TaxTips

Dedicated to making your life less taxing

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Economic impact payments

How will they affect your 2020 return?

As part of the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act), the IRS made economic impact payments (EIPs) to certain taxpayers. The eligibility for and the amount of an EIP generally depended on the taxpayer's 2019 federal income tax return. If one was not filed at the time of eligibility, the IRS used the taxpayer's 2018 federal income tax return. If you received an EIP, the IRS mailed a Notice 1444 to your last known address. That form shows the amount of your EIP. Keep this notice with your tax records.

The EIP is considered an advance credit against your 2020 tax. You are not required to include the payment in taxable income on your 2020 tax return or pay income tax on the payment. When you file your 2020 federal income tax return next year, the EIP will not reduce your refund or increase the amount of tax you owe.

If the EIP was based on your 2018 tax return and your circumstances changed in 2019, you may claim any additional credit for which you are eligible on your 2020 return. This may occur, for example, if you had a child or if your income was lower in 2019. Conversely, if your payment was based on your 2018 return and circumstances changed so that you would have received a smaller amount based on your 2019 return, you are not required to repay the excess or reduce your 2020 refund.

New charitable contribution rules

Nonitemizers can claim a deduction

The CARES Act makes two significant changes to the rules governing charitable deductions for individuals.

Individuals will be able to claim a $300 above-the-line deduction for **cash** contributions made to public charities in 2020. This rule effectively allows a limited charitable deduction to any taxpayer claiming the standard deduction. For this deduction, married taxpayers who file a joint return are considered one taxpayer and are limited to $300.

For individuals, the limitation on charitable deductions that is generally 60% of modified adjusted gross income (the contribution base) doesn't apply to cash contributions made to public charities in 2020. Instead, an individual's qualifying contributions, reduced by other contributions, can be as much as 100% of the contribution base. No connection between the contributions and COVID-19 is required. **Note:** This higher limit does not apply to donations to private foundations or donor-advised funds.

Solar panels are hot

For a tax credit

The residential energy efficient property credit has been reinstated through 2021. This means you could get a tax credit for installing solar panels on your home. You can even get a credit if you shared the cost of solar panels not directly located on your home, such as at an off-site community solar array or similar arrangement that generates solar energy directly for your home. The credit is equal to 26% of the cost of qualified solar electric property expenditures made in 2020 and 22% for expenditures made in 2021. There are some limitations on the credit. Additionally, unused credit amounts may be carried to future tax years.

As with any tax law, there are many variables that come into play for this credit. If you are thinking about making energy efficient improvements, let's get together and make improvements not only for our planet but for your taxes as well.

Safe Harbor for Rental Properties

Getting a qualified business income deduction

Landlords who spend at least 250 hours a year managing and maintaining their rental properties may be eligible for the Qualified Business Income (QBI) deduction. That averages out to just under five hours a week.

Unlike other deductions, the qualified business income deduction does not require that you spend money. Instead, it's a straight deduction, for up to 20% of net rental income for the year. For clients who qualify, this deduction allows rental property owners to pay tax on as little as 80% of their net income from qualifying rental properties. We even have the option of grouping several rental properties together to meet the 250-hour requirement.

Qualifying for this deduction can be tough. Here are the three factors we're looking for:

- 250 hours per year spent managing and maintaining your rental properties.
- You did not live in the rental property for any part of the year.
- The property isn't rented under a triple-net lease.

To reach the 250-hour threshold for the QBI deduction, we add up the hours you spend managing the rental property, and also time spent by your property manager, landscapers, repair contractors, and any other people you hire to maintain or manage the rental properties. Rental services that count toward the 250-hour test include:

- Advertising
- Negotiating leases
- Verifying rental applications from prospective tenants
- Collecting rents
- Maintenance and repairs
- Purchasing materials
- Supervising contractors and employees

Keep meticulous records of all the time spent managing your rental properties. Reviewing your time logs is how we—and the IRS—will be able to figure out if you qualify for the QBI deduction for the year.

