4909 Windy Hill Drive • Raleigh, NC 27609
Office: 919-872-1260 Fax: 919-872-6182

Tax Strategies – Looking Forward to a Biden Administration

Stancil CPAs • Advisors | December 2, 2020

4909 Windy Hill Drive • Raleigh, NC 27609
Office: 919-872-1260 Fax: 919-872-6182

Presenters:

Ken Martin, CPA: Managing Partner
Scott Hensley, CPA, Esq.: Tax Partner
Charles Garrison, CPA: Tax Partner
Ryan Christians, CPA: Sr. Tax Manager

Stancil CPAs • Advisors | December 2, 2020

© 2020 Stancil PC All Rights Reserved

2020 Individual Tax Strategies

Agenda

I. What has Changed? – 2020 Tax Changes

II. What Might Change? – Biden Tax Proposals

III. Frequently asked Questions – Better Tax Planning.

IV. Should I _____? – Tax Strategies to Consider

2020 Individual Tax Changes

I. Changes Impacting IRAs

A. Start date for taking Required Minimum Distributions (RMDs) changed from age 70 ½ to age 72.
   - Effective for individuals who had not turned age 70 ½ by the end of 2019.

B. RMDs waived for 2020.
   - Taxpayers had until August 1 to roll 2020 distributions back into IRA. Also have 60 days from date of withdrawal to roll back into IRA.

2020 Individual Tax Changes

I. Changes Impacting IRAs

C. Relief for "Coronavirus-Related Distributions" to "Qualified Individuals" – someone who has been diagnosed with Covid, who has had a **spouse or child diagnosed with Covid**, or who has **lost employment** or had **pay reduced** due to Covid.

- Qualified Distributions up to $100,000.
- No **10% early-withdrawal penalties** (but still taxable).
- Can report income over **3 years**.
- Can roll distribution back into IRA within 3 years.

2020 Individual Tax Changes

I. Changes Impacting IRAs

D. **Age limit** for contributing to IRAs is removed.

- Must have earned income - at least as much as the amount contributed to the IRA.
  - Earnings can be by either spouse.
  - Deductible IRA contributions will impact ability to use Qualified Charitable Deductions (QCDs)
  - 2020 contribution limits are $6,000, or $7,000 if age 50 or older.

Planning Idea: Retiree with a part-time job should consider making a Roth IRA contribution of these earnings.

2020 Individual Tax Changes

I. Changes Impacting IRAs

E. Payout period for inherited IRAs is reduced to **10 years** for individuals dying after 2019.

- There is an exception to the 10-year rule for **surviving spouses and certain others**. They can continue to use expected remaining lifetime as the payout period.
- No RMDs are required during the 10-year period.
- Most **trust beneficiaries** will be subject to the10-year rule. Check with us for planning.

2020 Individual Tax Changes

I. Changes Impacting IRAs

F. Penalty-free IRA withdrawals for birth or adoption of a child beginning in 2020.

- Still subject to income tax.
- Maximum withdrawal is $5,000 for each parent.

2020 Individual Tax Changes

II. COVID-19 Tax Relief

A. Economic Impact Payment: Payments of $1,200 per individual and $500 per qualifying child were paid during the summer of 2020.

- Payment amounts were phased out if adjusted gross income was greater than **$150,000** for married taxpayers, **$112,500** for head of household taxpayers and **$75,000** for single taxpayers.
- Gross income used to determine any phase-out was from most recently filed tax return, whether 2018 or 2019.
- If taxpayers did not receive a refund but would qualify for one based on 2020 gross income, then a credit for the payment may be **claimed on the 2020 tax return**.

2020 Individual Tax Changes

II. COVID-19 Tax Relief

B. $300 charitable contribution deduction allowed for those who take the standard deduction. For 2020 only.

C. Charitable contribution limit for cash gifts raised for those who itemize.

- The limit was raised from 50% to 60% of adjusted gross income under the 2017 Tax Cuts and Jobs Act. This is good through 2025.
- For 2020 only, **taxpayers can elect to use 100% of adjusted gross income limit.** This does NOT apply to gifts to a Donor Advised Fund.

2020 Individual Tax Changes

II. COVID-19 Tax Relief

D. Net Operating Losses (NOLs) incurred in 2018, 2019 & 2020 may be **carried back for 5 years.**
   - Previously, NOLs could only be carried forward.

E. The $500,000 maximum cap for deduction of **business losses** is waived for 2018, 2019 & 2020.
   - Previously, the annual cap was $500,000 for married individuals and $250,000 for single.
   - Most commonly seen with regards to losses reported on a K-1.

