Partners

Patrick M. Hantske, CPA
Michele L. Moore, CPA
John G. Wiland, CPA
Philip J. Wimbish Jr., CPA
Eric P. Siegfried, CPA

Of Counsel

Edward F. Mullen Jr., CPA
Sharon M. Wimbish, CPA
Mary K. Stone

888 Bestgate Road • Suite 310 • Annapolis, Maryland 21401
Annapolis (410) 224-4920 • DC (301) 970-2524 • Baltimore (410) 841-2440 • Fax (410) 224-4927

2020 YEAR-END INCOME TAX PLANNING NEWSLETTER

It is that time of year when individuals and businesses start developing year-end planning strategies. However, there has never been a year quite like 2020. We think it is safe to say that year-end tax planning for 2020 is proving to be the trickiest in recent memory. In response to the Coronavirus, Congress and the IRS have been exceedingly busy enacting and issuing never-seen-before tax relief for businesses and employers. Congress had little choice but to pass this complex legislation quickly, without time for adequate review. Consequently, as one would expect, there continues to be significant uncertainty on the application and implementation of many of the most important provisions in this legislation. In addition, Congress may not be through as it continues to struggle with attempts to enact even more Coronavirus relief legislation before the end of the year. We are sending this letter to help bring you up to date on the most significant tax provisions that could impact year-end planning. This letter is broken down in three sections:

- **Planning Ideas for Individual Taxpayers**
- **Paycheck Protection Program Loans (PPP Loans)**
- **Planning Ideas for Businesses**

Pay Special Attention To "Timing" Issues this Year! From a tax-planning standpoint, 2020 has been anything but a "normal" year for most. In normal times, a traditional year-end tax planning strategy would include reducing your current year taxable income by deferring taxable income into later years and accelerating deductions into the current year. This strategy is particularly beneficial where your income tax rate in the following year is expected to be the same or lower than the current year. Consequently, in the following discussion we include traditional year-end tax planning strategies that would allow you to accelerate your deductions into 2020, while deferring your income into 2021. **Caution!** For individuals and businesses that expect their taxable income to be much lower in 2020 than in 2021, the opposite strategy might be more advisable. That is, a better year-end planning strategy might include accelerating income into 2020 (to be taxed at lower rates), while deferring deductions to 2021 (to be taken against income that is expected to be taxed at higher rates). As we discuss the planning methods that involve the "timing" of income or deductions, please keep in mind that you might want to consider taking the precise opposite steps recommended if you decide it would be better to defer deductions into 2021, while accelerating income into 2020.

2020 YEAR-END INCOME TAX PLANNING FOR INDIVIDUALS

2020 MAY BE OUR LAST CHANCE TO TAKE ADVANTAGE OF THESE TRADITIONAL TAX BREAKS

For well over a decade, we have been faced with the off-and-on expiration of a long list of popular tax breaks. Historically, Congress has temporarily extended the majority of these tax breaks every few years. However, several popular tax breaks for individuals **are scheduled to expire at the end of 2020,** and Congress has yet to extend them. Some of the more popular tax breaks scheduled to expire at the end of 2020 include: Deduction (up to $4,000) for Qualified Higher Education Expenses; Deduction for Mortgage Insurance Premiums as Qualified Residence Interest; Income Exclusion For Discharge Of Qualified Principal Residence Indebtedness; and the 10% Credit (with a lifetime cap of $500) for Qualified Energy-Efficient Home Improvements (e.g., qualified energy-efficient windows, storm doors, roofing). As we send this letter, it has been reported that some members of Congress are still pushing for these tax breaks to be extended beyond 2020. However, only time will tell whether these tax breaks will be extended.

HIGHLIGHTS OF RECENT LEGISLATIVE CHANGES

In late December 2019, Congress passed the *Consolidated Appropriations Act of 2020* (the "Appropriations Act") which pre-dated the more recent flurry of COVID-related legislation. The Appropriations Act included significant changes to various IRA and qualified retirement plan rules. Most of these changes are first effective in 2020. In addition, the more recently enacted "CARES Act" provided temporary relief relating to Required Minimum Distributions from IRAs and qualified retirement plans. The following are highlights of selected changes from both of those pieces of legislation that we feel will have the greatest impact on tax planning for individuals:

Required Beginning Date for Required Minimum Distributions (RMDs) Delayed To Age 72. Before this change, you were required to begin taking "*Required Minimum Distributions*" (RMDs) from your IRA or qualified retirement plan account no later than the April 1st following the year you reached age 70½ (i.e., the required beginning date). For individuals who **reach age 70½ after 2019,** the *Appropriations Act* changed the age of the required beginning date for RMDs from 70½ to age 72. So, if you reach age 70½ **after 2019,** you will not be required to take your first RMD until April 1st following the year in which you reach age 72! **Planning Alert!** Individuals who reached age 70½ during 2019 were still generally required to take their first RMD no later than April 1st of 2020 and were also required to take their second RMD no later than December 31, 2020. However, the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") **suspended all RMDs** from an IRA or employer-sponsored defined contribution retirement plan **that are otherwise required in 2020.** This suspension applies to owners of IRAs and beneficiaries of inherited IRAs.

