paying room and board at a college, but your child ends up staying at home due to the pandemic. To add insult to injury, the IRS may impose a **10% tax penalty** on earnings.

When you return money to a 529 account, be sure it is characterized as a "recontribution" in the same exact amount as the distribution.

**Facts and Figures**
**Timely points of particular interest**

**Social Security Tax**—In both good times and bad, Social Security tax keeps going up. Latest news: The Social Security Administration (SSA) just announced that the "wage base" is increasing from $137,700 in 2020 to **$142,800 in 2021**, an increase of 3.7%. The Social Security tax rate remains at 6.2% while the 1.45% Medicare tax continues to apply to all wages. In addition, an extra 0.9% tax applies to single filers with income above $200,000; $250,000 for joint filers.