PAUL H. BURGESS, ATTORNEY/CPA – "YIELDING A BETTER RESULT"

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Year-End Tax & Financial Strategies from the "Power of the Dual View"

This ***Tax & Financial Newsletter*** has five sections. Section I is the time honored five-step tax savings process. It's a good general guide. Sections II to IV includes many personal, business, and financial tax strategies to consider at year-end. Section V is a "How to Guide" for organizing your taxes for preparation. Organized accountings and tax information will save taxes and preparation fees.

I. The Five Steps to Saving Taxes

Most tax planning strategies utilize one or more of the following five steps: (A) Exclude from taxation the income and gains that you can; (B) defer the income that you must report; (C) use deductions to reduce your reported income; (D) pay taxes on the rest; and (E) pay on the latest date possible without incurring penalties or interest. Saving taxes many times is "hitting the singles and doubles" for turning an amount due into a refund! The next four sections just may have a 2020 hit for you, and it provides suggestions how to set up the playing field for 2021.

II. Business Tax Tips!

√ ***Oklahoma Business SALT Election:*** If for 2020 your flow through entity (S corporations and LLC partnerships) did not elect to deduct its Oklahoma income taxes at the business level, consider it for 2021. The election is due March 15, 2021 and can essentially convert non-deductible state income taxes into a deduction.

√ ***Qualify for Oklahoma SALT Election:*** Yield a better tax result by converting certain sole-proprietorships or rental operations to a flow through such as an OK partnerships or S-corporation.

√ ***Year-end Business Asset Purchases:*** Purchasing business assets at the end of the year can certainly save taxes. However, acquiring assets merely for the tax benefits is questionable. Use the four rules of thumb as a guide:

(1) November and December purchases typically make sense if the assets are going to be replaced in the following year anyway.

(2) Especially for longer term equipment, saving taxes now may be worth it for assets that will be replaced in over a year, but less than two.

(3) Tax savings from year-end purchases that increase efficiencies, expand needed capacity, or improve safety are usually good moves.

(4) Asset purchases that reduce 2020 taxes typically reduce 2021 estimated tax payments.

√ ***Business Vehicles:*** First year maximum automobile depreciation for 2020 is $18,100. The larger SUVs and Trucks enjoy up to a 100% first year deduction! Thus, December vehicle purchases will reduce taxable income.

√ ***Bonus Depreciation Percentages:*** For 2020 and 2021, Bonus depreciation is 100% of the cost of the asset; and Bonus does not have a maximum dollar amount.

√ ***Tax Basis:*** IRS is requiring more verification for tax basis. Make sure you have tax basis in your partnerships and S corporations to deduct any losses. Increasing your tax basis can be accomplished by several methods including loans, and capital investments.

√ ***Active Participation:*** Step up your level of participation in partnerships, S corporations, or LLCs to qualify as an "active participant" for flow-through entities reporting losses.

√ ***Specified Service Businesses:*** For doctors, lawyers, accountants, consultants, etc., maximize contributions to traditional IRAs, §401(k)s, and others pension plans to help qualify for the 20% business income deduction.

√ ***Business Losses:*** You are not in business to generate losses, but they do happen. This is a list of possible business loss deductions:

1. Business Bad Debts
2. Casualty and Theft Losses
3. Capital Loss/Worthless Investments
4. Losses on Sales of Business Assets

Sometimes it can be difficult to ascertain what year a business or investment loss should be written off. The general rule is to deduct the loss in the earliest year possible.

√ ***Payment by Check:*** Cash basis businesses can date checks before the end of the year and mail them right before January 1, 2021 to obtain a 2020 deduction.

√ ***Pension Plans:*** Set up pension plans before year-end and fund those plans later. In many cases if a plan is "set up" by December 31, you can contribute to the plan as late as October 15, 2021 for a 2020 tax deduction. A small employer can claim up to a $500 credit for administration costs for pension plans.

√ ***Pre-Paid Expenses & the 12 Month Rule:*** A cash basis business can typically deduct any amounts paid for a right or benefit that does not extend beyond 12 months after the date of the payment. Thus, a business can pre-pay expenses in December 2020 that are for 2021. For example, pre-paying rent, health insurance, etc. can yield sizable deductions.

√ ***Leasing Vehicles & the 12 Month Rule:*** In December make a one-time lump sum payment on a 36-month auto lease and deduct one-third of it in December under the 12-month rule.

III. Individual Tax Tips!

√ ***December W-2 Withholdings:*** Avoid underpayment of estimated tax payment penalties by increasing your withholdings from your December paychecks.

√ ***Employer Flexible Spending Accounts (FSAs).*** Increase the amount you set aside in your FSA account if you have set aside too little for 2020. The 2020 maximum is $2,750.

√ ***Health Saving Accounts (HSAs).*** If you become eligible in December 2020 to make HSA contributions, you can contribute a full year's worth by the end of 2020. Nevertheless, this year's maximum is $3,550 for self-only, and $7,100 for family plan, and an additional $1,000 if age 50 or over.