Age Limit on Contributing to An IRA Removed. Before 2020, an individual who reached age 70½ during the year could not contribute to a traditional IRA for that year, or any later year. For contributions made for tax years beginning **after 2019,** the Appropriations Act removed all age limits for contributing to an IRA. Stated more simply, for contributions made for tax years beginning **after 2019,** there is **no age limit** on contributions to a traditional or Roth IRA! **Planning Alert!** Regardless of your age, you must have "earned income" (e.g., W-2 wages; Income subject to self-employment tax) at least equal to the amount of your contribution to a traditional or Roth IRA.

Changes To "Qualified Charitable Distributions" (QCDs) For IRA Owners. If you have reached **age 70½** and you are planning to make charitable contributions before the end of 2020, there is a long-standing tax break known as a "Qualified Charitable Distribution" (QCD) that could apply to you. This popular provision generally allows taxpayers, who **have reached age 70½,** to have their IRA trustee transfer **up to $100,000** from **their IRAs "directly" to a qualified charity and exclude the IRA transfer from income.** The IRA transfer to the charity also counts toward the IRA owner's "Required Minimum Distributions" (RMDs) for the year.

Changes Under the Appropriations Act. Although the Appropriations Act increased the required beginning date for RMDs from age 70½ to age 72, the minimum age for making a QCD remains at age 70½. **But beware, starting in 2020,** the Appropriations Act generally reduces the tax-free portion of a QCD by the amount of any deductible contributions made to an IRA after reaching age 70½.

New 10-Year Pay-Out Requirement for Those Who Inherit An IRA Or Qualified Plan Account. If an individual died before 2020 and someone other than the surviving spouse was named as the beneficiary of the decedent's IRA or qualified plan account, RMDs to the named beneficiary were required to begin by December 31 of the year following the year of death, and could be paid over the life expectancy of the named beneficiary. For example, if an individual died in 2019 and a child (regardless of age) was the beneficiary of the individual's IRA, the child could take RMDs over the child's life expectancy. **Planning Alert!** Effective for individuals **dying after 2019,** the Appropriations Act generally requires a decedent's entire remaining IRA or qualified account balance to be distributed to a named beneficiary **by December 31 of the 10th year following** the year of the decedent's death. This required 10-year payout does not apply if the named beneficiary is the decedent's spouse, has a qualified disability, is chronically ill, or is no more than 10 years younger than the decedent. If the named beneficiary is a minor, the 10-year pay-out requirement does not kick in until the beneficiary reaches majority (age 18 in many jurisdictions).

- **Planning for Rollovers By Surviving Spouses.** The new 10-year payout requirement does not apply to a surviving spouse who is the named beneficiary of the decedent's IRA or qualified retirement plan. In that event, the surviving spouse would generally treat the IRA as an "inherited" IRA and be required to take RMDs over the surviving spouse's *"single life expectancy"* (with no 10-year payout requirement).

However, it is generally advisable for the surviving spouse to convert the decedent's IRA into the name of the surviving spouse (i.e., convert it into a "spousal IRA"). This is generally advisable because, once the decedent's IRA is converted to a spousal IRA: **1)** The surviving spouse will not be required to begin taking RMDs until the April 1st following the year the surviving spouse reaches age 72, and **2)** When the RMDs begin, the surviving spouse's RMDs will be determined using the "*Uniform Lifetime Distributions Table"* (with no 10-year payout requirement), which will result in a smaller annual required payout than under the "single life expectancy" computation that would otherwise be required had the surviving spouse not converted the decedent's IRA into a spousal IRA.

For Some - 2020 May Be A Good Year to Consider A Roth Conversion. If you have been considering converting your traditional IRA into a Roth IRA, it is best to convert in a low-income year so your Roth conversion income is taxed at the lower tax rates. Therefore, if you are in a situation where, due to COVID (or for any other reason), your 2020 income is significantly lower than the income you expect in 2021 and later years, it may be a good idea to consider converting all or a portion of your traditional IRA into a Roth IRA before the end of 2020. **Planning Alert!** If you want a Roth conversion to be **effective for 2020,** you must transfer the amount from the regular IRA to the Roth IRA **no later than December 31, 2020** (you do not have until the due date of your 2020 tax return).

Economic Impact Payments. By now, the vast majority of individuals qualifying for an "economic impact payment" (EIP) under the CARES Act of up to $1,200 per qualifying individual (and $500 per qualifying dependent) have received the payment. **Planning Alert!** Technically, the EIP is an advance payment of a 2020 refundable tax credit. A "**refundable**" credit generally means to the extent the credit exceeds the taxes you would otherwise owe with your individual income tax return without the credit, the IRS will send you a check for the excess. If for some reason you did not get the EIP (or the amount you received was too low), the credit will be re-computed when you file your 2020 income tax return based on your 2020 AGI. You will be entitled to a refundable credit for the amount of the credit computed on your 2020 income tax return in excess (if any) of the advance payment you previously received. If the credit computed on your 2020 return is less than the EIP you received, generally you will not have to pay back the excess.

