2020 YEAR END TAX PLANNING FOR BUSINESSES AND INDIVIDUALS

Year-end tax planning is always challenging, but President-Elect Biden entering the White House along with the coronavirus pandemic have added a whole new layer of complexity to the equation. The balance of power in the Senate will be determined after the Georgia run-off elections on January 5, 2021. A Republican win could hamper Biden's tax plans. And to complicate matters even more we have several new significant pieces of tax legislation added in 2020 such as the CARES Act and the SECURE Act. With all these new considerations, we've shared some key ideas that individuals and businesses should consider before the New Year. Each taxpayer's situation is different and we are here to help evaluate your position so you can decide the best moves to take.

Individuals

With so many changes in the tax law, it is strongly recommended to have a tax plan in place. Even though most laws are the same for 2020 as they have been since 2018, your income and deductions may have changed which will make your tax results very different. The best way to start is by identifying any changes in your personal tax situation.

Timing Matters

Postponing income is typically desirable for those taxpayers who anticipate being in a lower tax bracket next year due to a change in their financial circumstances. In the past postponing income went hand in hand with accelerating deductions; however, accelerating deductions into 2020 may not be advisable due to the increased standard deduction. Instead, you may want to consider bunching your deductions (see bunching deductions discussion below). If you think you will be in a higher tax bracket in 2021 due to increased income or perhaps increased tax rates, then postponing income to 2021 may not be advisable. One of Biden's tax proposals was to increase the top rate from 37% to 39.6% for those with taxable incomes over $400,000.

Capital Gains and Losses

If you currently have large, realized capital gains, you should consider harvesting capital losses. You can realize losses on stock while substantially preserving your investment position. There are several ways this can be done. For example, the original holding can be sold, then buy back the same securities at least 31 days later. Minimizing the net capital gains will also help lower the 3.8% surtax on net investment income and the QBI deduction described below. If you are in a lower tax bracket, your long-term capital gains tax rate may be 0% so make sure to analyze your situation before you sell stocks at a loss. One of Biden's tax proposals is to increase capital gains rates for taxpayers making over $1 million so you may be paying a higher capital gains rate in the future.

Retirement Savings

Another way to lower your 2020 income is through retirement plans. Employees wishing to defer income to future years should take advantage of maximizing the amount contributed to their employer-sponsored retirement plan. For 401(k) plans, the maximum deferral for 2020 is $19,500 with an additional catch-up contribution of $6,500 for those over 50 years old as of December 31, 2020.

Qualified Business Income (QBI) Deduction

The rules for this new deduction are very complex. Adding to the complexity are taxable income limitations, wage limitations, and/or asset limitations. If you are in a specified trade or business (most service businesses), the taxable income limitations are critical and will likely make the difference of getting the QBI deduction or not. For these business owners, lowering your taxable income may

help you take full advantage of this new deduction. Lowering your taxable income can be done in various ways, including postponing income into 2021, increasing itemized deductions such as charitable contributions, and increasing retirement plan contributions. You can also elect to aggregate several businesses together potentially allowing you a larger 20% deduction. One of Biden's tax proposals is aimed at eliminating this QBI deduction for taxpayers with taxable income above $400,000.

Alimony

For divorces finalized on or after January 1, 2019, alimony is no longer deductible for the payer, or taxable to the payee. For divorces finalized on or before December 31, 2018, the old rules still apply.

Required Minimum Distributions

Due to Covid-19 RMDs are not required for 2020. This year, unless you need the cash or you need the tax withholding to avoid penalties, it is most likely better to leave the money in your retirement account for another year.

Education planning

Consider funding a 529 Plan for educational purposes. There is no current-year federal deduction for 529 plan contributions, but Ohio doubled the state tax deduction to $4,000 per beneficiary. In addition, 529 plan distributions can now be used for grades K-12 tuition (up to $10,000 per year) making them even more advantageous. If you have kids in college, you may be eligible for some tuition tax credits, even if they are working on their master's degree.

Verify Your Withholding

The IRS allows tax to be paid via several methods: payroll withholding, retirement withholding, and quarterly estimates. The IRS has two safe harbors to avoid underpayment penalties. The first is by paying 100% of your prior year's tax amount (110% if your prior year's adjusted gross income was over $150,000), and the second is paying 90% of your current year's tax amount. Because the payroll withholding tables have changed again, it is likely that your payroll withholding changed even if your income stayed that same. It is important to verify that you will meet one of these safe harbors to avoid penalties.

