ACCOUNTANTS & ADVISORS

2020 YEAR-END TAX PLANNING MEMO

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Frankel Loughran Starr & Vallone, LLP
Main Office | 1475 Franklin Avenue, Garden City, NY 11530
Tel: (516) 874-8800 | Fax: (212) 683-5121
West Palm Beach Office | 777 S. Flagler Drive, Suite 225 East,
West Palm Beach, FL 33401 | Tel: (561) 770-1500

Effective tax planning can maximize the amount of funds you will have available for retirement, reduce eventual estate taxes, reduce the cost of financing your children's education, and assist you in managing your cash flow to help you meet your financial objectives, in addition to saving income taxes for the current and future years.

As the year-end approaches, individuals and business owners should be reviewing their situation to identify any opportunities for reducing, deferring or accelerating tax obligations. **Areas that should be looked at include tax reform provisions that remain in effect as a result of the Tax Cuts & Jobs Act as well as new opportunities and relief granted earlier in 2020 under the CARES and SECURE Acts.**

Suggested end-of-year strategies are a little different this year because the year itself was different. What began as a normal tax filing season was extended to July 15, 2020 and other ramifications of the COVID-19 pandemic, quarantine, working from home, and CARES Act legislative issues, were part of these differences; in addition to the results of the presidential election and the current uncertainty as to the control of the Senate. **Because COVID-19 has made this a negative year for many individuals and businesses, the traditional year-end tax planning strategies may not make sense.**

On December 22, 2017, President Trump signed Public Law No. 115-97, better known as the **"Tax Cuts & Jobs Act"** (hereunto referenced as "The TCJ Act"). The Act was the most comprehensive overall change in our tax law since the Tax Reform Act of 1986. The Act was instituted on January 1, 2018 and impacts your tax returns until 2025, unless the law is repealed at a sooner date. In 2019 the tax law changes have been further clarified with additional IRS provisions and guidance in certain matters which include, but are not limited to, section 199A income reporting, rental properties having the potential to be considered non-SSTB activity, and the elimination of claw-backs for estate exemption purposes. Some of the laws that changed in 2018 remain consistent for your 2020 return filings with the exception of inflation adjustments.

The Coronavirus Aid, Relief and Economic Security Act (The CARES Act) is a stimulus bill passed by Congress and signed into law on March 27, 2020 in response to the economic fallout of the COVID-19 pandemic. Its impact on 2020 year-end tax planning is reflected in the memorandum.

The Setting Every Community Up for Retirement Act (The SECURE Act) makes it easier to save for retirement. Most changes based on this act took effect on January 1, 2020. The impact of this act on 2020 year-end tax planning is also reflected in this memorandum.

The SECURE Act repealed the maximum age for traditional IRA contributions starting in 2020. An individual at any age may contribute to a traditional IRA if compensation is received. One change beginning in 2020 under the SECURE Act includes the increase of the age from 70 ½ to 72 for the required minimum distribution. Another change under this Act is that for participants or IRA owners whose death is after 2019, the distribution to a non-spousal beneficiary is required to be withdrawn from the plan within ten years following the plan owner's death. Eligible beneficiaries who are less than 10 years younger than the plan participant are not subject to this rule. The Act reinstated the Kiddie Tax previously suspended by the Tax Cuts and Jobs Act. Starting in 2020, the unearned income of a child is no longer taxed at the same rates as estates and trusts. Instead, the unearned income of a child will be taxed at the parents' tax rates if those rates are higher than the child's tax rate.

The enactment of the CARES Act results in the following changes: taxpayers can elect to suspend the requirement to take required minimum distributions (RMD) in 2020 from their retirement plans. The 10% penalty for early distributions (under age 59 ½) is waived for those who are diagnosed with COVID-19 (including spouse and dependents) or who are experiencing adverse financial consequences resulting from quarantine, furlough, lay-off, reduction of work, inability to work due to lack of child care, or is an owner of a business forced to reduce hours due to COVID-19. The CARES Act allows eligible individuals to

withdraw up to $100,000 from qualified retirement plans without incurring the 10% early distribution penalty. The CARES Act allows individuals to deduct 100% of AGI if gifts of cash are given to a qualified charitable organization. This does not include donor advised funds or private family foundations. An individual can still contribute to the fund but the old rules of deducting 60% of AGI for cash gifts and 30% of AGI for securities still apply. Any excess contributions can be carried forward five years.

The CARES Act does not change the law that allows you to make a Qualified Charitable Deduction (QCD) from IRAs if you are over age 70 ½; up to $100,000.

The CARES Act creates an above the line deduction (to determine AGI) of up to $300 for cash contributions from taxpayers who do not itemize their deductions (take the standard deduction). To take advantage of this provision, taxpayers should make sure to make cash donations before the end of 2020.

The 2020 top federal tax rate remains unchanged at 37% on ordinary income for taxpayers with taxable income above $622,500 for married taxpayers filing jointly and $518,400 for single filers. The top tax rate for capital gains and qualified dividends is currently 20% for taxpayers with taxable income above $496,600 for married taxpayers filing jointly and $441,450 for single filers. The Pease Rule which reduced itemized deductions of certain taxpayers by three percent of their adjusted gross income (AGI) remains suspended. For Federal estate and gift tax, the exclusion amount is $11,580,000 in 2020 and the top tax rate continues to be 40%.