Temporary *"Above-The-Line"* Deduction of Up To $300 For Charitable Contributions For Individuals Who Do Not Itemize Deductions. For the ***2020 tax year only,*** the CARES Act allows individuals who do not elect to itemize their deductions, to take a so-called *"above-the-line"* deduction of up to $300 for **cash contributions** to a qualifying charity. Therefore, an individual may deduct this $300 amount in addition to the standard deduction for 2020.

HIGHLIGHTS OF TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

Taking Advantage Of "Above-The Line" Deductions. Traditional year-end planning includes accelerating deductible expenses into the current tax year. So-called **"above-the-line"** deductions reduce both your "adjusted gross income" (AGI) and your "modified adjusted gross income" (MAGI), while **"itemized"** deductions (i.e., below-the-line deductions) do **not** reduce either AGI or MAGI. Deductions that reduce your AGI (or MAGI) can generate multiple tax benefits by: **1)** Reducing your taxable income and allowing you to be taxed in a lower tax bracket; **2)** Potentially freeing up other deductions (and tax credits) that phase out as your AGI (or MAGI) increases (e.g., Certain IRA Contributions, Certain Education Credits, Adoption Credit, Child and Family Tax Credits, etc.); **3)** Potentially reducing your MAGI below the income thresholds for the 3.8% Net Investment Income Tax (i.e., 3.8% NIIT only applies if MAGI exceeds $250,000 if married filing jointly; $200,000 if single); **or 4)** Possibly reducing your household income to a level that allows you to qualify for a "refundable" Premium Tax Credit for health insurance purchased on a government Exchange. **Planning Alert!** In addition, individuals reporting Qualified Business Income will generally find it much easier to qualify for the new 20% 199A Deduction with respect to that Qualified Business Income if their 2020 taxable income does not exceed $326,600 if filing a joint return or $163,300 if single. So, if you think that you could benefit from accelerating ***"above-the-line"*** deductions into 2020, consider the following:

- **Identifying "Above-The-Line" Deductions.** **"Above-the-line"** deductions include: Deductions for IRA or Health Savings Account (HSA) Contributions; Health Insurance Premiums for Self-Employed Individuals; Qualified Student Loan Interest; Qualifying Alimony Payments (if the divorce or separation instrument was **executed before 2019);** and, Business Expenses for a Self-Employed Individual.

- **"Itemized" Deductions.** Although **"itemized"** deductions (i.e., below-the-line deductions) do **not** reduce your AGI or MAGI, they still may provide valuable tax savings. **Starting in 2018 and through 2025,** recent legislation **substantially** increased the Standard Deduction. For 2020, the Standard Deduction is: Joint Return - $24,800; Single - $12,400; and Head-of-Household - $18,650. **Planning Alert!** If you think your itemized deductions this year could likely exceed your Standard Deduction of $24,800 if filing jointly ($12,400 if single), consider the following:

  - **Accelerating Charitable Contributions Into 2020.** If you want to accelerate your charitable deduction into 2020, please note that a charitable contribution deduction is allowed for 2020 if the check is **"mailed" on or before December 31, 2020,** or the contribution is made by a credit card charge in 2020. However, if you merely give a note or a pledge to a charity, no deduction is allowed until you pay the note or pledge.

- **Medical Expense Deductions.** If you think your itemized deductions this year could likely exceed your standard deduction of $24,800 if filing jointly ($12,400 if single), but you do not expect your itemized deductions to exceed your Standard Deduction next year, you could save taxes in the long run by accelerating elective medical expenses (e.g., braces, new eye glasses, etc.) into 2020.

- **$10,000 Cap on State And Local Taxes.** **From 2018 through 2025,** your aggregate itemized deduction for state and local real property taxes, state and local personal property taxes, and state and local income taxes (or sales taxes if elected) is **limited to $10,000** ($5,000 for married filing separately).

- **Limitations on The Deduction For Interest Paid On Home Mortgage "Acquisition Indebtedness."** Before the Tax Cuts And Jobs Act (TCJA), individuals were generally allowed an *itemized* deduction for home mortgage interest paid on up to $1,000,000 ($500,000 for married individuals filing separately) of **"Acquisition Indebtedness"** (i.e., funds borrowed to purchase, construct, or substantially improve your principal or second residence and secured by that residence). Subject to certain transition rules, TCJA reduced the dollar cap for **Acquisition Indebtedness incurred after December 15, 2017 from $1,000,000 to $750,000** ($375,000 for married filing separately) for **2018 through 2025.**

- **"Home Equity Indebtedness" Suspended For 2018 through 2025.** TCJA suspended the deduction for **interest** with respect to **"Home Equity Indebtedness"** (i.e., up to $100,000 of funds borrowed that do not qualify as "Acquisition Indebtedness" but are secured by your principal or second residence). **Caution!** Unlike the interest deduction for "Acquisition Indebtedness," TCJA **did not grandfather** any interest deduction for **"Home Equity Indebtedness"** that was **outstanding before 2018.**

Postponing Taxable Income May Save Taxes. Generally, deferring taxable income from 2020 to 2021 may also reduce your income taxes, particularly if your effective income tax rate for 2021 will be lower than your effective income tax rate for 2020.

