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Tax Newsletter

Ten Top Above-the-Line Deductions
Tax-savers on 2020 returns

Frequently, taxpayers pay close attention to itemized deductions, but forget about "above-the-line" deductions that could be even more valuable. These deductions reduce your adjusted gross income (AGI) for various tax purposes. Following is a list of ten key items available on 2020 returns.

1. Charitable donations: Usually, charitable deductions are limited to itemizers. However, under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, non-itemizers can claim a deduction of up to $300 for monetary contributions made in 2020. Note: The Consolidated Appropriations Act (CAA) passed late last year extends this tax break through 2021.

2. IRA contributions: For 2020, you can contribute up to $6,000 to a traditional IRA ($7,000 if you are age 50 or over). Depending on your modified adjusted gross income (MAGI) and whether you (or your spouse) actively participate in a qualified retirement plan, contributions may be wholly or partially deductible.

3. Tuition and fees: In lieu of claiming a higher education credit, you may deduct either $4,000 or $2,000 of the qualified tuition and fees you paid in 2020. This deduction is phased out based on MAGI. Note: The tuition-and-fees deduction, which was scheduled to expire after 2020, was repealed by the CAA.

4. Student loan interest: The tax law allows you to deduct up to $2,500 of student loan interest if you are legally obligated to repay the debt. However, this deduction is also phased out based on MAGI for 2020.

5. Alimony: The deduction for alimony has been repealed for divorce and separation agreements executed after 2018. Nevertheless, the alimony deduction is still available for most payments pursuant to pre-2019 agreements, even if they have subsequently been modified.

6. Health Savings Accounts: With a Health Savings Account (HSA), you can contribute to an account set-up to pay qualified medical expenses in conjunction with a high-deductible health insurance plan. The HSA contributions are deductible up to generous limits based on individual or family coverage.

7. Self-employment tax: If you are self-employed, you must pay self-employment tax at twice the combined Social Security and Medicare tax rates for employees. Thus, the rate is 15.3% instead of 7.65%. On the flip side, the tax law permits self-employed individuals to deduct half of their self-employment tax payments.

8. Self-employed retirement plans: Frequently, self-employed individuals will set-up and fund a qualified retirement plan—for example, a SEP, SIMPLE or solo 401(k)—for themselves. Contributions to the plans are deductible within generous limits on your 2020 tax return.

9. Self-employed health insurance: Self-employed individuals may deduct 100% of qualified health insurance premiums they pay for themselves, their spouse, and dependents. This tax break includes dental and long-term care insurance (LTCI) coverage (subject to certain limits) as well as traditional health insurance.

10. Early withdrawal penalty: If you withdraw money from a Certificate of Deposit (CD) or other time-deposit savings account before maturity, you generally have to pay an early withdrawal penalty. On the bright side, you can salvage a tax deduction for any penalties. Caution: This list is by no means all-inclusive. For instance, other tax deductions are available to groups ranging from educators to military reservists to those in the performing arts. Consult with your professional tax advisor regarding your situation.

Preserve Deductions for Charitable Donations
Observing key rules on 2020 returns

If you usually itemize deductions on your tax return, one of the biggest tax write-offs is probably the one for charitable donations. (Non-itemizers are entitled to a limited deduction for 2020 and 2021.) But deductions are not automatic if you do not have the proper records to back up your claims. Here are several important reminders for the current tax filing season.

Monetary contributions: Deductions for monetary gifts, regardless of the amount, may be disallowed if the donor does not maintain either a bank record—including a cancelled check, bank statement or credit card statement—or a written communication from the charity indicating the donor's name, contribution amount and date of the contribution.

Note: For 2020, a donor can deduct monetary contributions of up to 100% of adjusted gross income (AGI). The Coronavirus Aid, Relief, and Economic Security (CARES) Act increased this limit from 60% of AGI to 100% for 2020 and now the Consolidated Appropriations Act (CAA) extends the higher limit through 2021.

Contributions of $250 or more: The IRS also requires charitable donors to obtain a written acknowledgement from a charitable organization for gifts of $250 or more. The acknowledgement must be obtained by the time you file your tax return. It should include the amount of the check or cash donated, a detailed description of any property that was donated and the value of the benefit received if any goods or services were provided. But you don’t have to establish a value for intangible religious benefits.

Contributions made through payroll deductions may be substantiated by pay stubs or a Form W-2. Note: Substantiation is not required if the recipient organization files a return with the IRS providing the information to be included in an acknowledgement.

Quid Pro Quo Contributions: If you make a “quid pro quo” contribution (i.e., a contribution made partially or fully in exchange for goods or services) for an amount above $75, you must obtain a good faith estimate from the charity detailing the value of the benefit received.