√ ***Maximize Pension & IRA Contributions:*** Increase your retirement plan contributions to take advantage of the maximum write-offs. For

2020: (1) the §401(k) contribution limit is $19,500, and if age 50+ add an additional $6,500; (2) the Simple Plan limits are $13,500 and $3,000 extra for age 50 or over; and (3) the IRA limits are $6,000 and $1,000 more if age 50 or older; and (4) take full advantage of employer matching with additional contributions.

√ ***Sale of Loss Entities:*** Dispose of your interests in those flow-through entities in which you have "suspended" loss carryforwards.

√ ***IRA Distributions for Charity:*** If you are over 70 ½, you can donate up to $100,000 of your IRA to charity and: (1) it is not included in your income, (2) it counts toward your RMD, and (3) although not deductible, with less opportunities to itemize, it is particularly tax advantageous.

√ ***Charitable Contributions:*** Consider gifting appreciated property, typically publicly traded stock, to a charitable organization for a deduction equal to its fair market value without having to report the gain.

√ ***Achieving a Better Life Experience (ABLE) Accounts:*** This is a savings account for individuals with disabilities and their families. For 2020, taxpayers can contribute up to $15,000. Earnings are not taxable and distributions are tax-free if used to pay the beneficiary's qualified disability expenses.

√ ***Single and Head of Household:*** If you are single and assist your parents financially, make sure you meet the support level test to file head of household instead of single.

√ ***State Tax Returns:*** A good tax advisor pays close attention to state income taxes to make sure all the state tax benefits are claimed. Most states have tax breaks that are not applicable to a federal return. Oklahoma's are extensive.

√ ***Lower College Tuition by 5%:*** Take advantage of the Oklahoma §529 plans now by contributing to it in December for a 2020 Oklahoma deduction, then use it for the January 2021 tuition invoice.

√ ***§529 Plans – Higher Education Costs:*** §529 plans can now be used for tuition paid in connection with enrollment or attendance at a public, private, or religious elementary or secondary school, but are subject to a $10,000 distribution annual limit.

IV. Investment Tax Tips!

√ ***Short-Term (ST) vs. Long-Term (LT) Capital Gains:*** Capital gains on property held one year or less are ST and are taxed as high as 50%. If held over a year it is LT and taxed about half as much. For taxpayers not in the highest tax brackets, the tax rate for LT capital gains can be as low as zero!

√ ***Defer the Sale:*** If you have a borderline holding period, consider holding the asset a little longer than a year to take advantage of the favorable LT capital gains rates.

√ ***Offset Gains*****:** Consider selling capital assets that will generate a loss to offset any capital gains recognized earlier in the year. But, be careful not to waste the benefits of LT capital gains with ST capital losses.

√ ***Avoid Fluctuations:*** Realizing net capital gains in 2020 and then suffering net capital losses in 2021 increases the probability of wasting deductions. Thus, a good tax strategy is to try to realize losses in years with gains or sell loss assets in year #1, and sell gain assets in year #2.

√ ***Dividend Taxes:*** Most stock dividends are taxed at LT preferential rates. Thus, dividend paying stocks, and similar stocks held in mutual funds are tax advantageous investments.

√ ***Oklahoma Capital Gain Exclusion:*** If you have appreciated Oklahoma real property or own stock, or LLC membership interests in companies that are located primarily in Oklahoma, the capital gain, under many circumstances, can be totally excluded from Oklahoma taxation.

√ ***Gift Appreciated Stock:*** One of the best tax savings strategies can be for a parent to gift appreciated stock to their lower tax bracket adult child.

√ ***Tax Strategy for Pension Plans and Personal Investments:*** Generally, if possible: (1) Hold capital appreciation stocks personally to take advantage of the lower capital gain rates, and (2) Hold bonds producing interest income in your 401(k) or traditional IRA; (3) typically holding any stocks or bonds in a Roth IRA is preferable to a traditional 401(k) or IRA; and (4) utilizing a "Back Door Roth" is an excellent strategy for an otherwise disallowed Roth contribution.

V. Organize - Saves Taxes and Costs

√ With COVID-19 and budget cuts, the IRS is struggling to timely and accurately process tax returns, post tax payments, and issue refunds or credits. Thus, it is particularly important to be organized to reduce the probability of getting caught in the IRS "abyss" and having to untangle problems that did not exist a few years ago.

√ Organizing your tax information also allows us to concentrate more quickly on tax savings for the current year, and suggestions for next year.

√ We recently published our "Small Business Accounting – 101 Newsletter." Please see our website "Paulhburgess.com" for its 10 helpful accounting suggestions.

√ Use spreadsheets to help compile your income and deductions. Clients who organize with spreadsheets tend to have lower fees, plus it becomes their annual checklist.

√ Create a file (electronic or physical) in early January to place tax documents (W-2s, 1099s, K-1s, etc.) in as you receive them.

√ Write your questions or comments as you gather tax documents, or draft us an email, or call Paul or Theresa at (918) 599-7755 for yielding a better tax result with *The Power of the Dual View*.