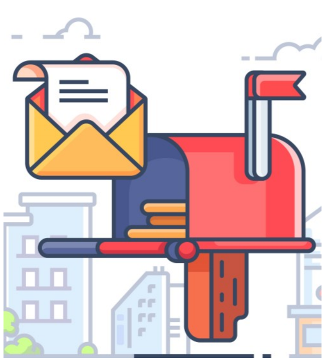
2020 YEAR-END TAX LETTER

INSIDE THIS ISSUE:

IT'S TAX TIME AGAIN…

Your mailbox should be filling up with the information you will need to get the job done.

This letter is full of information designed to help you prepare your tax documents so you will pay only the tax that you rightfully owe.



Time to get organized:

The following checklist will help you collect the documents needed to file your tax return.

☐ **Your last 3 years' tax returns** *(new client)*.

☐ **Social Security numbers and dates of birth** for all taxpayers, spouses and dependents.

☐ **Copy of Driver's License** for taxpayer & spouse.

☐ **W-2 Forms.**

☐ Amount of **Economic Impact Payment (a.k.a. "the stimulus")** received in 2020.

☐ **Your last paycheck stub of the year** (for each job).

☐ **1099 Forms** for interest, dividends, sales, retirement, Social Security, self-employment, and unemployment. ★ **Remember to download statements from 'online' accounts that don't send paper tax forms.**

☐ **Property tax statements.**

☐ **Forms 1098 for mortgage interest.**

☐ **Assets held outside the USA.** Bring statements. Such assets must be disclosed even if they do not generate income.

☐ **Purchase and sale information,** including dates, relating to anything sold.

☐ **Stock options.** Form 1099-B and 'supplemental' brokerage statements showing amounts already reported as income on form W-2.

☐ **Cryptocurrency** (e.g. Bitcoin) sales. Bring details including dates, proceeds, and original cost.

☐ **Child care provider information** (name, address, SS#, amount paid). Required *even if you have a daycare flex account at work.*

☐ **Names, addresses, and Social Security numbers** from whom you received interest, or to whom you paid interest.

☐ **Bankruptcy or divorce papers** (if applicable).

☐ **If you paid an individual $600 or more for services in connection with your business,** please provide their name, address, and tax ID#.

☐ **Records showing income and expense for business and/or rental property you own.** Records of business and personal mileage are required for automobile deductions.

☐ If you have an interest in a **Partnership, S Corporation, Estate or Trust** you will need to bring Form K-1.

☐ **IRA year-end statements.**

☐ **Bring details for all other income,** whether you think it's taxable or not. Examples may include foreign income, barter, hobby, etc.

☐ **Forms 1098-T** for post-secondary tuition payments are sent to the student. If the student is your dependent you must get it from them.

☐ **Forms 1099-Q** for distributions from education savings plans.

☐ **Estimated taxes paid** (including amount and date of each separate payment).

☐ **Student loan interest forms 1098-E.**

☐ **Adoption costs** if applicable. Also bring the legal adoption documents.

☐ **Form 1098-C** for donations of automobiles or boats.

☐ **Details for charitable donations.** Bring receipts. For noncash donations totaling over $500 include date, place, fair market value, and original cost.

☐ **If you purchased a new electric plug-in vehicle,** bring the year, make and purchase date.

☐ **If you purchased solar-electric or solar water heating systems** for your home bring receipts.

☐ **Bring a voided check for direct deposit** of any refunds you expect to receive.

☐ **Noncustodial parents claiming children** need a signed IRS Form 8332 to claim the child.

☐ **If debts were forgiven,** bring Form 1099-C or 1099-A.

☐ **If you bought, sold, or refinanced a home** bring the closing papers.

☐ **Forms 1099-K for internet or credit card sales.**

☐ **Health Savings Account (HSA) contributions and distributions.** Bring forms 5498-SA and 1099-SA.

☐ **Form(s) 1095** for health insurance.

☐ **Out of pocket medical expenses** may be deductible (if large). Bring details.

☐ Pandemic related business assistance, bring details related to the following:

- **PPP and/or EIDL Loan(s)**
- **Employee Retention Credits**

Caution: *the IRS is very attentive to taxpayers who write off local travel costs.*

A daily log of business use is essential. Also, don't forget to record the beginning and the year-end odometer readings.

Need help? There are plenty of smartphone apps that can help with tracking mileage.

DEDUCTING MILEAGE?

Did you drive for charity? If so, you can deduct **14¢** for every mile you drove.

If your medical expenses are substantial, you may want to calculate a mileage deduction. Medical miles for 2020 are calculated at **17¢ per mile.**

If you drove for business purposes, the situation is a little more complicated: First decide which miles qualify.