Higher-income taxpayers currently pay an additional 3.8% Medicare tax on Net Investment Income when Modified Adjusted Gross Income ("MAGI") exceeds the thresholds of $250,000 for married taxpayers filing jointly and $200,000 for single filers. Net Investment Income ("NII") is unearned income comprised of gross income from interest, dividends, royalties, rents, passive activities, gross income from the trade or business of trading in financial instruments or commodities, net gain (to extent taken into account in computing taxable income) attributable to the disposition of property (e.g., capital gain), less properly allocable deductions. Certain types of income are excluded from NII such as wages, self-employment income, active trade or business income, retirement plan distributions (from IRA, Roth IRA conversions, and other qualified plans), unemployment compensation, Social Security benefits, alimony, and interest from tax-free bonds (such as municipal bonds).

As a result, the effective Federal maximum rate for many higher-income taxpayers in 2020 is 23.8% for long-term gains and qualified dividends, and 40.8% for short-term capital gains and ordinary dividends (as they are taxed at the ordinary rate). An additional 0.9% Medicare surtax continues to be imposed on wages and self-employment income for higher-income taxpayers. Payment of the additional tax is determined by the combined wages or self-employment income of both the taxpayer and spouse over $250,000 for joint filers, and $200,000 of wages for a single filer.

It is important to continue to evaluate not only the amount of income but also the types of income you anticipate generating, if your business income can be separated between SSTB and non-SSTB, your marginal tax bracket, net investment income, wages and self-employment earnings, and capital gains and losses. Taxpayers who are decision makers for their businesses may have influence over the timing of income and of expense payments. It is possible to use ordinary losses from business activities to offset income from other sources and thus reduce your overall tax burden. Additionally, determining whether you are subject to the AMT in any given year continues to be a critical planning component.

With that in mind, we have compiled a checklist of actions that can help you save tax dollars if you act before year-end. Not all actions will apply in your situation, but you will likely benefit from many of them. We can narrow down the specific actions you can take and help you develop a detailed plan tailored to your own unique situation.

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.

TAX PLANNING IDEAS FOR INDIVIDUALS:

- Previous year-end tax planning included the suggestion to take required minimum distributions (RMDs) from your IRA or 401(k) plan or other employer sponsored retirement plans if you have reached age 70 ½. See the discussion above regarding the recently enacted SECURE Act. If you were born on or after 7/1/1949 you can now wait until you reach the age of 72 to start taking your RMDs. You can also elect to suspend the requirement to take your RMDs in 2020. You should contact your custodian to calculate your RMDs for you before making the election.

- Review unrealized loss positions within investment accounts and consider realizing the losses.

- Consider triggering capital gains to offset capital loss carryovers from 2019 and earlier. Current-year capital losses will first be applied to offset capital gains that are in the same category as the losses. Any additional loss will then be applied to gains in the other category. Therefore, you might consider a strategy that ensures that your carryover losses offset short-term capital gains when possible, regardless of whether those losses resulted from short-or long-term transactions.

- Rebalance your investment portfolio by incorporating additional tax-efficient investments to help reduce taxes, such as municipal bond investments, growth-oriented stocks that pay out lower dividends, Qualified Opportunity Zone Funds "QOF" (which defer tax payments on capital gains and give a step-up in basis on the QOF investment if held for 5 or 7 years) and investments (such as in real estate, energy, and natural resources) that produce income sheltered by depreciation or depletion.

- Both worthless securities and bad debts could give rise to capital losses. Since no specific transaction generally alerts you to this deduction, you should review your portfolio carefully. If you own securities that have become worthless or made loans that have become uncollectible, ensure that the losses are deductible in the current year by obtaining substantive documentation to support the deduction.

- Wash sales occur when you realize a capital loss and acquire a substantially identical security within the 61-day period beginning 30 days before the sale and ending 30 days after the sale. While this rule makes it difficult to claim a loss on a stock that you want to keep in your portfolio, it is possible to manage around the time requirements.

- To realize losses in your bond portfolio, it may be possible to sell a bond at a loss and repurchase a very similar bond without running afoul of the wash sale rule. Bonds with different interest rates or maturity dates, even from the same issuer, are generally not considered substantially identical.

- When weighing your options with regards to diversifying your portfolio and selling marketable securities to harvest gains or losses, consider using margin debt for replacement securities. The interest on the debt will be deductible, subject to the investment interest limitation, which could reduce your NII for purposes of the NII tax.

- For securities bought on margin, any interest accrued as of December 31, 2020 will be deductible this year only if you pay the interest by December 31st.

- Sell qualified assets on the installment method to spread out gains when applicable.

- Consider investing in oil and gas investments, taking into consideration recent fluctuations in the oil and

gas market. Intangible drilling costs (IDC) provide a large immediate income tax deduction (up to 85% of the initial investment). Losses, if any, created as a result of IDCs will be ordinary and will lower adjusted gross income. Depletion and other depreciation provide for additional deductions during the term of the investment. However, the new Excess Business Loss rules along with AMT considerations may limit the amount of deductions allowed for tax years after 2020.

- Consider reviewing your employee stock options prior to year-end to determine whether they should be exercised this year. Exercising most employee stock options will result in ordinary income which may be advantageous if you expect to be in a higher bracket in 2021. A secondary benefit is that future stock appreciation after exercise may qualify for capital gain treatment which is taxed at the lower capital gain rate if held for more than one year after the date of exercise.

    - If you hold incentive stock options, a poorly planned exercise can be very costly because the spread between the fair market value of the stock and the exercise price is a tax preference item for AMT purposes. While the AMT exemption has increased under the TCJ Act, ISO spreads continue to be a preference item for AMT purposes.

