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Tax Strategies – Finding Opportunities in an Uncertain Environment

Stancil CPAs • Advisors | February 13, 2021

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2020 Individual Tax Strategies

Agenda

I. What has Changed? – 2020 Tax Changes
- Secure Act, passed in December, 2019
- Families First Coronavirus Response Act, (FFCRA) March 16, 2020
- Coronavirus Aid, Relief, and Economic Security Act (Cares Act), passed March 27, 2020
- Consolidated Appropriations Act(CAA) signed December 27, 2020, by President Trump.

2020 Individual Tax Strategies

Agenda

II. What Might Change? – Biden Tax Proposals

III. Strategies to Consider:

a) Retirement Plan Strategies
b) Capital Gain Strategies
c) Charitable Contribution Strategies
d) "Marginal Rate" Strategies

2020 Individual Tax Changes

I. Changes Impacting IRAs

A. Start date for taking Required Minimum Distributions (RMDs) changed from age 70 ½ to age 72.

- Effective for individuals who had not turned age 70 ½ by the end of 2019.

B. RMDs waived for 2020.

- Taxpayers had until August 1 to roll 2020 distributions back into IRA. Also have 60 days from date of withdrawal to roll back into IRA.

2020 Individual Tax Changes

I. Changes Impacting IRAs

C. Relief for "Coronavirus-Related Distributions" to "Qualified Individuals" – someone who has been diagnosed with Covid, who has had a **spouse or child diagnosed with Covid**, or who has **lost employment** or had **pay reduced** due to Covid.

- Qualified Distributions up to $100,000.
- No **10% early-withdrawal penalties** (but still taxable).
- Can report income over **3 years**.
- Can roll distribution back into IRA within 3 years.

2020 Individual Tax Changes

I. Changes Impacting IRAs

D. Age limit for contributing to IRAs is removed.

- Must have earned income - at least as much as the amount contributed to the IRA.
  - Earnings can be by either spouse.
  - Deductible IRA contributions will impact ability to use Qualified Charitable Deductions (QCDs)
  - 2020 and 2021contribution limits are $6,000, or $7,000 if age 50 or older.

Planning Idea: Retiree with a part-time job should consider making a Roth IRA contribution of these earnings.

2020 Individual Tax Changes

I. Changes Impacting IRAs

Example #1:

Anna and Kyle are a married couple age 74. Their income consists of interest and dividends equal to $12,000, Social Security benefits of $50,000 and a pension equal to $45,000. Because they have no earned income, they are not permitted to make an IRA distribution.

2020 Individual Tax Changes

I. Changes Impacting IRAs

Example #2:

Emily and Michael are a married couple age 73. Their income consists of interest and dividends equal to $12,000, Social Security benefits of $50,000 and a pension equal to $45,000. In addition, Emily has a part-time job where she earns $9,000 and Michael has self-employment income of $5,000. Both Emily and Michael can contribute $7,000 to either a traditional or Roth IRA.

2020 Individual Tax Changes

I. Changes Impacting IRAs

E. Payout period for inherited IRAs is reduced to **10 years** for individuals dying after 2019.

- There is an exception to the 10-year rule for **surviving spouses and certain others**. They can continue to use expected remaining lifetime as the payout period.
- No RMDs are required during the 10-year period.
- Most **trust beneficiaries** will be subject to the10-year rule. Check with us for planning.

2020 Individual Tax Changes

I. Changes Impacting IRAs

F. Penalty-free IRA withdrawals for birth or adoption of a child beginning in 2020.

- Still subject to income tax.
- Maximum withdrawal is $5,000 for each parent.

2020 Individual Tax Changes

II. COVID-19 Tax Relief

A. Economic Impact Payment: Payments of $1,200 per individual and $500 per qualifying child were paid during the summer of 2020.