- **Planning for Tax Rates.** The deferral of income could cause your 2020 taxable income to fall below the thresholds for the highest 37% tax bracket (i.e., $622,050 for joint returns; $518,400 if single). In addition, if you have income subject to the 3.8% Net Investment Income Tax (3.8% NIIT) and the income deferral reduces your 2020 modified adjusted gross income (MAGI) below the thresholds for the 3.8% NIIT (i.e., $250,000 for joint returns; $200,000 if single), you may avoid this additional 3.8% tax on your investment income.

Traditional Year-End Planning with Capital Gains And Losses. Generally, net capital gains (both short- term and long-term) are potentially subject to the 3.8% NIIT. This could result in an individual filing a joint return with taxable income for 2020 of $496,600 or more ($441,450 or more if single) paying tax on his or her **net long-term capital gains** at a **23.8%** rate (i.e., the maximum capital gains tax rate of 20% plus the 3.8% NIIT). In addition, this individual's **net short-term capital gains** could be taxed as high as **40.8%** (i.e., 37% plus 3.8%). Consequently, traditional planning strategies involving the timing of your year-end sales of stocks, bonds, or other securities continue to be as important as ever. The following are time-tested, year-end tax planning ideas for sales of capital assets. **Planning Alert!** Always consider the **economics of a sale or exchange first!**

- **Planning with Zero Percent Tax Rate For Capital Gains And Dividends.** For individuals filing a **joint return** with 2020 Taxable Income of **less than $80,000 (less than $40,000 if single),** their long-term capital gains and qualified dividends are taxed at a **zero percent rate.** **Tax Tip.** Individuals who have historically been in higher tax brackets but are now expecting a significant drop in their 2020 taxable income, may find themselves in the zero percent tax bracket for long-term capital gains and qualified dividends for the first time. For example, a significant drop in 2020 taxable income could have occurred due to COVID-19; or because you are between jobs; or you recently retired; or you are expecting to report higher-than-normal business deductions in 2020.

- **Timing Your Capital Gains and Losses.** If the value of some of your investments is less than your cost, it may be a good time to harvest some capital losses. For example, if you have already recognized capital gains in 2020, you should consider selling securities **prior to January 1, 2021** that would trigger a capital loss. These losses will be deductible on your 2020 return to the extent of your recognized capital gains, plus $3,000. **Planning Alert!** If, within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the "wash sale" rules (although the disallowed loss will increase the basis of the acquired stock).

The "Premium Tax Credit" Under the Affordable Care Act. Although TCJA essentially eliminated the penalty for individuals who fail to purchase qualified health coverage by reducing the **"Shared Responsibility Tax"** (SR Tax) **to Zero, it did not repeal** the refundable **"Premium Tax Credit" or "PTC."** The PTC is still generally available for eligible low-and-middle income individuals who purchase health insurance through a State or Federal Exchange. The PTC is generally paid **in advance directly to the insurer** ("Advance Payments"). Any individual who received Advance Payments for 2020 **is required to file** a **2020 income tax return** to reconcile: **1)** The amount of the **"actual"** PTC (based on the individual's **"actual"** 2020 Household Income), with **2)** The **Advance Payments** of the PTC (which were determined by the Exchange based on the individual's **"projected"** 2020 Household Income). **Caution!** If an individual's Advance Payments for 2020 exceed the "actual" PTC, the **excess must be paid back** on the **2020 tax return.**

- **Possible Cap on The Amount That Must Be Paid Back!** The amount of the 2020 excess payment that must be repaid as an additional tax liability **is capped if** the individual's actual 2020 Household Income is **less than 400%** of the Federal Poverty Line (FPL) for the individual's family size. For example, for 2020, as long as an individual's actual household income is **less than 400% of the FPL,** the maximum amount that must be repaid will not exceed **$1,350 for a single individual** and **$2,700 for others.** **Planning Alert!** In some cases, an individual whose "**actual**" 2020 Household Income is projected to be 400% or more of the FPL may be able to trigger these dollar caps by reducing his or her "**actual**" 2020 Household Income **below** 400% of the FPL. **For example,** an individual might contribute to an IRA (if eligible to do so) in order to reduce his or her 2020 Household Income to less than 400% of the 2020 FPL for the individual's family size.

