October 2020

Taximpact

YOUR GUIDE TO YEAR-END TAX PLANNING

Who doesn't like opportunities that allow us to reduce our taxes? Uncle Sam loves having American taxpayers as business partners; the feeling is typically not mutual. As holistic financial advisors, one of our main goals is to help our clients recognize tax reduction opportunities within their investment portfolios and overall financial planning strategies. Staying current on the ever-changing tax environment is a key role we fill so we can help our clients benefit from potential tax reduction strategies.

2020 was an unusual year which saw the passing of several major legislative bills that may have an impact on your taxes now and in the future. Further, it's a presidential election year, so investors should start considering how current tax reduction strategies can be used to mitigate against future potential tax policies. Although it takes more than a new presidential administration cycle to enact tax law changes, being aware of any potential changes in advance is always a wise thing to do. This *TaxImpact* will review possible tax law changes (based on current proposals) if there is a change in administration as well as notable CARES Act and SECURE Act changes you should know about. As always, the focus of this report is to share strategies on what individual taxpayers can do to potentially save money on their 2020 taxes when they are considered and implemented before year-end.

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HUGHES FINANCIAL SERVICES, LLC

Year-end tax planning

The best time to start is now

TAX PLANNING SHOULD *ALWAYS* BE A CRUCIAL FOCUS WHEN REVIEWING YOUR FINANCIAL SITUATION

The Tax Cuts and Jobs Act (TCJA), enacted in 2017, was a huge overhaul of the U.S. tax code and provided taxpayers with shorter tax forms. While it's uncertain what will happen when many of the individual provisions of the Act expire after 2025, we can take steps now to optimize your tax situation using the tax laws currently on the books.

While everyone's financial and tax situations are unique, everyone should start their final year-end tax planning now! Choosing the appropriate tactics will depend on issues that are specific to your financial situation. As you read through this report, mark those strategies that may apply to your situation so you can discuss them with your tax professional and financial advisor.

ITEMIZED VS STANDARD DEDUCTION

For 2020, the standard deduction amounts increase to $12,400 for individuals and married couples filing separately, $18,650 for heads of household, and $24,800 for married couples filing jointly and surviving spouses.

Back in 2018, the TCJA roughly doubled the standard deduction which reportedly decreased tax payments for those who typically claimed this deduction. Although personal exemption deductions are no longer available, the larger standard deduction, combined with lower tax rates and an increased child tax credit, may result in a lower tax bill. Before opting to use itemized deductions, you should run the numbers to determine the impact on your situation.

The TCJA still eliminates or limits many of the previous laws concerning itemized deductions. One example is the state and local tax deduction (SALT), now capped at $10,000 per year, or $5,000 for a married taxpayer filing separately.

BUNCH CHARITABLE CONTRIBUTIONS OR USE A DONOR-ADVISED FUND (DAF)

The increased standard deduction and changes to itemized deductions drove many taxpayers to no longer itemize their deductions. In fact, it was estimated that about 15 million filers used the charitable contribution write-off in 2018, a sharp decline from 36 million in 2017. For taxpayers who are charitably inclined, it makes sense to put together a plan. One method is "bunching." Bunching is the consolidation of donations and other deductions into targeted years so that in those years, the deduction amount will exceed the standard deduction amount.

Another strategy to consider is a **Donor-Advised Fund (DAF)**. A DAF is a philanthropic vehicle established with a public charity. It allows donors to make a charitable contribution of cash, stock, or other assets, receive an immediate tax benefit and then recommend grants from the fund over time. Taxpayers can take advantage of the charitable deduction when they're at a higher marginal tax rate while the actual payouts from the fund can be deferred until later. It can be a win-win situation for the taxpayer and the charity. **If you are charitably inclined and need some guidance, call us for our assistance.**

REVIEW HOME EQUITY DEBT INTEREST

For mortgages taken out after October 13, 1987, and before December 16, 2017, mortgage interest is fully deductible up to the first $1,000,000 of mortgage debt. For homes purchased after December 15, 2017, the threshold has been lowered to the first $750,000 (or $375,000 married filing separately). All interest paid on any mortgage taken out before October 13, 1987 is called "grandfathered debt" and is fully deductible regardless of your mortgage amount. Under TCJA, this change applies to all tax years between 2018 and 2025. Many mortgage holders refinanced for lower rates in the last few years so for larger mortgages, that could change your situation.

