HUGHES FINANCIAL SERVICES, LLC

Taximpact

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Tax Planning & Tax Risk Management

FILING FOR 2020, PLANNING FOR 2021

Income tax is a large revenue source for the United States government. Although our tax rates have changed many times since the 1860's, the United States uses a "progressive" tax code. A progressive tax code means that people who make more money are taxed at a higher rate than those who make less money. Our progressive tax system works by placing earners through different tax brackets according to how much money they earn. The dollar amounts define your tax brackets with differing tables depending on your filing status (single, married, etc.). These items are important when determining your marginal tax rate.

UNDERSTANDING YOUR MARGINAL TAX RATE

Determining your tax bracket is not as simple as just adding up your total income and checking a tax table. You'll need to calculate your taxable income (which can be sometimes referred to as your "adjusted gross income") and adjust your income for any allowable deductions, adjustments, and exemptions to come up with your final taxable amount.

Once you determine your final taxable income amount, it's critical to know that not all of your income will be taxed at the same rate. For example, if you are married filing jointly with a final taxable income of $95,000, the first $19,750 is taxed at 10% with the remainder at a marginal tax rate of 22%. The key thing to note in this example is that the last dollar earned is taxed at the 22% tax rate.

The CARES Act and SECURE Act made significant changes to our tax laws that can impact your 2020 and 2021 taxes. This report includes some helpful strategies to address both Acts. If you want to review your retirement plan or know someone who needs help in this area, please contact our office | (703) 669-3660

Hughes Financial Services, LLC, is an independent Registered Investment Advisor (RIA) that works closely with individuals and families, helping them to accomplish their unique financial goals and objectives through the allocation of their assets.

We are a fee-only firm that seeks to adhere to the highest fiduciary standards and provide clients with advice that is truly unbiased and has only our clients' best interests in mind.

We offer our clients a wealth of comprehensive financial planning expertise in:

- retirement planning
- estate planning
- investment management
- risk management
- insurance
- education planning

Our advisors hold a variety of professional designations and certifications and are well-versed in a number of financial disciplines. Our combined education and experience allows us to proudly offer you independent financial advice you can trust.

At Hughes Financial Services, we strongly believe tax planning should always be an essential focus when reviewing your personal financial situation. Our goal as financial advisors is to try to point out as many tax savings opportunities and strategies as possible.

This report reviews some of the broader tax law changes along with a wide range of tax reduction strategies.

We always recommend addressing any strategy with a tax professional to consider how one strategy may affect another and calculate both state and federal income tax consequences. Tax strategies and ideas that have worked in the past might not work now or even be available under today's tax laws.

As you read along, note each tax strategy you think could be beneficial but keep in mind that not all ideas are appropriate for everyone. Always attempt to understand the details before making any decisions — it's always easier to avoid a problem than it is to solve one!

TAX ALERT: Your state income tax laws could be different from federal income tax laws. To view a wide range of tax info and access links to tax forms for all 50 states, go to www.tax.findlaw.com.

2020 TAX RATES & INCOME BRACKETS

There are seven federal income tax brackets for 2020. The lowest of the seven tax rates is 10%, while the top tax rate is still 37%. The income that falls into each bracket is scheduled to be adjusted each year for inflation. For 2020, see the charts below to see which bracket you fall into.

TAX TIP

Not sure how to file? Ask your tax preparer or review IRS Publication 17, Your Federal Income Tax, which is a complete tax resource. It contains helpful information such as whether you need to file a tax return and how to choose your filing status.

2020 TAX TABLES

SINGLE FILERS

Up to $9,875	10% of taxable income
$9,876 – 40,125	$987.50 + 12% of excess over $9,875
$40,126 – 85,525	$4,617.50 + 22% of excess over $40,125
$85,526 – 163,300	$14,605.50 + 24% of excess over $85,525
$163,301 – 207,350	$33,271.50 + 32% of excess over $163,300
$207,351 – 518,400	$47,367.50 + 35% of excess over $207,350
$518,401 +	$156,235 + 37% of excess over $518,400