PAYCHECK PROTECTION PROGRAM LOANS (PPP LOANS)

This program was intended to provide struggling businesses with a quick infusion of cash to stay afloat and to retain employees in the midst of government-mandated shutdowns. The initial cash outlay was in the form of a PPP Loan, with a potential for all or a portion of the loan to be forgiven if the borrower could establish that the borrowed funds were used for certain qualifying business expenditures (i.e., generally payroll, rent, utilities, and mortgage payments) during a designated 8-week or 24-week "Covered Period." **Planning Alert!** Most PPP Loan borrowers are now struggling with how and when they should apply to the lender for their PPP Loan forgiveness. There are continued uncertainties regarding the PPP Loan forgiveness process, and we are hoping for additional guidance in the near future. As we wait for that guidance, here are a few things you should know:

- **No Defined Deadline for Submitting PPP Loan Forgiveness Application.** There is currently no deadline for submitting a PPP Loan Forgiveness Application. Generally, payments (if any) are not due on a PPP Loan until the SBA remits the PPP Loan's forgiveness amount (if any) to the initial lender of the PPP Loan. However, if the borrower fails to apply for loan forgiveness within 10 months of the end of the borrower's 8-week or 24-week covered period, payments of principal and interest on the PPP Loan must begin at the end of that 10-month period.

- **Deductibility of Expenses Related to The PPP Loan Forgiveness Amount.** Even though the CARES Act provides that forgiveness of a PPP Loan is tax free, the IRS is currently taking the position that no tax deduction will be allowed for an expense, if the payment of that expense results in the forgiveness of a PPP Loan amount. As we complete this letter, there is significant pressure from business and professional groups urging the IRS to allow such deductions, or for Congress to pass legislation that would allow the deductions. Please contact our firm if you want a status report on this issue.

- **Expedited Forgiveness Procedures for Smaller PPP Loans.** The procedures for gathering documentation and applying for PPP Loan forgiveness could be tedious and time consuming. **Planning Alert!** In early October, the IRS and the SBA released a new "simplified" PPP Loan forgiveness Application Form that can be used only by borrowers that **received a PPP Loan of $50,000 or less.** This should significantly simplify the PPP Loan Forgiveness process for those qualifying borrowers who borrowed $50,000 or less. **Caution!** Certain members of Congress are currently promoting legislation that, if passed, could also substantially streamline the loan forgiveness process for PPP Loans under a certain dollar threshold that could turn out to be higher than $50,000. As we complete this letter, the chance of this type of legislation being enacted is uncertain.

2020 YEAR-END INCOME TAX PLANNING FOR BUSINESSES

HIGHLIGHTS OF SELECTED COVID-RELATED TAX PROVISIONS IMPACTING BUSINESSES

Largely in response to government-mandated shutdowns caused by COVID-19 (COVID), Congress enacted a series of tax-relief measures for businesses, including: The **Families First Coronavirus Response Act ("Families First Act")** and the **Coronavirus Aid, Relief and Economic Security Act ("CARES Act").** It is well beyond the scope of this letter to provide you a detailed discussion of the many business tax relief provisions contained in this voluminous legislation. Instead, the following are *selected* highlights that could have an impact on your business tax planning.

Employment-Related Payroll Tax Credits, Deferrals, Etc. Last Spring, in addition to the PPP Loan provision, Congress passed a dizzying array of tax relief provisions designed to subsidize qualifying employers for keeping employees on their payroll, and to provide additional liquidity for their businesses. These tax relief provisions include: Refundable employer tax credits of up to 100% of the qualifying Sick Leave And Family Leave Payments made to qualifying employees; Refundable income tax credits for self-employed individuals with respect to their "Family Leave and Sick Leave Equivalent Amounts;" Refundable 50% Employee Retention Credit for qualifying wages paid by certain employers experiencing business closure or economic hardship due to COVID; and, Deferral of deposits for the 6.2% portion of employer payroll taxes (can also apply to the 6.2% portion of S/E Tax).

Temporary Relief for Net Operating Losses (NOLs). Before the Tax Cuts and Jobs Act of 2017 (TCJA), net operating losses (NOLs) could generally be carried back two prior years and carried forward for 20 years. TCJA generally repealed the 2-year carried back period for NOLs (except for NOLs attributable to certain farming businesses and certain property and casualty insurance companies) and allowed NOLs to be carried forward indefinitely. TCJA also limited the deduction for NOL carryforwards to 80% of the taxable income for the carryover year. The CARES Act generally provides the following temporary relief with respect to NOLs: **1)** Allows NOLs arising in tax years beginning after 2017 and before 2021 (e.g., NOLs arising in calendar years 2018, 2019, or 2020 for calendar-year taxpayers) to be carried back to 5 preceding years; and **2)** Removes the 80% of taxable income limit for the NOL deduction for any tax year beginning before 2021. **Planning Alert!** A taxpayer may elect to forego the carryback of an NOL. Generally, the election to forego the NOL carryback must be made by the due date (including extensions) for the year of the NOL. The CARES Act provides that the election to forego the 5-year NOL carryback for tax years beginning in 2018 or 2019, may be made by the due date (including extensions) of the taxpayer's return for the first taxable year ending after March 27, 2020.

