This Year's Law Takes Pandemic's Impact Into Account

# 2020 Year-End Tax Planning Tips

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**It is common for many people to start thinking about their tax return in early March or even later. By that time, it's too late to take action to reduce your taxes for this calendar year. Therefore, before you get too caught up in planning for the holidays we recommend you look at your tax situation now, while you can still make some changes. In addition, both the election and coronavirus pandemic are adding additional uncertainty to our ability to plan for the future.**

Below we discuss some ways you can reduce your 2020 tax burden, as well as some coronavirus-related changes and deadlines.

### A Note on Taxes and the Election

When we find ourselves in a presidential election year, then a debate about tax rates is never far behind. At the time of this writing we do not know the outcome of the election. We don't know what changes may be coming to taxes in the future. But taking an objective view, with historically low tax rates and a rising national debt in the wake of the pandemic along with strains on both the Social Security and Medicare systems, we think it is a distinct possibility that taxes will increase in the coming years.

### Understanding Marginal Tax Rates

Let's start with your tax rate. At right you can see the tax schedule for 2020. For example, if you're married filing a joint return, and you estimate your taxable income after all deductions will be $75,000, your federal income tax will be $8,605 ($1,975 + 12% of $55,250 = $6,630). If your income goes over $80,250 (but is less than $171,050), any of this additional income will be taxed at 22%. So your goal would be to figure out how to keep it in the 12% bracket.

## Federal Income Tax Rates

| Single | Pay | Plus | Of the Amount Over |
|---|---|---|---|
| Up to $9,875 | $ 0 | 10% | $ 0 |
| 9,875 – 40,125 | 987.50 | 12 | 9,875 |
| 40,125 – 85,525 | 4,617.50 | 22 | 40,125 |
| 85,525 – 163,300 | 14,605.50 | 24 | 85,525 |
| 163,300 – 207,350 | 33,271.50 | 32 | 163,300 |
| 207,350 – 518,400 | 47,367.50 | 35 | 207,350 |
| 518,400 and up | 156,235 | 37 | 518,400 |
| **Married, Filing Jointly** | **Pay** | **Plus** | **Of the Amount Over** |
| Up to $19,750 | $ 0 | 10% | $ 0 |
| 19,750 – 80,250 | 1,975 | 12 | 19,750 |
| 80,250 – 171,050 | 9,235 | 22 | 80,250 |
| 171,050 – 326,600 | 29,211 | 24 | 171,050 |
| 326,600 – 414,700 | 66,543 | 32 | 326,600 |
| 414,700 – 622,050 | 94,735 | 35 | 414,700 |
| 622,050 and up | 167,307 | 37 | 622,050 |

## Capital Gains Tax Rate

| Single | Married, Filing Jointly | Capital Gains Tax Rate |
|---|---|---|
| Up to $40,000 | Up to $80,000 | 0% |
| 40,001 – 441,450 | 80,001 – 496,600 | 15 |
| Over 441,451 | Over 496,601 | 20 |

### Long- and Short-Term Capital Gains Tax Rates

Long-term capital gains on securities (those held for more than one year) are currently taxed at a lower rate between 0% and 20% (*see bottom chart at right*).

As you can see from this chart, taxpayers who make less than $40,000 (single) or $80,000 (married filing joint) won't be taxed on their long-term gains. Filers with income above those thresholds, but below $441,450 (single) or $496,601 (married filing joint) will pay 15% on long-term capital gains.

Gains from the sale of short-term holdings (those owned for one year or less) will be taxed as ordinary income — at a federal rate as high as 37% depending on your other sources of income. If your overall capital losses exceed your capital gains, you can deduct up to $3,000 of that excess loss each year from ordinary income and unused capital losses above that amount can be carried forward indefinitely to be used in future years.

### Medicare Surtax

In addition, there is a separate Medicare surtax of 3.8% on net investment income which is applied using a third set of income thresholds. Single taxpayers who make over $200,000 and married couples who make more

than $250,000 will be subject to this 3.8% surtax on net investment income, in addition to the capital gains tax noted above.

### Taking Tax Losses

If you have an investment showing a loss, you might consider selling the shares to realize the loss and reduce your taxes. If you believe the holding is still a good long-term investment, there are two ways to do this. First, you can sell the stock for a loss and repurchase it in 31 days. The Internal Revenue Service requires you to wait 30 days to do so to avoid erasing the tax loss, the so-called "wash-sale rule" (*see page 11*).

However, if you're concerned about the stock moving up during the 30-day waiting period, you could double up on your position now, wait 30 days and then sell the shares that cost the most, assuming they're still at a loss. Obviously, you need to make the purchase before the end of November in order to wait the 31 days and still be able to take the loss in the 2020 tax year. Trades completed on the last business day of the year count for 2020, even if they don't settle until 2021.

### Accelerating Deductions

Tax changes put in place in 2018 eliminated or limited many itemized deductions, in favor of an increased standard deduction of $12,000 for single filers and $24,000 for married couples. If you are over 65 you get a slightly higher deduction — $13,600 for single filers, $26,600 for married filing joint.