- If you anticipate a net loss from business activities in which you do not materially participate, consider disposing of the loss activity by December 31st. If sufficient basis exists, all suspended losses become deductible when you dispose of the activity. If you are limited by your tax basis or the "at risk" rules, consider contributing capital to the entity or, in some cases, making a loan to the entity prior to December 31st to secure your deduction this year. Even if there is a gain on the disposition, you may still benefit from having the long-term capital gain taxed at 23.8% (inclusive of the NII tax) with the previously suspended losses offsetting other ordinary income.

- If you enter the 2021 tax year with passive-activity loss carryforwards you should consider pursuing investment strategies that generate passive income, since that would allow use of the passive-activity losses carried over from prior years.

- There are ways to become active in a trade or business to reduce the NII tax, such as increasing the amount of time devoted to a specific activity or restructuring entities. Increasing your material participation in the activity can reduce the amount of income subject to the NII tax. Proceed with caution, though, because a change in participation level may impact other short and long-term tax obligations.

- If you own shares of a U.S. corporation that has announced plans to convert to public ownership, but has not yet obtained shareholder approval, there are two suggested courses of action to consider. First, you may wish to gift shares of stock to family members who pay capital gains tax at a lower rate than you do. State tax rates must be considered since they can make this gap wider or narrower. Second, you may wish to donate the stock to charity, thereby obtaining the charitable deduction for the fair market value of the shares (assuming you have held them for over a year) and avoiding recognition of the capital gain altogether.

- If you are near the applicable threshold for NII tax liability, consider revising the timing of distributions from retirement plans to manage your net investment income. While the distributions themselves are not NII, the distributions increase you MAGI, which could subject more of your investment income to the NII tax.

- Tax planning within the hedge fund and private equity fund space to consider and discuss with your tax advisor:

    - Tax treatment of management fees considering 2% miscellaneous deductions being

previously repealed through 2025, investment interest expense **subject to new limitation rules**, etc. Are the deductions taken as an adjustment to gross income or as an itemized deduction? Investment management fees treated as miscellaneous itemized deductions are no longer deductible.
    - Do you anticipate receiving a tax benefit and how does that factor into your calculation of the return on investment over the life of the investment?
    - Additional non-resident state filing requirements (generally more common in the private equity fund space)
    - Will you have an opportunity to participate in state composite tax filings and minimize overall cost?
    - State tax issues regarding treatment of expenses, especially in states that either phase out deductions for high-income taxpayers or assess a tax on gross income, without accounting for deductions
    - More frequent review of tax basis within an investment to address any issues arising from current-year losses, distributions, etc.
    - Is the fund foreign or domestic, and does the investment create additional regulatory disclosure at the individual level or add an additional level of complexity in terms of informational reporting required to be submitted with your individual income tax return?
    - Are these investments more opportune when developing gift-planning strategies given the statistically greater chance of higher average returns (while measuring risk) versus stock, bonds, etc.?

- If a child has earned income, there are various strategies he or she can use to contribute to a traditional or Roth IRA. Consider employing children in the business to generate earned income. Those earnings can be contributed, or funds could be gifted, into the IRA accounts up to the lesser of their earned income or the maximum allowable contribution.

- Employees should consider making the maximum contribution into their company retirement plan, since these contributions lower your current year taxable income, and the earnings grow tax free. Such contributions will allow you to defer taxable income until retirement while saving for the future. The maximum contribution into such plans for 2020 is $19,500 ($26,000 for taxpayers age 50 or older).

- Self-employed individuals should consider taking advantage of the $57,000 maximum tax-deductible limit for contributions provided under defined contribution plans (or $63,500 for those age 50 or older). Making such a contribution will offset the ordinary income earned in 2020, lessening the tax burden. The deadline for setting up and funding a plan is as late as the due date of your 2020 individual tax return.

- **Prior to the CARES Act, the annual charitable deduction limitations ranged from 20% to 60% of a taxpayer's adjusted gross income (AGI), depending on the assets donated and the charitable recipient. The limitation acts as a cap on the amount that can be deducted against income that year. Any charitable contribution in excess of that cap is not lost, rather it carries forward for up to five subsequent years, subject to the same limitations that are then in effect. Before the CARES Act, individuals who itemized deductions were subject to the following limitations:**

    - Public charities (includes donor-advised funds)
        - Cash: 60% of AGI
        - Short-term capital gain property: 50% of AGI
        - Long-term capital gain property (publicly traded): 30% of AGI

    - Private nonoperating foundations (includes family foundations)
        - Cash: 30% of AGI

- Short-term capital gain property: 30% of AGI
- Long-term capital gain property (publicly traded): 20% of AGI

