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The Bottom Line

2020 Tax Planning Guide

2020 Year-End Tax Planning Tips for Businesses and Individuals

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 may drag on forever. Nevertheless, 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 pandemic, 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'll highlight planning techniques stemming from these recent bills, as well as other year-end planning ideas.

The election that occurred in early November may also have a large impact on future tax law changes. Barring unprecedented legal intervention, it appears that Joe Biden will be the next President of the United States. President-elect Biden will almost certainly attempt tax reform (with potentially higher tax rates). Biden's chances of successfully implementing his proposed tax changes likely rest on whether Democrats can win two January Senate runoffs in Georgia. It's also possible that we'll see additional COVID-19 legislation. As always, we're paying close attention to the ever-changing tax environment to discover planning opportunities.

We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you (or a family member) will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make.

Year-end Planning Moves for Businesses

Paycheck Protection Program (PPP) Loans. The PPP loan program was a lifeline for many businesses that struggled with (and continue to be impacted by) the COVID-19 pandemic. Backed by the SBA, this program provided cash flow assistance for small businesses in the form of loans. The loans can be forgiven as long as the money was spent on qualifying expenses (payroll, mortgage interest, utilities and rent). The most enticing part of this program (potential loan forgiveness) has also created the most uncertainty from an income tax reporting standpoint.

Assuming a business applies for and receives forgiveness of the PPP loan, the main question is "Will the IRS tax businesses on the money that they received"? In general, the cancellation of indebtedness results in taxable income. However, The CARES Act spells out that the forgiven loan amount won't be included in taxable income. This means that businesses won't directly pay taxes on the money that was received. This is consistent with what some members of Congress have said was the legislative intent for the program by providing money to keep businesses running and paying employees without creating a tax burden. There is, however, a major catch. Relating to forgiven loans, the IRS has stated that expenses that were paid with PPP loan proceeds can't be deducted because no cancellation of debt income will be recognized on the loan forgiveness. In effect, this disallowance of the deductions for expenses paid with the loan proceeds reverses the tax-free benefit of the exclusion of loan forgiveness from taxable income. If Congress does not intervene (which is still a possibility) the expenses will not be deductible.

Prior to Revenue Ruling 2020-27, there was also uncertainty regarding the timing of when expenses paid with forgiven loan proceeds would be non-deductible. The ruling, issued on November 18, 2020, clarified this issue to a certain extent by denying any taxpayer the ability to deduct qualifying expenses paid with PPP loan proceeds if the PPP loan is forgiven (or is expected to be forgiven). This applies even if forgiveness is not granted until 2021. Like most PPP guidance, this clarification also created more questions. There is still a great deal of uncertainty as to how this ruling applies to self-employed individuals. We are monitoring this situation closely for additional guidance.

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. The CARES Act also changed the rules for NOL's that occurred in tax years 2018 and 2019 to allow these losses to be carried back to the five prior tax years. Additionally, the CARES Act temporarily removed the 80% taxable income limitation relating to NOL's. If it is more beneficial, an election is still available to waive the NOL carry back period for the impacted years. If you incurred an NOL in 2018 or 2019, or expect an NOL in 2020, it is crucial that you take into consideration all of these factors in order to determine the course of action that will provide optimal tax savings. Keep in mind that under current tax law this is a temporary change. The restrictive rules relating to NOL's will be reinstated for 2021 and future years.

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. So, consider making additional acquisitions between now and year-end.

The CARES Act also made a technical correction to the TCJA that retroactively treats a wide variety of interior, non-load-bearing building improvements [known as Qualified Improvement Property (QIP)] as eligible for bonus deprecation (and hence a 100% write-off). Alternatively, if you elect out of bonus depreciation, you can depreciate QIP over 15 years (rather than the 39 years provided by the TCJA). Small businesses can take advantage of this provision by filing for a change in accounting method or by amending the applicable return. Contact us for more details.

Claim 100% Bonus Depreciation for Heavy SUVs, Pickups, or Vans. The 100% bonus depreciation provision can have an extremely beneficial impact on first-year depreciation deductions for new and used heavy vehicles used over 50% for business. That's because heavy SUVs, pickups, and vans are treated for tax purposes as transportation equipment that qualifies for 100% bonus depreciation. However, 100% bonus depreciation is only available when the SUV, pickup, or van has a manufacturer's Gross Vehicle Weight Rating (GVWR) above 6,000 pounds. The GVWR of a vehicle can be verified by looking at the manufacturer's label, which is usually found on the inside edge of the driver's side door where the door hinges meet the frame. If you are considering buying an eligible vehicle, doing so and placing it in service before the end of this tax year could deliver a significant write-off on this year's return.

Claim First-year Depreciation Deductions for Cars, Light Trucks, and Light Vans. For both new and used passenger vehicles (meaning cars and light trucks and vans) that are acquired and placed in service in 2020, the luxury auto depreciation limits are as follows:

- $18,100 for Year 1 if bonus depreciation is claimed.
- $16,100 for Year 2.
- $9,700 for Year 3.
- $5,760 for Year 4 and thereafter until the vehicle is fully depreciated.