- Payment amounts were phased out if adjusted gross income was greater than **$150,000** for married taxpayers, **$112,500** for head of household taxpayers and **$75,000** for single taxpayers.
- Gross income used to determine any phase-out was from most recently filed tax return, whether 2018 or 2019.
- If taxpayers did not receive a refund but would qualify for one based on 2020 gross income, then a credit for the payment may be **claimed on the 2020 tax return**.

2020 Individual Tax Changes

II. COVID-19 Tax Relief

A. Economic Impact Payment: CAA provides for payments of $600 per tax payer and dependent child

- Income phase-out are the same as earlier phase-outs of relief from the Cares Act.
- This can also be **claimed on the 2020 tax return** if not received earlier.

2020 Individual Tax Changes

II. COVID-19 Tax Relief

A. Economic Impact Payment Round 3: The current stimulus bill being debated in Congress proposes an additional stimulus payment of $1,400. **This prospect might impact whether you want to file your 2020 soon, or delay filing until after stimulus payments are made**:

- If 2019 gross income is above the Income threshold, but 2020 is below it, file 2020 return before the stimulus bill is passed.
- If 2019 income was below the income threshold, but 2020 will be above the threshold, delay filing 2020 until after stimulus payments are made.

2020 Individual Tax Changes

II. COVID-19 Tax Relief

B. $300 charitable contribution deduction allowed for those who take the standard deduction. For 2020 only.

- Consolidated Appropriations Act (CAA) increases the deduction to $600 for married couples for 2021.

2020 Individual Tax Changes

II. COVID-19 Tax Relief

B. Charitable contribution limit for cash gifts raised for those who itemize.

- The limit was raised from 50% to 60% of adjusted gross income under the 2017 Tax Cuts and Jobs Act. This is good through 2025.
- For 2020 only, **taxpayers can elect to use 100% of adjusted gross income limit.** This does NOT apply to gifts to a Donor Advised Fund.
- CAA extends this provision through 2021.

2020 Individual Tax Changes

II. COVID-19 Tax Relief

D. Net Operating Losses (NOLs) incurred in 2018, 2019 & 2020 may be **carried back for 5 years.**
   - Previously, NOLs could only be carried forward.

E. The $500,000 maximum cap for deduction of **business losses** is waived for 2018, 2019 & 2020.
   - Previously, the annual cap was $500,000 for married individuals and $250,000 for single.
   - Most commonly seen with regards to losses reported on a K-1.

Potential Tax Changes for Individuals Under President Biden

Proposed Biden Individual Tax Changes

I. Change in Tax Rates for Individuals & Estates

A. The top tax rate would change **from 37% to 39.6%.** This affects those with **excess of $620,000** of taxable income.

- The provision **not totally clear** as proposal is to raise the tax rates for incomes above $400,000 from 37% to 39.6%, but under current law the 37% bracket starts at incomes above $620,000, not $400,000.

Proposed Biden Individual Tax Changes

I. Change in Tax Rates for Individuals & Estates

A. The **Qualified Gains rate and Long-Term Capital Gains rate** would increase from **20% to 39.6%** for people where taxable income is **greater than $1 million.**

- This particularly hurts those who have large one-time capital gain events, such as selling a business or a large tract of real property.

Proposed Biden Individual Tax Changes

I. Change in Tax Rates for Individuals & Estates

C. Estate Tax Changes:

- The **estate tax exemption** would drop from $11.58 million to $3.5 million.
- The Tax Rate would increase from 40% to 45%.

Proposed Biden Individual Tax Changes

II. Other Changes on Taxable Income

A. If your wages or net self-employment income exceeds $400,000, **the social security tax** will kick in again.

- For employees, 6.2% of the wages **above $400,000** will be withheld for social security tax
- For self-employed taxpayers, 12.4% of the net self-employment income **above $400,000** will need to be paid.

Proposed Biden Individual Tax Changes

II. Other Changes on Taxable Income

B. Phase out of the 20% **Qualified Business Income Deduction** for taxpayers with taxable income in **excess of $400,000**.
   - Currently, this only applies to taxpayers in the Specified Service business.
   - This proposal would apply the phase out to all businesses.