Retroactive Fix for Computing Depreciation For "Qualified Improvement Property." The CARES Act finally corrected the depreciation "glitch" contained in TCJA with respect to "Qualified Improvement Property." **Qualified Improvement Property (QIP)** is generally defined as ***"an improvement"*** to the ***interior portion*** of a ***commercial building*** (provided the improvement is not attributable to an enlargement of the building, elevators or escalators, or the internal structural framework of the building), if the improvement is placed in service ***"after"*** the building was first placed in service. Due to a drafting error in TCJA, QIP was assigned a depreciable life of 39 years, instead of the intended 15-year life. To compound the error, assigning QIP a depreciable life of 39 years (instead of 15 years) also disqualified QIP for the 100% 168(k) first-year bonus depreciation, because 168(k) property must have a depreciable life of 20 years or less. The CARES Act fixes this mistake retroactively by assigning a 15-year depreciable life for all QIP that was **placed in service after 2017.** Therefore, QIP placed in service in 2018 or 2019 retroactively qualifies for the 100% 168(k) bonus depreciation.

- **Claiming The 100% 168(k) Depreciation for QIP Placed in Service In 2018 Or 2019.** The IRS says that we generally have two options to recoup the unclaimed 100% depreciation deduction for QIP placed in service in 2018 or 2019. **First,** we can amend the 2018 or 2019 return and claim the 100% depreciation deduction on the amended return. If we choose to amend the 2018 return, the IRS says that we must file the amended 2018 return **no later than October 15, 2021. Second,** we could recoup the 100% 168(k) depreciation by claiming it through an automatic accounting method change in a subsequent year. For example, by filing an automatic accounting method change, you could claim the 100% deduction on your 2020 return (or even a later return).

SELECTED TAX CHANGES INCLUDED IN OTHER RECENT LEGISLATION

Recent Legislation Extends the Due Date for Establishing A New Retirement Plan. Before the passage of the Consolidated Appropriations Act of 2020 (the "Appropriations Act"), calendar-year taxpayers wishing to establish a new qualified retirement plan for a tax year generally had to adopt the plan by December 31st of that year. However, a SEP could be established by the due date of the tax return (including extensions), but a **SIMPLE plan** was required to be established by October 1st of that year. **Effective for plans adopted for taxable years beginning after 2019,** the Appropriations Act generally allows the adoption of a stock bonus, pension, profit-sharing, or annuity plan for a taxable year after the close of the taxable year as long as the plan is adopted by the due date of the employer's tax return, including extensions. **Caution!** The IRS says that a SIMPLE plan must still be adopted for an existing business with an effective date no later than October 1st of the year. Moreover, the Committee Reports to the Act say this new extended adoption date does not override rules requiring certain plan provisions to be in effect during a plan year, such as the provision for elective deferrals under a qualified cash or deferral arrangement (also known as a 401(k) plan).

Don't Overlook Simplified Accounting Methods for Certain Small Businesses. Although not part of the recent COVID-related tax legislation, it's important to be aware that the Tax Cuts And Jobs Act (enacted in late 2017) provides for the following accounting method relief for businesses with **Average Gross Receipts (AGRs)** for the **Preceding Three Tax Years** of **$26 Million or Less for 2020: 1)** Generally allows businesses to use the cash method of accounting even if the business has inventories, **2)** Allows simplified methods for accounting for inventories, **3)** Exempts businesses from applying UNICAP, and **4)** Liberalizes the availability of the completed-contract method.

Maryland Pass Through Entity (PTE) Tax Regime aka SALT Workaround. Earlier this year, Maryland passed Senate Bill 523, a new taxpayer-friendly law which allows pass-through entities (PTEs such as partnerships and S corporations) to fully deduct state income tax on business income at the entity level. This could allow for a substantial entity level federal tax deduction for certain PTE owners whose state tax deductions have been capped at $10,000 per year under the Tax Cuts and Jobs Act (TCJA) of 2017. The potential federal tax savings is approximately 3% of business income allocated to Maryland. Since the Maryland bill was passed, we have been anxiously awaiting additional IRS and Maryland guidance as to the mechanics of the new regime. On November 9, 2020, the IRS released Notice 2020-75, allowing the federal tax deduction at the entity level for state PTE taxes paid. As of this writing, many questions remain unanswered about this very important tax matter. We are monitoring developments daily and we are committed to providing you with the information needed to make informed decisions.

TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

Planning with The First-Year 168(k) Bonus Depreciation Deduction. Traditionally, a popular way for businesses to maximize current-year deductions has been to take advantage of the **First-Year 168(k) Bonus Depreciation Deduction.** Before the *"Tax Cuts and Jobs Act"* (TCJA) which was enacted in late 2017, the 168(k) Bonus Depreciation deduction was equal to 50% of the cost of qualifying "**new**" depreciable assets placed in service. TCJA temporarily increased the 168(k) Bonus Depreciation deduction **to 100%** for qualifying property acquired and placed in service **after September 27, 2017** and **before January 1, 2023.** TCJA further enhanced the 168(k) Bonus Depreciation deduction by making the following changes:

- **"Used" Property Temporarily Qualifies For 168(k) Bonus Depreciation.** Before TCJA, only "**new**" qualifying property was eligible for the 168(k) Bonus Depreciation deduction. For qualifying property acquired and placed in service **after September 27, 2017 and before 2027,** the 168(k) Bonus Depreciation may be taken on "**new**" **or** "**used**" property. Therefore, property that generally qualifies for the 168(k) Bonus Depreciation includes "**new**" or "**used**" business property that has a depreciable life for tax purposes of **20 years or less** (e.g., machinery and equipment, furniture and fixtures, sidewalks, roads, landscaping, computers, computer software, farm buildings, and qualified motor fuels facilities.