Note that the $18,100 first-year luxury auto depreciation limit only applies to vehicles that cost $58,500 or more. Vehicles that cost less are depreciated over six tax years using percentages based on their cost.

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 Section 179 deduction phase-out threshold amount is $2.59 million.

Time Business Income and Deductions for Tax Savings. If you conduct your business using a pass-through entity (sole proprietorship, S corporation, LLC, or partnership), your share of the business's income and deductions is passed through to you and taxed at your personal rates. If you assume next year's individual federal income tax rate brackets will be roughly the same as this year's, 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. Deferring income and accelerating deductions will, at a minimum, postpone part of your tax bill from 2020 until 2021.

However, for some businesses 2020 was a comparatively bad year thanks to COVID-19. If you are in this situation, hopefully, you expect to be in a higher tax bracket in 2021. If so, take the opposite approach. Accelerate income into this year (if possible) and postpone deductible expenditures until 2021. That way, more income will be taxed at this year's lower rate instead of next year's higher rate.

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. For example, if you're self-employed and set up a SEP-IRA, you can contribute up to 20% of your self-employment earnings, with a maximum contribution of $57,000 for 2020. If you're employed by your own corporation, up to 25% of your salary can be contributed with a maximum contribution of $57,000.

Other small business retirement plan options include the 401(k) plan (which can be set up for just one person), the defined benefit pension plan, and the SIMPLE-IRA. Depending on your circumstances, these other types of plans may allow bigger deductible contributions.

The SECURE Act offers an additional incentive for establishing a retirement plan in 2020. The credit for employers that adopt a new eligible plan is increased from $500 to a maximum of $5,000, and a $500 credit has been added for new small employer plans with an auto-enrollment feature.

Contact us for more information on small business retirement plan alternatives, and please be aware that if your business has employees, you may have to cover them too.

Year-end Planning Moves for Individuals

Take Advantage of Generous Standard Deduction Allowances. For 2020, the standard deduction amounts are $12,400 for singles and those who use married filing separate status, $24,800 for married joint filing couples, and $18,650 for heads of household. If your total annual itemized 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.

The easiest deductible expense to accelerate is included in your house payment due on January 1. Accelerating that payment into this year will give you 13 months' worth of interest in 2020. Mortgage insurance premiums for eligible taxpayers also are deductible in 2020, but will once again be disallowed in 2021 barring extension.

Also, consider state and local income and property taxes that are due early next year. Prepaying those bills before year-end can decrease your 2020 federal income tax bill because your itemized deductions will be that much higher. However, the maximum amount you can deduct for state and local taxes is $10,000 ($5,000 if you use married filing separate status).

Warning: This can be a bad idea if you owe Alternative Minimum Tax (AMT) this year. That's because write-offs for state and local income and property taxes are completely disallowed under the AMT rules. Therefore, prepaying those expenses may do little or no good if you're an AMT victim. Contact us if you're unsure about your exposure to AMT.

Accelerating other expenditures could cause your itemized deductions to exceed your standard deduction in 2020. For example, consider making bigger charitable donations this year and smaller contributions next year to compensate. The CARES Act offers two unique opportunities for charitable minded taxpayers in 2020. Individuals who don't itemize will be allowed an "above the line" deduction of up to $300 in 2020. For those who do itemize, the CARES Act increases the limit on charitable deductions to 100% of the individual's Adjusted Gross Income (AGI) for cash contributions made to public charities in 2020. Note there is no requirement that the contributions be related to COVID-19.

Among the provisions of the Disaster Act set to expire in 2020 is the reduced threshold for the medical expense deduction. You might consider accelerating elective medical procedures, dental work, and vision care. For 2020, medical expenses are deductible to the extent they exceed 7.5% of AGI, but that threshold is set to increase to 10% in 2021.

Traditional IRA Contributions for All. 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. However, if you're over age 70½ and considering making a charitable donation directly from your IRA (known as a Qualified Charitable Distribution or QCD) in the future, making a deductible IRA contribution will affect your ability to exclude future QCDs from your income. Please contact us for further explanations of QCDs and how they can be an effective way to give to charity and reduce your taxable income.

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 folks, although it can reach a maximum of 20% at higher income levels. The 3.8% Net Investment Income Tax (NIIT) also can apply at higher income levels.

To the extent you have capital losses that were recognized earlier this year or capital loss carryovers from pre-2020 years, selling winners this year will not result in any tax hit. In particular, sheltering net short-term capital gains with capital losses is a great deal because net short-term gains would otherwise be taxed at higher ordinary income rates.

What if you have some loser investments that you would like to unload? Biting the bullet and taking the resulting capital losses this year would shelter capital gains, including high-taxed short-term gains, from other sales this year.