You'll need to keep track not only of the time you spent yourself, but also time spent by any other people you hire to work on your rental properties. Your time log will need to track four data points:

- The dates rental property services were performed
- Number of hours spent
- Who performed the work
- A description of all the work done on that day

Finally, the IRS requires that you maintain separate books and records for each rental property. We can help you set up your bookkeeping, records and time logs so that you can claim this valuable deduction.

Recent legislation changes some IRA rules

How does this affect you?

The CARES Act suspended the required minimum distribution (RMD) rules for 2020. This means any RMD a taxpayer would have been required to make before Dec. 31, 2020, as well as any RMD required to be made by April 1, 2020, based on meeting the required beginning date in 2019, is not required. However, if the RMD due on April 1, 2020, was made before Jan. 1, 2020, it may not be rolled over or redeposited.

If you received distributions from your IRA in 2020, you might be able to spread the tax over the course of three years if you were diagnosed with coronavirus, if your spouse or dependent was diagnosed with coronavirus or if you experienced adverse financial consequences while being quarantined, furloughed, laid off or had work hours reduced; were unable to work due to lack of child care because of the disease; or a business you operated closed or had reduced hours due to the pandemic.

The *Setting Every Community Up for Retirement Enhancement Act of 2019* (SECURE Act) also made changes to the RMD rules, including raising the RMD to age 72 for individuals who had not yet attained age 70-1/2 by Dec. 31, 2019, and limiting the type of beneficiaries who can continue to receive RMDs over the beneficiary's life expectancy. "Stretch IRAs" are eliminated for non-spouse beneficiaries who may no longer "stretch" inherited IRA distributions over their lifetime. Distributions must be made within 10 years of the IRA owner's death.

The additional 10% tax on early distributions from IRAs and defined contribution plans such as a 401(k) is waived for distributions made between Jan. 1 and Dec. 31, 2020, if you or a family member was infected with COVID-19 or were economically harmed by COVID-19. Penalty-free distributions are limited to $100,000 and, subject to plan guidelines, may be re-contributed to the plan or IRA. Income arising from the distributions is spread out over three years unless you elect to not have the three-year spread apply.

Section179 vs. bonus depreciation

Either choice brings large deductions

Eventually all business owners will need to purchase or replace assets. When this happens, they need to determine how the cost of those assets will be recovered. Typically, the cost of business assets is recovered over their expected life through depreciation. If your goal is to recover that cost faster, you can either expense it under §179 or bonus depreciation.

Only certain property qualifies for the §179 deduction. That property includes tangible personal property, certain computer software and certain qualified real property, such as interior improvements, HVAC or alarm systems or roofs. The property must be acquired by purchase, meaning it cannot be a gift to you or property that you already own and convert to business use.

Under §179, businesses can deduct up to $1,040,000 of qualified equipment immediately, with a limit of $2,590,000, after which the deduction begins to phase out on a dollar-for-dollar basis. The deduction is limited to your taxable income from the business; however, any amount that can't be deducted because of this limitation is carried over indefinitely to later years.

You can choose which purchases to cover under the §179 deduction and which to save as future tax breaks. You can even split the deduction for individual purchases (for example, claiming half the cost of a new car upfront while spreading out the rest of the purchase over time). One notable drawback to the §179 deduction is that if the business use drops to less than 50%, some or all of your previous deduction must be recaptured.

Did you receive a PPP loan?

For some, it may be tax free

Many small businesses impacted by the coronavirus pandemic were eligible to apply for a loan through the Payroll Protection Program (PPP). These loans were essential for helping to keep employees working and businesses open. You've probably heard a lot in the media as to what the loan proceeds can be used for and whether they need to be repaid.

In general, 100% of the loan can be forgiven—if you meet certain criteria. First and foremost, to get your loan forgiven, you will need to complete a PPP loan forgiveness application form and submit it to your lender. You can obtain the necessary form (Form 3508, Form 3508-EZ or Form 3508-S) from the Small Business Administration at sba.gov.