Potential Tax Changes for Individuals Under President Biden

Proposed Biden Individual Tax Changes

I. <u>Change in Tax Rates for Individuals & Estates</u>

A. The top tax rate would change from 37% to 39.6%. This affects those with excess of $620,000 of taxable income.

B. The Qualified Gains rate and Long-Term Capital Gains rate would increase from 20% to 39.6% for people where taxable income is greater than $1 million.

- This particularly hurts those who sell their businesses.

Proposed Biden Individual Tax Changes

I. <u>Change in Tax Rates for Individuals & Estates</u>

C. Estate Tax Changes:

- The exemption would drop from $11.58 million to $3.5 million.
- The Tax Rate would increase from 40% to 45%.

Proposed Biden Individual Tax Changes

II. Other Changes on Taxable Income

A. If your wages or net self-employment income exceeds $400,000, the social security tax will kick in again.

- For employees, 6.2% of the wages above $400,000 will be withheld for social security tax
- For self-employed taxpayers, 12.4% of the net self-employment income above $400,000 will need to be paid.

Proposed Biden Individual Tax Changes

II. Other Changes on Taxable Income

B. Phase out of the 20% Qualified Business Income Deduction for taxpayers with taxable income in excess of $400,000.

- Currently, this only applies to taxpayers in the Specified Service business.
- This proposal would apply the phase out to all businesses.

Proposed Biden Individual Tax Changes

II. Changes to Itemized Deductions

A. Re-instate the 3% limit on itemized deductions. This provision reduces a taxpayer's total itemized deductions by 3% for every dollar that income exceeds $400,000.

B. The tax plan would cap the benefit of itemized deductions at a 28% tax rate once taxable income exceeds $400,000.

Proposed Biden Individual Tax Changes

III. Expansion of Individual Tax Credits

A. The Child Tax Credit would increase from $2,000 to $3,600 per child and be FULLY refundable. Currently only $1,000 is guaranteed to be refunded.

B. The Child and Dependent Care Credit would increase the costs eligible for the credit from $3,000 per child to $8,000 per child with a $16,000 family cap at a credit rate of 50%.

Proposed Biden Individual Tax Changes

III. Expansion of Individual Tax Credits

C. A new $5,000 credit would be created for caregivers of elderly relatives.

D. A First Time Homebuyer credit of $15,000.

E. A renter's credit to reduce rent and utilities to 30% of income.

Frequently Asked Tax Questions

Frequently Asked Tax Questions

1) What are the tax consequences of making a gift?
   a. No consequences to the recipient regardless of the size of the gift.
   b. No consequence to the giver for gifts of no more than **$15,000** to any one individual.
   c. Gift tax return required if gift is more than $15,000. Gift tax return applies remaining portion of lifetime exemption to the gift. For 2020, **this exemption is $11.58 million**. No gift tax is due until the lifetime exemption is fully used. Use of the lifetime exemption also uses the estate tax exemption.

Frequently Asked Tax Questions

1) What are the tax consequences of making a gift? (cont.)

Example: Hailey decides to make a $2,000,000 gift to her cousin Josie. Josie has no tax reporting. Hailey files a gift tax return and uses $2.0M of her lifetime exemption. Hailey pays no tax. Hailey has $9.58 million lifetime exemption remaining. Hailey's estate tax exemption is reduced from $11.58 million to $9.58 million.

Frequently Asked Tax Questions

2) What are the tax consequences of making a gift of appreciated property?
   a. There are the same tax consequences to the giver and recipient as in the previous question.
   b. The recipient receives the **same tax basis** in the property as that of the giver. There is **no step-up in basis**.

Frequently Asked Tax Questions

2) What are the tax consequences of making a gift of appreciated property? (cont.)

   Example: Harper decides to gift property to her cousin Cayden that is worth $400,000. Her cost basis is only $50,000. Two years later, Cayden sells the property for $450,000. Cayden will recognize capital gain of $400,000. Had instead Harper willed the property to Cayden at her death, Cayden's gain upon the sale would be only $50,000 due to the step up in basis for inherited property.

Frequently Asked Tax Questions

3) What tax reporting is required if I sell my primary residence?
   a. Gain up to a maximum of **$500,000** (married taxpayers) or **$250,000** is not taxable if the sale qualifies.
      - The house has been your primary residence for 2 of the 5 years before the date of sale.
      - You have not had other qualified sales within the last 2 years.

Frequently Asked Tax Questions

3) What tax reporting is required if I sell my primary residence? (cont.)
   b. Gain is the difference between the sales price and one "adjusted basis". **Adjusted basis includes the purchase price and the cost of improvements.** This means that it is important to maintain records of the purchase price of the home and all subsequent improvements.