MARRIED FILING JOINTLY

Up to $19,750	10% of taxable income
$19,751 – 80,250	$1,975 + 12% of excess over $19,750
$80,251 – 171,050	$9,235 + 22% of excess over $80,250
$171,051 – 326,600	$29,211 + 24% of excess over $171,050
$326,601 – 414,700	$66,543 + 32% of excess over $326,600
$414,701 – 622,050	$94,735 + 35% of excess over $414,700
$622,051 +	$167,307.50 + 37% of excess over $622,050

MARRIED FILING SEPARATELY

Up to $9,875	10% of taxable income
$9,876 – 40,125	$987.50 + 12% of excess over $9,875
$40,126 – 85,525	$4,617.50 + 22% of excess over $40,125
$85,526 – 163,300	$14,605.50 + 24% of excess over $85,525
$163,301 – 207,350	$33,271.50 + 32% of excess over $163,300
$207,351 – 311,025	$47,367.50 + 35% of excess over $207,350
$311,026 +	$83,653.75 + 37% of excess over $311,025

HEAD OF HOUSEHOLD

Up to $14,100	10% of taxable income
$14,101 – 53,700	$1,410 + 12% of excess over $14,100
$53,701 – 85,500	$6,162 + 22% of excess over $53,700
$85,501 – 163,300	$13,158 + 24% of excess over $85,500
$163,301 – 207,350	$31,830 + 32% of excess over $163,300
$207,351 – 518,400	$45,926 + 35% of excess over $207,350
$518,401 +	$154,793.50 + 37% of excess over $518,400

THE MOST HELPFUL

TAX STRATEGIES CHECKLIST

- ☐ It's always helpful to keep a log of and all the receipts for purchases or services you think could be tax deductible. Sometimes, taxpayers assume that various expenses are not deductible and don't mention them to their tax preparers. Don't assume anything – give your tax preparer the chance to tell you whether something is or is not deductible.
- ☐ Be careful to not overpay your Social Security taxes. If you received a paycheck from two or more employers and earned more than $137,700 in 2020, you may be able to file a claim on your tax return for the excess Social Security tax withholding.
- ☐ Don't forget items carried over from prior years because you exceeded annual limits such as capital losses, passive losses, charitable contributions and alternative minimum tax credits.
- ☐ Check your 2019 tax return to see if there was a 2019 refund applied to your 2020 estimated taxes.
- ☐ Calculate your estimated tax payments for 2021 very carefully. Many computer tax programs will automatically assume that your income tax liability for the current year is the same as the prior year. This is done to avoid paying penalties for underpayment of your estimated income taxes. However, in some cases, this might not be the correct assumption especially if 2020 was an unusual income tax year due to the sale of a business, unusual capital gains, the exercise of stock options or even winning the lottery! A qualified tax preparer could be very helpful in preparing a tax projection for 2021.
- ☐ IRS.gov can be a valuable online resource for tax info.
- ☐ Always double check your math where possible and remember it's always wise to consult a tax preparer before filing your taxes.

PROACTIVE TAX PLANNING IDEAS FOR THE SECURE ACT

BE PROACTIVE, NOT REACTIVE

On December 20, 2019, the Setting Every Community Up for Retirement Enhancement (SECURE) Act was signed into law. The SECURE Act made major changes to several tax rules that govern retirement savings. Changes that started in 2020 that impact retirement savers and their tax strategies include:

- The Required Minimum Distribution (RMD) age was raised from 70½ to age 72
- The age limit for making contributions to a traditional IRA was eliminated
- With few exceptions, a new 10-year rule essentially requires most non-spouse beneficiaries to take full distribution of all inherited IRAs, Roth IRAs, and qualified plans within 10 years of the original owner's death
- There are additional 529 Education Fund usage rules
- A 10% retirement account penalty exception for births and adoptions

2020 STANDARD DEDUCTION AMOUNTS

Most taxpayers claim the standard deduction. For 2020, the standard deduction has slightly increased. The amounts are now $12,400 for single filers and $24,800 for those filing jointly ($18,650 for head of household filers). If you are filing as a married couple, an additional $1,300 is added to the standard deduction for each person age 65 and older. If you are single and age 65 or older, an additional deduction of $1,650 can be made.

3.8% MEDICARE INVESTMENT SURTAX

In its 8th year, the 3.8% net investment income tax is also known as the Medicare surtax. If you earn more than $200,000 as a single or head of household taxpayer, $125,000 as married filing separately, or $250,000 as married joint return filers, this tax applies to either your modified adjusted gross income or net investment income (including interest, dividends, capital gains, rentals, and royalty income), whichever is lower. This tax is in addition to capital gains or other tax you already pay on investment income.