Proposed Biden Individual Tax Changes

II. Changes to Itemized Deductions

A. Re-instate the 3% limit on itemized deductions. This provision reduces a taxpayer's total itemized deductions by 3% for every dollar that **income exceeds $400,000.**

B. The tax plan would cap the benefit of itemized deductions at a 28% tax rate **once taxable income exceeds $400,000.**

Proposed Biden Individual Tax Changes

II. Changes to Itemized Deductions

B. **Example**: Suppose Cayden's income is $400,000. Under current law, it he has a $10,000 YE bonus and makes a charitable deduction of $10,000, the deduction offsets the additional income and there is no increase in tax. Under Biden's plan, the income will increase tax by $3,900, whereas the deduction will decrease tax by only $2,800, so the net result would be an $1,100 increase in federal income tax even though Cayden gave away the entire bonus.

Proposed Biden Individual Tax Changes

III. Expansion of Individual Tax Credits

A. The Child Tax Credit would increase from $2,000 to $3,600 per child and be FULLY refundable. Currently only $1,000 is guaranteed to be refunded.

B. The Child and Dependent Care Credit would increase the costs eligible for the credit from $3,000 per child to $8,000 per child with a $16,000 family cap at a credit rate of 50%.

Proposed Biden Individual Tax Changes

III. Expansion of Individual Tax Credits

C. A new $5,000 credit would be created for caregivers of elderly relatives.

D. A First Time Homebuyer credit of $15,000.

E. A renter's credit to reduce rent and utilities to 30% of income.

Tax Strategies for 2020

I. Retirement Plan Strategies

II. Capital Gain Strategies

III. Charitable Contribution Strategies

IV. “Marginal Tax-Rate” Strategies

Tax Strategies for 2020

I. Retirement Plan Strategies

A. Traditional vs. Roth

1. Key Factor: Which is higher **– current tax rate or future tax rate** when you anticipate IRA withdrawals?

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

Example 1			
		Traditional	Roth
Funds available for Retirement Account		10,000	10,000
Current Marginal Tax Rate	17.5%		
Tax savings from Contribution		2,121	
Total Contribution to IRA		12,121	10,000
Growth	100%	12,121	10,000
Balance Prior to Distribution		24,242	20,000
Future Marginal Tax Rate	17.5%		
Tax Paid - Distribution		(4,242)	-
After-Tax Funds		20,000	20,000
Advantage (Disadvantage) Roth Conversion		$0	

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

1. Key Trade-off: Understand **current tax savings vs. future tax savings**. Key questions to consider:
   - How much does a traditional IRA/401K contribution save you in taxes now?
   - How much will a traditional IRA/401K distribution cost you in the future?
   - How much in current tax would a Roth IRA conversion cost you?

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

Examples:

- If one is currently in the **24% federal tax bracket** (and 5.25% NC), then a $26,000 401K deferral reduces taxes by $7,605. Your net cost of making the 401K deferral is $18,395.
- If one retires in the **15% federal tax bracket** (NC still 5.25%), then a $100,000 Traditional IRA will net $79,750 after tax.
- For the above taxpayer, you could say a $100,000 Traditional IRA and a $79,750 Roth IRA have the same after-tax value

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

2. Other considerations for **Traditional IRA / 401k**.

- **Advantage**: Tax savings could be enhanced beyond current tax rate by reducing your income below the threshold where any of a number of **"phase-outs" take effect**. This could be the phase-out for the Qualified Business Income (QBI) deduction, the Child credit, Education credits, or active rental loss deduction, among others.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

2. Other considerations for Traditional IRA / 401k.

- **Disadvantage**: If you are self-employed and eligible for a full QBI deduction, then a traditional retirement plan **reduces your QBI deduction**. This means if your federal tax bracket is 24%, then a traditional retirement plan only reduces federal tax by 19.2% of the amount contributed rather than the expected 24%.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