Use the following three scenarios to determine how many miles you can deduct:

Keep in mind the following statement: **In general, commuting is not deductible.**

If you have an office or regular place of business outside your home, you may not deduct miles commuting to and from work or to your first or from your last stop, but you may deduct mileage to drive to a *temporary work place* (less than one year's duration) and mileage to and from different work locations during the day.

If you have an office in your home that qualifies for a home office deduction, all of your business-related mileage is deductible (see below for home office details).

If you work out of your home but do not qualify for the home office deduction, the distance between home and your first stop and between your last stop and home are nondeductible commuting miles. You should carefully plan to have your first and last stops close to home to maximize the mileage deduction. A trip to the bank, post office, or a supplier can help increase deductible business miles.

Once you have determined which miles to count, you need to decide whether to use the *standard mileage* rate or actual expenses.

The ***standard mileage rate*** *for qualified business use* for 2020 is **57.5¢ per mile** (down 1/2 cent from 2019).

Which method is best? In general, the standard method works best if your business miles are high or your vehicle is economical to run.

The actual expense method works best if your vehicle weighs over 6000 pounds, is costly to run, or you do not have that many miles in total.

DO YOU WORK AT HOME?

If you are self-employed, you may qualify for the home office deduction if you use a portion of your home **exclusively** as your principal place of business, to store inventory, or to conduct substantial management or administrative activities. There can be no other fixed location where the above activities can be done.

The office space still needs to be **used regularly and exclusively for business**. You can not have any other usage of the area whatsoever. Using your office for personal or investment reasons eliminates the deduction as far as the IRS is concerned, so be careful to keep your office space all business.

Having a deductible home office means you can deduct all of your local business travel as described earlier.

If your office qualifies, you will need additional information: Measure the business space and the total space. You will also need your mortgage interest, taxes, insurance, association fees, repairs, maintenance, utilities, garbage, security, and rent paid. Also, provide an accounting of the total investment in your home.

The IRS has provided a simplified home office deduction, if you choose. Instead of calculating all of the above information, $5 per square foot can be deducted (maximum $1,500). The IRS estimates that the new calculation will save taxpayers 1.6 million hours per year.

To avail yourself of tax deductions, you need to be organized and well documented.

Save proof of all tax deductible purchases.

COMPUTER & CELLPHONE GUIDELINES

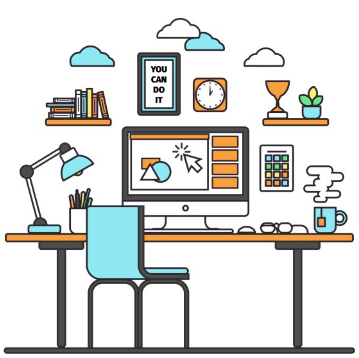
Did you buy a computer that you would like to deduct? You can use the following guidelines to determine what is deductible.

If you are self-employed, the business percentage of computer usage, measured by time, is deductible. ***If you are a student***, the use of a computer is not deductible, but you can tap your 529 plan for a computer purchase.

Keep a log of computer usage to support your deduction.

Cell phone deductions are as follows:

- Employers providing cell phones do not have to require records of use to provide tax-free cell phones to employees.
- Self employed individuals can deduct business cell phone usage. The IRS, however, still has a hard time believing a cell phone is 100% for business. It's wise to keep a log of use.



EMPLOYEE BUSINESS EXPENSE DEDUCTIONS ARE NOT ALLOWED ON THE FEDERAL RETURN

The Tax Cuts & Jobs Act eliminated federal deductions for employee work expenses. As such, the deductions discussed on this page are for <u>business owners</u> only. If you are an employee, ask your employer for reimbursement of any business expenses as they are no longer deductible on your federal tax return.

WHAT'S NEW FOR 2020?

It's been a BIG year for tax changes. Six bills affecting tax-year 2020 became law. Here's what you need to know:

Did you get Economic Impact Payment(s)?
The EIP (a.k.a. "stimulus") is not taxable income, but you still need to remember how much you got. That's because if your stimulus was too small you can claim the balance as a 2020 tax credit. However, don't worry about having to pay-back the stimulus. The IRS says you can keep it even if you don't qualify based on 2020 income.

Don't forget to remember how much you got for BOTH rounds of EIP (including the $600 stimulus plan passed on 12/27/20).

Did your business get a PPP?
Great news! Congress acted to allow tax deductions for expenses paid with forgiven PPP funds.

Do not include PPP loan proceeds in the gross receipts for your business. Loans are not taxable income.

If you never received a PPP it is not too late. Congress approved a fresh $284 billion in PPP funding (signed 12/27/20). Some businesses that already received a PPP can apply too if their revenue dropped by 25% due to the pandemic. Call your business banker today to see if you might qualify.

Lastly, Congress has made it easier to apply for PPP forgiveness (for loans under $150,000). Ask your business banker for details if you haven't already applied for PPP forgiveness.