- **The 100% 168(k) Bonus Depreciation Deduction For "Used" Property Generally Makes Cost Segregation Studies More Valuable.** Depreciable components of a building that are properly classified as depreciable personal property under a **cost segregation study** are generally depreciated over 5 to 7 years. **Before TCJA,** these depreciable building components for a purchaser of a "used" building generally qualified for the 179 Deduction (subject to the dollar caps), but did not qualify for a 168(k) Bonus Depreciation deduction because the 168(k) depreciation deduction only applied to "new" property. However, after TCJA, the depreciable components of a building that are properly classified as "personal property" (as opposed to "real property") will qualify for the 100% 168(k) Bonus Depreciation (whether new or used).

- **Annual Depreciation Caps for Passenger Vehicles Increased.** Vehicles used primarily in business generally qualify for the 168(k) Bonus Depreciation. However, there is a dollar cap imposed on business cars, and also on trucks, vans, and SUVs that have a **loaded vehicle weight of 6,000 lbs or less.** This dollar cap was increased significantly under TCJA. More specifically, for qualifying vehicles placed in service **in 2020** and used 100% for business, the annual depreciation caps are as follows: **1st year - $10,100; 2nd year - $16,100; 3rd year - $9,700; fourth and subsequent years - $5,760.** Moreover, if the vehicle (new or used) otherwise qualifies for the 168(k) Bonus Depreciation, the first-year depreciation cap (assuming 100% business use) is increased by $8,000 (i.e., from $10,100 to $18,100 for 2020). Thus, a vehicle otherwise qualifying for the 168(k) Bonus Depreciation deduction with loaded **Gross Vehicle Weight (GVW) of 6,000 lbs or less** used **exclusively for business** and **placed in service in 2020** would be entitled to a **depreciation deduction for 2020 of up to $18,100,** whether purchased new or used. If the vehicle continues to be used exclusively for business during the **second year** (i.e., during 2021), it would be entitled to a second-year depreciation deduction of **up to $16,100.** **Planning Alert!** Even better, if the same new or used business vehicle (which is used 100% for business) has a loaded GVW **over 6,000 lbs, 100% of its cost** (without a dollar cap) could be deducted **in 2020** as a **168(k) Bonus Depreciation deduction. Caution!** When taking the 168(k) Bonus Depreciation on your business vehicle (and whether or not it weighs more than 6,000 lbs), if your business-use percentage **drops to 50% or below** in a later year, you will generally be required to bring into income a portion of the deduction taken in the first year.

- **168(k) Bonus Depreciation Taken in Tax Year Qualifying Property Is "Placed in Service."** The 168(k) Bonus Depreciation deduction is taken in the tax year the qualifying property is "placed in service." Consequently, if your business anticipates acquiring qualifying 168(k) property between now and the end of the year, the 168(k) Bonus Depreciation deduction is taken in 2020 if the property is placed in service **no later than December 31, 2020.**

Restrictions on Deducting Entertainment Expenses. Generally, business expenditures with respect to an entertainment, amusement or recreation activity are not deductible after 2017. **Planning Alert!** Fortunately, the IRS has announced that taxpayers can still generally deduct 50% of the cost of meals with a business associate (e.g., a current or potential business customer, client, supplier, employee, agent, partner, professional advisor). In addition, the IRS stated that a taxpayer could deduct 50% of the cost of food and beverages provided during a nondeductible entertainment activity with a business associate provided the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts.

S Corporation Shareholders Should Check Stock and Debt Basis Before Year-End. If you own S corporation stock and you think your S corporation will have a tax loss this year, you should contact us as soon as possible. These losses will not be deductible on your personal return unless and until you have adequate "basis" in your S corporation. Any pass-through loss that exceeds your "basis" in the S corporation will carry over to succeeding years. You have basis to the extent of the amounts paid for your stock (adjusted for net pass-through income, losses, and distributions), **plus** any amounts you have personally loaned to your S corporation. **Caution!** A shareholder cannot get debt basis by merely guaranteeing a third-party loan to the S corporation.