Home equity lines of credit (HELOCs) are deductible as well, but only if the funds were used to buy or substantially improve the home that secures the loan. When filing your taxes, please share with your tax preparer how the proceeds of your home equity loan were used. If you used the HELOC to pay off credit card or other personal debts, the interest is not deductible.

State income tax laws may vary 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.sisterstates.com

NEW INCOME TAX RATES FOR 2020

For 2020, there are still seven tax rates ranging between 10% and 37%. Under current tax law, this seven-rate structure will be phased out on January 1, 2026.

FEDERAL TAX RATES	SINGLE		HEAD OF HOUSEHOLD		MARRIED FILING SEPARATELY		MARRIED FILING JOINTLY/ QUALIFYING WIDOW(ER)	
Ordinary Income	Taxable Income Over	to	Taxable Income Over	to	Taxable Income Over	to	Taxable Income Over	to
10%	$0	$9,875	$0	$14,100	$0	$9,875	$0	$19,750
12%	9,876	40,125	14,101	53,700	9,876	40,125	19,751	80,250
22%	40,126	85,525	53,701	85,500	40,126	85,525	80,251	171,050
24%	85,526	163,300	85,501	163,300	85,526	163,300	171,051	326,600
32%	163,301	207,350	163,301	207,350	163,301	207,350	326,601	414,700
35%	207,351	518,400	207,351	518,400	207,351	311,025	414,701	622,050
37%	Over $518,401		Over $518,401		Over $311,026		Over $622,051	

REVISIT USE OF QUALIFIED TUITION PLANS

Qualified tuition plans, aka 529 plans, are a great way to mitigate your tax bill while planning for the challenge of paying tuition for children or grandchildren. Originally, earnings in a 529 plan could be withdrawn tax-free only when used for qualified higher education at colleges, universities, vocational schools, or other post-secondary schools.

Now, 529 plans can also be used to pay for tuition at an elementary or secondary public, private or religious school, up to $10,000 per year. Unlike IRAs, there are no annual contribution limits for 529 plans. Instead, there are maximum aggregate limits, which vary by plan. Under federal law, 529 plan balances cannot exceed the expected cost of the beneficiary's qualified higher education expenses with limits varying by state (often ranging from $235,000 to $529,000).

Some states offer a state tax credit or deduction up to a certain amount for 529 plan contributions. For federal tax purposes, 529 plan contributions are considered completed gifts and, in 2020, up to $15,000 per donor, per beneficiary, qualifies for the annual gift tax exclusion. Excess contributions above $15,000 must be reported on IRS Form 709 and will count against the taxpayer's lifetime estate and gift tax exemption amount ($11.58 million in 2020).

There is also an option to make a larger tax-free 529 plan contribution if the contribution is treated as if it were spread evenly over a 5-year period. For example, a $75,000 lump sum contribution to a 529 plan can be applied as though it were $15,000 per year as long as no other monetary gifts are made to the same beneficiary over the next five years. Grandparents may want to consider this 5-year gift-tax averaging as an estate planning strategy. **If you want to explore setting up a 529 plan for your child or grandchild, call us and we would be happy to assist you.**

MAXIMIZE QUALIFIED BUSINESS INCOME (QBI) DEDUCTION (if applicable)

The Qualified Business Income (QBI) deduction under Section 199A allows taxpayers who own interests in a sole proprietorship, partnership, LLC, or S corporation may be able to deduct up to 20% of their QBI. This deduction is subject to various rules and limitations so it would be wise to discuss this with your tax preparer.

There are planning strategies for business owners to consider when determining your potential QBI. For example, business owners can adjust their business's W-2 wages to maximize the deduction. Also, it may be beneficial to convert independent contractors to employees where possible; before doing so, make sure the benefit of the deduction outweighs the increased payroll tax burden and cost of providing employee benefits. Other planning strategies can include investing in short-lived depreciable assets, restructuring the business, and leasing or selling property between businesses. The QBI deduction would take an entire report to discuss, so we recommend that if you are a business owner, talk with a qualified tax professional about how Section 199A could potentially work for you.

