2020 Tax Year Updates

While the 2020 tax year may not experience the drastic and numerous tax changes brought on in 2018 by the Tax Cuts and Jobs Act of 2017 (TCJA), 2020 will have changes to the U.S. tax laws that taxpayers should be aware especially if it is beneficial to them. The highlights of these changes are summarized here, which were inspired by several congressional acts:

1. Economic Recovery Rebates – "Stimulus"

Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, most Americans will receive the economic recovery rebate payments of $1,200 ($2,400 for couples filing jointly), plus $500 more for each child under age 17. The payments will start to phase out for joint filers with adjusted gross incomes above $150,000, head-of-household filers with AGIs above $112,500, and single filers with AGIs above $75,000.

However, taxpayers should be aware that the rebate is an advance payment of a 2020 tax credit. On the 2020 return, taxpayers will need to reconcile the receipt of the payment. For most people, the rebate will equal the tax credit allowed. Taxpayers whose credits exceed their rebates can claim the balance on their 2020 returns. This is especially help for parents having children in 2020. It is not certain yet, but taxpayers may not have to pay any overpayment of their special tax credit.

2. Penalty-free Distributions on Retirement Savings Plans for New Parents

New U.S. parents may withdraw up to $5,000 from their 401(k), IRA, or other retirement account for the birth or adoption of a child (under the age of 18 or physically or mentally incapable of self-support). The distribution will be taxable, as expected, but it will not be subject to the 10% early withdrawal penalty. If the taxpayer is married, both spouses can withdraw $5,000 from their <u>own</u> account for a total of $10,000 penalty-free.

The taxpayer has one year from the date of the child's birth or on which the adoption is finalized to withdraw the funds. The money can be redeposited later and will be treated as a direct trustee-to-trustee rollover. However, this provision does not apply to the adoption of a spouse's child.

3. Retirement Savings Plans

<u>SECURE & CARES Acts</u>: There are a several changes in 2020 for retirement plans. Most of the changes we enacted in the SECURE Act, which was signed into law late in 2019. However, the CARES Act includes a few provisions affecting retirement accounts, as well.

<u>Required Minimum Distributions</u>: Both acts significantly impact required minimum distributions (RMDs) for senior citizens. For example, under the SECURE Act, the beginning age for taking RMDs rises from 70½ to 72. (This change <u>only</u> applies to account owners who

turn 70½ after 2019.) The CARES Act allows seniors to completely omit their RMDs in 2020 without penalty.

Contributions page age 70 ½: The SECURE Act allows holders of traditional IRAs to make contributions past the age of 70½ starting in 2020. Beginning in 2020, fellowships, stipends or similar payments to graduate or post-doctoral students are treated as compensation for purposes of making IRA contributions. This will help qualifying students begin saving for retirement sooner, since contributions to a retirement account generally cannot exceed the amount of compensation.

Inherited IRAs Distributions: The rules for withdrawing funds from inherited IRAs and workplace retirement accounts are also *stiffened* by the SECURE Act, in that most accounts now need to be liquidated within 10 years of the death of the IRA owner or 401(k) participant. Exceptions allow payouts over the beneficiary's life expectancy for surviving spouses, the disabled or chronically ill, minor children until they reach 18 and beneficiaries who are not more than 10 years younger than the account owner. Inherited accounts of individuals who died before 2020 are not affected by this change.

Coronavirus-related Distributions: In addition to the RMD suspension, the CARES Act includes a additional retirement-related tax breaks for 2020. One, the 10% penalty is *waived* on pre-age-59½ payouts from retirement accounts for up to $100,000 of coronavirus-related payouts. A coronavirus-related distribution can also be included in income in equal installments over a three-year period, and have three years to put the money back into the retirement account and undo the tax consequences of the distribution. Additionally, the Act allows eligible individuals to borrow more from workplace plans such as 401(k)s—up to the lesser of $100,000 or 100% of the account balance—until September 23, 2020. Repayments on retirement plan loans due in 2020 are also delayed for one year.

Contribution Limits: Many dollar limits on retirement plans and IRAs are higher in 2020. The maximum 401(k) contribution for 2020 is $19,500, but those born before 1971 can deposit $6,500 more (both amounts are $500 higher than in 2019). The caps apply to 403(b) and 457 plans as well. This year's maximum on contributions to SIMPLE IRAs is $13,500 ($500 more than last year), plus $3,000 extra for people age 50 and up.