Maximize Above-the-Line Deductions

Health Savings Accounts (HSA) If you become eligible on or before December 2020 to make HSA contributions, you can make a full year's worth of deductible

HSA contributions for 2020. **Simplified Employee Pension (SEP) Contribution** If you have self-employed income, consider putting money into a SEP. This option is available to you even if you have already deferred the maximum amount into your employer-sponsored 401(k) plan. By contributing money to a SEP, you can typically avoid both current year federal and state taxes on the amount contributed. The maximum SEP contribution for 2020 is $57,000 and it can be funded as late as the due date of your federal tax return, including extensions. **Student Loan Interest** You may be eligible to take an above-the-line deduction for student loan interest paid up to a maximum of $2,500. **Self Employed Health Insurance** Partners and S-Corp shareholders owning more than 2% of the entity stock and self-employed individuals are permitted a deduction for their health insurance for themselves and their dependents. This is different than the Schedule A itemized deduction as it is above-the-line and not subject to the 7.5% AGI limitation. **NEW! Charitable Deduction for Non-Itemizers |** As part of the CARES Act a new charitable deduction of $300 is allowed for gifts to qualified charitable organizations in 2020, even if you are not itemizing your deductions.
Bunching Itemized Deductions
With the TCJA, many itemized deductions were either eliminated or severely limited. Bunching deductions may be a way to preserve deductions that would otherwise be wasted or lost due to the higher standard deduction. The deduction for state and local taxes and real estate taxes is limited to $10,000. If your mortgage is paid off and you don't have any high medical expenses, your only other itemized deduction would be charitable contributions. It may be worth your while to fund several years' worth of charitable contributions in one year to accelerate the deduction into that year, and then use the standard deduction in the subsequent years. One good way to do this is through a Donor-Advised Fund. This vehicle allows you to donate the money for one year and get a tax deduction while keeping the money in the fund until you distribute it to the various charities in subsequent years. **Medical Expense Deduction** For 2020, medical expenses are only deductible to the extent that they exceed 7.5% of your adjusted gross income (AGI), even for taxpayers over age 65. Medical expenses include health insurance premiums, Medicare premiums, amounts paid to doctors for medical care, prescriptions, etc. Unless you have a high amount of medical expenses, you most likely will not qualify for this deduction. **State and Local Tax Deduction** The

TCJA limited the total deduction for state and local income taxes and real estate taxes to $10,000. If you can itemize your deductions and have not reached the $10,000 limit, you may want to consider paying your real estate taxes in December as opposed to January 2021. If you have already met the $10,000 limitation, then there is no benefit to pre-paying these taxes. **Mortgage Interest Deduction** Interest you pay on your home is typically deductible to the extent that the average mortgage balance does not exceed $750,000. For mortgages placed in service prior to December 15, 2017, the limit is $1,000,000. Home equity loan interest is only deductible if the loan was used to buy, build or improve the home. The old rule allowing a deduction for the first $100,000 of home equity interest was eliminated. Also, don't overlook mortgage points paid upon purchase or refinancing as these may be deductible as well. **Charitable Contribution Deduction |** Consider making charitable contributions before year-end either in cash or non-cash such as highly appreciated stocks. If you donate highly appreciated stock, you can get a donation deduction for the fair market value of the stock and avoid capital gains tax. You can also make contributions at year-end using your credit card, even if the credit card is not paid until 2021. You can write a check to charity and mail it on December 31, 2020, and take a 2020 tax deduction even if the check doesn't clear your bank until January 2021. Non-cash donations valued at over $5,000 (except publicly-traded stock) require a written appraisal and a letter from the charity acknowledging the donation to be deductible. If you are over age 70 ½, you can make a charitable contribution up to $100,000 directly from your IRA to satisfy the required minimum distribution requirement. However, since no RMDs are required as mentioned above, this may not be the best tax strategy for 2020.