2020 Retirement Savings Options

In 2020, if you have earned income or are still working, consider contributing to your retirement plan.

Now is an ideal time to maximize the benefits of retirement plans for 2020 and start thinking about what your strategy should be in 2021. For many investors, retirement contributions represent one of the smarter tax moves to make.

Here are some strategies worth considering:

401(K) Contribution Limits Increased

The elective deferral (contribution) limit for employees under the age of 50 who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan is $19,500. The catch-up contribution limit for employees aged 50 and over who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan increased to an additional $6,500 ($26,000 total). **As a reminder, these contributions must be made in 2020.**

IRA Contribution Limits Unchanged

The limit on annual contributions to an Individual Retirement Arrangement (IRA) remains at $6,000. The additional catch-up contribution limit for individuals aged 50 and over is not subject to an annual cost-of-living adjustment and remains $1,000 (for a total of $7,000). **IRA contributions for 2020 can be made all the way up to the April 15, 2021, filling deadline.**

Higher Roth IRA Income Cutoffs

The MAGI phase-out range for taxpayers making contributions to a Roth IRA is $196,000 to $206,000 for married couples filing jointly. For singles and heads of household, the income phase-out range is $124,000 to $139,000. For a married individual filing a separate return, the phase-out range remains at $0 to $10,000. **If your earned income is less than your eligible contribution amount, your maximum contribution amount equals your income.**

Higher IRA Income Limits

The deduction for making contributions to a traditional IRA is phased out for singles and heads of household who are covered by a workplace retirement plan and have modified adjusted gross incomes (MAGI) of $65,000 and $75,000 for 2020. For married couples filing jointly, in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, the income phase-out range is $104,000 to $124,000. For an IRA contributor who isn't covered by a workplace retirement plan and is married to someone who is, the 2020 deduction is phased out as the couple's income reaches $196,000 and completely at $206,000. For a married individual filing a separate return who is covered by a workplace retirement plan, the phase-out range remains at $0 to $10,000. **If your earned income is less than your eligible contribution amount, your maximum contribution amount equals your income.**

Larger Saver's Credit Threshold

The MAGI limit for the Saver's Credit (also known as the Retirement Savings Contribution Credit) for low- and moderate-income workers is $65,000 for married couples filing jointly, $48,700 for heads of household, and $32,500 for all other filers.

Be Careful Of The IRA One Rollover Rule

IRA investors are still limited to making only one rollover from all of their IRAs to another in any 12-month period. A second IRA-to-IRA rollover in a single year could result in income taxes becoming due on the rollover, a 10% early withdrawal penalty, and a 6% per year excess contributions tax as long as that rollover remains in the IRA. While individuals can only make one IRA rollover during a one-year period, there is no limit on trustee-to-trustee transfers. Multiple trustee-to-trustee transfers between IRAs and conversions from traditional IRAs to Roth IRAs are allowed in the same year.

The CARES Act allowed you to not take your Required Minimum Distribution (RMD) in 2020. If you took an RMD in 2020, you had until August 31, 2020, to roll that distribution back into your IRA without penalty.

If you are rolling over an IRA or have any questions on IRA strategies, please reach out to us.

A TAXING STORY: CAPITAL GAINS & LOSSES

Investments can provide plenty of tax-saving opportunities! Review the various sales you have realized this year on stocks, bonds, and other investments. Then review what is left and determine whether these investments have an unrealized gain or loss (unrealized means you still own the investment, versus realized, which means you have already sold the investment).

Know Your Cost Basis

To determine if you have unrealized gains or losses, you must know the investment's tax basis (the cost of the investment when you bought it). However, this gets trickier with investments that allow you to reinvest your dividends and/or capital gain distributions. We will be glad to help you calculate your cost basis.

Consider Loss Harvesting

If your capital gains are larger than your losses, you may want to do "loss harvesting" (selling investments that will generate a loss). You can use an unlimited amount of capital losses to offset capital gains. However, you are limited to only $3,000 (married, filing jointly; $1,500 married, filing separately) of net capital losses that can offset other income, such as wages, interest, and dividends. **Bonus:** any remaining unused capital losses can be carried forward into future years indefinitely.