The 2020 contribution limit for traditional IRAs and Roth IRAs remains at $6,000, plus $1,000 as an additional catch-up contribution for individuals age 50 and up. However, the income ceilings on Roth IRA contributions went up. Contributions phase out in 2020 at adjusted gross incomes (AGIs) of $196,000 to $206,000 for couples and $124,000 to $139,000 for singles ($193,000 to $203,000 and $122,000 to $137,000, respectively, for 2019).

Deduction phaseouts for traditional IRAs also start at higher levels in 2020, from AGIs of $104,000 to $124,000 for couples and $65,000 to $75,000 for single filers ($103,000 to $123,000 and $64,000 to $74,000 last year). If only one spouse is covered by a plan, the phaseout zone for deducting a contribution for the uncovered spouse starts at $196,000 of AGI and ends at $206,000 ($193,000 and $203,000 for 2019).

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4. Tax Bracket Ranges

Although the tax rates did not change, the income tax brackets for 2020 are slightly wider than prior year. The difference is due to inflation during the 12-month period from September 2018 to August 2019, which is used to figure the adjustments.

2020 Tax Brackets for Single/Married Filing Jointly/Head of Household

Tax Rate	Taxable Income (Single)	Taxable Income (Married Filing Jointly)	Taxable Income (Head of Household)
10%	Up to $9,875	Up to $19,750	Up to $14,100
12%	$9,876 to $40,125	$19,751 to $80,250	$14,101 to $53,700
22%	$40,126 to $85,525	$80,251 to $171,050	$53,701 to $85,500
24%	$85,526 to $163,300	$171,051 to $326,600	$85,501 to $163,300
32%	$163,301 to $207,350	$326,601 to $414,700	$163,301 to $207,350
35%	$207,351 to $518,400	$414,701 to $622,050	$207,351 to $518,400
37%	Over $518,400	Over $622,050	Over $518,400

5. Standard Deductions

Many of the standard deduction amounts were increased for 2020. Married couples get $24,800 ($24,400 for 2019), plus $1,300 for each spouse age 65 or older. Singles can claim a $12,400 standard deduction ($12,200 for 2019)—$14,050 if they're at least 65 ($13,850 for 2019). Head-of-household filers get $18,650 for their standard deduction ($18,350 for 2019), plus an additional $1,650 once they reach age 65. Blind people can tack on an extra $1,300 to their standard deduction ($1,650 if they're unmarried and not a surviving spouse). A simple chart can be viewed here.

6. Capital Gain Rates

Tax rates on long-term capital gains and qualified dividends did not change for 2020, but the income thresholds to qualify for the various rates did increase. In 2020, the 0% rate applies for individual taxpayers with taxable income up to $40,000 on single returns ($39,375 for 2019), $53,600 for head-of-household filers ($52,750 for 2019) and $80,000 for joint returns ($78,750 for 2019).

The 20% rate for 2020 starts at $441,451 for singles ($434,550 for 2019), $469,051 for heads of household ($461,700 for 2019) and $496,601 for couples filing jointly ($488,850 for 2019). The 15% rate is for filers with taxable incomes between the 0% and 20% break points. The 3.8% surtax on net investment income stays the same for 2020. It is applied for single people with modified AGI over $200,000 and for joint filers with modified AGI over $250,000.

7. Charitable Gift Deductions

A major change is a breakthrough for taxpayers to get a small tax break. Nonitemizers can write off up to $300 of charitable *cash* contributions. This is a new "above-the-line" deduction for people who do not file Schedule A. Time for some year-end donations?

More donations to charity can be deducted for 2020 under the CARES Act. The 60%-of-AGI limit on deductions for *cash* donations by people who itemize is suspended (gifts to donor-advised funds and private nonoperating foundations are excluded).

8. Foreign Earned Income Exclusion

U.S. taxpayers working abroad have a larger income exclusion in 2020. It jumped from $105,900 in for 2019 to $107,600 this year. Taxpayers should claim the foreign earned income exclusion on Form 2555.

9. Tax "Extenders"

A number of expired or expiring tax breaks were revived late last year—most through 2020. They include deductions for mortgage insurance premiums and college tuition, as well as the $2-million exclusion for forgiven mortgage debt and the credit for certain energy-saving improvements to taxpayers' homes.

These tax breaks apply for 2018 as well. So, if taxpayers qualified for any of them in 2018, it might be worth filing an amended 2018 return and claiming a refund. Contact your tax accountant to complete the amendments.