Did you get an Economic Injury Disaster Loan (EIDL)?
Congress acted to make the advance payments of the EIDL non-taxable.

Did your business get Employee Retention Credits (ERTC)?
If not, you still can try. Initially, businesses were not allowed to claim both the ERTC and a PPP loan. However, Congress acted to allow both the ERTC and PPP if they had greater than 20% quarterly revenue reductions (vs. the prior year or prior quarter). There are additional qualifiers beyond the scope of this letter, so ask for help to see if you qualify.

Did you get unemployment?
If yes, you will need form 1099-G to file your taxes. Some states do not mail the form and require you to login and download it.

Unemployment (UE) compensation is taxable income. Be prepared to owe if the withholding on your UE was too low. This is common for those that received bonus federal UE.

Did you skip your 2020 RMDs?
Taxpayers are allowed to skip their Required Minimum Distributions (RMDs) in 2020. As a refresher, RMDs are required distributions from retirement accounts (including 401ks, IRAs, pensions, annuities, etc.) for taxpayers that turned $70^{1/2}$ prior to 1/1/20 (or turned 72 after 12/31/19). RMDs are scheduled to resume in 2021.

If you have already taken your RMDs and want to put the money back it must be done within 60 days. You are only allowed to do this once per year. Previously, the IRS was allowing taxpayers to put-back multiple RMDs, but the deadline for doing so expired 8/31/20.

Did you give to charity but don't itemize?
Good news! This year you can deduct up to $300 in cash contributions even if you don't itemize. This applies to cash contributions only, not goods.

Did you cash-out retirement funds to make ends-meet?
You might be able to spread the tax burden over 3 years, PLUS avoid the 10% early withdrawal penalty on up to $100,000 of distributions. There are qualifiers however. The taxpayer (or spouse / dependent) must have tested positive for COVID-19 or experienced adverse financial effects due to quarantine, furlough, lay-off, reduced work hours, or being unable to work due to coronavirus related matters.

Did you defer withholding Social Security from your pay?
The President's executive order allowed some employees to defer Social Security withholding as long as it was paid-back by 4/31/21. Congress acted to extend the deadline to pay it back until 12/31/21.

Do you usually qualify for the Earned Income Credit (EIC)?
Don't worry about losing your 2020 EIC due to changes in earned income. That's because you are now allowed to use your 2019 earned income to calculate your 2020 EIC. This also works for the Additional Child Tax Credit. These tax breaks are only allowed for tax year 2020.

Are you working in your 70s?
Now you can contribute to a traditional IRA regardless of age (before 2020 that was limited to workers under $70^{1/2}$).

Do you have student loans?
Beginning in 2020 you can use 529 plan funds to make loan payments for yourself or a sibling ($10,000 lifetime cap).

Do you work part-time?
Beginning in 2020 part-time workers are allowed to participate in employer sponsored 401(k) plans (if they have 500+ hours in three consecutive years). Talk to your employer to see if you qualify.

Did you inherit an IRA?
If the inheritance was in 2020 you now have to completely distribute the funds within 10 years. The old rules apply for IRAs inherited before 2020.

Did you have an addition to the family?
Penalty-free distributions from retirement plans are now allowed (up to $5000) for births or adoptions.

Did you (or will you) have large medical expenses?
Good news! The medical expense deductibility threshold was permanently reduced to 7.5% of Adjusted Gross Income (down from 10%).

Did you have unspent medical or childcare FSA money?
Don't worry about losing unspent 2020 Flexible Spending Account (FSA) funds. Congress acted to allow roll-overs of 2020 medical and/or childcare FSA money into 2021... and 2021 into 2022.

Do you have unfiled returns?
The failure-to-file penalty was increased to $435 per return. It's time to get them done if you know you owe. If you are due a refund you will not be penalized (but the refund will expire 3 years from the original due date of the return).

Do you owe the IRS?
The IRS reduced the interest rate on tax debts from 5% to 3% (as of 7/1/20).

Did you enjoy the extra time to file 2019 returns?
The IRS hasn't announced an extension of the 2021 tax season. Plan to get your taxes filed by 4/15/21 to be safe.

2020 was an unprecedented year of political and economic change. As such, it's no surprise that taxes changed in a big way too.

These are only the highlights of the new laws affecting your 2020 tax situation. Don't forget to ask for help in using these new rules to their fullest.

Turn the page for some great year-end tax tips

YEAR-END TAX TIPS

You're probably ready for 2020 to finally end. That said, consider the following before it does:

Lower Your Taxable Income:
Employees still have time to increase pre-tax deductions (e.g. 401(k), 403(b), etc.) from their paycheck (unless already maxed). Self-employed folks can lower their taxable income too by making business purchases before the end of the year or contributing to a SEP IRA before the filing deadline (including extensions).

