

Income Tax Planning 2020



Overview

The 2017 Tax Act, popularly known as the “Tax Cuts and Jobs Act” (H.R. 1), was signed into law on December 22, 2017 and affects almost every aspect of tax, estate, business and other planning. The Act

retained the existing seven-bracket structure, but at different marginal rates and with modified threshold amounts. The Act also retained the same three tax rates for capital gains and dividends, but at different thresholds that do not coincide with particular tax brackets.

2020 Taxable Income*

Rates:	Individual Filers		Married Joint Filers	
	Over	but not over:	Over	but not over:
10%	\$0	\$9,875	\$0	\$19,750
12%	\$9,875	\$40,125	\$19,750	\$80,250
22%	\$40,125	\$85,525	\$80,250	\$171,050
24%	\$85,525	\$163,300	\$171,050	\$326,600
32%	\$163,300	\$207,350	\$326,600	\$414,700
35%	\$207,350	\$518,400	\$414,700	\$622,050
37%	\$518,400		\$622,050	

*Brackets adjusted for inflation in future years.

2020 Long Term Capital Gains & Dividends

Taxable income up to \$441,550/\$496,600	0% – 15%*
Taxable income over \$441,550/\$496,600	20%*

*For taxpayers in the 10% or 12% income tax brackets, long term capital gains and dividend tax rates are 0%.

In 2020, personal exemptions are not available. The standard deduction was increased to \$12,400 for single filers and \$24,800 for married taxpayers filing jointly. The standard deduction is a flat amount a taxpayer may deduct in lieu of itemizing deductions. Taxpayers who are age 65 years or over, or who are blind, may take an additional

deduction of \$1,300 if married or \$1,650 if not married for 2020.

The significant increase in the standard deduction may reduce the number of taxpayers who itemize deductions. However, those who continue to itemize will see many of the itemized options eliminated or reduced, including:

- The mortgage interest deduction was retained under the 2017 Tax Act but is reduced to \$750,000 of acquisition debt; the home equity interest deduction is eliminated.
- The deduction for state and local income taxes (SALT) and the state and local sales taxes are capped at a combined \$10,000 annually.
- The deduction for property taxes is preserved, though limited to \$10,000 annually.

Taxpayers remain subject to the “alternative minimum tax” (AMT) instead of regular income tax when they have substantial “tax-preferenced income.” Basically, the taxpayer must pay whichever tax is higher – the regular tax or the AMT. The 2020 exemptions from the AMT are \$72,900 for single filers and \$113,400 for married taxpayers filing jointly. AMT income is taxed at 26% if below \$194,800 or 28% if over, for married taxpayers filing jointly.

Under the Affordable Care Act of 2010, certain additional taxes became effective in 2013. For example, there is a Medicare surtax of 3.8% on net investment income to the extent income exceeds \$250,000 for a married couple filing jointly, or \$200,000 for a single person.¹ Also, there is another 0.9% Medicare tax on earned income above the same level.

Filing Status	NIIT Threshold Amount
Married filing jointly	\$250,000
Married filing separately	\$125,000
Single	\$200,000
Head of household (with qualifying person)	\$200,000
Qualifying widow(er) with dependent child	\$250,000
Estate or trust	\$12,750

Many states and municipalities also levy income taxes. The maximum rate may climb as high as 13.3% in some states. Even where state income taxes are deductible from income for federal tax purposes, more than 50 cents on the dollar can be lost. Because of the impact taxes can have on the growth of personal wealth, tax planning is a critical element of income and estate planning.

Reducing Table Incomes

Individual Retirement Accounts (IRAs). In 2020, an individual may contribute \$6,000 (or \$7,000 if age 50 years or older) of his/her earned income on a pre-tax basis to an IRA. If the individual is eligible to participate in a work-sponsored retirement plan, the deductibility of the contribution may be limited based on the individual’s adjusted gross income. As with a qualified retirement plan, any growth in the account is typically tax-deferred. Distributions attributable to deductible IRA contributions are taxable and, unless an exception (e.g., after age 59½, etc.) applies, subject to a 10% penalty.

Qualified Retirement Plans. Like IRAs, contributions to qualified plans are typically pre-tax and any growth is tax-deferred, but distributions are usually taxable. Because qualified plans are established by employers, the availability of this alternative depends on where one works. Qualified plans are governed by ERISA, which establishes standards for participation, funding, vesting, reporting, etc. Nevertheless, for many business owners, it may be possible to channel more of the contributions to principals and less to rank-and-file employees.

