Dear Clients and Friends:

As year-end approaches, it is a good time to think about planning moves that may help lower your tax bill for this year and possibly next. Year-end planning for 2020 takes place during the COVID-19 pandemic, which in addition to its devastating health and mortality impact, has widely affected personal and business finances. New tax rules have been enacted to help mitigate the financial impact of the disease, some of which should be considered as part of this years' planning, most notably elimination of required retirement plan distributions, and liberalized charitable deduction rules.

The following paragraphs will review major changes for the 2020 tax year, as well as some other tax planning strategies that may be relevant to your unique tax situation. Please contact us to discuss any 2020 tax planning questions you have.

Key tax considerations related to COVID-19

Many tax provisions were implemented under the Coronavirus Aid, Relief and Economic Security (CARES) Act aimed to help individuals and businesses deal with the COVID-19 pandemic and its ongoing economic disruption.

1. **Economic impact payment (EIP)** - Eligible individuals received a payment of $1,200 ($2,400 for joint filers) plus $500 for each qualifying child, with payments phased out based on adjusted gross income. The payments are treated as advance refunds of a 2020 tax credit. If you received an EIP, you should have re-ceived IRS Notice 1444, *Your Economic Impact Payment.* Keep this for record-keeping purposes.

2. **Charitable deductions** - Unique to 2020, individuals who do not itemize their deductions can take an above-the-line charitable deduction of up to $300. Such contributions must be made in cash and made to qualified organizations. (See further discussion on 2020 charitable contributions below.)

3. **Retirement accounts** - You can take up to $100,000 in coronavirus-related distributions from retirement plans through the end of the year without being subject to the 10% additional tax for early distributions. Additionally, required minimum distributions (RMDs) are temporarily suspended for 2020. If your

retirement assets have taken a hit, not having to take an RMD may allow those assets to recover some value before you liquidate them. (See further discussion on retirement accounts below.)

4. **State tax obligations related to teleworking arrangements for employees -** As the COVID-19 outbreak continues, many employers are encouraging or requiring their employees to work from home (i.e., telework). Such remote working arrangements could potentially have tax implications that should be considered, especially if you are working remotely in a different state than where your employer is located. Please speak to us to find out if you are impacted by certain state tax reporting requirements.

5. **Fraudulent activity remains a significant threat -** Our firm takes security seriously and we think you should as well. Fraudsters continue to refine their techniques and tax identity theft remains a significant concern. Beware if you:

- Receive a notice or letter from the Internal Revenue Service (IRS) regarding a tax return, tax bill or income that doesn't apply to you
- Get an unsolicited email or another form of communication asking for your bank account number or other financial details or personal information
- Receive a robocall insisting you must call back and settle your tax bill

Year-End Tax Planning Moves for Individuals

We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you (or a family member) will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make:

1. Higher-income earners must **be wary of the 3.8% surtax on certain unearned income**. The surtax is 3.8% of the lesser of: (1) net investment income (NII), or (2) the excess of modified adjusted gross income (MAGI) over a threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case). As year-end nears, a taxpayer's approach to minimizing or eliminating the 3.8% surtax will depend on estimated MAGI and NII for the year. Some taxpayers should consider ways to minimize (e.g., through deferral) additional NII for the balance of the year, others should try to see if they can reduce MAGI other than NII, and other individuals will need to consider ways to minimize

both NII and other types of MAGI. An important exception is that NII does not include distributions from IRAs and most other retirement plans.

2. **The 0.9% additional Medicare tax** also may require higher-income earners to take year-end action. It applies to individuals whose employment wages and self-employment income total more than a threshold amount ($250,000 for joint filers, $125,000 for married couples filing separately, and $200,000 in any other case). Employers must withhold the additional Medicare tax from wages in excess of $200,000 regardless of filing status or other income. Self-employed persons must take it into account in figuring estimated tax. There could be situations where an employee may need to have more withheld toward the end of the year to cover the tax. For example, if an individual earns $200,000 from one employer during the first half of the year and a like amount from another employer during the balance of the year, he or she would owe the additional Medicare tax, but there would be no withholding by either employer for the additional Medicare tax since wages from each employer don't exceed $200,000.