It's helpful to pay attention to timing, especially if your income fluctuates from year to year or is close to the $200,000 or $250,000 amount. Consider realizing capital gains in years when you are under these limits. The inclusion limits may penalize married couples, so realizing investment gains before you tie the knot may help in some circumstances. This tax makes the use of depreciation, installment sales, and other tax deferment strategies suddenly more attractive.

CALCULATING CAPITAL GAINS AND LOSSES

With different tax rates for different types of gains and losses in your marketable securities portfolio, it's a good idea to familiarize yourself with some of the rules.

- Short-term capital losses must first be used to offset short-term capital gains.
- If there are net short-term losses, they can be used to offset net long-term capital gains.
- Long-term capital losses are similarly first applied against long-term capital gains, with any excess applied against short-term capital gains.
- Net long-term capital losses in any rate category are first applied against the highest tax rate long-term capital gains.
- Capital losses in excess of your capital gains can be used to offset up to $3,000 of ordinary income ($1,500 if married filing separately).
- Any remaining unused capital losses can be carried forward and used in the same manner as described above.

TAX TIP

Remember to look at your 2019 income tax return Schedule D (page 2) to see if you have any capital loss carryover for 2020. This is often overlooked, especially if you are changing tax preparers.

Always double-check your capital gains or losses. If you sold an asset outside of a qualified account during 2020, you most likely incurred a capital gain or loss. Sales of securities showing the transaction date and sale price are listed on the 1099 generated by the financial institution. However, your 1099 might not show the correct cost basis or realized gain or loss for each sale. You will need to know the full cost basis for each investment sold outside of your qualified accounts, which is usually what you paid for it, but is not always the case.

CARES ACT RECOVERY REBATE PAYMENTS

Under the **Coronavirus Aid, Relief, and Economic Security (CARES) Act**, many Americans received direct economic recovery rebate payments of $1,200 ($2,400 for couples filing jointly), plus $500 more for each child under age 17. Year-end Coronavirus-related relief provided additional rebates of $600 per individual and dependent. The payments phase out for joint filers with adjusted gross incomes above $150,000, head-of-household filers with adjusted gross incomes above $112,500, and single filers with AGIs above $75,000. Technically, the rebate is an advance payment of a special 2020 tax credit. You will reconcile your rebate on your 2020 return. If you received a rebate, please alert your tax preparer.

(help for your taxing problems)

NEW! CHARITABLE GIFTS AND DONATIONS DEDUCTIONS

The Coronavirus Aid, Relief, and Economic Security (CARES) Act created a new charitable deduction for taxpayers who will not itemize their deductions in 2020. This benefit, known as a **Universal Deduction**, allows for an above-the-line charitable deduction of up to $300 (this increases to up to $600 for those married filing jointly in 2021). To qualify, the charitable gift must be a cash donation (or cash equivalent) made to a qualified charity (501(c)(3)) and should have been made on or before December 31, 2020.

For those who are itemizing, the CARES Act also allows you to take deductions up to 100% of your 2020 AGI (up from 60%) for cash contributions to qualified charities.

When preparing your list of charitable gifts, remember to review your checkbook register **AND** credit card statements so you don't leave any out. Everyone remembers to count the monetary gifts made to charity, but you should count noncash donations as well. Make it a priority to always get a receipt for every gift and store your receipts safely.

If your contribution totals more than $250, you will also need an acknowledgement from the charity documenting the support you provided. Remember that you will have to itemize to claim this deduction.

You can't deduct the value of your time spent volunteering, but if you buy supplies for a group, the cost of that material is deductible as an itemized charitable donation. You can also claim a charitable deduction for the use of your vehicle for charitable purposes, such as delivering meals to the homebound in your community or taking your child's Scout troop on an outing. For 2020, the IRS will let you deduct that travel at .14 cents per mile.

CHARITABLE GIFTS DIRECTLY MADE FROM IRAs

Individuals at least 70½ years of age can still exclude from gross income Qualified Charitable Distributions (QCDs) from IRAs of up to $100,000 per year. These distributions must be made directly to the charity. Remember to double check on what counts as a qualified charity and distribution before using this tax strategy.