Frequently Asked Tax Questions

3) What tax reporting is required if I sell my primary residence? (cont.)

Example: Leland and Ruth purchased their home in 1992 for $200,000. Over the years, they have made improvements to the home totaling $100,000. They now sell the home for $900,000. Total gain is $600,000, of which $100,000 will be taxable.

Frequently Asked Tax Questions

3) What tax reporting is required if I sell my primary residence? (cont.)

c. If the home was **not your primary residence during periods of your ownership**, a portion of the gain may be taxable. This commonly happens when the home is rented out for a period, or when it might have been a second home.

d. A strategy to consider is to **make one's vacation home your primary residence** for at least two years before selling it. A portion of the gain will be non-taxable, subject to the limitation mentioned above.

Frequently Asked Tax Questions

4) Can I contribute to an IRA?

a. One must have **earned income** (W-2 wages of self-employment income) at least equal to the amount of the IRA contribution.

b. Annual IRA contribution limit for 2020 is $6,000, or $7,000 for taxpayers 50 years of age and older. This is the aggregate limit for both Traditional and Roth IRA's.

<u>Example</u>: Ava is age 50 and has W-2 income of $10,000. She could choose to contribute $4,000 to a Traditional IRA and $3,000 to a Roth IRA.

Frequently Asked Tax Questions

4) Can I contribute to an IRA?

c. Contributions may be limited if one's income is above a certain threshold.

i. For **Traditional IRAs:**

- No income limit if neither you nor your spouse participate in a retirement plan at work.
- If you are covered by a retirement plan at work, your joint modified gross income must be less than **$104,000 ($65,000** If single) to make a fully deductible contribution.
- If your spouse is covered by a retirement plan at work, your joint income must be less than **$196,000** to make a fully deductible contribution.

Frequently Asked Tax Questions

4) Can I contribute to an IRA? (cont.)

c. Contributions may be limited if one's income is above a certain threshold.

ii. For **Roth IRAs:**

- If your joint modified gross income is less than **$196,000 ($124,000** if single), you can make a full Roth IRA contribution. If your income is between $196,000 - $206,000 ($124,000 - $139,000 if single), you can make a partial Roth IRA contribution.

Frequently Asked Tax Questions

4) Can I contribute to an IRA? (cont.)

c. Contributions may be limited if one's income is above a certain threshold.

iii. For nondeductible IRAs:

- No income limit.
- Form 8606 must be filed annually to track your "IRA basis", which allows a portion of future IRA distributions to be non-taxable.
- Many use this strategy to make **"back-door" Roth contributions** if income is too high for a regular Roth contributions. This strategy can be tricky, especially if you have existing Traditional IRA balances. Please consult Stancil for further guidance.

Frequently Asked Tax Questions

5) My child just graduated from college. Do I claim them as a dependent?

   a. If one of the following requirements is met, you can claim him as a dependent. If not, the child claims himself.

      i. The child's income is less than **$4,300**, OR

      ii. All of the following are true:

         - The child is under age 24 at the end of the year.
         - The child was a full-time student for at least 5 months during the year (typically Spring semester).
         - In considering the year as a whole, the child provided less than half of his support.

Frequently Asked Tax Questions

5) My child just graduated from college. Do I claim them as a dependent? (cont.)

   b. If you are claiming your child as a dependent, make sure the child does not claim herself on her personal return. She should check the box **"Someone can claim you as a dependent"** when she completes her return.

Frequently Asked Tax Questions

6) Why am I receiving this IRS notice?

   a. There can be many causes, but the two most common are an incorrect amount is claimed for **estimated tax payments** made for the year or the tax return **fails to report the income from a 1099** that was filed with the IRS.

Frequently Asked Tax Questions

6) Why am I receiving this IRS notice?

   b. Error in estimated payments. Stancil does not have access to confirm the amount of estimated tax payments you have made. We depend on your representation to us. The most common source of errors are:

   - Payments made on **January 15** are the Q4 payments of the previous year. For 2020 tax returns, <u>you should NOT provide the payment made on January 15, 2020, but rather January 15, 2021</u>.
   - Payments made on **April 15** can be either the Q1 payment for the current year, or the extension payment for the previous year. <u>Do not include the extension payment for the previous year</u>. Credit for that payment is considered when the overpayment from the 2019 return is applied to 2020. Stancil <u>does</u> have a record of this amount.

Frequently Asked Tax Questions

6) Why am I receiving this IRS notice?
   a. **Under reported error for 1099:** The IRS matches all 1099's sent to it by your payer with income reported on your 1099 and will send you a notice of any amount not reported.
   b. This is NOT an assessment, but only an inquiry. **Please do NOT pay the proposed amount without consulting Stancil**. We often find that these notices are in error.
   c. These notices are usually not received until a year or more after your return is filed.