If selling a bunch of losers would cause your capital losses to exceed your capital gains, the result would be a net capital loss for the year. No problem! That net capital loss can be used to shelter up to $3,000 of 2020 ordinary income from salaries, bonuses, self-employment income, interest income, royalties, and whatever else ($1,500 if you use married filing separate status). Any excess net capital loss from this year is carried forward to next year and beyond.

In fact, having a capital loss carryover into next year and beyond could work to your advantage. The carryover can be used to shelter both short-term and long-term gains recognized next year and beyond. This can give you extra investing flexibility in those years because you won't have to hold appreciated securities for over a year to get a preferential tax rate. Since the top federal rates on net short-term capital gains recognized in 2021 are 35% and

37% (plus the 3.8% NIIT, if applicable), having a capital loss carryover into next year to shelter short-term gains could be a very good thing.

Key Point: If you still have a capital loss carryover after 2020, it could come in handy if the presidential election results in increased tax rates for 2021 and beyond.

Take Advantage of 0% Tax Rate on Investment Income. A potential silver lining to a down year may be the ability to harvest some long-term capital gains at very favorable rates. 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. Gains will be long-term, as long as your ownership period plus the gift recipient's ownership period (before the sale) equals at least a year and a day.

Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 0% rate bracket, they will be federal-income-tax-free.

Warning: 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. That would defeat the purpose. Please contact us if you have questions about the Kiddie Tax.

Convert Traditional IRAs into Roth Accounts. This may be the perfect time to make that Roth conversion you've been thinking about. The current tax rates are still relatively low, and while they are scheduled to remain that way until 2026, the election results hint at the possibility they could increase sooner. 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.

It's possible the overall value of your retirement account suffered as a result of the economic downturn. The depressed value in your IRA means a rollover distribution will contain more assets. Once in the Roth IRA, the recovery of value and ultimate withdrawal will be tax free.

Conclusion

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 situation.

Iowa Matters

Section 179 and Bonus Depreciation – Beginning in 2020, Iowa's section 179 deduction limit is the same as the Federal limit ($1.04 Million with a phase-out threshold of $2.59 Million). Iowa does not allow bonus depreciation as a deduction.

Refund Opportunities – Married couples, both with income, may find it beneficial to file married filing separately on a combined return. 2017-2019 tax returns may be amended to reflect a change in filing status.

Military Personnel – Active duty military pay received from the federal government, and military retirement and survivor benefits are exempt from Iowa income tax. The retirement and survivor benefits exemption is in addition to the pension exemption.

Pension Exemption – An exemption of up to $12,000 for married taxpayers and $6,000 for other filers is available to eligible Iowa taxpayers for certain kinds of retirement income.

Social Security – Iowa does not tax Social Security benefits for regular income tax. It is used in determining if a tax return must be filed.

First-time Homebuyer Savings Account (FTHSA) – Taxpayers who open up a FTHSA in an Iowa financial institution can deduct up to $2,137 in 2020 ($4,274 for married couples who open a joint account) to be used by a designated person for certain expenses related to purchasing a first home.

Itemized Deductions vs. Standard Deduction – Either method may be used regardless of which method was used on your federal return. The Iowa standard deduction for married filing jointly or head of household is $5,210; all other filers may each deduct $2,110.

Differences between federal and Iowa:

- Iowa income taxes are not deductible, except for school district surtax.
- Expenses of caring for a disabled relative are deductible.
- Adoption expenses are deductible, even if none are recognized on the federal return.
- Charitable mileage is 39 cents per mile.

Sales and use tax deduction – Taxpayers may choose to deduct state sales and use taxes as an itemized deduction if they deducted them on the federal return.

College Savings Iowa – Each taxpayer has until April 30, 2021, to contribute up to $3,439 per beneficiary for a 2020 deduction of qualified education contributions. For more information see www.collegesavingsiowa.com.

Health & Long-Term Care Insurance – 100 percent of qualified premiums paid with after tax dollars may be deducted even if you do not itemize deductions.

Volunteer Firefighter, Emergency Medical Services Personnel and Reserve Peace Officer Tax Credit – A maximum tax credit of $100 is allowed if the volunteer served an entire tax year.

Tuition and Textbook Credit – The credit is 25 percent of the first $1,000 paid for tuition, textbooks, and qualified extracurricular activities for each dependent attending an accredited Iowa K-12 school.

Iowa Tax Credits – You may access a complete listing of Iowa tax credits on the Iowa Department of Revenue website at tax.iowa.gov and search for Iowa tax credits.

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LattaHarris has been a trusted adviser to business, agriculture and individuals for over 30 years.

For those of you in the trade or business of farming . . .

The following should be reviewed as a part of your pre-year-end tax planning.

- Prepaid expenses, including critical rules that must be followed
- Deferred payment grain and livestock sales which also have very specific rules
- Wages paid to spouse or children in cash or commodities
- Gifts of commodities to qualified charities
- Depreciation options
- Managing the combined level of Social Security and Medicare taxes
- Targeting taxable income to take advantage of tax brackets and the use of farm income averaging in achieving a targeted taxable income goal.