Flexible Spending Accounts. Employees also may contribute on a pre-tax basis to work-sponsored accounts that grow tax-deferred and allow for tax-free distributions to pay for certain expenses, e.g., dependent care, health insurance, and medical costs.

Business Expenses. In addition to helping employers to recruit and reward employees, the aforementioned plans and other fringe benefits can save companies a substantial amount of federal income tax each year. Employee salaries, bonuses, and other compensation are also deductible, assuming the amount is considered “reasonable.”

Internal Revenue Code (IRC) Section 179 allows a business to deduct the cost of depreciable property acquired for business use, up to a maximum deduction of \$1,000,000. To the extent Section 179 is not used, the cost of assets used in a business, e.g., equipment, furniture, buildings, etc., can be depreciated over a period of years and the depreciation deducted from income.

¹ Net investment income generally includes interest, dividends, capital gains, rents, royalties, and other forms of passive income. NIIT and Medicare surtax thresholds are not indexed for inflation.

A business may be able to deduct other expenses not attributable to capital expenses or the cost of goods sold. Examples include rent paid from property used in the business or interest on loans to the business.

Capital Loss Acceleration. Where investments have underperformed and will be sold as part of the overall asset allocation strategy or for other non-tax reasons, timing the sale to coincide with other gain recognition events can reduce taxable income. Where there is a net capital loss, up to \$3,000 can be applied to offset other income and any excess can be carried over and used in future years.

Oil and Gas Investments. Investors can deduct the intangible drilling costs (IDCs), which can represent a significant portion of the investment in oil or gas drilling. In general, IDCs are deductible only against passive income. However, IRC Section 469(c)(3) allows investors who have a working interest, i.e., whose liability is not limited, to use IDCs to offset AGI. Liability is limited with respect to an investor's limited partnership or limited liability company interests or stock in a corporation. Under the regulations related to §469, if an investor

owns both general partnership interests in addition to limited interests, none of the interests are treated as passive investments.

Charitable Contributions. In addition to satisfying philanthropic objectives, charitable gifts can offer personal income tax benefits. In general, the value of the property donated is deductible. The deductible amount may be limited to an asset's basis depending on the asset (e.g., tangible personal property not related to the use of the charity, or gifts of short term capital gain property or ordinary income property to a private charity) or the recipient (e.g., private charities). The asset, recipient, and type of property donated also determine whether the amount can be deducted up to 20%, 30%, 50%, or 60% of AGI. For gifts of long-term capital gain property and "related use" tangible personal property to a public charity, the donor may either (i) use the fair market value of the property and deduct the gift only up to 30% of AGI, or (ii) use the basis but deduct the gift up to 50% of AGI. Gifts of cash to a public charity can be deducted at 60% of AGI. Unused charitable deductions can be carried forward for up to 5 years.

Charitable Deduction Summary Chart

Type of Property Contributed	Public Charity*		Private Foundation*		Other 30% Charity	
	Deduction Value	Percentage Limit	Deduction Value	Percentage Limit	Deduction Value	Percentage Limit
Cash	Cost	60%	Cost	30%	Cost	30%
Ordinary-income property	Cost	50%	Cost	30%	Cost	30%
Short-Term Capital Gain Property	Cost	50%	Cost	30%	Cost	30%
Long-Term Capital Gain Property						
General Rule	FMV	30%	Cost	20%	FMV	20%
Donor Elects Reduced Deduction	Cost	50%	N/A		N/A	
Qualified Appreciated Stock	N/A		FMV	20%	N/A	
Tangible Personal Property – Unrelated Use	Cost	50%	Cost	20%	Cost	20%

* Private operating foundations, passthrough foundations and pooled fund foundations are considered public charities.

An added advantage to making charitable gifts of appreciated property is the avoidance of capital gains tax. If appreciated property is given to charity and then sold, the donor may still be able to deduct the market value but there will be no tax on the gain because the charity is tax-exempt.

In addition to deductible charitable gifts discussed above, the Protecting Americans from Tax Hikes

("PATH") Act of 2015 made permanent a provision that allows individuals over the age of 70½ to exclude from gross income up to \$100,000 that is paid directly from their IRA to a qualified charity. This Qualified Charitable Distribution can be used to satisfy any required minimum distribution that the individual must otherwise receive from their IRAs.

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