Always Double-Check Brokerage Firm Reports

The cost-basis for stock sold in 2020 will be reported by the brokerage firm on IRS Form 1099-B in early 2021. Discrepancies sometimes happen so we suggest you double-check these numbers to make sure that the cost-basis is calculated correctly and does not result in a higher amount of tax than you need to pay.

Know The "Wash Sale" Rule

If you sell an investment at a loss and buy it right back, the IRS disallows the deduction. The "wash sale" rule disallows a capital loss write-off if you purchase a substantially identical security up to 30 days **before and after** a sale. However, you can buy a similar security, perhaps a different stock in the same sector, that will allow you to maintain your general market position while enjoying a tax break.

LONG-TERM CAPITAL GAINS TAX RATES

Tax rates on long-term capital gains and qualified dividends did not change for 2020 but the income thresholds to qualify for the various rates did increase.

You may qualify for a 0% capital gains tax rate for some or all your long-term capital gains realized in 2020. This year, the 0% rate applies for individual taxpayers with taxable income up to $40,000 on single returns, $53,600 for head-of-household filers, and $80,000 for joint returns. If this is the case, the strategy is to figure out how much long-term capital gains you might be able to recognize to take advantage of this tax break.

The 3.8% surtax on net investment income (NII) remains the same for 2020. It begins for single filers with modified AGI over $200,000 and for joint filers with modified AGI over $250,000.

NOTE: The 0%, 15% and 20% long-term capital gains tax rates only apply to "capital assets" (such as marketable securities) held longer than one year. Anything held less than one year is considered "short-term capital gains" and is taxed at ordinary income tax rates.

2020 Long Term Capital Gains Tax Brackets			
Tax Bracket/Rate	**Single**	**Married Filing Jointly**	**Head of Household**
0%	$0 - $40,000	$0 - $80,000	$0 - $53,600
15%	$40,001 - $441,450	$80,001 - $496,600	$53,601 - $469,050
20%	$441,451+	$496,601+	$469,051+

Notable 2020 Tax Changes

Deductible Medical Expenses
The 2020 threshold for deducting medical expenses on Schedule A is 7.5% of your AGI. IRS.gov provides an extensive list of medical expenses that qualify for this deduction.

SALT
State and local income, sales, and real and personal property taxes (SALT) are still limited to $10,000.

ALIMONY DEDUCTIONS
Under prior tax laws, alimony and separate maintenance payments could be deducted by the payor and included as income by the payee.

Under the TCJA, for divorce and separation instruments executed or modified after December 31, 2018, alimony and separate maintenance payments are no longer deductible by the payor-spouse, nor included as income for the payee-spouse.

EDUCATION PLANNING
The student loan interest deduction, education credits, exclusion for savings bond interest, tuition waivers for graduate students, and the educational assistance fringe benefit are all still available in 2020. **Also, starting in 2020, 529 plan funds** can also now be used to pay for fees, books, supplies and equipment for certain apprenticeship programs. In addition, up to $10,000 in total (not annually) can now be withdrawn from 529 plans to pay off student loans.

An additional educational tax benefit is the 2020 **lifetime learning credit**, which allows you to claim 20% of your out-of-pocket costs for tuition, fees and books, up to $10,000, for a total of $2,000. This credit phases out for couples at $118,000 to $138,000 and for singles at $59,000 to $69,000.

Estate, Gift and Generation-Skipping Taxes

Exemption amounts for gift, estate, and generation-skipping taxes for 2020 is $11.58 million ($23.16 million for married couples). Additionally, the income tax basis step up/down to fair market value at death continues. These changes provide high net worth individuals a significant planning window to make gifts and set up irrevocable trusts.

Of note is that come 2026, the estate tax exclusion is scheduled to drop to $5 million (adjusted for inflation). On November 26, 2019, the Treasury Department and IRS issued final regulations under IR-2019-189 confirming that individuals who take advantage of the increased gift tax exclusion or portability amounts in effect between 2018 and 2025 will not be adversely impacted when the TCJA provisions expire on January 1, 2026. Claiming the portable exemption will remain an important discussion topic for decedents with large estates.