Maximize Your 20% 199A Deduction For "Qualified Business Income" (QBI). First effective in 2018, the 20% 199A Deduction has had a major impact on businesses. This provision allows qualified taxpayers to take a 20% Deduction with respect to **"Qualified Business Income," "Qualified REIT Dividends,"** and **"Publicly-Traded Partnership Income."** Based on 2018 and 2019 tax filings, of these three types of qualifying income, **"Qualified Business Income" (QBI)** has had the biggest impact by far on the greatest number of taxpayers. Consequently, this discussion of the 20% 199A Deduction focuses **primarily on "Qualified Business Income" (QBI).**

- **W-2 Wage and Capital Limitation on The Amount Of The 20% Of QBI Deduction.** Generally, the amount of your 20% of QBI Deduction with respect to each Qualified Trade or Business may not exceed **the greater of: 1)** 50% of the allocable share of the business's W-2 wages allocated to the QBI of each "Qualified Trade or Business," or **2)** The sum of 25% of your allocable share of W-2 wages with respect to each "Qualified Trade or Business," plus 2.5% of your allocable share of unadjusted basis of tangible depreciable property held by the business at the close of the taxable year. **Caution!** For 2020, the Wage and Capital Limitation phases in ratably as a taxpayer's Taxable Income **goes from more than $163,300 to $213,300, or from more than $326,600 to $426,600** (if filing jointly).

- **Business Income From "Specified Service Trade or Businesses" (SSTBs) Does Not Qualify For The 20% 199A Deduction For Owners Who Have "Taxable Income" Above Certain Thresholds.** Based on your "Taxable Income" (before the 20% 199A Deduction), all or a portion of your qualified business income from a so-called "Specified Service Trade or Business" (i.e., certain service-type operations in various professional fields such as law, medicine, accounting, consulting, etc.) **may not qualify** for the 20% 199A Deduction. More specifically, if your **"Taxable Income"** for 2020 (before the 20% 199A Deduction) is **$163,300 or below ($326,600 or below** if married **filing jointly), "all"** of the qualified business income from your "Specified Service Trade or Business" **(SSTB)** is eligible for the 20% 199A deduction. However, if for 2020 your **"Taxable Income"** is **$213,300 or more ($426,600 or more** if married **filing jointly), "none"** of your SSTB income qualifies for the 20% 199A Deduction. **Caution!** If for 2020, your **"Taxable Income"** is **between $163,300 and $213,300** (between **$326,600 and $426,600** if married **filing jointly**), only **"a portion"** of your SSTB income will be eligible for the 20% 199A Deduction.

- **Evaluating Reasonable W-2 Compensation Levels Paid to S Corp Owners/Employees Is More Important Than Ever!** Even before the 20% 199A Deduction provision was enacted, S corporation shareholder/employees have had an incentive to pay themselves W-2 wages as low as possible because only the shareholder's W-2 income from the S corporation is subject to FICA taxes. Other income of the shareholder from the S corporation is generally not subject to FICA or Self-Employment (S/E) taxes. Traditionally, where the IRS has determined that an S corporation shareholder/employee has taken unreasonably **"low"** compensation from the S corporation, the IRS has argued that other amounts the shareholder has received from the S corporation (e.g., distributions) are disguised **"compensation"** and should be subject to FICA taxes. In light of the 20% 199A Deduction, reviewing the W-2 wage level for Shareholder/Employees of S Corporations becomes even more important. **For example,** for S Corporation shareholder/employees who expect to have 2020 Taxable Income (before the 20% 199A Deduction) of **$163,300 or less** (**$326,600 or less** if married filing jointly), in order to maximize their potential 20% 199A Deduction **there is a tax incentive** to keep the shareholders' **W-2 wages as "low" as possible,** because: **1)** The W-2 Wages paid to shareholders **do not qualify** for the 20%199A Deduction, but the W-2 Wages **do reduce** a shareholder's pass-through Qualified Business Income, **2)** The shareholder will be exempt from the W-2 Wage and Capital Limitation (so lower W-2 wages will not limit the shareholder's potential 20% 199A Deduction amount), and **3)** The shareholder's pass-through SSTB income (if any) will be fully eligible for the 20% 199A Deduction, while W-2 wages paid to the shareholder/employee will not qualify.

FINAL COMMENTS

Caution! It is entirely possible that Congress could enact additional COVID-related tax legislation before the end of this year. In addition, the IRS continues releasing guidance on various important tax provisions (particularly on COVID-related tax provisions that have already been enacted). We closely monitor new tax legislation and IRS releases on an ongoing basis. **Please call our firm if you want an update on the latest tax legislation IRS notifications, announcements, and guidance or if you need additional information concerning any item discussed in this letter.**

Be Careful! We suggest you call our firm before implementing any tax planning technique discussed in this letter. You cannot properly evaluate a particular planning strategy without calculating your overall tax liability with and without that strategy. This letter contains ideas for Federal income tax planning only. **State income tax issues have not been addressed.**

Please contact us if you are interested in a tax topic that we did not discuss. We will gladly assist you. **Note!** The information contained in this material should not be relied upon without an independent, professional analysis of how any of the items discussed may apply to a specific situation.

Disclaimer: Any tax advice contained in the body of this material was not intended or written to be used, and cannot be used, by the recipient for the purpose of promoting, marketing, or recommending to another party any transaction or matter addressed herein. The preceding information is intended as a general discussion of the subject addressed and is not intended as a formal tax opinion. The recipient should not rely on any information contained herein without performing his or her own research verifying the conclusions reached. The conclusions reached should not be relied upon without an independent, professional analysis of the facts and law applicable to the situation.