Why consider this? Not only can it reduce tax, but there are plenty of credits and surtaxes that are sensitive to income levels. Each income threshold is calculated differently and there are other limiting factors, so ask for help if you need to figure out precisely how much extra to contribute. With that in mind, here are some of the most common examples:

Did you not get the stimulus because you made too much in 2018 & 2019? Perhaps you can qualify by lowering your 2020 AGI.

Do you have kids in college? The American Opportunity Credit (first four years of college) begins to phase out at an income of $80,000 (single) and $160,000 (married).

Do you own a business? The QBI deduction begins to phase out for many businesses starting at a taxable income of $163,300 (single) and $326,600 (married).

Do you have a modest income? The Earned Income Credit phases out at varying income levels between $15,820 (single with no qualifying children) and $56,844 (Married with 3+ children).

Do you have a larger income? The Child Tax Credit begins to phase out at $200,000 (single) and $400,000 (married). Medicare and investment surtaxes begin at $200,000 (single) or $250,000 (married).

Do you put money in a Roth IRA? Contributions to a Roth IRA begin to phase-out at $124,000 (single) or $196,000 (married). Roth conversions, however, are still allowed at any income level.

Do you own rental property? Your ability to deduct most rental losses incurred during the current tax year phases out between $100,000 and $150,000 of income.

Are you paying student loans? Your ability to deduct the interest begins to phase out at $70,000 (single) and $140,000 (married).

Do you buy health insurance on healthcare.gov or a state run exchange? If you receive a subsidy you will have to pay it all back if you make more than four times the federal poverty level. The federal poverty level starts at $12,760 (single) and goes up based on the number of people on the tax return. HHS publishes the poverty guidelines on their website (www.aspe.hhs.gov/poverty-guidelines).

Charity:
Roughly 85%+ of taxpayers will not itemize this year. If that's you, consider the following charity tax strategies:

- **Give up to $300 anyway**. A new rule allows you to deduct up to $300 in cash contributions even if you don't itemize. The rule applies to gift of money only (not goods).
- **Plan ahead for a QCD:** Qualified Charitable Distributions (QCDs) from an IRA are allowed for taxpayers over $70^{1/2}$. The contribution must be made directly from the IRA to the charity. Seniors that use this strategy can take the deduction even if they don't itemize.

Selling investments?
If your taxable income is likely to fall below $40,000 (single) or $80,000 (married) consider selling long term investments that have gained in value. You will not pay any federal tax on the gain if you keep your taxable income below those thresholds.

Conversely, it might be wise to check your portfolio for losses to reduce your income. You can offset up to $3,000 of other income with investment losses. If you wish to repurchase the stock again, wait at least 31 days to avoid a "wash sale" that disallows the loss.

If you are planning on deducting worthless stock, remember that it's not deductible until it's completely worthless.

Roth conversions:
The deadline to convert funds from a traditional IRA to a Roth IRA is 12/31/20. Remember that you pay tax on the amount converted. Also remember that you can no longer undo Roth conversions at a later date.

Health insurance:
If you choose a health plan that is compatible with **Health Savings Accounts (HSA)** you should start funding your HSA right away. That's because medical expenses do not count as a "qualified" for tax free distributions if they occur before the HSA was funded. The maximum amount you can shelter per year is $3,550 (single) or $7,100 (married). You should contribute the maximum if you can afford. That's because HSAs have three tax benefits;

1. Contributions are a tax deduction.
2. Distributions for qualified medical expenses are tax free.
3. You can invest the funds and reimburse yourself for qualified medical expenses after the account has grown in value.

Employee fringe benefits:
Aside from HSAs, look into other pre-tax spending options that your employer offers such as; insurance, daycare, commuting, parking, education, etc.

Looking to 2021...
Congress extended or tweaked many popular tax provisions. Here are the ones that will affect the most folks in 2021:

- Increased income thresholds for the **Lifetime Learning Credit** (this benefits some middle-income folks going back to college).
- **Discharge of qualified principle residence indebtedness** can be excluded from taxable income (this benefits folks that have mortgage debt forgiven).
- The credit for **residential solar energy** equipment was maintained at 26% (vs. 22%) of installed cost (this benefits home owners that install solar panels).
- **Private Mortgage Insurance (PMI) premiums** count as an itemized deduction (subject to income limitations).
- **Business meals** are 100% deductible. They will go back to 50% deductible after 12/31/22.
- Married couples filing jointly can deduct $600 in **charitable cash contributions** even if they don't itemize (in 2020 the limit was $300).

The basic strategy for year-end tax planning can be summed up in the following two statements:

- *Channel your income into the year where it will be taxed at a lower rate.*
- *Channel your deductions to the year where your income will be taxed at a higher rate.*

If you need year-end tax planning a consultation would be wise.