HK | HAGA KOMMER
CERTIFIED PUBLIC ACCOUNTANTS

Introduction

As we write our annual tax-planning letter, we are constantly reminded that this is no ordinary year. The fall continues to be dominated by a highly partisan election, a second wave of COVID-19, an economy struggling to recover from the worldwide pandemic and a wildly fluctuating stock market.

Adding to this mix of uncertainty is the ever-changing tax landscape. 2020 has seen not only continued guidance relating to the Tax Cuts and Jobs Act (TCJA), but also the passage of the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The CARES Act contains numerous revisions to the TCJA, which in some cases require taxpayers to redo returns two years after the fact. The CARES Act also introduced the PPP loan program, the rules for which were written hastily and leave several important questions still unanswered.

All of this created a perfect storm for taxpayers — businesses and individuals alike. Besides continuing economic uncertainty, tax rates could be in play depending on the election results. The prospect for increasing rates could hinge on control of the Senate, especially if the Democrats win the White House. While a change in control of the House of Representatives is not anticipated, if Republicans retain their majority in the Senate, it is unlikely any meaningful rate changes would be enacted.

Solid financial and tax planning is needed now more than ever. With our year-end letter, we urge readers to conduct annual tax planning and review your 2020 income tax situation and take steps to ensure that you are taking full advantage of the many tax planning strategies available. Minimizing taxes is all about planning ahead and having the knowledge of tax law that can give you an advantage; we at Haga Kommer would like to remind you that we are available to assist you and/or your business with this effort.

Individual Tax Notes

- **Business Use of Home** – Since the spring, taxpayers across the country have turned kitchens, living rooms, bedrooms or other rooms of their homes into temporary offices. With so many people currently working from home and the likelihood that this could continue for the foreseeable future, a reasonable question becomes whether a home office deduction is now available. In general, certain taxpayers can deduct business expenses related to their personal residence for space used exclusively and regularly in connection with a trade or business. Self-employed taxpayers or individual partners in partnerships can qualify. Employees working from a home office are no longer eligible to take a home office deduction.

- **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. Technically, the rebate is an advance payment of a special 2020 tax credit. You'll reconcile your rebate on your 2020 return. For most people, the rebate will equal the tax credit allowed. Taxpayers whose credits exceed their rebates can claim the balance on their 2020 returns. We expect you won't have to repay the IRS if the payment you received was more than your credit.

- **Charitable Deductions** – Beginning in 2020 there is now a $300 charitable deduction option for clients not filing itemized deductions. For all other donations you may want to consider "bunching" charitable contributions in the year they will benefit you the most. For example, if you are itemizing in 2020 you may want to accelerate January giving. If you have long term charitable goals, you may want to consider donor advised funds, which can allow immediate deductions and the elimination of capital gains tax for appreciated assets.

- **State and Local Taxes** – As before, an itemized deduction is available for any combination of state and local tax payments such as property taxes and state income taxes. However, the total deduction cannot exceed $10,000. Again, the timing of such payments is critically important and should be managed as part of your itemization strategy.

- **Capital Gains** – Take advantage of the 0% federal rate on long-term capital gains. If your taxable income is not greater than $40,000 single or $80,000 married filing joint, you may have the ability to sell appreciated securities held for more than one year at a 0% federal rate.

- **Rental Real Estate** – One of the largest benefits from the TCJA was the 199A deduction allowing certain business owners a deduction. One of the areas of confusion last year was what qualified as a trade or business. Specifically, for individual taxpayers with rental property this was especially important. More guidance and court rulings have been received since last year and many are favorable to individuals with rental property that are active in the management of such property. Documentation will be especially important so visit with your HK tax professional about this prior to year-end.

- **Roth IRA Conversion** – If you currently are contributing to a Traditional IRA you may want to consider converting the IRA to a Roth IRA to protect against future higher income tax rates. At the time of the conversion to the Roth IRA, the taxpayer pays tax on the value of the account but future increases in value would not be subject to income tax, protecting against a rise in tax rates due to tax law changes or higher earnings potential.

- **Required Minimum Distributions** – In 2019 the Secure Act increased the required minimum distributions (RMD's) age to 72. If this applies to you now, or in the near future, you will want to ensure you have received an RMD prior to December 31st in order to avoid penalty. The Coronavirus Aid, Relief, and Economic Security Act, or CARES Act, waives required minimum distributions during 2020 for IRAs and retirement plans, including beneficiaries with inherited accounts. This waiver includes RMDs for individuals who turned age 70 ½ in 2019 and took their first RMD in 2020.

- **Retirement Contribution** – One of the best planning tools is still maximizing your contribution to retirement plans. This year you can contribute up to $19,500 and up to $26,000 if you are age 50 or older.