As a result, you must have significant deductions, including state and local taxes, medical expenses, charitable contributions and mortgage interest, in order to itemize.

One important note — in 2020, medical expenses are deductible once they surpass 7.5% of your adjusted gross income (AGI). Next year, the threshold for taking a deduction will be 10% of AGI. Therefore, if you are close to the standard deduction threshold and the 7.5% medical threshold this year, you should consider paying for any upcoming medical procedures before year-end. You will have a lower hurdle to clear in 2020 in order to deduct a portion of these expenses.

### Temporary Changes to Charitable Contribution Deductions

Whether you contribute cash, stock or other assets, it's important to adhere to the year-end deadlines for 2020 charitable contributions.

If you donate cash to a charitable organization, you can deduct your donation in 2020 as long as you mail your check by **Dec. 31**. This is true even if the organization doesn't cash your check until 2021. If you charge your donation to your credit card, your donation is treated as occurring on the date the charge occurs.

If you donate stock or other securities by mailing certificates, the date of mailing is the date of the donation. If you have the shares donated electronically, the date your brokerage statement shows the shares leaving the account is the date of the gift. The value of your donation for stocks equals the average of the highest and lowest selling prices for that date, not the value the charity acknowledges as your gift. If you donate shares you have held less than a year, you can only deduct the cost of the shares.

Donations of clothing, household items and other goods can be deducted based on the fair market value of the goods. We recommend you make an itemized list of donated items and take pictures of your donated items in case your tax return is audited. If you give a charity an item worth $5,000 or more you should get an outside appraisal prior to gifting it.

Typically, charitable cash contributions are limited to 60% of your adjusted gross income. This restriction has been temporarily removed for 2020. This year you can make deductible cash contributions of up to 100% of your adjusted gross income, wiping out your 2020 tax liability entirely. While that may not be feasible for most, this also means you have an increased ability to lower your tax bracket through charitable deductions. Note this temporary increase does not apply to gifts of securities.

In order to get tax benefits for charitable contributions you generally must itemize deductions, as noted above. There is one exception for 2020 only. The CARES Act passed earlier this year includes a provision that allows taxpayers to deduct up to $300 in charitable contributions (cash only) if the taxpayer does not itemize deductions. This provision applies only to the 2020 tax year.

### Contribute the Maximum You Can to a Qualified Retirement Plan

In 2020, you can contribute the lower of $19,500 or whatever you earned to your 401(k) or 403(b) plan. If you're age 50 or older, you can add another $6,500 to that number. Contributing the maximum lowers your taxable income and the money in the 401(k) compounds tax-deferred. These contributions must be made in the form of payroll deductions before year-end.

If your AGI is below $104,000 as a married person filing jointly or $65,000 as a single/head of household, you can also make a tax-deductible contribution of $6,000 (or $7,000 if you are age 50 or older) to an individual retirement account, even if you are covered by a 401(k) plan at work.

Contributions to an IRA for 2020 can be made any time before the normal filing deadline of April 15, 2021, or when you file your 2020 tax return on extension, whichever date comes first. This is one area where you can wait until after year-end to make a decision.

### Coronavirus-Related Distributions Expire at Year-End

The CARES Act also created the ability to take Coronavirus-Related

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Distributions (CRDs) and here again this provision expires on **Dec. 31, 2020.** These are distributions of up to $100,000 from IRAs and/or employer-sponsored plans by an individual affected by coronavirus. In order to quality to take the distribution you must meet one of several criteria, including:

- **You, your spouse or your dependent** were diagnosed with COVID-19.
- **You experienced adverse consequences** as a result of being quarantined, furloughed, laid off or having work hours reduced.
- **You experienced adverse financial consequences** due to being unable to work because of lack of child care.

If you meet one of these criteria, a distribution from your IRA or employer plan will carry some one-time tax benefits, including:

- **An exemption from the 10%** early withdrawal penalty if you are under age 59½;
- **No mandatory tax withholding** from the distribution;
- **A repayment window** of three years;
- **The income may be spread out** over three years if not repaid.

Some clarification is necessary on the last bullet points. If you take a CRD, you have three years from the date of the distribution to repay all or a portion back into the account. If you do so, any tax owed on the distribution is eligible to be refunded back to you.

If you do not repay the distribution, then the income from a CRD may be spread evenly over the 2020, 2021 and 2022 tax years, so that you are not on the hook for all the taxes this year. Having said that, if you will have lower income in 2020 due to reduced hours or a job loss, you may want to count the distribution as taxable income entirely in 2020. The key here is that if you think you will need the distribution, you must take it before **Dec. 31**.

### Consulting Your Tax Adviser

This time of year is an excellent time for you to check in with your accountant about your situation — the earlier the better! Your accountant can advise you as to whether you should be making estimated federal or state tax payments by year-end or in January based on the information you provide. By taking some steps now, you should be able to reduce your tax bill somewhat. In addition, it will be easier for you to put together your tax information in January. Good luck and enjoy the holidays!

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