With respect to the charitable deduction limitations, the CARES Act raises the limitation up to 100% of AGI for cash contributions to a public charity given in 2020 only. Theoretically, this would allow individuals to reduce their 2020 taxable income to zero if cash gifts are large enough and are given to a public charity. All other charitable deduction limitations weren't impacted by the CARES Act. Gifts of marketable securities are still limited to 20% – 50% of AGI, depending on the recipient and whether they're short-term or long-term capital gain property. Another caveat is the treatment of contributions to a donor-advised fund (DAF). DAFs usually fall under public charity rules for contribution limitations. However, the CARES Act change doesn't apply to DAFs, and therefore contributions are still limited to a maximum deduction of 60% of AGI. Similarly, contribution limitations for nonpublic charities and private nonoperating foundations also remain the same. Though most contribution limitations remain unchanged, with proper planning, individuals can benefit from the increased cash limitation. Taxpayers can still donate long-term capital gain property and contribute to a DAF or private foundation up to the pre-CARES Act limitations. Taxpayer can then supplement such donations with cash contributions to public charities to receive a combined deduction of up to 100% of AGI. For example, with an AGI of $1,000,000 in 2020, taxpayers could gift appreciated marketable securities equal to 30% of AGI ($300,000) to a DAF and give cash up to 70% ($700,000) of AGI to public charities. The gift of the appreciated marketable securities will still provide a full charitable deduction, and the taxpayers will not recognize any capital gain tax on the appreciated amount of their contribution. The CARES Act does not change the law on a Qualified Charitable Deduction (QCD) from an IRA if you are over 70 ½ years old; up to $100,000.

- Sell depreciated stocks to realize the benefit from deducting capital losses in current year. Then gift the net proceeds to charity and take a charitable deduction.

- If a large charitable deduction is desirable for 2020 but you haven't decided on a charity (or charities) to receive the gift, consider making a charitable contribution by year-end to a donor-advised fund. This will allow you to receive the large charitable deduction in the current year, but you can give the money to charities over time.

- Make gifts sheltered by the annual gift tax exclusion before the end of the year to individuals and/or an Irrevocable Life Insurance Trust. You can give up to $15,000 in 2020 to each of an unlimited number of individuals but you can't carry over unused exclusions from one year to the next. Spouses together may gift up to $30,000 per recipient, without incurring any federal gift tax. The transfers also may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to kiddie tax. By making these gifts annually, taxpayers can transfer significant wealth out of their estate without using any of their lifetime exclusion.

- Contributions to an IRC Section 529 College Savings Plan can also help reduce income and future estate taxes. By taking advantage of a special provision in the tax code that allows you to take five years' worth of gift tax exclusions in a single year, you can make an accelerated gift through a 529 plan. You can gift up to $75,000 ($150,000 for couples) per beneficiary – which effectively removes the assets from your taxable estate yet does not force you to give up control. You can still spend up to $10,000 per year from a 529 Plan for tuition at elementary or secondary public, private or parochial schools without regard to the already allowed distributions available for college education expenses (subject to certain state tax rules).

- The previously mentioned SECURE Act reinstates the Kiddie Tax previously suspended by the TCJ Act. For tax years beginning after 12/31/19, the unearned income of a child is no longer taxed at the same rates as estates and trusts. Instead, the unearned income for a child is taxed at the parents' tax rates. The Kiddie

Tax applies to a child's investment income above $2,100 and applies until a child turns 19. If the child is a full-time student who provides less than half of his or her support, the Kiddie Tax applies until the year the child turns 24.

- Certain assets may have declined in value. If you're holding assets you believe might rebound in value, it might be advantageous to consider making a lifetime gift to – or a lifetime sale for – your beneficiaries.

- **The CARES Act retroactively eliminates the loss limitation for tax years 2018 and 2019 and suspends this limitation for 2020. This, thereby, enables taxpayers to fully deduct business losses without limitation.** The Excess Business Loss (EBL) limitation for trade or business losses remains in effect at $500,000 for couples and $250,000 for other filers. Any excess losses will be carried forward and treated as part of the taxpayer's net operating loss in the subsequent year. This limitation applies *after* the application of the current basis, at-risk and passive-activity loss rules. The NOL carryforward which is created under this rule is limited to 80% of taxable income of such year without regard to the NOL carryforward. The elimination of the NOL carryback provisions (except for farming losses) and the provision that NOLs can be carried forward indefinitely remains in effect. This rule applies to NOLs incurred in taxable years ending after 12/31/17. This change did not apply to NOLs arising in taxable years ending prior to January 1, 2018. This may require calendar year taxpayers to separately track pre-2018 NOLs.

- Certain tax planning should be considered under the new EBL/NOL rules. Taxpayers planning a large capital asset acquisition eligible for immediate expensing under the new rules, should evaluate the benefits of purchasing that property in years with higher income, so that the expensing can be 100% absorbed without the EBL limitation and subsequent NOL.

- If you are in an overall loss position for the year after all your items of income and loss have been calculated, you may be entitled to a deduction for a net operating loss. Significant planning opportunities become available with net operating losses because you have the option to offset prior and future income with the losses generated in current year. The CARES Act allows a five-year carryback of any NOL generated in a taxable year beginning after 12/31/17 and before 1/1/21. The CARES Act removes the 80% limit for taxable years beginning before 2021 to allow an NOL carryforward to fully offset future income.

- The deduction available for qualified business income under IRC Section 199A, commonly known as the QBI deduction, remains in effect. Taxpayers can receive a deduction against federal income for up to 20% of their Qualified Business Income received from partnerships, LLCs, Subchapter S corporations, sole proprietorships, trusts, estates and rental activities for tax years beginning after 12/31/17 and before 1/1/26. The provision is a significant tax benefit for many noncorporate businesses and was passed in part to provide a corollary tax benefit to non-C corporation business, as the C corporation rate was decreased from 35% to a flat 21% rate. The QBI deduction is taken at the partner, S corporation shareholder, estate and trust or sole proprietor level. There are several limitations and thresholds that apply to this deduction and the calculation involves a multistep process that may phase out some or all of the deduction. Please contact us for further details related to your specific situation with respect to the QBI deduction.