3. **Long-term capital gain from sales of assets held for over one year is taxed at 0%, 15% or 20%**, depending on taxable income. If you hold long-term appreciated-in-value assets, consider selling enough of them to generate long-term capital gains that can be sheltered by the 0% rate. The 0% rate generally applies to the excess of long-term capital gain over any short-term capital loss to the extent that, when added to regular taxable income, it is not more than the maximum zero rate amount (e.g., $80,000 for a married couple). If the 0% rate applies to long-term capital gains you took earlier this year for example, you are a joint filer who made a profit of $5,000 on the sale of stock held for more than one year and your other taxable income for 2020 is $75,000 then try not to sell assets yielding a capital loss before year-end, because the first $5,000 of those losses won't yield a benefit this year. (It will offset $5,000 of capital gain that is already tax-free.)

4. **Postpone income until 2021 and accelerate deductions into 2020** if doing so will enable you to claim larger deductions, credits, and other tax breaks for 2020 that are phased out over varying levels of adjusted gross income (AGI). These include deductible IRA contributions, child tax credits, higher education tax credits, and deductions for student loan interest. Postponing income also is desirable for taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that **in some cases, it may pay to actually accelerate income into 2020**. For example, that may be the case for a person who will have a more favorable filing status this year than next (e.g., head of household versus individual filing status), or who expects to be in a higher tax bracket next year.

5. If you believe a **Roth IRA** is better than a traditional IRA, **consider converting traditional-IRA** money invested in any beaten-down stocks (or mutual funds) into a Roth IRA in 2020 if eligible to do so. Keep in mind, however, that such a conversion will increase your AGI for 2020, and possibly reduce tax breaks geared to AGI (or modified AGI).

6. It may be advantageous to try to arrange with your employer to defer, until early 2021, a bonus that may be coming your way. This could cut as well as defer your tax.

7. **Many taxpayers won't be able to itemize because of the high basic standard deduction** amounts that apply for 2020 ($24,800 for joint filers, $12,400 for singles and for marrieds filing separately, $18,650 for heads of household), and because many itemized deductions have been reduced or abolished. Like last year, no more than $10,000 of state and local taxes may be deducted; miscellaneous itemized deductions (e.g., tax preparation fees and unreimbursed employee expenses) are not deductible; and personal casualty and theft losses are deductible only if they're attributable to a federally declared disaster and only to the extent the $100-per-casualty and 10%-of-AGI limits are met. You can still itemize medical expenses but only to the extent they exceed 7.5% of your adjusted gross income, state and local taxes up to $10,000, your charitable contributions, plus interest deductions on a restricted amount of qualifying residence debt, but payments of those items won't save taxes if they don't cumulatively exceed the standard deduction for your filing status. **Two COVID-related changes for 2020** may be relevant here: (1) Individuals may claim a **$300 above-the-line deduction for cash charitable contributions on top of their standard deduction**; and the **percentage limit on charitable contributions has been raised from 60% of modified adjusted gross income (MAGI) to 100%.**

   Some taxpayers may be able to work around these deduction restrictions by applying a bunching strategy to pull or push discretionary medical expenses and charitable contributions into the year where they will do some tax good. For example, a taxpayer who will be able to itemize deductions this year but not next will benefit by making two years' worth of charitable contributions this year, instead of spreading out donations over 2020 and 2021. The COVID-related increase for 2020 in the income-based charitable deduction limit for cash contributions from 60% to 100% of MAGI assists in this bunching strategy, especially for higher income individuals with the means and disposition to make large charitable contributions.

8. Consider using a credit card to pay deductible expenses before the end of the year. Doing so will increase your

2020 deductions even if you don't pay your credit card bill until after the end of the year.

9. If you expect to owe state and local income taxes when you file your return next year and you will be itemizing in 2020, consider asking your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2020. But remember that state and local tax deductions are limited to $10,000 per year, so this strategy is not good to the extent it causes your 2020 state and local tax payments to exceed $10,000.

10. Importance of retirement planning - We recommend you review your retirement situation at least annually. That includes making the most of tax-advantaged retirement saving options, such as traditional IRAs, Roth IRAs and company retirement plans. It's also advisable to take advantage of health savings accounts that can help you reduce your taxes and save for your future. We can help you determine whether you're on target to reach your retirement goals.

11. **Required minimum distributions (RMDs) that usually must be taken from an IRA** (or other employer-sponsored retirement plan) **have been waived for 2020**. This includes RMDs that would have been required by April 1 if you hit age 70½ during 2019 (and for non-5% company owners over age 70½ who retired during 2019 after having deferred taking RMDs until April 1 following their year of retirement). So if you don't have a financial need to take a distribution in 2020, you don't have to. Note that because of a recent law change, plan participants who turn 70½ in 2020 or later needn't take required distributions for any year before the year in which they reach age 72.