CHILDCARE AND DEPENDENT CARE CREDIT

Although COVID-19 halted in-person school attendance for most children, millions of parents typically claim the Child and Dependent Care Credit each year to help cover after-school daycare costs while working.

TAX TIP

Did you know that some parents overlook claiming this tax credit for childcare costs incurred during the summer? This tax break can also be applied to summer day camp costs; for deduction purposes, the camp can only be a day camp, not an overnight camp.

In 2020, if you paid a daycare center, babysitter, (day) summer camp, or other care provider to care for a qualifying child under age 13 or a disabled dependent of any age, you may qualify for a tax credit of up to 35% of qualifying expenses of $3,000 for one child or dependent, or up to $6,000 for two or more children.

INCREASED CHILD TAX CREDIT

For 2020, the maximum child tax credit is $2,000 per qualifying child. Up to $1,400 of the Child Tax Credit is refundable; that is, it can reduce your tax bill to zero and you might be able to get a refund on anything left over. There is also a non-refundable credit of $500 for dependents other than children. The modified adjusted gross income threshold at which the credit begins to phase out is $200,000 and $400,000 if married filing jointly.

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INVESTMENT INCOME

Long-term capital gains are taxed at more favorable rates compared to ordinary income. For qualified dividends, investors continue to be taxed at 0%, 15% or 20%.

One tax strategy is to review investments that have unrealized long-term capital gains and sell enough of the appreciated investments to generate long-term capital gains that can push you to the top of your federal income tax bracket. This can be helpful if you are in the 0% capital gains bracket and do not have to pay any federal taxes on this gain. Then, if you want, you can buy back your investment on the same day, increasing your cost-basis in those investments. If you sell them in the future, the increased cost-basis will help reduce long-term capital gains. You do not have to wait 30 days before you buy back this investment — the 30-day rule only applies to losses, not gains.

Note: *This non-taxable capital gain for federal income taxes might not apply to your state.*

TAX TIP

Remember that marginal tax rates on long-term capital gains and dividends can be higher than expected. The 3.8% surtax can raise the effective rate to 18.8% for single filers with income from $200,000 to $441,500 and 23.8% for single filers with income above $441,500. It can raise the effective rate to 18.8% for married taxpayers filing jointly with income from $250,000 to $496,600 and to 23.8% for married taxpayers filing jointly with income above $496,600.

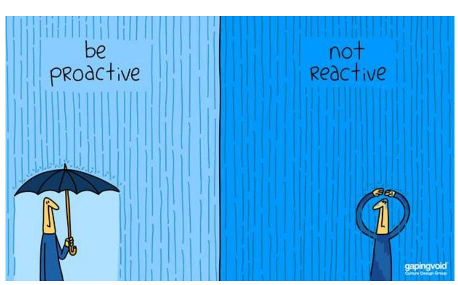
MEDICAL EXPENSE DEDUCTION

The 2020 threshold for deducting medical expenses is 7.5% of AGI. The adjusted-gross-income threshold was slated to jump from 7.5% to 10% after 2018, but COVID-related relief legislation in 2020 made the 7.5% figure permanent. The IRS website, www.IRS.gov, provides a long list of expenses that qualify as "medical expenses" so it's a good idea to review their list and keep track of yours if you think they may qualify.

MEDICARE HEALTH INSURANCE TAX ON WAGES

If you earn more than $200,000 in wages, compensation, and self-employment income ($250,000 if filing jointly, or $125,000 if married and filing separately), the Affordable Care Act levies a special 0.9% tax on your wages and other earned income. You'll pay this all year as your employer withholds this additional Medicare Tax from your paycheck. If you're self-employed, plan for this tax when you calculate your estimated taxes.

There's little you can do to reduce the bite of this tax. Requesting non-cash benefits in lieu of wages won't help — they're included in the taxable amount. If you're self-employed, you may want to take special care in timing income and expenses (especially depreciation) to avoid the income limit.