Estate Tax Planning

Gifting Take advantage of the annual gift tax exclusion. Make gifts sheltered by the annual gift tax exclusion before the end of the year to save gift and/or estate 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 might also 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. **Lifetime Exemption Planning |** Although the estate tax exemption is now $11,580,000 and is indexed for inflation,

there is a sunset clause after December 31, 2025. After this date, the estate tax exemption will revert to the pre-TCJA amount of roughly $5.5 million. The IRS has recently confirmed that it will not retroactively "clawback" gifts made during this temporary increase in the exclusion amount. However, Biden has proposed lowering the lifetime exemption to 2009 levels which were $3.5 million for estates, $1 million for gifting, and a 45% tax rate. **It is important to consider whether additional wealth transfer strategies should be implemented before any change in lifetime exemption amounts takes effect.**

Businesses

Businesses were greatly impacted by the TCJA. While the rules for 2020 are mostly the same as in 2019, it is imperative to consider the TCJA rules as part of your tax plan. One huge difference from 2019 is the passage of the CARES Act to help combat the economic fallout of the COVID-19 pandemic. Under TCJA Corporate tax rates were cut to a flat 21% (previously 35%), and the addition of the QBI deduction (20% business income deduction) for other taxpayers (noted above) is the most profound. Is your structure the most optimal under the new rules? The TCJA also expanded the small business gross receipts threshold to $26 million for 2020, which allows businesses to elect or remain eligible for various accounting methods, such as utilizing the cash method of accounting and treating inventory as non-incidental materials and supplies, or to avoid the uniform capitalization rules for resellers and manufacturers. Your business' taxable income could be much lower under the cash method of accounting or through various other method changes allowed for small businesses.

Timing and the Election
Normally the essence of good tax planning is to defer income and accelerate deductions. For 2020 that may not be appropriate. If Biden tax proposals are implemented, Corporate tax rates will go up from 21% to 28% in 2021 and there will be a phase-out of the QBI 20% deduction for pass-through entity owners with over $400,000 of taxable income. As mentioned earlier, the personal income tax rates may go back up to the maximum 39.6% rate enacted before the TCJA as well. Because the makeup of the Senate is still in limbo, the likelihood of these

proposals being enacted is unclear but, the potential implications need to be addressed in any tax planning.
CARES Act and PPP Loans
The CARES act made significant modifications to the TCJA rules. The most important of these are mentioned below but, there are some standalone provisions of note. Specifically, the NOL rules were expanded to allow 5-year carrybacks of NOLs generated from 2018-2020. Also 100% of NOLs generated before 2021 can offset taxable income as opposed to the 80% indicated under the TCJA rules.

The most profound item in the CARES act is the introduction of the Paycheck Protection Program loans from the SBA. These loans, as written, were supposed to be tax-free if complicated employee retention metrics were met. Unfortunately, the IRS has interpreted these loans to be effectively taxable by disallowing the deductions used to allow forgiveness. Currently, Congress has vowed to fix this misinterpretation in legislation but, they have been saying that since April. It is important to take the PPP forgiveness taxability into account in your tax planning.

Accelerated Depreciation
Take advantage of generous depreciation rules for assets such as computers, software, equipment, furniture, or certain property improvements purchased in 2020. **Section 179** Allows you to expense otherwise depreciable property if placed in service in 2020. You may elect to expense up to $1,040,000 of fixed asset costs (with a dollar-for-dollar phase-out for purchases greater than $2,590,000). If the cost of your §179 property placed in service during 2020 is $3,630,000 or more, you cannot take a §179 deduction. Additionally, the deduction is limited to business income. **Certain real estate improvements can be "Qualified Improvement property" (QIP) and be eligible for the §179 deductions.** **Bonus |** In addition to the §179 deductions, your business can also deduct first-year bonus depreciation equal to 100% of the cost of most fixed assets with a tax life of 20 years or less. Under the TCJA, the law has eliminated the requirement that eligible property must be new to qualify for bonus depreciation (if the property was not acquired from a related party). The 100% first-year bonus depreciation will remain in effect through 2022, in which the

applicable percentages will then be phased-out through 2026. The CARES act has clarified this further by confirming that QIP is a 15-year property eligible for 100% bonus depreciation. QIP includes most non-residential improvements to the interior of a building.

De Minimis Safe Harbor Election

The "de minimis safe harbor election" (also known as the book-tax conformity election) allows businesses to expense lower-cost assets, materials, and supplies assuming the costs don't have to be capitalized under the Code Section 263A uniform capitalization (UNICAP) rules. To qualify for the election, the unit of property cost cannot exceed $5,000 if the taxpayer has an applicable financial statement (e.g., a certified audited financial statement along with an independent CPA's report). If there's no applicable financial statement, the cost of a unit of property can't exceed $2,500. If the UNICAP rules aren't an issue, consider purchasing qualifying items before the end of 2020.