2. Other considerations for Traditional IRA / 401k.

<u>Example</u>: Ava is a self-employed, single taxpayer in a "Specified Service Trade or Business"(SSTB) with net business income of $210,000. She also has $25,000 of other income. Ava makes a $30,000 contribution into an SEP. Ava's federal tax is reduced by **$15,214, or 50.7%,** of the SEP contribution. If Ava's business income is $160,000, then her federal tax is reduced by only **$5,852 or 19.5%** of the SEP contribution.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

3. Advantages of a Roth Retirement Account.

- Tax-free income!
- **Principal is always accessible without tax or penalty**.
- No Required Minimum Distributions at age 72
- Tax-free income to heirs.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

3. Short-term Opportunity for Roth Conversion.

- Current rates are schedules to revert back to pre 2018 brackets after 2025.
- 12% bracket increases to 15%, 22% increases to 25%. 24% increases to 28%.
- **Almost always a good idea** in an amount that gets one to the top of the **12% tax bracket**.
- **Worth considering** to the extent that one is in the **22% or 24% bracket.**

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

3. Short-term Opportunity for Roth Conversion.

- Need to have **funds available to pay the tax**.
- One can convert **any amount** of your current traditional IRA.
- No requirement to sell current investments inside your IRA.
- Beware! Can **impact other things** (e.g. Medicare premiums, capital gain tax bracket).

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

A. Traditional vs. Roth

3. Short-term Opportunity for Roth Conversion.

Example: Molly and Travis have taxable income of $80,000, which includes long term capital gains of $18,000 and qualified dividends of $12,000. Molly and Travis are in the 0% tax bracket for the long term capital gains and qualified dividends. Suppose Molly converted $30,000 of her traditional IRA to a Roth. Molly expects to pay federal tax of 12% on the $30,000 conversion. **Molly later discovers she paid a federal tax rate of 27% on the conversion as it caused the tax rate on the capital gains and dividends to increase from 0% to 15%.**

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

B. Mega Retirement Plan Deductions

1. Cash Balance Plans: Small businesses can establish these plans that may allow $200,000 or more in annual retirement account contributions.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

C. Those age 72 and older can now make IRA contributions.

1. Must have **earned income,** at least as much as IRA contribution. W-2 wages or self employment income.
2. Income can be earned by **either spouse**.
3. If tax bracket is low, recommend a **Roth IRA** contribution.

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

D. Consideration of Future Changes

1. **Deduction vs. Credit:** Currently, because a 401K contribution is a deduction, **the tax savings depends on your tax bracket.**

   Example: Hailey and Leland each contribute $10,000 to their 401K. Leland is the 12% federal tax bracket **reduces his federal tax by $1,200**. Hailey is in the 37% federal tax bracket **reduces her federal tax by $3,700**

Tax Strategies for 2020

I. Retirement Plan Strategies (cont.)

D. Consideration of Future Changes

1. **Deduction vs. Credit:** Mr. Biden's tax plan includes a proposal to change the deduction to a **26% credit**.

   Example: Using the last example, **both taxpayers would receive a federal tax reduction of $2,600** regardless of their individual tax brackets.

Tax Strategies for 2020

II. Capital Gain Strategies

A. Timing Strategies

1. Accelerate gain if in **0% federal tax bracket** ($80,800 for married taxpayers, $40,400 if single).
   - For gains, there is no "wash sale" rule to prevent you from immediately repurchasing the investment.

     Example: Harper & Knox are married taxpayers age 65 with total income of $60,000 and taxable income of $32,600. They realize **$50,000 capital gain**. The capital gain **increases their federal tax by only $390**. This is because $47,400 of the capital gain is in the 0% capital gain bracket.

Tax Strategies for 2020

II. Capital Gain Strategies (cont.)

A. Timing Strategies

2. Accelerate gain if it will be impacted by Biden tax plan.
   - **Proposed raising capital gain rate from 20% to 39.6%** for taxpayers with income > $1,000,000.
   - This increased rate is only proposed at this point.