Make Use of the Annual Gift Tax Exclusion

In 2020, you may gift up to $15,000 tax-free per beneficiary. These annual exclusion gifts do not reduce your $11,580,000 lifetime gift tax exemption. The annual exclusion gift doubles to $30,000 per beneficiary for gifts made by married couples of jointly held property or when one spouse consents to “gift-splitting” for gifts made by the other spouse.

Make Gifts to Trusts

If direct and immediate, these gifts often qualify as annual exclusion gifts ($15,000 in 2020) and upon meet certain requirements, removes the property from your estate. The annual exclusion gift can be contributed for each beneficiary of a trust.

ROTH IRA CONVERSIONS

To take advantage of historically low interest rates, some IRA owners may want to consider converting part or all their traditional IRAs to a Roth IRA. This is not a simple or easy decision, but Roth IRA conversions can be helpful to taxpayers. However, they can also create immediate tax consequences and trigger additional rules and potential penalties. Further, under the TCJA, you can no longer unwind a Roth conversion by recharacterizing it. It’s best to run the numbers with a financial professional and calculate the most appropriate strategy for your situation. Call us if you would like to review your Roth IRA conversion options.

CHARITABLE GIVING

This is a great time of the year to clean out and donate items to charity. Remember that you can only write off these donations to a charitable organization if you itemize your deductions.

Send cash donations by December 31, 2020 and be sure to hold on to your cancelled check or credit card receipt as proof of your donation. If you contribute $250 or more, you will need a written acknowledgement from the charity.

If you plan to make a significant gift to charity, consider gifting appreciated stocks or other investments you've owned for more than one year to boost the savings on your tax returns. Your contribution deduction is the fair market value of the securities on the date of the gift, not the amount you paid for the asset, and so you avoid having to pay taxes on the profit!

Do not donate investments that have lost value. It is best to sell the asset with the loss first and donate the proceeds so you can take both the charitable contribution deduction and the capital loss. Also, if you give appreciated property to charity, the unrealized gain must be a long-term capital gain for the entire fair market value to be deductible. (The amount of the deduction must be reduced by any unrealized ordinary income, depreciation recapture and/or short-term gain.)

The law allowing taxpayers age 70½ and older to make a Qualified Charitable Distribution (QCD) in the form of a direct transfer of up to $100,000 directly from their IRA to a charity (including all or part of the Required Minimum Distribution) was made permanent in 2015. If you meet the qualifications to use this strategy, the funds must come out of your IRA by December 31, 2020.

ELECTION 2020

Potential Tax Changes to Look For if Biden Wins

While the election has not yet been decided, Democratic Party nominee Joe Biden has released some possible tax law changes if he unseats incumbent Republican Donald Trump for the Presidency come November. While these would be future changes and need approval by Congress, we want you to start thinking about future tax planning strategies should any of these proposed changes come to fruition. As always, we continually monitor these situations and will provide clients with updates and guidance as needed.

Increase Corporate Tax Rates: Under the TCJA, the peak marginal corporate tax rate was reduced from 35% to 21%. Under the Biden tax plan, the corporate tax rate would be increased to 28%.

Increase Marginal Tax Rate for Top Earners: Biden's tax plan would raise the top marginal income tax bracket from 37% to 39.6%. In 2018, the TCJA lowered the top marginal bracket from 39.6% to 37%.

Raise Capital Gains Tax on Filers with Incomes Above $1 Million: Biden's tax proposal calls for filers with over $1 million in income to pay ordinary tax rates on their 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%.

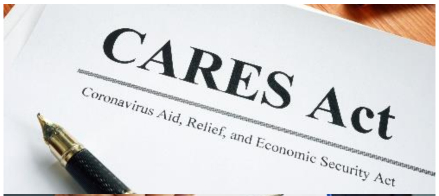
Limit Itemized Deductions: Biden's tax plan includes a cap on itemized deductions at 28%. For each dollar of itemized tax deductions, including charitable contributions, a taxpayer or couple filing jointly would receive a maximum benefit of $0.28 per dollar. This 28% limit would hold true even if a filer is paying a higher marginal tax rate.