For example, say you attended a fundraising dinner last February where the tickets cost $100 a piece and the dinner is valued at $40. The charity must provide a written statement limiting the deductible amount to $60 per ticket. However, a written statement from a charity is not required if you receive token goods, minimal services, or intangible religious benefits in exchange for your donation.

Other points: There are several other key points to keep in mind. For example, if you gave charitable gifts of property exceeding $500 in 2020, additional information must be attached to your tax return. If your donation for non-cash property exceeds $5,000, you must also provide an independent appraisal of the property’s value.

In summary: The recordkeeping rules for charitable donations are tough with a capital T. However, as long as you have the proper documentation, you may be able to claim top-dollar deductions on your 2020 return.

Take Aim at a Target Tax Credit
New law extends the WOTC

The Consolidated Appropriations Act (CAA) gives employers another shot at a valuable tax credit that was scheduled to go off the books at the end of 2020. It extends the Work Opportunity Tax Credit (WOTC), which had expired and been reinstated numerous times in the past, for a period of **five years**. In the past, extensions have only lasted for one or two years.

Therefore, an employer may benefit from the WOTC on the 2020 return it will be filing in 2021 as well as during the next five years—at least. Of course, Congress could change its mind again.

Background: The WOTC is available to employers that hire workers from certain disadvantaged "target groups" of individuals. Generally, the credit equals 40% of the first $6,000 of the employee's first-year wages, for a maximum credit of $2,400 per worker. However, for a veteran with a service-connected disability, the credit can be claimed on the first $24,000 of wages, for a maximum of $9,600 per worker.

There is no overall limit on the employer's credit amount. For instance, if your firm hires five qualified workers, the maximum total credit is $12,000, a dollar-for-dollar reduction of your tax bill.

The list of **target groups** includes the following.

- Qualified IV-A Temporary Assistance for Needy Families (TANF) recipients: These individuals are part of a family receiving assistance from a state plan approved under Part A of Title IV of the Social Security Act relating to TANF. The assistance must have been received for any nine-month period during the 18-month period before hire.

- Qualified veterans (including disabled veterans): The veteran must be unemployed for at least four weeks (whether or not consecutive), but less than six months in the one-year period ending on the hiring date.

- Ex-felons: A qualified ex-felon is a person hired within a year of being convicted of a felony or being released from prison.

- Designated Community Residents (DCRs): The worker must reside in an empowerment zone, enterprise community or renewal community and continue to live there after employment.

- Vocational rehabilitation referrals: This applies to someone with a physical or mental disability that has been referred to the employer during or after rehabilitative services under certain programs.

- Supplemental Nutrition Assistance Program (SNAP) recipients: This covers members of a family that received SNAP benefits for the previous six months or at least three of the previous five months.

- Supplemental Security Income (SSI) recipients: A person is a qualified SSI recipient for any month in which he or she received SSI benefits within 60 days of the hiring date.

- Long-term family assistance recipients: This applies to family members that receive assistance under a Title IV-A program.

- Qualified long-term unemployment recipients. A qualified long-term unemployment recipient is someone who has been unemployed for not less than 27 consecutive weeks at the time of hiring and received unemployment compensation during this time.

Finally, your business may qualify for a special **summertime credit** for hiring youths aged 16 or 17 residing in an empowerment zone or enterprise or renewal community. This credit is 40% for the first $3,000 of wages paid between May 1 and September 15, up to a maximum of $1,200 per qualified worker.

Caution: The WOTC requires a complex certification process. Obtain expert professional guidance to secure the maximum credit for your business.

Early Tax Filers Get the Worm

The IRS has announced that tax filing season will kick off on **February 12**, about two weeks later than usual. The delay is needed to accommodate the latest legislative changes.

Should you arrange to have your tax return filed early? Most likely it will not hurt, and it certainly may help, especially if you have plans to immediately use the money from a refund.

Note that the deadline for filing both individual and corporate tax returns for the 2020 tax year is **April 15**. You may obtain a filing extension to October 15, 2021—but not an extension for payment—if more time is needed.

Facts and Figures
Timely points of particular interest

Economic Stimulus Payments—If you did not receive your second economic stimulus payment yet, or you received less than the amount you were entitled to, you have some recourse. As with first round last year, you may obtain a credit for a missing payment on the 2020 return you are filing in 2021. The maximum credit, the same as the payment, is $600 per individual, plus $600 for each qualified child.

Stretch IRAs—In the past, you could stretch the benefits of an IRA by designating a much younger family member as the beneficiary, basing payments on his or her long life expectancy. However, under the Saving Every Community Up for Retirement Enhancement (SECURE) Act, an account inherited after 2019 must be emptied out in **ten years**. As a result, review your IRA beneficiary designations to determine if they still meet your main objectives.