Frequently Asked Tax Questions

7) I received an Advance Premium Credit during the year to reduce the cost of insurance I purchased from the marketplace. Does that have to be reported on my tax return?
   a. **YES!** If you receive a **Form1095-A** reporting Premium Tax Credits, you must use the information from that form to complete **Form 8962.**
   b. Failure to include the form could result in suspension of your premium credit and a delay in the processing of your tax refund.

Frequently Asked Tax Questions

8) Should I take the standard deduction?

a. Every taxpayer deducts the **higher of itemized deductions or the standard deduction**.

b. For 2020, the following are the standard deduction amounts:

- Married taxpayers under age 65: **$24,800**.
- Married taxpayers, one spouse age 65 or older: **$26,100**.
- Married taxpayers, both spouses age 65 or older: **$27,400**.

Frequently Asked Tax Questions

8) Should I take the standard deduction? (cont.)

b. For 2020, the following are the standard deduction amounts:

- Head of Household taxpayer under age 65: **$18,650**.
- Head of Household taxpayer age 65 or older: **$20,300.**
- Single taxpayer under age 65: **$12,400**.
- Single taxpayer age 65 or older: **$14,050**.

Frequently Asked Tax Questions

8) Should I take the standard deduction? (cont.)

c. In determining whether itemized deductions are higher than the standard deduction, consider the following key factors:

- Medical deductions are deductible only to the extent they exceed **7.5% of adjusted gross income**.
- The tax deduction (for property taxes and state income taxes) is capped at $10,000.
  1) This means for most married taxpayers, the combination of **mortgage interest + charitable deductions** must exceed **$14,800 ($17,100** if both spouses are at least age 65).

Frequently Asked Tax Questions

8) Should I take the standard deduction? (cont.)

d. Bunching strategy for maximizing deductions. For some taxpayers, it makes sense to "bunch" strategies in one year so that **one can itemize one year and take the standard deduction in the next year**.

- Bunching medical deductions allows one to exceed the 7.5% of gross income threshold. **Medical deductions are deductible in the year paid**.
- Bunching charitable deductions in one year means that you have enough charity to itemize in one year and in the next year with fewer deductions, you take the standard deduction.

Frequently Asked Tax Questions

8) Should I take the standard deduction? (cont.)

Example: Harper and Knox's itemized deductions are as follows:

- Property tax of $5,000
- State income tax of $9.000
- Mortgage interest of $6,000
- Charitable contributions of $8,000
- Total = $24,000.

Harper and Knox will take the standard deduction of $24,800.

Frequently Asked Tax Questions

8) Should I take the standard deduction? (cont.)

Example: Harper and Knox's itemized deductions are as follows:

- Tax Deductions of $10,000 (maximum)
- Mortgage interest of $6,000
- Charitable contributions of $8,000
- Total = $24,000.

Harper and Knox will take the standard deduction of $24,800.

Frequently Asked Tax Questions

8) Should I take the standard deduction?(cont.)

Example: Suppose instead that Harper and Knox made $14,000 of charitable contributions in Year 1 and $2,000 in Year 2.

- In Year 1, they would itemize total deductions of $30,000.
- In Year 2, they would take the standard deduction of $24,800 (or higher as adjusted by inflation).

Frequently Asked Tax Questions

9) What is my tax benefit for making an additional charitable contribution of $10,000?

a. This answer can have many contingent answers. The only way to know for sure is to **ask Stancil to prepare a tax projection for you**.

b. In most cases, the answer is that the tax benefit is related to your "**marginal" tax bracket**. This is a critical factor that Stancil established during a tax planning engagement. It is the amount of tax you pay for the next dollar of income or the amount of tax savings from the next dollar of deduction.

c. For example, if one is in the 22% federal tax bracket and the 5.25% NC tax bracket, then a charitable contribution of $10,000 reduces tax by $2,725.

Frequently Asked Tax Questions

10) What are the critical income thresholds where I should be concerned about moving into a higher tax bracket?

a. This answer can have many contingent answers. The only way to know for sure is to **ask Stancil to prepare a tax projection for you**.