10. Sick and Family Leave Credits for Self-Employed

The Families First Coronavirus Response Act includes tax relief for self-employed people who can't work because of the coronavirus. The law forces many employers to provide paid sick and family leave for workers affected by the virus. However, tax credits against the self-employment tax are also allowed for the self-employed who could not work for a reason that would entitle them to coronavirus-related sick or family leave if they were an employee. Employers also get tax credits to help them pay for the paid leave they are required to give their employees.

11. Student Loan Payments by Employers

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The CARES Act allows employers to pay down up to $5,250 in workers' college loans in 2020. The payments are excluded from the workers' wages for federal tax purposes. The $5,250 cap applies to both student loan repayment benefits and other educational assistance (e.g., tuition, fees, books, etc.) offered by an employer under current law.

12. Adoption of a Child

For 2020, the adoption credit can be taken on up to $14,300 of qualified expenses ($14,080 for 2019). The full credit is available for a special-needs adoption, even if it costs less. The credit begins to phase out for filers with modified AGIs over $214,520 and disappears at $254,520 ($211,160 and $251,160, respectively, for 2019). The exclusion for company-paid adoption aid was also increased from $14,080 to $14,300 for 2020.

13. Estate Taxes

The lifetime estate and gift tax exemption for 2020 jumps from $11.4 million to $11.58 million—$23.16 million for couples ($22.8 million for 2019) if portability is elected by timely filing Form 706 after the death of the first-to-die spouse. The estate tax rate remains steady at 40%.

14. Kiddie Tax

The TCJA revamp of the "kiddie tax" has been repealed. Prior to 2018, children age 18 or younger (under 24 if a student) were taxed on unearned income in excess of a certain amount at their tax rate or their parents' rate, whichever was higher. The tax reform law changed the rules to tax unearned income at the ordinary income rates and capital gains rates that apply for trusts. This resulted in higher tax for many filers, including military families with survivor benefits. So, Congress repealed the kiddie tax change, and the pre-2018 rules apply again for 2020. Taxpayers can elect to apply the pre-2018 rules to 2018 and 2019 returns as well.

15. Education Tax Breaks

The 2020 lifetime learning credit phases out at higher modified AGI amounts for couples—$118,000 to $138,000 ($116,000 to $136,000 for 2019). The AGI range for singles is $59,000 to $69,000 ($58,000 to $68,000 for 2019).

The income caps are also higher in 2020 for tax-free EE bonds used for education. The exclusion starts phasing out above $123,550 of modified AGI for couples and $82,350 for others ($121,600 and $81,100 for 2019). It ends at modified AGI of $153,550 and $97,350, respectively ($151,600 and $96,100 for 2019). The savings bonds must be redeemed to help pay for tuition and fees for college, graduate school or vocational school for the taxpayer, spouse or dependent.

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There are two expansions to 529 college savings plans starting in 2020, as well. First, funds can now be used to pay for fees, books, supplies and equipment for certain apprenticeship programs. In addition, up to $10,000 in total (not annually) can be withdrawn to pay off student loans.

16. Employee Fringe Benefits

The maximum on employer-provided tax-free parking increases from $265 to $270 a month. The 2020 exclusion for mass transit passes and commuter vans is the same amount.

Employees covered by health flexible savings plans can defer up to $2,750 in 2020. It is an increase from $2,700 in 2019.

17. Energy Credits

The residential solar credit falls to 26% for 2020, which is down from 30% in 2019. It drops again to 22% next year and ends after 2021. It is the same for the tax breaks for geothermal heat pumps, residential wind turbines and fuel cell property.

18. Payroll Taxes

The Social Security annual wage base is $137,700 for 2020 (that's a $4,800 increase from prior year). The Social Security tax rate on employers and employees stays at 6.2%. Both workers and employers continue to pay the 1.45% Medicare tax on all compensation in 2020, with no cap. Workers must also pay the 0.9% Medicare surtax on wages and self-employment income over $200,000 for singles and $250,000 for couples. The surtax doesn't affect employers, though.

The CARES Act lets employers defer payment of the Social Security taxes they owe on wages paid from March 27 through December 31, 2020. Self-employed people can defer 50% of their self-employment tax. Employers affected by the coronavirus can also claim a new payroll tax credit for 2020 if they retain and continue to pay their workers.

19. Standard Mileage Rates

The 2020 standard mileage rate for business driving falls from 58¢ to 57.5¢ a mile. The mileage allowance for medical travel and military moves also declines from 20¢ to 17¢ a mile in 2020. However, the charitable driving rate remains at 14¢ a mile—it is fixed by law.