REINVESTED DIVIDENDS

This is not a tax deduction, but it is an important calculation that can save investors a bundle. Former IRS commissioner Fred Goldberg told *Kiplinger's* for their annual overlooked deduction article that **missing this break costs millions of taxpayers a lot in overpaid taxes.**

Many investors have mutual fund dividends that are automatically used to buy extra shares. Each reinvestment increases your tax basis in that fund and in turn, will reduce the taxable capital gain (or increase the tax-saving loss) when you redeem shares. Please keep good records. Forgetting to include reinvested dividends in your basis results in double taxation of the dividends — once in the year when they were paid out and immediately reinvested and later when they are included in the proceeds of the sale.

If you are not sure what your basis is, ask the fund or us for help! Funds often report to investors the tax basis of shares redeemed during the year. Regulators currently require that for the sale of shares purchased, financial institutions must report the basis to investors and to the IRS.

REQUIRED MINIMUM DISTRIBUTIONS (RMDs)

The **SECURE Act** increased the age for Required Minimum Distributions (RMDs) starting January 1, 2020 to age 72 (this change only applies to account owners who turn 70½ after 2019). Under previous law, participants were generally required to begin taking distributions from their retirement plan at age 70½.

(help for your taxing problems)

Reminder: The **CARES Act** allowed you to not take RMDs in 2020. If you took an RMD in 2020, you had until August 31, 2020, to roll that distribution back into your IRA and this roll back was not subject to the 60-day or one per year rule.

RETIREMENT ACCOUNT CONTRIBUTIONS

Starting in 2020, the **SECURE Act** allowed people with earned income to make contributions to Traditional IRAs past the age of 70½.

If you have not already funded your retirement account for 2020, consider doing so by April 15, 2021. This is the deadline for contributions to a traditional IRA (deductible or not) and a Roth IRA. However, if you have a Keogh or SEP and you get a filing extension to October 15, 2021, you can wait until then to put 2020 contributions into those accounts. To start tax-advantaged growth potential as quickly as possible, try to not delay in making contributions. If eligible, **a deductible contribution will help you lower your tax bill for 2020 and your contributions can grow tax-deferred!**

To qualify for the full annual IRA deduction in 2020, you must either: 1) not be eligible to participate in a company retirement plan, or 2) if you are eligible, there is a phase-out from $65,000 to $75,000 of MAGI for singles and from $104,000 to $124,000 for married taxpayers filing jointly. If you are not eligible for a company plan but your spouse is, your traditional IRA contribution is fully deductible if your combined gross income does not exceed $196,000. For 2020, the maximum IRA contribution you can make is $6,000 ($7,000 if you are age 50 or older by the end of the calendar year). For self-employed persons, the maximum annual addition to SEPs and Keoghs for 2020 is $57,000.

Although contributing to a Roth IRA instead of a traditional IRA will not reduce your 2020 tax bill (Roth contributions are not deductible), it could be the better choice because all qualified withdrawals from a Roth can be tax-free in retirement while withdrawals from a traditional IRA are fully taxable in retirement. To contribute the full $6,000 ($7,000 if you are age 50 or older by the end of 2020) to a Roth IRA, you must have MAGI of $124,000 or less a year if you are single or $196,000 if you are married and file a joint return. **If you have any questions on making retirement contributions, call us.**

RETIREMENT PLAN	2020 LIMITS
Elective deferrals to 401(k), 403(b), 457(b)(2), 457(c)(1)	$19,500
Defined Contribution Plans	$57,000
SIMPLEs	$13,500
Traditional IRAs	$6,000
Catch-Up Contributions: 401(k), 403(b), 457(b)(2), 457(c)(1)	$6,500
Catch-Up Contributions: SIMPLEs	$3,000
Catch-Up Contributions: IRAs	$1,000

ROTH IRA CONVERSIONS

A Roth IRA conversion is when you convert part or all your traditional IRA into a Roth IRA. This is a taxable event with the amount converted subject to ordinary income tax. It may also cause your income to increase, subjecting you to the Medicare surtax. Roth IRAs grow tax-free and qualified withdrawals are tax-free in the future, a time when tax rates might be higher.

Converting part or all your traditional IRA to a Roth IRA depends on your situation. It's best to prepare a tax projection and calculate the appropriate amount to convert. You do not have to convert all your IRA to a Roth. Roth IRA conversions are not subject to the pre-age 59½ penalty of 10%.