Frequently Asked Tax Questions

10) What are the critical income thresholds where I should be concerned about moving into a higher tax bracket? (cont.)

b. For **married taxpayers** under age 65 taking the standard deduction, the following **gross income thresholds** are particularly important:
   - One moves from 12% to 22% bracket at **gross income of $105,050.**
   - One moves from the 24% bracket to 32% bracket at **gross income of $351,400**

Frequently Asked Tax Questions

10) What are the critical income thresholds where I should be concerned about moving into a higher tax bracket? (cont.)

   c. For **head of household** taxpayers under age 65 taking the standard deduction, the following **gross income thresholds** are particularly important:
      - One moves from 12% to 22% bracket at **gross income of $72,350.**
      - One moves from the 24% bracket to 32% bracket at **gross income of $181,950.**

Frequently Asked Tax Questions

10) What are the critical income thresholds where I should be concerned about moving into a higher tax bracket? (cont.)

   d. For **single taxpayers** under age 65 taking the standard deduction, the following **gross income thresholds** are particularly important:
      - One moves from 12% to 22% bracket at **gross income of $52,525.**
      - One moves from the 24% bracket to 32% bracket at **gross income of $175,700.**

Frequently Asked Tax Questions

11) Help me understand how much taxable income I will have on my investment account?

a. **Dividends and interest** paid from your portfolio are taxable income regardless of whether you withdraw the income or whether it is **re-invested** back into your portfolio.

b. **Capital gain distributions** are capital gains your mutual fund generates by selling investments inside the fund. These are reported to you as income annually on your Form 1099. You have no control over when or how much of these capital gains are recognized each year.

Frequently Asked Tax Questions

11) Help me understand how much taxable income I will have on my investment account? (cont.)

c. Capital gains or losses are reported **whenever you sell a specific investment**. The gain or loss is equal to the change in the FMV of the investment during your entire period of ownership. If **you move funds from one investment to another**, that is a sale of the first investment and gain or loss is reported.

d. **Unrealized capital gains or losses** are not reported. This is the normal increase and decrease in value of your investments.

- Thus, an increase in value of your investments does NOT generate reportable gain if you do not sell the investment.
- Similarly, a decrease in value of your investments does NOT generate reportable loss if you do not sell the investment.

Tax Strategies for 2020

I. Retirement Plan Strategies

II. Capital Gain Strategies

III. Charitable Contribution Strategies

IV. "Marginal Tax-Rate" Strategies

Tax Strategies for 2020

I. Retirement Plan Strategies

   A. Traditional vs. Roth

      1. Key Factor: Which is higher **– current tax rate or future tax rate** when you anticipate IRA withdrawals?

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

Example 1			
		Traditional	Roth
Funds available for Retirement Account		10,000	10,000
Current Marginal Tax Rate	17.5%		
Tax savings from Contribution		2,121	
Total Contribution to IRA		12,121	10,000
Growth	100%	12,121	10,000
Balance Prior to Distribution		24,242	20,000
Future Marginal Tax Rate	17.5%		
Tax Paid - Distribution		(4,242)	-
After-Tax Funds		20,000	20,000
Advantage (Disadvantage) Roth Conversion		$0	

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

1. Key Trade-off: Understand **current tax savings vs. future tax savings**. Key questions to consider:
   - What does a traditional IRA/401K contribution save you in taxes now?
   - What will a traditional IRA/401K distribution cost you in the future?
   - How does the amount saved in a traditional IRA/401K compare to the amount saved in a Roth IRA/401K?

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

Examples:

- If one is currently in the **24% federal tax bracket** (and 5.25% NC), then a $26,000 401K deferral reduces taxes by $7,605. Your net cost of making the 401K deferral is $18,395.
- If one retires in the **15% federal tax bracket** (NC still 5.25%), then a $100,000 Traditional IRA will net $79,750 after tax.
- For the above taxpayer, you could say a $100,000 Traditional IRA and a $79,750 Roth IRA have the same after-tax value

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

2. Other considerations for Traditional IRA / 401k.

- **Advantage**: Tax savings could be enhanced beyond current tax rate by reducing your income below the threshold where any of a number of **"phase-outs" take effect**. This could be the phase-out for the Qualified Business Income (QBI) deduction, the Child credit, Education credits, or active rental loss deduction, among others.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

2. Other considerations for Traditional IRA / 401k.

- **Disadvantage**: If you are self-employed and eligible for a full QBI deduction, then a traditional retirement plan **reduces your QBI deduction**. This means if your federal tax bracket is 24%, then a traditional retirement plan only reduces federal tax by 19.2% of the amount contributed.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

2. Other considerations for Traditional IRA / 401k.

Example: Ava is a self-employed, single taxpayer in a "Specified Service Trade or Business" (SSTB). She also has $25,000 of other income. Ava makes a $30,000 contribution into an SEP. If Ava's business income before the contribution is $210,000, then Ava's federal tax is reduced by **$15,214, or 50.7%,** of the SEP contribution. If Ava's business income is $160,000, then her federal tax is reduced by only **$5,852 or 19.5%** of the SEP contribution.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