Tax Credits

There are numerous tax credits that can help lessen the tax burden for a business and its owner. The CARES Act added the Employee Retention Credit. **R&D Credit** Businesses that incur certain research and development (R&D) costs, such as wages, supplies and contract research, are eligible for this general business R&D tax credit. Eligible small businesses, $5 million or less in gross receipts, may also be able to claim the R&D credit against the employer's payroll tax (i.e. FICA) liability under TCJA rules. **Work Opportunity Tax Credit** Businesses that hire individuals from targeted groups (i.e. qualified veterans, long-term unemployment recipients, ex-felons) are eligible for a tax credit equal generally to 40% of up to $6,000 of the individual's first-year wages paid (per employee). **Employee Retention Credit |** A credit of up to 50% of wages paid by employers forced to close or partially close by government order or experiencing a 50% or greater quarterly reduction in sales. This credit is generally not available to PPP loan recipients.

Accounting Method

Review your methods of accounting for tax purposes to determine if you are using the optimal methodologies to maximize tax deductions. Deducting certain prepaid items, accruing for company payroll or bonuses (must be paid within 2.5 months of year-end) and reviewing all depreciation methods are common areas

to analyze. As mentioned earlier, a change to the cash method of accounting may now be available even for businesses with inventory. (see below)

Cash Method

Many businesses, especially service-based businesses utilize the cash method of accounting. These businesses should accelerate deductions into the current year by bunching expenses to the extent possible. Under TCJA even more businesses are eligible if they are considered 'small' (<$26 mill. gross receipts).

LIFO (Last-in-First-Out) Inventory

While not new, this method allows, in periods of rising inflation, for deductions for Cost of Goods Sold to be maximized, substantially reducing taxable income.

State and Local Taxes

We are seeing an increase in changes to state tax laws and regulations, as well as their approach to tax audits. Most states are becoming increasingly aggressive in trying to capture tax revenue from out-of-state businesses. The Wayfair decision will require increased sales tax filings for most out-of-state sellers of goods. Make sure your business is not caught off guard. Specific state and local tax areas to be mindful of include income tax, sales and use tax, payroll tax, and property tax.

Tax Basis

If you own an interest in a partnership or S corporation where losses may be limited due to basis limitations, consider whether you need to increase your basis in the entity to deduct a loss from it for this year.

Meals & Entertainment

The TCJA brought stricter limitations on deductions for both meal and entertainment expenditures, including no longer permitting a deduction of entertainment, amusement or recreation expenses. Business activities that include a meal and an entertainment component should be broken out and tracked as separate line items or should be purchased as separate transactions, as meal expenditures may still be 50% or 100% deductible. Businesses should consider categorizing meals and entertainment expenses into three categories: entertainment/nondeductible expenses, 100% deductible items, and 50% deductible items. Note that meals for employees are no longer 100% deductible in most cases now.

Interest Deductions

If your business is not 'small' (as defined above), deductions for interest under the TCJA rules can be suspended. The rules in this area are complex and wide-ranging but, proper planning can ensure that deductions are not missed unexpectedly. Generally, 30% of the "Adjusted Taxable Income" (ATI) limit applied. The CARES Act expanded this further to 50% of ATI and 2019 income can be used to calculate the limit for 2020.

Passive Losses

To reduce 2020 taxable income, consider disposing of a passive activity in 2020 if it will allow you to deduct suspended passive activity losses.

IC-DISC

If your business has foreign sales, consider utilizing an IC-DISC. A business that has export sales and utilizes an IC-DISC can create a tax benefit in which a portion of its income is taxed at the long-term capital gains rate.

Foreign Reporting

The foreign reporting requirements are very comprehensive and complex for businesses with activities outside of the U.S. Business owners and employees who have any financial interest in or signature authority over a foreign financial account exceeding $10,000 at any time in a calendar year must file a Report of Foreign Bank and Financial Accounts (FBAR). The Foreign Account Tax Compliance Act (FATCA) requires businesses to report and possibly withhold on payments made to foreign entities. Investments, assets, and legal entities outside the U.S. may subject the business to various reporting requirements.

These are some of the year-end steps that can be taken to minimize your tax burden. We can help tailor a customized plan that will work best for your tax planning goals. Additional ideas and information may be found in our 2020 Tax Planning Guide.

Please contact your BMF Advisor if you would like to review any of the items mentioned, schedule a tax planning strategy session or discuss potential implications of the various tax law changes.