Phase Out Small Business Income Deductions Over $400,000: Biden's tax plan aims to keep Qualified Business Income (QBI) deductions in place for those with less than $400,000 in earnings but phasing out pass-through deductions for those with over $400,000 in earnings.

Eliminate Step-Up in Cost Basis: Biden's tax plan wants to end the step-up in cost basis. A step-up in cost basis refers to the cost basis of assets or property transferrable to an heir upon death. If, as an example, an individual purchased a home for $300,000 that was worth $600,000 at the time of their death, their heir would pay capital gains on anything over $600,000 if the home were sold. If Biden's tax proposal were to become law, heirs would not be able to inherit a stepped-up cost basis.

Reduce Estate Tax Exemption: Biden's tax plan reduces estate tax exemptions back down to $3.5 million immediately. Estates valued over the $3.5 million value would be taxed.

★★★★★ **FIVE STAR TIP: YOU CAN FIND ESTIMATED VALUES FOR YOUR DONATED ITEMS AT: https://goo.gl/WcQEfL**



ALERTS

Provisions in the CARES Act and the SECURE Act (passed in December 2019) could affect you in 2020. This section reviews some of the changes for informational purposes only. You should discuss specific impacts on your situation with a qualified tax professional.

CARES ACT ECONOMIC RECOVERY REBATES

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. The payments phased out for joint filers with adjusted gross incomes (AGIs) 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, so you will need to reconcile this rebate on your 2020 tax return. If you received a rebate, remember to factor this in when you complete your 2020 taxes and/or let your tax preparer know.

RETIREMENT PLAN CHANGES

Several changes for retirement plans in 2020 derived from the **SECURE Act**, which was signed into law late in 2019. The **CARES Act** also included a few stipulations that impacted retirement accounts. Both Acts significantly impact required minimum distributions (RMDs). One notable change under the **SECURE Act** is the beginning age for taking RMDs changes from 70½ to 72. This change only applies to account owners who turned 70½ after 2019. **Reminder: the CARES Act allowed you to not take your RMDs in 2020. If you took an RMD in 2020, you had until August 31, 2020 to roll that distribution back into your IRA. This roll back was not subject to the 60 day or one per year rule.**

The **SECURE Act** also provided that:

- People with earned income can make contributions to Traditional IRAs past the age of 70½ starting in 2020.
- Anyone having a baby or adopting a child can take payouts from IRAs and 401(k)s of up to $5,000 without having to pay the 10% fine for pre-age-59½ withdrawals.
- Fellowships, stipends, or similar payments to graduate/post-doctoral students are treated as compensation for purposes of making IRA contributions.

One of the biggest changes from the SECURE Act was the rules for withdrawing money from inherited IRAs and workplace retirement accounts were tightened. Now, most inherited retirement accounts need to be fully distributed within 10 years of the death of the IRA owner or 401(k) participant. This new rule is somewhat complex and has some exceptions so handling inherited retirement accounts will require some professional planning. Please call us or see a tax professional for details. Inherited IRAs from individuals who died before 2020 are not affected by this change.

In addition to the RMD suspension mentioned above, the **CARES Act** includes a few other key retirement-related tax breaks for 2020 including:

- Waiving the 10% penalty on pre-age-59½ payouts from retirement accounts for up to $100,000 of coronavirus-related expenses. This distribution can also be included in income in equal installments over a 3-year period, and you have 3 years to return the money to your retirement account and undo the distribution's tax consequences.
- Allowing eligible taxpayers to borrow from workplace plans such as 401(k)s — up to the lesser of $100,000 or 100% of the account balance — until September 23, 2020. Repayments on retirement plan loans due in 2020 are also delayed for one year.

NEW CHARITABLE DEDUCTION CHANGES FOR 2020

The **CARES Act** created a new **charitable deduction available to taxpayers who do not itemize their deductions in 2020.** Known as a universal deduction, it allows for an above-the-line **charitable deduction of up to $300 per individual ($600 for married filing jointly).** To qualify, the charitable gift must be cash (or cash equivalent), and made to a qualified charity (i.e., 501(c)(3)) on or before 12/31/2020.

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