Secondly, you must use the funds from the loan for certain expenses. The funds from the PPP can be used for the following:

- Payroll (salary, wage, vacation, parental, family, medical or sick leave, health benefits)
- Mortgage interest, if the mortgage was signed before Feb. 15, 2020
- Rent, if the lease agreement was in effect before Feb. 15, 2020 (rent includes rental of office space business equipment, vehicles, or warehouse)
- Utilities, if service began before Feb. 15, 2020
  (utilities include electricity, water, gas, sewage, cell phone/landline, internet, and transportation costs)

Eligible expenses are those that are incurred over 24 weeks, starting from the day the first payment was made by your lender. This is not necessarily the date on which you signed your loan agreement. At least 60% of the loan proceeds must be used to cover payroll costs. The remaining 40% can be used for other costs.

While all this seems straightforward, there are several other conditions of forgiveness that are dependent on how many employees you retain and how much you pay them.

How to protect your business and your customers

Cyberthieves are everywhere

Everyone knows that having strong locks, a security alarm and perhaps a security guard will help protect your business from a physical break in. But what about the sneaky cyberthieves you can't see coming? There are several things you must implement to protect yourself, your livelihood and your client or customer data. Here are a few essential tips:

- Encrypt your data. Software programs are available to help you do this.
- Use strong passwords and change them often. The longer the password, the better.
- Back up your files often, daily if possible. Using the cloud is a great option.
- Avoid public Wi-Fi. If you do one thing, forbid all use of public Wi-Fi for work activities.
- Provide alternatives such as a mobile virtual private network (VPN) for employees to use when they're not in the office.
- Install antivirus software and use firewalls to protect you from unwanted intrusions.
- Keep your operating systems up to date with the latest security features.
- Develop policies for suspicious emails. This means educating your employees on how to recognize phishing and other suspicious emails.

Cyberattacks have become common, and there is no better investment for your business than a good security plan. If you aren't confident you can create one on your own, hire an expert.

Employer Identification Number

Does my business need one?

An Employer Identification Number (EIN) is a nine-digit number that the IRS assigns to identify tax accounts. It's also referred to as a Federal Tax Identification Number.

When deciding if your business needs to obtain an EIN, consider the following questions:

- Will you have employees?
- Will you operate your business as a corporation or partnership?
- Will you file employment, excise, or alcohol, tobacco and firearms tax returns?
- Will you withhold taxes on income, other than wages, paid to a non-resident alien?
- Will you have a retirement plan?
- Will you be involved with: (1) trusts, except certain grantor-owned revocable trusts, IRAs, exempt organization business income tax returns; (2) estates; (3) real estate mortgage investment conduits; (4) non-profit organizations; (5) farmers' cooperatives; or (6) plan administrators?

If you answered "yes" to any of the above, then you need to obtain an EIN.

Generally, businesses need a new EIN when their ownership or structure has changed. And it's important to note that if you are applying for tax-exempt status, be sure that your organization is formed legally before applying for an EIN.

Applying for an EIN is a free service offered by the IRS. An EIN can be obtained online, by fax, mail or telephone. All EIN applications must disclose the "responsible party." This is the person or entity who controls, manages or directs the applicant entity and the disposition of its funds and assets. Unless the applicant is a government, the responsible party must be an individual, not an entity.

Thinking of starting a new venture? Let's start by tackling the EIN application together.

QUIK TIPS

1. If by year-end you haven't contributed funds to your IRA, or if you've put in less than the maximum allowed, don't worry. You can contribute to either a traditional or Roth IRA up until the April due date for filing your tax return. Your employer contributions to a Keogh, SEP, or a SIMPLE plan are due by the time you file your tax return unless you have a valid extension then you have until the extended due date to make the contribution.

2. Are you planning on making any substantial gifts? Talk to me first. For 2020 & 2021, gifts with values exceeding $15,000 must be reported to the IRS.

