COVID-19 Makes 2020 Tax Planning Tricky

by
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Let's cut right to the chase – your 2020 tax return will probably not look anything like last year's return. It may even look downright dismal. Job losses, wage reductions, self-employment income falling off the cliff, near-zero interest rates on savings, and a volatile stock market will all have an impact on your taxes this year. Understanding your situation, and how things might play out as the year progresses, will allow you to prepare for cash flow needs, eliminate surprises, and even create opportunity. Here is what you need to know now.

- Income from wages will drop if you have been laid off, furloughed, or have worked reduced hours. This will translate into a lower tax liability but at the same time, your withholdings will be lower and if you were counting on the withholdings to cover the tax on other sources of income such as dividends, you will need to find another way to get the taxes paid in, such as through estimated tax payments. Lower wages also mean lower FICA taxes paid in, which could impact your future Social Security benefit. This is especially important if you plan to retire in the next year or two.

- Self-employment income – if you are a consultant or part of the gig economy, this income source could take the same hit as income from wages. If you pay your own health insurance premiums as a self-employed person, you could see this deduction drastically reduced or eliminated since it is an above-the-line deduction and limited to your net income from self-employment.

• In both the case of salaried employees and contractors, lower income could also translate to lower contributions to retirement plans. If you can still afford to contribute to your employer's plan, you should do so, even if it is only enough to get the employer match (note that many companies have reduced or eliminated their match for 2020). Self-employed individuals may be hit the hardest since contributions to SEPs are generally based on net income from self-employment earnings. You may be able to make up for lower contributions to an employer qualified plan by making a Roth or traditional IRA contribution for the year, which can be made as late as April 15, 2021 for the 2020 tax year.

• With interest rates near zero on savings accounts, and not much higher on certificates of deposits (CDs), interest income will be lower in 2020.

• Large companies will probably continue to pay dividends, although some companies severely impacted by the pandemic have either reduced or eliminated upcoming dividend payouts. Overall, and depending on how you invested, you may not see a difference in this area.

• Capital gains – This is where many taxpayers get surprised at the end of the year when they read their year-end gain/loss report. Prior to mid-February, the stock market was on a roll, so even if a stock's value went down 10, 20 or even 30 percent, there could still be sufficient appreciation to trigger a capital gain when sold. The same could hold true for capital gain distributions from mutual funds. Now would be a good time to speak with your investment and tax advisors about a year-end strategy based on your projected income situation for 2020. If you end the year with a net capital loss, you can only claim up to $3,000 of the loss ($1,500 if married filing separately) in 2020. Any remaining loss can be carried forward indefinitely.

• Rentals – My guess is this will be a disaster for many landlords. However, if your adjusted gross income drops below $100,000, you may be able to claim up to $25,000 of those rental losses, including losses that were suspended in prior years due to the passive loss rules. (The deduction is phased out as income approaches $150,000.)

• Distributions from IRAs and Retirement Plans – If you were impacted by COVID-19 and need take a distribution from your retirement savings to pay bills (and this should always be the last resort), the CARES Act allows you to either report all of the income in 2020 (which may not be bad since your tax bracket may be really low) or report one-third of the distribution in each of 2020, 2021, and 2022. The Act also provides

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that the funds can be redeposited into a retirement plan within three years and considered a rollover and therefore nontaxable.

• In addition, the CARES Act waives all 2020 required minimum distributions, with the ability to possibly roll some or all of the distributions you've already taken back into a qualified plan to avoid tax. There are some hoops to jump through to accomplish this, especially if you had taxes withheld from your distribution, so be sure to consult with a qualified tax advisor before implementing this strategy. In some cases, not rolling the distribution back may make sense if you are otherwise in a lower bracket this year. Also, if you are in a lower bracket in 2020, this may be a good time to think about a Roth conversion.

• If you received unemployment compensation in 2020, it is taxable for federal purposes and, depending on where you live, it may or may not be taxable for state tax purposes. You will therefore need to account for taxes on this income.

• Many individual taxpayers no longer itemize deductions since the standard deduction was doubled beginning in 2018. If you have been impacted by the downturn in the economy, you may end up (1) donating less to charity than you normally would, (2) receiving a deferral on your mortgage payments, resulting in a lower interest deduction, and (3) depending on your circumstances, you might have lower state and local income taxes as a deduction in 2020 (although they are still limited to $10,000). The result is that you might be claiming the standard deduction in 2020, rather than itemizing. If this is the case, you may want to postpone charitable contributions until January 2021 and double up next year when you can itemize again.

• If you are 70½ , you can still make a qualified charitable distribution directly from your IRA to charity (up to an aggregate of $100,000), which won't be considered as a taxable distribution, although you can't take a deduction (which does not matter anyway if you aren't itemizing).

• If your income is under $75,000 ($150,000 for married couples) and you aren't being claimed as a dependent on someone else's return, you probably qualify for a recovery rebate check (a.k.a. stimulus check) of either $1,200 for individuals or $2,400 for married couples. There is also an additional $500 for each dependent child under the age of 17. The advance payment is based on either your 2019 or 2018 tax return, but is really an advance payment for 2020, so you will need to do a reconciliation when you file your 2020 tax return. The good news is that the stimulus payment is not taxable. If you determine that you are due more than what you actually received as an advance, you can claim the difference as a credit on your 2020 tax return. And here is the good part – if you received more than you should have, you do not have to pay it back!

As of the time of the writing of this article, Congress is still debating the terms of a second round of legislation that could extend additional unemployment benefits, which expired August 31, as well as a second round of stimulus checks. For questions or further information, please be sure to check our COVID-19 Resource Page (www.belfint.com/resources/covid-19/) for up-to-date resources related to tax planning ideas or contact us at info@belfint.com.

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