Tax Strategies for 2020

II. Capital Gain Strategies (cont.)

A. Timing Strategies

3. Do NOT recommend accelerating capital gains to utilize capital loss carryforwards.
   - **Capital loss carryforwards** never expire.

Tax Strategies for 2020

II. Capital Gain Strategies (cont.)

A. Timing Strategies

4. Plan Capital Gain events in years you can **avoid the higher capital gain rates.**
   - **Net Investment Income tax adds 3.8%** to most capital gains once gross income is greater than $250,000 ($200,000 for single taxpayers).
   - Capital gain rate increases from 15% to 20% at taxable income of **$501,600 ($445,850** for singles).
   - Utilizing the **"installment sale method"** is one way of spreading a large capital gain from a property sale over two tax years to avoid reaching the higher capital gain brackets.

Tax Strategies for 2020

II. Capital Gain Strategies (cont.)

A. Timing Strategies

4. Defer gain if future year will have lower tax rate.

   Example: Josie is a single taxpayer with an annual income of $150,000. Josie sells property that produces a $600,000 capital gain. Josie's federal income tax on the gain is **$134,016, which includes 20% capital gain, NIIT and AMT**. If Josie is able to work out an installment sale with the buyer such that she receives half of the income in Year 1 and half in Year 2, then her total federal tax on the capital gain is only **$109,000**.

Tax Strategies for 2020

II. Capital Gain Strategies (cont.)

A. Timing Strategies

5. **"Harvest" capital losses** in investment account to offset realized capital gains.
   - Check with financial advisor or broker to see if you have available unrealized losses where you can realize the capital loss by selling before year-end.
   - **Investment strategy offsets tax strategy.**
   - Beware of 30-day **"wash sale" rule**.

Tax Strategies for 2020

II. Capital Gain Strategies (cont.)

A. Timing Strategies

5. **"Harvest" capital losses** in investment account to offset realized capital gains.

   Example: Leland sold property with a $50,000 gain. He checks with his financial advisor and finds that he has an unrealized loss in an investment equal to $20,000. He sells this investment so that his net capital gains for the year are only $30,000. He can repurchase this investment after 31 days and avoid the "wash sale" rule.

Tax Strategies for 2020

III. Charitable Contribution Strategies

A. **$300 charitable contribution** deduction allowed in 2020 even for those taking the standard deduction.
   - CAA increased the maximum deduction to **$600 for married taxpayers** in 2021.

B. Charitable contribution deduction allowed for **100% of gross income in 2020** vs. the regular limitation of 60%.
   - This is an optional election.
   - <u>May be better to carryforward deduction to a future year</u> where it offsets income at a higher tax bracket.
   - Available only for cash contributions.
   - Not available for contributions to a Donor Advised Fund.

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

B. Charitable contribution deduction allowed for **100% of gross income in 2020** vs. the regular limitation of 60%.

   <u>Example</u>: Hailey's gross income for 2020 was $100,000. Hailey made substantial cash donations this year of $90,000. Normally, Hailey's charitable contribution deduction is limited to $60,000, with the remaining $30,000 to carry forward to next year. Hailey can choose in 2020 to deduct the entire contribution this year… but it may not be the best decision.

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

C. Consider **bunching charitable contributions** into one year.

Example: Harper and Knox's itemized deductions are as follows:

- Tax Deductions of $10,000 (maximum).
- Mortgage interest of $6,000.
- Charitable contributions of $8,000.
- Total = $24,000.

Harper and Knox will take the standard deduction of $24,800

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

C. Consider bunching charitable contributions into one year.

Example: Suppose instead that Harper and Knox made $14,000 charitable contributions in Year 1, and $2,000 in Year 2.

- In Year 1, they would itemize total deductions of $30,000.
- In Year 2, they would take the standard deduction of $24,800 (or higher as adjusted by inflation).

