

November 2020

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, we are 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 will highlight planning techniques stemming from these recent bills, as well as other year-end planning ideas.

As always, we are paying close attention to the ever-changing tax environment to discover tax planning opportunities, and this may be significant with the outcome of the election.

Year-End Planning Moves for Individuals

Here are some strategies that may lower your individual income tax bill for 2020:

- **Take Advantage of Generous Standard Deduction Allowances.** For 2020, the standard deduction amounts are \$12,400 for singles and those who use married filing separately status, \$24,800 for married filing jointly couples, and \$18,650 for heads of household. Additionally, individuals who don't itemize will be allowed an "above the line" deduction of up to \$300 in cash donations in 2020. Note that this extra write-off is per return, meaning couples who file jointly can deduct \$300, not \$600. 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.
- **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.
- **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 taxpayers, although it can reach a maximum of 20% at higher income levels (\$441,450 for taxable income single taxpayers and \$496,600 for married filing jointly). Additionally, the 3.8% Net Investment Income Tax (NIIT) also can apply at higher income levels. Be sure to manage your investment portfolio and consider harvesting capital losses, if appropriate.

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- **Take Advantage of 0% Tax Rate on Investment Income.** 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. However, 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.
- **Traditional IRAs.** 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.

The SECURE Act also increased the Required Minimum Distribution (RMD) age from 70½ to 72. The age increase will only apply to anyone born on or after July 1, 1949.

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 are scheduled to remain that way until 2026, subject to no changes under a new administration. 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.

- **529 Plans.** If the funds were used to pay tuition upon which a refund was received, there is a 60-day window to return the funds to the plan in order to avoid a penalty for excess distributions. Be sure to consider all expenses incurred for higher education before you return the funds.
- **Consider Intrafamily Loans or Gifting.** 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. Intrafamily loans, along with proper gift tax planning, may be a smart move. The annual gift amount for 2020 is \$15,000, but if you are in the position to make significant gifting, consider utilizing your lifetime exclusion of \$11,580,000 which will not be "clawed back" into an estate should the exclusion decrease under a new administration. This increased exclusion is scheduled to sunset December 31, 2025, under current law, reverting to \$5 million, adjusted for inflation.
- **Charitable Donations.** For 2020, the 60% of Adjusted Gross Income (AGI) limitation on charitable gifts of cash by individuals is suspended to allow no AGI limitation. Note that donations to donor-advised funds and private foundations retain their AGI limitations.
- **Health Insurance.** Beginning in 2020, be aware that California assesses a shared responsibility penalty for not having health insurance, and there is a premium credit for low- and middle-income taxpayers that may create a refund or a balance due. The federal health insurance individual mandate penalty was rescinded in 2019.

Year-End Planning Moves for Small Businesses

If you own a business, consider the following strategies to minimize your tax bill for 2020:

- **Net Operating Losses (NOLs).** The CARES Act temporarily relaxed many of the NOL limitations that were implemented under the Tax Cuts and Jobs Act (TCJA). If your small business expects a loss in 2020, know that you will be able to carry back 100% of that loss to the prior five tax years. If you had an NOL carried into 2020, you can claim a deduction equal to 100% of your 2020 taxable income.
- **Limit on California NOLs.** California may not allow that carryforward loss deduction if your 2020 net business income or Adjusted Gross Income (AGI) is over \$1 million. Instead, it will continue to carry forward. California's carryover period remains capped at 20 years. However, the carryover period is extended for any tax years in which taxpayers were precluded from claiming an NOL deduction due to any NOL suspension period. If you are close to the \$1 million limit, consider strategies to defer income to 2021 or increase 2020 expenses to enable use of the California NOL carryforward.
- **Establish a Tax-Favored Retirement Plan.** If your business doesn't already have a retirement plan, now might be the time to take the plunge. Current retirement plan rules allow for significant deductible contributions and credits. Contact us for more information on small business retirement plan alternatives, and be aware that if your business has employees, you may have to cover them too.
- **Take Advantage of Generous Depreciation Tax Breaks.** 100% first-year bonus depreciation is available for qualified new and used property that is acquired and placed in service in calendar-year 2020. That means your business might be able to write off the entire cost of some or all of your 2020 asset additions on this year's return. Thanks to the CARES Act, Qualified Improvement Property (QIP) is now eligible for bonus depreciation (or can be depreciated over 15 years rather than 39 years). So, consider making additional acquisitions, including QIP acquisitions, between now and year-end.
- **Cash In on Generous Section 179 Deduction Rules.** For qualifying property placed in service in tax years beginning in 2020, the maximum Section 179 deduction is \$1.04 million. The maximum 2020 spending cap on equipment is \$2.59 million before the Section 179 deduction available to your company begins to be reduced on a dollar-for-dollar basis.
- **Time Business Income and Deductions for Tax Savings.** If your business is conducted via a pass-through entity, the traditional strategy of deferring income into next year while accelerating deductible expenditures into this year makes sense if you expect to be in the same or lower tax bracket next year. On the other hand, if you expect to be in a higher tax bracket in 2021 (which could be the case due to COVID-19 and/or the results of the presidential election), take the opposite approach. Accelerate income into this year (if possible) and postpone deductible expenditures until 2021. But be aware that in 2021 the excess business loss is scheduled to apply (it was suspended through 2020). The excess business loss limits 2021 business losses to \$250,000 (\$500,000 if married filing jointly).
- **Paycheck Protection Program (PPP) Loan.** If your business took out a PPP loan, the federal and California provisions exclude any cancellation of debt income arising from loan forgiveness and specifically prohibit taxpayers from claiming any deductions or credits for expenses that are paid with forgiven PPP loan amounts. However, the IRS's position on the denial of the deduction for these expenses has been heavily criticized by key members of Congress. At this time, legislation is uncertain. We will keep you posted with any updates.

- ***Watch Out for Business Interest Expense Limit.*** The CARES Act temporarily relaxed the unfavorable TCJA limitation on a taxpayer's deduction for business interest expense. Under the TCJA, the deduction was limited to the sum of (1) business interest income, (2) 30% of adjusted taxable income, and (3) floor plan financing interest paid by certain vehicle dealers. For 2020, the 30% limit has been increased to 50% of adjusted taxable income. Barring additional legislation, the limit will go back to 30% in 2021. Fortunately, many businesses are exempt from the interest expense limit rules under the small business exception. Under this exception, a taxpayer is generally exempt from the limit if average annual gross receipts are \$26 million or less for the three-tax-year period ending with the preceding tax year. We can help you determine if an exemption applies.
- ***Increased Employee Headcount in Last Quarter of 2020.*** California just enacted a new hiring credit (SB 1447) that can give you \$1,000 per full-time equivalent employee increase, including rehires. However, you must apply to reserve the credit between December 1, 2020, and January 15, 2021.

This letter only covers some of the year-end tax planning moves that could potentially benefit you 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.

Sincerely,

JHS CPAs, LLP