20. Medical Expenses

The 2020 threshold for deducting medical expenses on Schedule A is 7.5% of AGI. The adjusted-gross-income threshold was slated to jump from 7.5% to 10% after 2018, but the 2019 government funding law revived the 7.5% figure for 2019 and 2020.

Long-term Care Premiums: The limits on deducting long-term-care premiums are higher in 2020. Taxpayers who are age 71 or older can write off as much as $5,430 per person ($5,270 for 2019). Filers age 61 to 70 can deduct up to $4,350 ($4,220 for 2019). Anyone who is 51 to 60 can deduct up to $1,630 ($1,580 for 2019). For people age 41 to 50, the max is $810 ($790 for 2019). Finally, for taxpayers age 40 and younger, the maximum is $430 ($420 for 2019). For most, long-term-care premiums are medical expenses deductible only by itemizers on Schedule A. However, self-employed people can deduct them on Schedule 1 of the 1040.

21. HSAs, FSAs and HRAs

The annual cap on deductible contributions to health savings accounts (HSAs) rises in 2020 from $3,500 to $3,550 for self-only coverage and from $7,000 to $7,100 for family coverage. People born before 1966 can deposit $1,000 more (same as last year).

Qualifying insurance policies must limit out-of-pocket costs in 2020 to $13,800 for family health plans ($13,500 in 2019) and $6,900 for people with individual coverage ($6,750 in 2019). Minimum policy deductibles increase this year from $2,700 to $2,800 for families and from $1,350 to $1,400 for individuals.

The IRS also announced that anyone with a high-deductible health plan that covers medical expenses related to COVID-19 before plan deductibles have been met can still contribute to an HSA. This includes coverage for the panel of diagnostic testing for influenza A and B, norovirus and other coronaviruses, and respiratory syncytial virus, and any items or services required by law to be covered with zero cost sharing. It also included telehealth and other remote care services.

In addition, beginning in 2020, funds from HSAs, health flexible spending arrangements (FSAs), and health reimbursement arrangements (HRAs) can be used to buy over-the-counter medicines without the need of a doctor's prescription, as well as menstrual care products. Workers can also make mid-year changes to their health and dependent care FSAs in 2020, if their employer modifies its FSA plan.

Employers can allow workers to:

a. Sign-up or revoke an election to contribute to a health or dependent care FSA for 2020; or
b. Increase or decrease the amount contributed in 2020 to a health or dependent care FSA.

Employers also have the option of upping the carryover amount for 2020 FSAs from $500 to $550. This doesn't apply to amounts carried over from 2019 to 2020, though. In addition, the carryover amount will be adjusted for inflation going forward.
The IRS is also letting employers extend the FSA grace period to incur health or dependent care expenses for the previous year to the end of the year. However, it is optional. For example, if an employer sponsored a 2019 FSA with a grace period ending on March 15, 2020, it could amend its FSA plan to let workers apply unused 2019 FSA funds to pay for

qualifying expenses incurred through December 31, 2020. Note, however, that a worker who had unused amounts from a 2019 health FSA and who is allowed an extension to the end of 2020 to incur expenses generally will not be allowed to contribute to an HSA during the extended period.

22. Alternative Minimum Tax (AMT)

There is good news for anyone worried about getting hit with the alternative minimum tax: AMT exemptions tick upward for 2020. They increase to from $111,700 to $113,400 for couples and from $71,700 to $72,900 for single filers and heads of household. The phaseout zones for the exemptions start at higher income levels as well—$1,036,800 for couples and $518,400 for singles and household heads ($1,020,600 and $510,300, respectively, for 2019).

In addition, the 28% AMT tax rate kicks in a bit higher in 2020—above $197,900 of alternative minimum taxable income. The rate applied to AMT over $194,800 for 2019.

23. Deduction for Pass-Through Income

A key dollar threshold on the 20% deduction for pass-through income was increased for 2020. Self-employed people and owners of LLCs, S corporations and other pass-through entities can deduct 20% of their qualified business income, subject to limitations for individuals with taxable incomes in excess of $326,600 for joint filers and $163,300 for others ($321,400 and $160,700, respectively, for 2019).

24. Penalties Tax Filing

The fine for filing late returns is higher for returns with post-2019 due dates. The minimum penalty for returns filed 60 or more days after the due date is now the lesser of $435 (up from $215) or 100% of the required tax shown on the return.

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