3. Advantages of a Roth Retirement Account.

- Tax-free income!
- **Principal is always accessible without tax or penalty**.
- No Required Minimum Distributions at age 72
- Tax-free income to heirs.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

B. Mega Retirement Plan Deductions

1. Cash Balance Plans: Small businesses can establish these plans that may allow $200,000 or more in annual retirement account contributions.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

C. Those age 72 and older can now make IRA contributions.

1. Must have **earned income,** at least as much as IRA contribution. W-2 wages or self employment income.
2. Income can be earned by **either spouse**.
3. If tax bracket is low, recommend a **Roth IRA** contribution.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

D. Consideration of Future Changes

1. **Deduction vs. Credit:** Currently, because a 401K contribution is a deduction, **the tax savings depends on your tax bracket.**

   <u>Example</u>: Hailey and Leland each contribute $10,000 to their 401K. Leland is the 12% federal tax bracket **reduces his federal tax by $1,200**. Hailey is in the 37% federal tax bracket **reduces her federal tax by $3,700**

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

D. Consideration of Future Changes

1. **Deduction vs. Credit:** Mr. Biden's tax plan includes a proposal to change the deduction to a **26% credit**.

Example: Using the last example, **both taxpayers would receive a federal tax reduction of $2,600** regardless of their individual tax brackets.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

E. Roth Conversion: Is 2020 the right year to complete a Roth Conversion?

1. All or any portion of one's traditional IRA (or 401k, if the plan allows) can be converted to a Roth account.
   - The amount converted **is taxable income in the year of conversion**.
   - Future growth in the value of the account is **never taxed** under the Roth principles.
   - Roth Conversion must be **completed by December 31**

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

E. Roth Conversion: Is 2020 the right year to complete a Roth Conversion?

2. Roth conversions should be considered in years when **one's tax bracket is lower**.
   - **Almost always a good idea** in an amount that gets one to the top of the **12% tax bracket**.
   - **Worth considering** to the extent that one is in the **22% or 24% bracket.**
   - Need to have funds available to pay the tax.
   - Can impact other things (e.g. Medicare premiums).
   - **Stancil can perform an analysis to help you make the decision**.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

E. Roth Conversion: Is 2020 the right year to complete a Roth Conversion?

3. Roth Conversion is in lieu of **Required Minimum Distribution (RMD).**
   - Cares Act waived requirement for RMD in 2020.
   - In Lieu of the RMD, many are considering a Roth Conversion

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

E. Roth Conversion: Is 2020 the right year to complete a Roth Conversion?

3. Roth Conversion is in lieu of RMD.

Example: Married Taxpayers. One spouse earns $120,000 W-2 wages. The other spouse is self-employed and usually earns $280,000 annually. They have investment income of $3,000 a year and normally have a RMD of $25,000. This year, due to COVID, the self-employed taxpayer's net profit is down to $150,000 but is expected to rebound in 2021.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

E. Roth Conversion: Is 2020 the right year to complete a Roth Conversion?

3. Roth Conversion is in lieu of RMD.

Example continued: The $25,000 Roth conversion would cost an increase in tax of about $7,300 this year, or 29.3%. The same $25,000 Roth Conversion taken after the business profit rebounds in 2021 would cost an increase in tax of about $9,300 or about 37.25%

Tax Strategies for 2020

II. Capital Gain Strategies

A. Timing Strategies

1. Accelerate gain if in **0% federal tax bracket** ($80,000 for married taxpayers, $40,000 if single).

- For gains, there is no "wash sale" rule to prevent you from immediately repurchasing the investment.

  Example: Fred & Wilma are married taxpayers age 65 with total income of $60,000 and taxable income of $32,600. They realize **$50,000 capital gain**. The capital gain **increases their federal tax by only $390**. This is because $47,400 of the capital gain is in the 0% capital gain bracket.

Tax Strategies for 2020

II. Capital Gain Strategies (cont.)

A. Timing Strategies

2. Accelerate gain if it will be impacted by Biden tax plan.

- **Proposed raising capital gain rate from 20% to 39.6%** for taxpayers with income > $1,000,000.
- This increased rate is only proposed at this point.

Tax Strategies for 2020

II. Capital Gain Strategies (cont.)

A. Timing Strategies

3. Do NOT recommend accelerating capital gains to utilize capital loss carryforwards.
   - **Capital loss carryforwards** never expire.

Tax Strategies for 2020

II. Capital Gain Strategies (cont.)

A. Timing Strategies

4. Plan Capital Gain events in years you can **avoid the higher capital gain rates.**
   - **Net Investment Income tax adds 3.8%** to most capital gains once gross income is greater than $250,000 ($200,000 for single taxpayers).
   - Capital gain rate increases from 15% to 20% at taxable income of **$496,600 ($441,430** for singles).
   - Utilizing the **"installment sale method"** is one way of spreading a large capital gain from a property sale over two tax years to avoid reaching the higher capital gain brackets.