Many 401(k) plan participants (if their plan allows) can convert the pre-tax money in their 401(k) plan to a Roth 401(k) plan without leaving the job or reaching age 59½. There are a few pros and cons to making this change. **Please call us to see if this makes sense for you.**

STUDENT LOAN INTEREST PAID BY PARENTS

Generally, you can only deduct interest if you are legally required to repay the debt. But if parents pay back a child's student loans, the IRS treats the transactions as if the money were given to the child, who then paid the debt. So long as the child is no longer claimed as a dependent, the child can deduct up to $2,500 of student loan interest paid by their parents each year. Parents: you cannot claim the interest deduction even though you footed the bill because you are not liable for the debt.

PROACTIVE TAX PLANNING IDEAS FOR 2021

BE PROACTIVE, NOT REACTIVE

Actions taxpayers could consider to proactively tax plan for 2021 include:

- **Prepare a 2021 tax projection:** taxpayers already know the 2021 rates and by reviewing their 2020 situation and all 2021 income expectations, a qualified tax preparer may be able to help you with a 2021 tax projection.
- **New contribution limits for retirement savings:** for 2021, the contribution limit for employees participating in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan remains at $19,500. The limit on annual contributions to an IRA also remains unchanged at $6,000 ($7,000 for those 50 or older). The catch-up contribution limits for those 50 and over remain at $1,000.
- **Explore if a potential Roth IRA conversion is helpful for your situation:** a Roth IRA can be beneficial in your overall retirement planning. Roth IRA investments have the potential to grow tax-free and they do not have required minimum distributions during the lifetime of the original owner. Also, Roth IRA assets may pass to your heirs tax-free. Roth conversions include complex details and are not right for everyone, so please call us to see if this makes sense for you.
- **Take advantage of annual exclusion gifts:** for 2021, the maximum gift tax exemption is $15,000. This means you can give up to that amount to a family member without having to pay a gift tax. Ideas for gifting can include contributing to a working child (or grandchild's) IRA or gifting to a 529 plan, which is a tax-sheltered plan for college expenses.
- **Consider bunching your charitable donations into a Donor Advised Fund (DAF):** now is the time to explore if it is helpful to your tax situation to deposit cash, appreciated securities or other assets in a Donor Advised Fund, and then distribute the money to charities over time. Up to 60% of your adjusted gross income can be deductible if given as donations to typical charities.
- **The new above-the-line charitable deduction increases from $300 to $600 for married taxpayers filing jointly.**

Potential U.S. Tax Policy SHIFTS

When President Biden was running for office, he noted several tax law changes he would look into changing should he be elected. While these proposals are not law, it's helpful to be aware of them now so you can be better prepared if they were to come to fruition. They include:

INCREASE CORPORATE TAX RATES: Under the TCJA, the current corporate tax rate is now at 21%; Biden's proposal raises it to 28%.

INCREASE MARGINAL TAX RATE FOR TOP EARNERS: The top marginal income tax bracket would return to the pre-TCJA level of 39.6%.

RAISE CAPITAL GAINS TAX ON FILERS WITH INCOMES ABOVE $1M: Filers with income over $1M would pay ordinary tax rates on dividends and capital gains, no matter how long the asset has been held. This would imply 39.6% plus the Net Investment Income Tax (NIIT) for a total tax rate of over 43%.

LIMIT ITEMIZED DEDUCTIONS: With a cap of 28%, taxpayers itemizing their deductions would receive a maximum benefit of $0.28 per dollar itemized. This also applies to filers paying a higher marginal tax rate.

PHASE OUT SMALL BUSINESS DEDUCTIONS OVER $400,000: Qualified Business Income (QBI) deductions would remain for those with less than $400,000 in earnings but phase out pass-through deductions for those with over $400,000 in earnings.

ELIMINATE STEP-UP IN COST BASIS: A step-up in cost basis is the readjustment of the value of an appreciated asset for tax purposes upon inheritance. Currently, for example, if an investor has a $300,000 marketable securities position that is worth $500,000 at the time of his/her death, the heir will pay capital gains on anything over $500,000 if the securities were sold. Under Biden's proposal, heirs would not "inherit" a stepped-up cost basis and upon liquating the position soon after receiving it would realize $200,000 of capital gains.

REDUCE ESTATE TAX EXEMPTION. Biden's tax plan wants to reduce estate tax exemptions back to $3.5 million per individual (currently $11.7 million per individual) immediately. Estates over that value would be subject to the federal estate tax.