- The IRS gave further guidance about rental real estate being classified as a trade or business for 199A purposes. To qualify as a trade or business, and therefore to be considered a non-SSTB for 199A purposes, you would need to have a minimum of 250 hours' worth of work done on your rental property, even if it was not done by yourself. The rental services can be performed by owners, employees or independent contractors. It is advised to keep contemporaneous records of how much time is being spent on the property. However, some activities that rental services exclude include the follow: financial or investment management activities (e.g., arranging financing, procuring property), studying or reviewing financial

statements or reports on operations, planning, managing or constructing long-term capital improvements, or hours spent traveling to and from the real estate.

- Businesses should continue to consider making expenditures that qualify for a Section 179 deduction. For 2020, you can expense up to $1,040,000 of eligible property. However, if you spend more than $2,590,000 on qualifying property, the deduction is reduced on a dollar-for-dollar basis, up to $3,630,000. The CARES Act expanded bonus depreciation on "Qualified Improvement Property" placed in service after 12/31/2017. Business can now treat QIP as 15-year property. It is eligible for bonus depreciation allowing taxpayer to deduct up to 100% of the cost of assets being depreciated over 39 years under the TCJ Act. QIP is any improvement made to an interior portion of a building which is nonresidential real property, if the property was placed in service after the date the building was originally placed in service.

- Preferential tax treatment is given for investments in property in Qualified Opportunity Zones. The Fund must hold at least 90% of the assets in qualified zones. Upon capital gain realization, you must reinvest the amount of the gain into a QOZ within 180 days in order to defer the gain until the earlier of the date on which this investment in the QOZ is sold or exchanged or December 31, 2026. If the QOZ investment is held longer than 5 years, there is a 10% exclusion of the deferred gain. If held for more than 7 years, the 10% becomes 15%. The tax on 85% of the deferred gain will be reported in 2026 if the QOZ is still held regardless if the investor continues to hold the QOZ after 2026. If the investor holds the QOZ for at least 10 years, the tax basis will increase to its fair market value on the date the QOZ investment is sold or exchanged resulting in no tax on the QOZ appreciation.

- Many US investors include foreign direct investments in their overall investment portfolio. One benefit to including foreign assets in your portfolio is to participate in the upside of a global economy. These investments are permitted under US tax law but require additional reporting and compliance. It is important to factor this requirement into your investment and tax planning.

- The lifetime federal gift tax exclusion for each individual is $11,580,000 for 2020. If you have not yet taken advantage of this monumental tax-free gifting opportunity, consider outright gifts or gifts in a trust, including trusts for your children's and grandchildren's education. Gifts can be made with real estate, stock or other assets.

    - Keep in mind, the gift tax rate for gifts greater than the lifetime exclusion is 40%. This rate is a permanent tax law change and isn't set to expire or change.

    - Consider state inheritance tax issues as part of your estate and gift planning process. Many states have their own gift and estate tax, and in many cases the exemption amounts are lower than the federal amounts.

    - The IRS recently released additional guidance which stated that there will be no claw-back if the law changes in 2026 and the pre-existing estate exemption comes back into place. Essentially, if you take advantage of the higher exemption amount now, no matter how much the exemption amount changes with the new laws there will be no tax consequences for you and you will be grandfathered in if you take advantage of this exemption limitation as long as it is done so before 2026.

- Portability, or the ability to use a deceased spouse's unused federal estate tax exemption, remains a viable planning technique and should be considered in your planning.

- If you're one of the many business owners who will sell your business to a new owner in the next five to ten years, make sure your estate plan is closely aligned with your business and personal goals. A smooth transition of ownership interests will also help protect your wealth after the sale of your business.

- Taxpayers who use their home for business (self-employed as opposed to working for an employer in which case the tax reform repealed the deduction) are allowed to continue to compute their deduction using a simplified method. In lieu of actual expenses such as electricity, depreciation, etc., they may compute their qualifying home office deduction at $5 per square foot for up to 300 of square feet of office space, up to $1,500 annually.

- Increase 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. Don't forget that you cannot set aside amounts to get tax-free reimbursements for over-the-counter drugs, such as aspirin and antacids.

- The deduction for personal casualties continues to be disallowed for losses incurred between 2018 through 2025 with the exception for Presidentially Declared Disaster Areas.

- Increasing your final estimated tax deposit due January 15, 2021, may reduce the amount of the penalty for under-payment of estimated taxes but is unlikely to eliminate it entirely. Withholding, even if done on the last day of the tax year, is deemed withheld ratably throughout the tax year.

- Special rules apply to estates and trusts, which are subject to the net investment income *(*NII) tax on the *lesser* of undistributed NII of the excess of adjusted gross income over the dollar amount at which the highest tax bracket begins. For 2020 the top bracket which is subject to NII tax begins at $12,950.

- Estates and trusts should consider whether net investment income left in the trust will be subject to the NII tax and, if so, whether it would be beneficial to distribute income to beneficiaries who may have Modified Adjusted Gross Income (MAGI) below the applicable threshold such that they will not be subject to the NII tax.

- Trustees of complex trusts should consider making income distributions to trust beneficiaries who are in lower income tax brackets. Trustees may also be able to take advantage of the "65-day rule" that enables a trustee to elect to treat a distribution made during the first 65 days of 2021 as though it was made on the last day of 2020.