Tax Strategies for 2020

II. Capital Gain Strategies (cont.)

A. Timing Strategies

4. Defer gain if future year will have lower tax rate.

<u>Example</u>: Josie is a single taxpayer with an annual income of $150,000. Josie sells property that produces a $600,000 capital gain. Josie's federal income tax on the gain is **$134,016, which includes 20% capital gain, NIIT and AMT**. If Josie is able to work out an installment sale with the buyer such that she receives half of the income in Year 1 and half in Year 2, then her total federal tax on the capital gain is only **$109,000**.

Tax Strategies for 2020

II. Capital Gain Strategies (cont.)

A. Timing Strategies

5. "Harvest" capital losses in investment account to offset realized capital gains.

- Check with financial advisor or broker to see if you have available unrealized losses where you can realize the capital loss by selling before year-end.
- **Investment strategy offsets tax strategy.**
- Beware of 30-day **"wash sale" rule**.

Tax Strategies for 2020

II. Capital Gain Strategies (cont.)

A. Timing Strategies

5. **"Harvest" capital losses** in investment account to offset realized capital gains.

   Example: Cayden sold property with a $50,000 gain. He checks with his financial advisor and finds that he has an unrealized loss in an investment equal to $20,000. He sells this investment so that his net capital gains for the year are only $30,000. He can repurchase this investment after 31 days and avoid the "wash sale" rule.

Tax Strategies for 2020

III. Charitable Contribution Strategies

A. **$300 charitable contribution** deduction allowed in 2020 even for those taking the standard deduction.

B. Charitable contribution deduction allowed for **100% of gross income in 2020** vs. the regular limitation of 60%.

- This is an optional election.
- May be better to carryforward deduction to a future year where it offsets income at a higher tax bracket.
- Available only for cash contributions.
- Not available for contributions to a Donor Advised Fund.

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

B. Charitable contribution deduction allowed for **100% of gross income in 2020** vs. the regular limitation of 60%.

Example: Hailey's gross income this year is $100,000. Hailey made substantial cash donations this year of $90,000. Normally, Hailey's charitable contribution deduction is limited to $60,000, with the remaining $30,000 to carry forward to next year. Hailey can choose in 2020 to deduct the entire contribution this year… but it may not be the best decision.

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

C. Consider **bunching charitable contributions** into one year.

Example: Harper and Knox's itemized deductions are as follows:

- Tax Deductions of $10,000 (maximum).
- Mortgage interest of $6,000.
- Charitable contributions of $8,000.
- Total = $24,000.

Harper and Knox will take the standard deduction of $24,800

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

C. Consider bunching charitable contributions into one year.

Example: Suppose instead that Harper and Knox made $14,000 charitable contributions in Year 1, and $2,000 in Year 2.

- In Year 1, they would itemize total deductions of $30,000.
- In Year 2, they would take the standard deduction of $24,800 (or higher as adjusted by inflation).

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

D. Utilize a Donor Advised Fund.

1. A **Donor Advised Fund (DAF)** is a charitable giving vehicle administered by a public charity on behalf of families or individuals.
2. Contributions are made to DAF, which **may hold and invest the funds** for some period of time before distributing to the charity.
3. Individuals make recommendations on future distributions from the DAF.
4. **Deduction is allowed when contribution is made to the DAF**, not when funds are distributed to the charity.
5. A DAF can be used in **"bunching strategy,"** or in making a large contribution in a year when in **high tax bracket**.

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

D. Utilize a Donor Advised Fund.

Example: Leland has received a huge bonus of $400,000 this year that has placed him in the 39.6% tax bracket. He decides to **establish a DAF and makes a contribution of $250,000**. Considering federal and NC tax savings, this contribution **reduces Leland's taxes by $112,750**. Leland will use the DAF to make contributions to his favorite charities over the next several years.

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

E. Qualified Charitable Deduction (QCD)

1. Charitable contributions paid directly by one's IRA.
   - Available to taxpayers **age 70 ½** or older.
   - Available for up to $100,000 per year.
   - Counts as **part of one's RMD**.
2. QCDs are not included in income and are not deductible as charitable contributions.