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

D. Utilize a Donor Advised Fund.

1. A **Donor Advised Fund (DAF)** is a charitable giving vehicle administered by a public charity on behalf of families or individuals.
2. Contributions are made to DAF, which **may hold and invest the funds** for some period of time before distributing to the charity.
3. Individuals make recommendations on future distributions from the DAF.
4. **Deduction is allowed when contribution is made to the DAF**, not when funds are distributed to the charity.
5. A DAF can be used in **"bunching strategy,"** or in making a large contribution in a year when in **high tax bracket**.

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

D. Utilize a Donor Advised Fund.

Example: Cayden has received a huge bonus of $400,000 this year that has placed him in the 37% tax bracket. He decides to **establish a DAF and makes a contribution of $250,000**. Considering federal and NC tax savings, this contribution **reduces Cayden's taxes by $105,625**. Cayden will use the DAF to make contributions to his favorite charities over the next several years.

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

E. Qualified Charitable Deduction (QCD)

1. Charitable contributions paid directly by one's IRA.
   - Available to taxpayers **age 70 ½** or older.
   - Available for up to $100,000 per year.
   - Counts as **part of one's RMD**.
2. QCDs are not included in income and are not deductible as charitable contributions.

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

E. Qualified Charitable Deduction (QCD)

3. QCDs are especially effective for taxpayers taking the standard deduction.
   - Reduce RMDs that otherwise would count as income. No reduction in standard deduction.
4. **QCD advantage was diminished in 2020 since RMDs are not required.**

Tax Strategies for 2020

III. Charitable Contribution Strategies (cont.)

E. Qualified Charitable Deduction (QCD)

Example: Josie and Jack are age 72. They have RMDs totaling $50,000. They **typically make $15,000/year in charitable contributions**. However, because they have no mortgage deduction, **they do not have enough deductions to itemize.** Therefore, they normally receive no tax benefit from making charitable contributions. Upon learning of the QCD strategy, they begin making their charitable contributions from their IRAs rather than their regular accounts. **This strategy reduces their taxable income by $15,000.**

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies

It is important to know your marginal tax rate to determine the impact of **potential transactions.**

Example:

- Lucy & Ricky are paid year-end bonuses totaling $10,000. They determine this increases their federal tax by $2,400. They are in the 24% federal tax bracket.
- Fred & Ethel decide to fulfill a $10,000 pledge to their church before year-end. If they are in the 24% tax bracket, then their federal tax decreases by $2,400.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

A. 2020 Tax Brackets:

	Married	Single	Head of Household
Move from 10% to 12% bracket	$ 19,750	$ 9,875	$ 14,100
Move from 12% to 22% bracket	$ 80,250	$ 40,125	$ 53,700
Move from 22% to 24% bracket	$ 171,050	$ 85,525	$ 85,500
Move from 24% to 32% bracket	$ 326,600	$ 163,300	$ 163,300
Move from 32% to 35% bracket	$ 414,700	$ 207,350	$ 207,350
Move from 35% to 37% bracket	$ 622,050	$ 518,400	$ 518,400

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "**Artificial**" Tax Brackets: There are numerous "phase-outs" in the tax code that eliminate or reduce various tax deductions. These have the effect of increasing one's marginal tax rate because the effect of additional income is not only the additional income, but also to take away deductions. **Understanding when these impact one's taxes allows for better planning.**

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies

B. "Artificial" Tax Brackets: Examples.

1. **Qualified Business Income** deduction: For "Specified Service Businesses", this 20% deduction phases between **taxable income** of **$163,300 - $213,300** for single taxpayers, and **$326,600 - $426,600** for married taxpayers. It has the impact of increasing the marginal tax rate of married taxpayers by over 7%, and single taxpayers by over 14%.

   Refer to earlier example under Retirement Plan Strategies.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets: Examples.

2. **Active Rental Losses:**

   <u>Example</u>: Taxpayers with rental losses from properties they actively participate in can deduct up to $25,000 in rental losses each year. That deduction is phased out as gross income increases from $100,000 to $150,000.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets: Examples.