- Taxpayers who acquire qualified small business stock and hold the stock for at least six months may elect to defer realized gain upon the sale by reinvesting such proceeds into new qualified business stock within sixty days. The taxpayer's basis in the replacement stock is reduced by the amount of the gain deferred.

- Home Mortgage Interest is still deductible for Acquisition Indebtedness; however, the threshold has changed from $1,000,000 to $750,000. For loans established on or before 12/15/2017 and closed on or before 4/1/2018, the $1,000,000 threshold still applies. Additionally, the interest on home equity indebtedness is no longer deductible, unless they meet the definition of acquisition indebtedness.

- Miscellaneous Deductions subject to 2% AGI floor have been repealed. These deductions include employee business expenses, investment advisory fees, hobby expenses (while hobby income still must be reported), estate planning fees, tax preparation fees, home office expense for the benefit of an employer as opposed to self-employed home office expense. Taxpayers may consider allocating certain expenses to their businesses, where allowable, to enable a portion of these deductions.

- State and local taxes and real estate tax total deductions are limited to $10,000. This includes state & city income taxes, sales taxes, and property taxes. For taxpayers with high state and local income taxes it may cost substantially more to live in high-income tax states. This analysis depends on your prior year AMT situation, as much of your tax deduction may have been disallowed by virtue of the AMT.

- Alimony deduction for divorce agreements entered into after 2018 can no longer be deducted.

- Child tax credit income-based phase-out has been substantially increased to begin at $400,000 for joint filers ($200,000 for single filers). For 2020, any children who reach their 17th birthday prior to 1/1/21 are not eligible for the credit.

- The most important tax planning strategy in any year is to minimize taxes with proper documentation for deductions and other tax-reducing items. Keep accurate records for vacation home rental and personal use, and for business days worked outside your state of residency. In addition, your charitable receipts must state whether any goods or services were provided to you for your donations. Without this clause, your gift is statutorily not deductible. It is therefore important that you check your letters before including them with your tax information.

- State Residency – Be sure to tell us if you own houses in states other than your domicile state. Many states have statutory residency rules which could prove to be very costly if you spend over a certain amount of time in that state and own or maintain a home.

- **Ask us to prepare a 2020 Year-End Income Tax projection on your behalf so that we can advise you on the strategies that suit your specific situation.** Be sure to keep us abreast of any major life changes such as marriage or divorce, birth of a child, purchase of a new primary residence or second home, starting a new business, etc., so we can provide you with the most effective tax planning.

THE ENCLOSED APPENDIX #1 DETAILS THE MAXIMUM 2020 MARRIED FILING JOINTLY FEDERAL INDIVIDUAL INCOME TAX RATES BY TYPE OF INCOME.

THE ENCLOSED APPENDIX #2 DETAILS THE MAXIMUM MARGINAL FEDERAL AND STATE PERSONAL TAX RATES.

THE ENCLOSED APPENDIX #3 DETAILS THE CURRENT STATUTORY TAX FILING DEADLINES.

ESTATE PLANNING IDEAS:

THE ENCLOSED APPENDIX #4 DETAILS THE CHANGES IN THE TAX RATES AND EXCLUSION AMOUNTS.

- **Consider utilizing your lifetime gift tax exemption if you have not already done so**. The Estate and Generation Skipping Transfer (GST) tax exemption for 2020 is $11.58 million and the proposed inflation-indexed amount for 2021 is $11.70 million. Be sure to utilize the current estate tax rates and gift tax exemptions to their full potential.

- **Use wealth-transfer techniques that might be limited in the future.** An individual who is considering implementing a grantor retained annuity trust (GRAT) or a transaction involving a valuation discount issue may want to consider doing so as soon as possible, at a time when the gift tax rate is 40%.

- **Multi-generational trusts.** Wealthy families often take advantage of the GST exemption by creating long-term multi-generational trusts, often referred to as "dynasty trusts." This type of trust avoids gift and estate tax at each generation and can continue for the benefit of multiple generations. Several states permit

trusts to last for hundreds of years, and some even permit perpetual trusts that can theoretically last forever.

- **Insurance Trust -** One of the easiest and most effective estate planning techniques is establishing an irrevocable insurance trust. Annual exclusion gifts can be made to a life insurance trust, for the purchase of life insurance on the grantor's life for the benefit of children or other individuals. By establishing a life insurance trust, an individual can meet the requirements for excluding the life insurance proceeds from his or her estate. Generally, an individual must fund the trust with an insurance policy and give up all rights of ownership including the right to borrow from the policy and to designate beneficiaries.

- **Charitable Remainder Trust** - The charitable remainder trust allows an investor to diversify out of a large position in an appreciated security without incurring a capital gains tax, while retaining an income interest for a period of time (e.g., life of the donor.) Under the terms of a charitable remainder trust, an investor makes an irrevocable contribution of an appreciated security to the trust, which sells the security and uses the cash proceeds to purchase a diversified investment portfolio. The investor will receive an income tax deduction for the remainder value of the charitable contribution. The value of the security transferred to the charitable remainder trust will escape estate taxes. The value of the charity's remainder interest must be at least 10% of the fair market value of the contributed property. With higher capital gains rates currently in effect, this strategy may have additional appeal.

- **Private Foundations** - Private foundations allow an individual or families to contribute funds to a foundation, receive a current charitable deduction, and direct the distribution of monies to charities at a later date. For appreciated publicly traded securities the deduction is for the full fair market value of the security if the taxpayer's holding period is greater than one year.