12. If you are age 70½ or older by the end of 2020, have traditional IRAs, and especially if you are unable to itemize your deductions, consider making **2020 charitable donations via qualified charitable distributions from your IRAs**. These distributions are made directly to charities from your IRAs, and the amount of the contribution is neither included in your gross income nor deductible on Schedule A, Form 1040. However, you are still entitled to claim the entire standard deduction. (Previously, those who reached reach age 70½ during a year weren't permitted to make contributions to a traditional IRA for that year or any later year. While that restriction no longer applies, the qualified charitable distribution amount must be reduced by contributions to an IRA that were deducted for any year in which the contributor was age 70½ or older, unless a previous qualified charitable distribution exclusion was reduced by that post-age 70½ contribution.)

13. If you are younger than age 70½ at the end of 2020, you anticipate that you will not itemize your deductions in

later years when you are 70½ or older, and you don't now have any traditional IRAs, establish and **contribute as much as you can to one or more traditional IRAs in 2020**. If these circumstances apply to you, except that you already have one or more traditional IRAs, make maximum contributions to one or more traditional IRAs in 2020. Then, in the year you reach age 70½, make your charitable donations by way of qualified charitable distributions from your IRA. Doing this will allow you, in effect, to convert nondeductible charitable contributions that you make in the year you turn 70½ and later years, into deductible-in-2020 IRA contributions and reductions of gross income from later year distributions from the IRAs.

14. Take an eligible rollover distribution from a qualified retirement plan before the end of 2020 if you are facing a penalty for underpayment of estimated tax and having your employer increase your withholding is unavailable or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2020. You can then timely roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2020, but the withheld tax will be applied pro rata over the full 2020 tax year to reduce previous underpayments of estimated tax.

15. Consider increasing the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year and anticipate similar medical costs next year.

16. If you become eligible in December of 2020 to make health savings account (HSA) contributions, you can make a full year's worth of deductible HSA contributions for 2020.

17. Make gifts sheltered by the annual gift tax exclusion before the end of the year if doing so may save gift and estate taxes. **The exclusion applies to gifts of up to $15,000 made in 2020** to each of an unlimited number of individuals. You can't carry over unused exclusions from one year to the next. Such transfers may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

18. If you were in federally declared disaster area, and you suffered uninsured or unreimbursed disaster-related losses, keep in mind you can choose to claim them either on the return for the year the loss occurred (in this instance, the 2020 return normally filed next year), or on the return for the prior year (2019), generating a quicker refund.

19. If you were in a federally declared disaster area, you may want to settle an insurance or damage claim in 2020 in order to maximize your casualty loss deduction this year.

20. **Virtual currency/cryptocurrency -** Virtual currency transactions are becoming more common. There are many different types of virtual currencies, such as Bitcoin, Ethereum and Ripple. The sale or exchange of virtual currencies, the use of such currencies to pay for goods or services or holding such currencies as an investment generally has tax consequences. We can help you understand those consequences.

Year-End Tax-Planning Moves for Businesses & Business Owners

1. **PPP loan forgiveness** – Small businesses may be hit with a surprise tax bill related to Paycheck Protection Program (PPP) loans unless Congress acts soon to correct the current IRS interpretation of the law. In the CARES Act, Congress clearly intended for recipients of forgiven PPP loans to be able to deduct expenses paid for with such loan proceeds. However, the IRS has contradicted this congressional intent.

   On 11/19/20, IRS issued Rev Rul 2020-27, guidance on deducting expenses when a PPP loan is or will be forgiven. The gist of this ruling is that, expenses paid with PPP loan proceeds in 2020 are not tax deductible either if a) a business's PPP loan has already been forgiven or b) if the business expects that the PPP loan will be forgiven in the future. This ruling increases the 2020 taxable income of essentially all PPP borrowers who will be eligible for PPP loan forgiveness.

   Separately, there is a safe harbor that does allow a 2020 expense deduction if the taxpayer knows that some or all of the PPP loan forgiveness will be denied by the SBA, or if the taxpayer who borrowed PPP funds never applies for forgiveness.

   Bills have been introduced in the Senate and in the House that would ensure that PPP loan recipients are provided the full benefits intended in the CARES Act. Our firm is following this matter closely for updates.