2. Active Rental Losses:

Example: Harper has $100,000 W-2 income and no other income. She has a rental property that she actively manages. It has a $25,000 loss. Harper is allowed to deduct the loss in full. Suppose Harper has a capital gain of $50,000. **Not only is she taxed on the additional capital gain, but she now can no longer deduct the rental loss**.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets:

3. **Social Security Benefits:** Depending on one's total income, none of your Social Security benefits might be taxable, or up to 85% may be taxable. It's complicated. First determine one's "provisional income", which is ½ of Social Security income plus all other income, including tax-exempt income.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets:

3. **Social Security Benefits:** If provisional income is less than $32,000 for a married couple or $25,000 for a single, Social Security is not taxable. From those income thresholds, the taxable percentage of Social Security increases until it eventually reaches 85%.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets:

	Married Couple		
Social Security Benefits	50,000	50,000	50,000
Interest & Dividend Income	10,000	10,000	10,000
Tax-exempt Interest income	1,000	1,000	1,000
Retirement income	20,000	20,000	20,000
Taxable Social Security	16,200	24,700	41,700
Additional income		10,000	30,000
Adjusted Gross Income	47,200	65,700	102,700
Standard Deduction	(27,800)	(27,800)	(27,800)
Taxable Income	19,400	37,900	74,900
Increase in taxable income		18,500	55,500

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets:

	Single		
Social Security Benefits	30,000	30,000	30,000
Interest & Dividend Income	10,000	10,000	10,000
Tax-exempt Interest income	1,000	1,000	1,000
Retirement income	10,000	10,000	10,000
Taxable Social Security	6,200	14,700	23,200
Additional income		10,000	20,000
Adjusted Gross Income	27,200	45,700	64,200
Standard Deduction	(14,250)	(14,250)	(14,250)
Taxable Income	12,950	31,450	49,950
Increase in taxable income		18,500	37,000

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets:

4. **American Opportunity Tax Credit (AOTC):** This tax credit for undergraduate tuition of up to $2,500 per child phases out as gross income moves from $80,000 to $90,000 for single taxpayers, and $160,000 - $180,000 for married taxpayers.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets: Examples.

4. **American Opportunity Tax Credit:**

Example: Ava has W-2 salary of $90,000. She also has two children who are college undergraduates, and after scholarships, she incurs $4,000 each in tuition expense. Because her income is over the threshold, she can claim no tax credits. Suppose she contributed $10,000 to her 401K. Not only would her federal tax be decreased by $2,200 for her 401K deduction, she would now be eligible for a $5,000 AOTC. **This means the 401K deferral of $10,000 decreased her federal tax by $7,200!**

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets: Examples:

5. **Child Tax Credit:** This $2,000 per child tax credit begins phasing out for married taxpayers at $400,000, and at $200,000 for single taxpayers.

Tax Strategies for 2020

IV. "Marginal tax rate" Strategies (cont.)

B. "Artificial" Tax Brackets: Examples:

6. **Medicare Premiums:** Medicare premiums begin increasing when gross income rises above certain levels.

	Married	Single
Monthly Medicare Premium = $144,60		
Monthly Medicare Premium = $202.40	$ 174,000	$ 87,000
Monthly Medicare Premium = $289.20	$ 218,000	$ 109,000
Monthly Medicare Premium = $376.00	$ 272,000	$ 136,000
Monthly Medicare Premium = $462.70	$ 326,000	$ 163,000
Monthly Medicare Premium = $491.60	$ 750,000	$ 500,000

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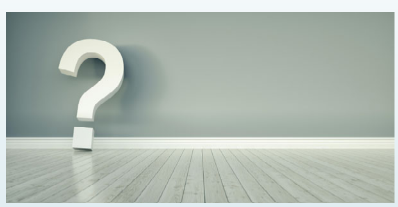
QUESTIONS???



Thank you for attending!

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