- **Family Limited Partnerships -** To maximize estate and gift tax savings, consider establishing a family limited partnership (FLP) to take advantage of both minority interest discount and a lack of marketability discounts which are otherwise not available on an outright gift of marketable securities. Recent court cases have held that the value of property transferred by a decedent to a family limited partnership in certain instances was includible in the decedent's gross estate under IRC Section 2036 (a). These court decisions have established a new, controversial framework under which FLP's will need to operate in the future. It should be noted that FLP's more than ever must administer the partnership with the proper formalities of a business entity, hold regular meetings, should not commingle personal assets, maintain proper accounting records and separate accounts in the partnership name. FLP's should be established while you are in good health. You may also need to consider reducing or giving up control over the assets in the partnership to avoid the risk of an estate tax inclusion. Please contact us if you would like to discuss the consequences of the recent tax court cases.

- **Defective Grantor Trusts** – This type of trust is extremely effective for estate planning purposes. This represents making a transfer to an irrevocable trust representing a completed gift for gift and estate tax purposes. By making it "defective" for income tax purposes the person establishing the trust continues to pay the income tax on trust income ultimately representing a tax-free gift to the trust's beneficiaries.

- **Making a Charity your Retirement Plan Beneficiary** – High net worth individuals with plans to leave money to charity in their estate should consider naming a charity as beneficiary of their qualified retirement plan. If a charity is named beneficiary, no income tax will be due on the retirement assets in the individual's estate. Additionally, the decedent would be able to obtain a charitable estate tax deduction. The individual's heirs might then be able to receive assets from the decedent's estate with no inherent income tax liability, which might instead have been left to the charity; this is more valuable to them than receiving retirement plan assets with inherent tax obligations. Your Private Foundation or Charitable Remainder Trust can be named the charitable beneficiary for these assets to remain under your family's direction.

- **<u>Grantor Retained Annuity Trusts</u>** – You can give appreciating assets to GRAT, incur no gift or estate tax and, if the assets appreciate, transfer the future appreciation estate and gift tax free to your beneficiary. A convergence of three factors – low interest rates, depressed stock values and a recent Court Case allowing "zero out" GRATS may make these trusts now especially attractive.

- **<u>Review your Wills, Health-Care Proxy, Power of Attorney Forms and Beneficiary Designations</u>** Year-end is a good time to update your will and your beneficiary designations. Make sure you are pleased with your choice of executor and guardian. If you have not finalized your estate planning, do so now.

A purposeful, informed year end plan will help taxpayers reap significant benefits. Not all actions will apply in every taxpayer's situation, but individuals will likely benefit from many of them. For those individuals who utilize our Firm's personal tax services, please let us know how we can best support you in building and implementing your plan for 2020 and beyond. Upon your request, we will prepare a year-end income tax projection incorporating the strategies applicable to your own specific situation.

<u>PRESIDENT ELECT JOE BIDEN'S TAX PROPOSALS:</u>

President elect Joe Biden has put forward several proposals to raise revenue as well as several proposals to provide targeted tax breaks. The enactment of these proposals is heavily dependent on the outcome of the Georgia senator's runoff elections on January 5, 2021. The outcome of these races will determine which party holds the majority in the Senate. Here are some of Biden's proposals:

- Biden's plan would increase the tax rate on corporate income from 21% to 28%.

- Biden's plan would institute a 15% minimum tax on "book" profits – or reported annual income net of annual expenses – for corporations with at least $100 million in annual income. Corporations would still be allowed to claim deductions for losses carried forward from previous years and foreign taxes paid.

- Under current law, a Global Intangible Low-Taxed Income (GILTI) tax requires multinational companies to pay a tax of at least 10.5% on foreign income generated from patents, trademarks & copyrights. Biden's plan would double the GILTI tax rate to 21%.

- Under current law, individuals making over $207,351 and couples filing jointly making over $414,701 face a marginal income tax rate of 35%; individuals making over $518,401 and couples making filing jointly making over $622,051 pay a tax rate of 37%. Biden's plan would restore the 39.6% rate for these taxpayers.

- Under current law, some revenue from pass-through entities (Sole Proprietorships, Partnerships & S Corporations) is partially deductible against income. Current law allows business owners to deduct 20% of Qualified Business Income (QBI) through 2025. Biden's plan would maintain the current deduction for those making under $400,000 per year while phasing the deduction out completely for higher earners.

- Under current law, net income from the sale of assets held longer than one year and related dividends is taxed at a top rate of 20% plus a 3.8% surtax, whereas earned income is taxed at a top rate of 37% plus a 3.8 percent payroll tax. Also, when one generation inherits an asset from another, the cost basis of that asset gets stepped up from the cost at the time of purchase to the cost of the time of transfer. The asset's appreciated value escapes taxation permanently. Biden's plan would eliminate the preferential treatment of capital gains and dividends for higher earners. Capital gains

and qualified dividends would be taxed as ordinary income at a rate of 39.6% for individuals and couples earning more than $1 million. Biden's plan would eliminate the stepped-up basis for capital gains at death.

- Under current law, taxpayers can claim a $24,800 per couple standard deduction or deduct from their income the combined cost of the mortgage interest paid, charitable giving and state and local taxes (up to $10,000). Biden's plan would institute an overall cap of 28% on the rates against which one could take itemized deductions. Biden's plan would reinstate the Pease limitation for those with income above $400,000. The limitation reduces the amount one can deduct above a threshold.