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

E. Qualified Charitable Deduction (QCD)

3. QCDs are especially effective for taxpayers taking the standard deduction.
   - Reduce RMDs that otherwise would count as income. No reduction in standard deduction.
4. **QCD advantage is diminished in 2020 since RMDs are not required.**

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

E. Qualified Charitable Deduction (QCD)

Example: Barney & Betty are age 72. They have combined RMDs of $50,000. They **typically make $15,000/year in charitable contributions**. However, because they have no mortgage deduction, **they do not have enough deductions to itemize.** Therefore, they normally receive no tax benefit from making charitable contributions. Upon learning of the QCD strategy, they begin making their charitable contributions from their IRAs rather than their regular accounts. **This strategy reduces their taxable income by $15,000.**

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies

It is important to know your marginal tax rate to determine the impact of **potential transactions.**

Example**:**

- Lucy & Ricky are paid year-end bonuses totaling $10,000. They determine this increases their federal tax by $2,400. They are in the 24% federal tax bracket.
- Fred & Ethel decide to fulfill a $10,000 pledge to their church before year-end. If they are in the 24% tax bracket, then their federal tax decreases by $2,400.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

A. 2020 Tax Brackets:

	Married	Single	Head of Household
Move from 10% to 12% bracket	$ 19,750	$ 9,875	$ 14,100
Move from 12% to 22% bracket	$ 80,250	$ 40,125	$ 53,700
Move from 22% to 24% bracket	$ 171,050	$ 85,525	$ 85,500
Move from 24% to 32% bracket	$ 326,600	$ 163,300	$ 163,300
Move from 32% to 35% bracket	$ 414,700	$ 207,350	$ 207,350
Move from 35% to 37% bracket	$ 622,050	$ 518,400	$ 518,400

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. **"Artificial"** Tax Brackets: There are numerous "phase-outs" in the tax code that eliminate or reduce various tax deductions. These have the effect of increasing one's marginal tax rate because the effect of additional income is not only the additional income, but also to take away deductions. **Understanding when these impact one's taxes allows for better planning.**

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies

B. "Artificial" Tax Brackets: Examples.

1. **Qualified Business Income** deduction: For "Specified Service Businesses", this 20% deduction phases between **taxable income** of **$163,300 - $213,300** for single taxpayers, and **$326,600 - $426,600** for married taxpayers. It has the impact of increasing the marginal tax rate of married taxpayers by over 7%, and single taxpayers by over 14%.

Refer to earlier example under Retirement Plan Strategies.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets: Examples.

2. Active Rental Losses:

Example: Taxpayers with rental losses from properties they actively participate in can deduct up to $25,000 in rental losses each year. That deduction is phased out as gross income increases from $100,000 to $150,000.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets: Examples.

2. Active Rental Losses:

Example: Harper has $100,000 W-2 income and no other income. She has a rental property that she actively manages. It has a $25,000 loss. Harper is allowed to deduct the loss in full. Suppose Harper has a capital gain of $50,000. **Not only is she taxed on the additional capital gain, but she now can no longer deduct the rental loss**.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets:

3. American Opportunity Tax Credit (AOTC): This tax credit for undergraduate tuition of up to $2,500 per child phases out as gross income moves from $80,000 to $90,000 for single taxpayers, and $160,000 - $180,000 for married taxpayers.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets: Examples.

3. American Opportunity Tax Credit:

Example: Ava has W-2 salary of $90,000. She also has two children who are college undergraduates, and after scholarships, she incurs $4,000 each in tuition expense. Because her income is over the threshold, she can claim no tax credits. Suppose she contributed $10,000 to her 401K. Not only would her federal tax be decreased by $2,200 for her 401K deduction, she would now be eligible for a $5,000 AOTC. **This means the 401K deferral of $10,000 decreased her federal tax by $7,200!**

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets: Examples:

4. **Child Tax Credit:** This $2,000 per child tax credit begins phasing out for married taxpayers at $400,000, and at $200,000 for single taxpayers.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets: Examples:

5. **Medicare Premiums:** Medicare premiums begin increasing when gross income rises above certain levels.

	Married	Single
Monthly Medicare Premium = $144,60		
Monthly Medicare Premium = $202.40	$ 174,000	$ 87,000
Monthly Medicare Premium = $289.20	$ 218,000	$ 109,000
Monthly Medicare Premium = $376.00	$ 272,000	$ 136,000
Monthly Medicare Premium = $462.70	$ 326,000	$ 163,000
Monthly Medicare Premium = $491.60	$ 750,000	$ 500,000

QUESTIONS???

Thank you for attending!

Presented by:
Scott Hensely, CPA | Shensley@stancilcpa.com
Ken Martin, CPA | kmartin@stancilcpa.com
Charles Garrison, CPA | cgarrison@stancilcpa.com
Ryan Christians, CPA | rchristians@stancilcpa.com

Stancil CPAs • Advisors
4909 Windy Hill Drive
Raleigh, NC 27609

919-872-1260 stancilcpa.com