2. **NJ Pass-Through Business Alternative Income Tax (BAIT) Act - For New Jersey tax purposes**, income and losses of a pass-through entity are passed through to its members. However, for taxable years beginning on or after January 1, 2020, pass-through entities may elect to pay a Pass-Through Business Alternative

Income Tax due on the sum of each of the member's share of distributive proceeds. The member(s) may then claim a tax credit for the amount of tax paid by the pass-through entity on their share of distributive proceeds.

This act allows pass-through businesses to pay income taxes at the entity level instead of the personal level. This helps business owners mitigate the negative impact of the federal SALT deduction cap. Under the Act, taxpayers who earn income from pass-through businesses and pay the pass-through business alternative income tax can obtain a refundable gross income tax credit. **There is no limit on the deduction of state taxes paid at the entity level** under the federal Tax Cuts and Jobs Act (TCJA), only at the individual income level. Currently, pass-through business owners can only deduct up to $10,000 in state and local taxes on their personal income taxes.

3. **Qualified Business Income Deduction** - Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income. For 2020, if taxable income exceeds $326,600 for a married couple filing jointly, $163,300 for singles, marrieds filing separately, and heads of household, the deduction may be limited based on whether the taxpayer is engaged in a service-type trade or business (such as law, accounting, health, or consulting), the amount of W-2 wages paid by the trade or business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the trade or business. The limitations are phased in; for example, the phase-in applies to joint filers with taxable income between $326,600 and $426,600, and to all other filers with taxable income between $163,300 and $213,300.

   Taxpayers may be able to achieve significant savings with respect to this deduction, by deferring income or accelerating deductions so as to come under the dollar thresholds (or be subject to a smaller phaseout of the deduction) for 2020. Depending on their business model, taxpayers also may be able increase the new deduction by increasing W-2 wages before year-end. The rules are quite complex, so don't make a move in this area without consulting your tax adviser.

4. More small businesses are able to use **the cash (as opposed to accrual) method of accounting** than were allowed to do so in earlier years. To qualify as a small business a taxpayer must, among other things, satisfy a gross receipts test. For 2020, the gross-receipts test is satisfied if, during a three-year testing period, **average annual gross receipts don't exceed $26 million** (the dollar amount was $25 million for 2018, and for earlier years it was $1 million for most businesses). Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings till next year or by accelerating expenses, for example, paying bills early or by

making certain prepayments.

5. Businesses should consider **making expenditures that qualify for the liberalized business property expensing option**. For tax years beginning in 2020, the expensing limit is $1,040,000, and the investment ceiling limit is $2,590,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. It is also available for qualified improvement property (generally, any interior improvement to a building's interior, but not for enlargement of a building, elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems. The generous dollar ceilings mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. The fact that the expensing deduction may be claimed in full (if you are otherwise eligible to take it) regardless of how long the property is in service during the year can be a potent tool for year-end tax planning. Thus, property acquired and placed in service in the last days of 2020, rather than at the beginning of 2021, can result in a full expensing deduction for 2020.

6. Businesses also can claim a **100% bonus first year depreciation deduction for machinery and equipment** bought used (with some exceptions) or new if purchased and placed in service this year, and for qualified improvement property, described above as related to the expensing deduction. The 100% writeoff is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the 100% bonus first-year writeoff is available even if qualifying assets are in service for only a few days in 2020.

7. Businesses may be able to take advantage of the **de minimis safe harbor election** (also known as the book-tax conformity election) to **expense the costs of lower-cost assets and materials and supplies**, assuming the costs don't have to be capitalized under the Code Sec. 263A uniform capitalization (UNICAP) rules. To qualify for the election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS; e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed $2,500. Where the UNICAP rules aren't an issue, consider purchasing such qualifying items before the end of 2020.

8. A corporation (other than a large corporation) that anticipates a small net operating loss (NOL) for 2020 (and substantial net income in 2021) may find it worthwhile to accelerate just enough of its 2021 income (or to defer

just enough of its 2020 deductions) to create a small amount of net income for 2020. This will permit the corporation to base its 2021 estimated tax installments on the relatively small amount of income shown on its 2020 return, rather than having to pay estimated taxes based on 100% of its much larger 2021 taxable income.

9. To reduce 2020 taxable income, consider deferring a debt-cancellation event until 2021.

10. To reduce 2020 taxable income, consider disposing of a passive activity in 2020 if doing so will allow you to deduct suspended passive activity losses.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Very truly yours,

MORGENSTERN WAXMAN ELLERSHAW, LLC