- Under current law, the social security program is funded through a 12.4% payroll tax, half paid by employers and half paid by employees, on income up to a certain amount. The taxable minimum is $137.000 for 2020. Biden's plan would subject wages above $400,000 to the 12.4% payroll tax.

- Biden's plan would reinstate and expand a tax credit for first-time homebuyers and establish a new credit for renters.

- Under current law, parents of children under the age of 13 and individuals who have a disabled dependent living in their household for more than half the year may claim a non-refundable tax credit. The credit is worth up to 35% of up to $3,000 of qualified expenses for one dependent and $6,000 for two or more phased down to 20% for higher income earners. Biden's plan would expand this credit by making it refundable for those with no tax liability, increasing the maximum allowable expenses to $8,000 ($16,000 for multiple dependents) and increasing the reimbursement percentage from 35% to 50%.

- Biden's plan would eliminate the $25,000 exemption from passive loss rules for rental losses, accelerated depreciation of rental housing and deferred of capital gains taxes from like kind exchanges.

Disclaimer:

We produce this guide for our clients and others who are concerned about planning and managing their personal financial affairs. Each individual's financial situation is unique, and the material in this guide is not intended to constitute specific accounting, tax, investment, or legal advice. This publication contains general information only and FLSV is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax or other professional advice or services.

APPENDIX #1

2020 FEDERAL INCOME TAX RATES

- MARRIED FILING JOINTLY **

Income Category	Income Tax Rate - 2020		Medicare Taxes on Income - 2020			Total Tax Rates -
	Top Rate	Taxable Income Threshold	Base Tax Rate	Add'l Tax Rate	AGI Threshold	Total Rate
Wages	**37.0%**	622,050	1.45%	**0.9%**	250,000	39.35%
Self-Employment Income	**37.0%**	622,050	2.9%	**0.9%**	250,000	40.80%
LT Capital Gains & Qualified Dividends	**20%**	496,600	-	**3.8%**	250,000	23.80%
Other Income - Investment (interest, rents, royalties, etc.)	**37.0%**	622,050	-	**3.8%**	250,000	40.80%
Active Business Income (Not subject to Self-Employ. Tax)	**37.0%**	622,050	-	**-**	-	37.0%
Passive Income from Businesses	**37.0%**	622,050	-	**3.8%**	250,000	40.8%

**The thresholds are lower for each of these taxes for non-married taxpayers.

APPENDIX #2

2020 MAXIMUM TAX RATES*

New York State/City Resident:

Ordinary Income	49.70%
Qualified Dividends/LTCG	36.50%
Other Investment Income	53.50%

New York State Resident:

Ordinary Income	45.82%
Qualified Dividends/LTCG	32.62%
Other Investment Income	49.62%

New Jersey Resident:

Ordinary Income	47.75%
Qualified Dividends/LTCG	34.55%
Other Investment Income	51.55%

Connecticut Resident:

Ordinary Income	43.99%
Qualified Dividends/LTCG	30.79%
Other Investment Income	47.79%

* Includes Maximum Federal Income Tax Rate (37% on ordinary income, and 20% on qualified dividend and net long-term capital gains), and the 3.8% Obama Healthcare tax that took effect in 2013.

NOTE- The above taxes do not reflect the maximum Medicare tax of 2.35% imposed on employees, and of 3.8% imposed on self-employed individuals.

APPENDIX #3

2020 STATUTORY TAX FILING DEADLINES*

RETURN TYPE:	**CURRENT LAW:** original and extended due dates (dates changed by law in **bold)**
Partnership (calendar year) Form 1065	**March 15** **September 15**
S corporation (calendar year) Form 1120-S	**March 15** **September 15**
Trust and estate (calendar year) Form 1041	**April 15** **September 30**
C corporation (calendar year) Form 1120	**April 15** **October 15**
C corporation (Fiscal year end other than Dec.31 or June 30) Form 1120	**15th day of month 4 after year-end** **15th day of month 10 after year-end**

C corporation (June 30 Fiscal year) Form 1120	**Before Jan 1, 2026:** **April 15** **September 15**	**After Dec 31, 2025:** **April 15** **October 15**
Individual Form 1040	**April 15** **October 15**	
Exempt organization (calendar year) Forms 990	**May 15** **November 15**	
Foreign trusts with a US owner Form 3520-A	**March 15** **September 15**	
FinCen Report 114	**April 15** **October 15**	

APPENDIX #4

ESTATE AND GIFT TAXES:

	Top Estate and Gift Tax Rate	Gift Tax Exemption Equivalent	Estate Tax Exemption Equivalent	GST Tax Exemption Equivalent
2010	Gift Tax = 35% Estate and GST Taxes Repealed	$1 million	Estate Tax Repealed	GST Repealed
2011	35%	$5 million	$5 million	$5 million
2012	35%	$5.12 million	$5.12 million	$5.12 million
2013	40%	$5.25 million	$5.25 million	$5.25 million
2014	40%	$5.34 million	$5.34 million	$5.34 million
2015	40%	$5.43 million	$5.43 million	$5.43 million
2016	40%	$5.45 million	$5.45 million	$5.45 million
2017	40%	$5.49 million	$5.49 million	$5.49 million
2018	40%	$11.18 million	$11.18 million	$11.18 million
2019	40%	$11.4 million	$11.4 million	$11.4 million
2020	40%	$11.58 million	$11.58 million	$11.58 million
2021	40%	$11.70 million	$11.70 million	$11.70 million