

TaxTips

Keeping you informed winter 2020/2021



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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 wasn't 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.

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 70½ 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 nonspouse 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.

Earning money from a side job?

Tips for avoiding the hobby loss rules

Like many of us, you've probably dreamed of turning a hobby or pastime into a regular business. Or perhaps the current economic condition necessitated that you turn to a side job to earn extra money. You won't have any unusual tax headaches if your new business is profitable. However, if you consistently generate losses, the IRS may step in and say it's a hobby—an activity not engaged in for profit—rather than a business.



Under the hobby loss rules, you can claim certain deductions, such as state and local property taxes. Your deductions for business-type expenses such as rent or advertising from the activity are limited to your gross income, however. Furthermore, deductible hobby expenses must be taken on Schedule A of Form 1040 as miscellaneous itemized deductions subject to 2% of your adjusted gross income. Since miscellaneous itemized deductions are repealed from 2018 through 2025, deductible hobby expenses are effectively wiped out until 2026. This creates taxable income without offsetting deductions.

There are two ways to avoid the hobby loss rules. The first way is to show a profit in at least three out of five consecutive years. The second way is to run the activity in such a way as to show that you intend to make it profitable, rather than operate it as a mere hobby. IRS regulations say the hobby loss rules won't apply if the facts and circumstances show you have a profit-making objective.

How can you prove that you have a profit-making objective? In general, you can do so by running the new venture in a businesslike manner. More specifically, the IRS and the courts will look to the following factors: how you run the activity; your expertise in the area; the time and effort you expend in the enterprise; whether there's an expectation the assets used in the activity will rise in value; your success in carrying on other similar or dissimilar activities; your history of income or loss in the activity; the amount of occasional profits (if any) that are earned; your financial status; and whether the activity involves elements of personal pleasure or recreation.

Preparing for your tax appointment

Make sure to have all your documents

Nothing makes a tax preparer happier than a prepared client. Here are a few tips for going to your tax appointment with everything you need.

Look at last year's tax return for income and expense reminders. Make sure you have all the 1099s from your bank reporting your interest and dividend income. If you opened new bank accounts, make sure you have those statements as well.

Gather all your W-2s for both you and your spouse if married. If you have income from other sources,



such as an S corporation, partnership, estate or trust, make sure you have all your K-1s.

Do you claim dependents? Each dependent must have a Social Security number. Bring those documents with you so your preparer has the correct information. Incorrect Social Security numbers delay processing of your return. If you are entitled to the earned income tax credit, you will have to provide proof that your dependents are really yours to claim. School or medical records will help substantiate that your dependents live with you.

If you don't itemize your deductions, there isn't much in the way of expenses to deduct. The standard deduction covers all expenses except for cash contributions to a charity. You can claim up to \$300 without itemizing. Otherwise, make sure you have your mortgage interest statement, property tax bill and an itemized list of medical expenses and charitable contributions.

Year-end tax saving strategies

What makes sense for you?

The year is almost over, and you want to reduce your taxable income. What options are still available? The answer depends on your specific financial position.

If you have investments that are doing poorly, you might want to consider selling them so you can claim a capital loss. You can claim a capital loss to the extent you have capital gains, plus an additional \$3,000. If you sold stock earlier in the year at a gain, selling stocks at a loss now will offset that gain and reduce your taxable income.

Do you have a high deductible health plan (HDHP)? Consider contributing to a health savings account (HSA). For 2020, you can contribute \$3,550 for self-only coverage or \$7,100 for family coverage. If

you are age 55 or older, you can sock away an additional \$1,000 a year. You can contribute up until the due date of your return. You can contribute to an HSA if your qualifying HDHP has a minimum annual deductible of \$1,400 for self-only coverage or \$2,800 for family coverage.

Maximize 401(k) contributions for which the 2020 limit is \$19,500. Employees age 50 or older by year end may also make an additional contribution of \$6,500, for a 2020 total limit of \$26,000. Take advantage of your employer matching contribution. Review and make appropriate adjustments to the contributions you make to your employer's 401(k) retirement plan for the remainder of this year and for next year. It's also a good idea to review your investment elections and their periodic performance.

Another strategy, while not reducing taxable income, is to make Roth IRA contributions. The benefit of the Roth IRA is that the earnings on the IRA will not be taxable to you upon distribution (assuming distributed after reaching age 59½). The ability to make a Roth IRA contribution continues even if you're participating in an employer savings plan like a 401(k), so it's not subject to the "active participant" rules that may prevent employees who participate in an employer plan from making deductible contributions to traditional IRAs. Your ability to make a Roth IRA contribution in 2020 will be reduced if your adjusted gross income (AGI) in 2020 exceeds \$196,000 and you file married filing jointly (MFJ), or \$124,000 if you file as a

single taxpayer. You won't be able to contribute to a Roth IRA in 2020 if you are MFJ and your 2020 AGI equals or exceeds \$206,000. The AGI cutoff for single filers is \$139,000 or more. Married filing separate (MFS) taxpayers who live together lose the Roth option once AGI hits \$10,000.

For 2020 and later, there is no longer an age limit on making regular contributions to a traditional or Roth IRA. The sum of all traditional and Roth IRA contributions for 2020 is limited to \$6,000, rising to \$7,000 if you're age 50 or older by the end of 2020.

Finally, consider adjusting your federal withholding. If you face a penalty for underpayment of federal estimated tax, you may be able to eliminate or reduce it by completing a new Form W-4 and increasing your withholding. You should review your withholding to ensure enough tax is withheld if you hold multiple jobs, you and your spouse both work or someone else can claim you as a dependent. If you became married or single in 2020, have added or lost a dependent or expect increased itemized deductions, be sure to provide your employer with an updated Form W-4 to adjust withholding.

Note: Allowances are no longer used on the redesigned 2020 Form W-4. In the past, withholding allowance values were tied to personal exemption amounts. Due to changes in law, currently you cannot claim personal exemptions or dependency exemptions. The 2020 form change is meant to increase transparency, simplicity and accuracy of the form.