Business & Farm Tax Notes

- **Paycheck Protection Loans** – The Coronavirus Aid, Relief, and Economic Security (CARES) Act expressly provides that Paycheck Protection Program (PPP) loan forgiveness is excluded from gross income. Generally, debt cancellation creates taxable income for the borrower unless specific exclusions available under the tax code apply. The CARES Act does not incorporate this concept.

  While the cancellation is excluded from gross income for federal purposes, the Treasury Department has ruled that expenses funded by subsequently forgiven PPP loan proceeds are nondeductible for federal tax purposes. Despite the fact that the CARES Act was silent on the matter, the IRS released Notice 2020-32, which provides that no deduction is allowed for an otherwise deductible expense if the payment of the expense results in the forgiveness of a covered loan under the CARES Act, and the income associated with the forgiveness is excluded from gross income. Immediately following the release of Notice 2020-32, many ranking members in Congress (on both sides of the aisle) rebuked the IRS' position, stating the intent of the CARES Act was for the expenses to remain deductible. While several bills have been introduced to override the notice, none have yet to pass both chambers of Congress.

  We believe the best course of action is to continue to wait for either additional guidance from the Treasury or the IRS, or for Congress to act. There have been some discussions that Congress may address this issue in a post-election session since making the PPP accommodating to borrowers (including overturning Notice 2020-32) has been an item of interest shared on both sides of the aisle. However, the willingness of members to cooperate and enact any legislation is dependent upon the outcome of the election and whether there is any degree of bipartisan interest in passing legislation during a lame-duck session.

- **CARES ACT Leave -** The Families First Coronavirus Response Act includes tax relief for self-employed people who can't work because of the coronavirus. The law forces many employers to provide paid sick and family leave for workers affected by the virus. However, tax credits against the self-employment tax are also allowed for self-employed people who can't work for a reason that would entitle them to coronavirus-related sick or family leave if he or she were an employee. (Employers also get tax credits to help them pay for the paid leave they are required to give their employees.

- **Section 199A Deduction** – No other aspect of tax planning has more of a broad application and important impact as this deduction for pass-through entities. The deduction could be up to 20% of the entity owner's qualified business income, subject to restrictions that apply as income increases. For pass-through entity owners it is extremely important to understand and manage taxable income to maximize the deduction. If you are part of an S corporation or partnership it is very important that proper tax planning is done before year end.

- **Partnership and S Corporation Basis** – If you own an interest in a partnership or S corporation, your ability to deduct any losses it passes through is limited to your basis. If you expect the partnership or S corporation to generate a loss this year you should check your basis and consider options for increasing basis prior to year-end.

- **Section 179 Deduction** – The TCJA doubled the maximum allowance to $1.04 million with a $2.59 million phase-out threshold that was indexed for inflation. Note that Section 179 cannot exceed the taxable income from all your business activities this year. Also note that Section 179 now applies to improvements to nonresidential property including roofs, HVAC and alarm systems.

- **Bonus Depreciation** – Under the TCJA, bonus depreciation will continue at 100% for property placed in service before January 1, 2023. The TCJA gradually phases out bonus deprecation after 2022 and it is scheduled to disappear in 2026. In order to maximize the benefits of bonus depreciation, factor in all the tax ramifications for your business before purchasing property and equipment. Remember that bonus depreciation applies to both new and used property and equipment.

- **Travel and Entertainment** – The tax rules for travel and entertainment continue to confuse many business owners, and for good reason. You can no longer deduct entertainment expenses such as tickets for a client, however you may be able to deduct the food and beverages for such an event that you attend with them. You can still deduct 100% of expenses related to a holiday party as long as the entire workforce is invited.

COVID-19 Precautions

In light of COVID-19 (Coronavirus) and in the interest of our clients, employees, and our community, we are strongly encouraging phone or video conference appointments rather than in person meetings this year. The health of our clients and employees is our main objective. On any given day we have anywhere from 50-100 clients in and out of our office during tax season. Due to this, we are practicing social distancing in hopes to limit contact with everyone and decrease the potential to spread the virus to our clients and employees who might have an elevated risk of exposure.

You are welcome to mail or drop off your tax information at the office using our drop boxes in the lobby or use our secure portal on our website, www.hagakommer.com, any time to upload your documentation. If you wish to have an in-person consultation we request that you limit the time to 15 minutes and we do require masks to be worn while visiting our offices.

As the pandemic situation is constantly changing and unknown, we urge you to get your documents to your us as early as you can so there will be ample time to assist you. We understand this is a big change and an inconvenience for everyone and we appreciate your patience during this time. Please know that we value you as our client and we will work with you to ensure timely filing of your tax returns.

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