3. The standard mileage rates for the use of a car, including vans, pickups, or panel trucks in 2021 are:

- 56 cents per mile for BUSINESS USE
- 16 cents per mile for all miles driven for medical or moving purposes; and
- 14 cents per mile for all miles driven for charitable purposes.

4. Did you know that there is still up to a $7,500 dollar tax credit for purchasing a qualified electric plug-in vehicle like a Tesla? Call me for all the details.

5. As a self-employed taxpayer, you may contribute to a sole-owner 401(k) retirement plan as both an employer and as an employee. As an employer, you may contribute up to 25 percent of your total income to your retirement plan. As an employee, you may also contribute up to an additional $19,500 in 2020 ($26,000) if age 50 or over). Your maximum contribution to an individual 401(k) plan is the lesser of $62,000 or the sum of the employer and employee maximums. Unlike other retirement plans such as SEPS and SIMPLE IRAs, an individual 401(k) plan allows you to take out loans from plan assets.

6. The Federal Estate Tax exemption for 2020 is $11,580,000. The rate is 40%. Additionally, heirs get to use stepped-up basis to value assets inherited. The exemption in MA, ME & NY is only $1 million with a top tax rate of 16%.

7. In 2020 the tax rate of 37 percent will affect individuals and Heads of Households whose taxable income exceeds $518,401 ($622,051) for married taxpayers filing a joint return.

8. If you turned age 70 on July 1, 2019 or later you are not required to begin your required minimum distributions (RMD) from your IRA until your 72nd birthday thanks to the just passed Secure Act. Now, RMDs must start no later than your 72nd birthday. Failure to do so results in a 50 percent penalty on the amount you do not take.

9. Long Term Care Premiums may be tax deductible with limits based on your age and whether you itemize deductions. Self-employed taxpayers may include the allowable premiums with their self-employed health insurance whether they itemize or not.

Working from home?

Know what's deductible

If you are self-employed and use part of your home for business, you may be able to deduct expenses allocable to the business use. The home office deduction is available for homeowners and renters. To qualify for the deduction, you must use the space in your home regularly and exclusively as your principal place of business. Any personal use of the space will disqualify you from claiming a home office deduction.

You may choose one of two methods for calculating your deduction—the simplified method or the regular method. The simplified method allows you to claim $5 per square foot for a maximum of 300 square feet. This gives you a home office deduction of no more than $1,500. No other deductions are allowed. You are still permitted, however, to claim any mortgage interest or property taxes on Schedule A, if you itemize deductions.

The regular method requires a bit more recordkeeping. Generally, when using the regular method, deductions for a home office are based on the percentage of your home devoted to business use. So, if you use a whole room or part of a room for conducting your business, you need to figure out the square footage of the business use compared to the square footage of your entire home. This percentage is then used to calculate the percentage of deductible expenses such as mortgage interest, insurance, utilities, repairs and depreciation.

You may choose to use either the simplified method or the regular method for any taxable year. Once you choose, you cannot change your mind for that year. You can, however, use the simplified method one year and the regular method in another. If you use the simplified method for one year and use the regular method for any subsequent year, you must calculate the depreciation deduction for the subsequent year using the appropriate optional depreciation table.

During 2020, many employees were sheltering in place and forced to work from home. The current rules for deducting home office expenses do not apply to employees since deductions for employee business expenses have been suspended until 2026.

Let us know if you work from home. We want to be armed with facts in case the IRS decides to ask any questions.

A Final Word from Charlie

As the 2020 year-end approached, I received quite a few emails and calls on a variety of subjects relating to taxes. So, I publish this newsletter to provide you some tax saving tips and to keep you abreast of some of the nuances in the tax code.

In addition to preparing your tax return for you I can assist you with retirement income planning. I can help you save for your retirement through a variety of plans that will grow with the market without any risk of losing your money, guaranteed! Don't wait any longer. Contact me today so I can help you accomplish your retirement goals.