Midyear Tax Planning Ideas
FOR INDIVIDUALS

The extended July 15 deadline for filing your 2019 federal income tax return is behind us. Now it's time to think about your current federal tax situation. Tax planning is especially complicated for 2020. There are a lot of moving pieces: The COVID-19 pandemic has caused some people to lose their jobs or take pay cuts. Many investors have suffered financial losses during the crisis — while other people have prospered by taking advantage of COVID-related business and investment opportunities. So, depending on your situation, you may have less (or possibly more) taxable income in 2020 than you did in 2019.

In addition, certain provisions in the Coronavirus Aid, Relief and Economic Security (CARES) Act may create opportunities for some taxpayers to save taxes or tap into alternative sources of cash (like retirement funds). Plus, it's a presidential election year — and a change in leadership could lead to changes in tax rates and other provisions for 2021 and beyond. Any change could possibly even be retroactive for 2020.

With all that in mind, individuals should consider the following tax planning moves midway through the year to lower their tax obligations for 2020.

Pay Taxes Due

In response to the COVID-19 crisis, the IRS extended to July 15 the due date for the first two estimated tax instalments for the 2020 tax year. The normal due dates for those instalments were April 15 and June 15, respectively. Estimated tax payments are most commonly an issue for self-employed individuals, rental property owners and investors.

If you haven't already paid your first two estimated tax installments, it's time to settle up with Uncle Sam by making a catch-up estimated tax payment. You can do that by the September 15 deadline for the third 2020 instalment or you can do it sooner, if you wish. That will stop the interest penalty that's charged on estimated tax underpayments. So far, the IRS hasn't extended the September 15 due date for the next estimated tax instalment, and it probably won't. So, settling up sooner rather than later might be in your best interest.

Rent Out Your Vacation Home

If you own a vacation home, you may not be able to enjoy your hideaway this year. But you may still be able to generate some income and salvage tax breaks if you rent out the vacation home while you're not using it.

You can write off expenses attributable to the home rental against your rental income. This may include a portion of the home's:

- Utilities
- Insurance
- Repairs
- Mortgage interest
- Property taxes.

These deductions offset your rental income. In fact, you may be able to claim an overall rental property tax loss for the year if: 1) your personal use of the vacation home doesn't exceed the greater of 14 days or 10% of the rental days, and 2) you can avoid the passive loss rules that can prevent you from currently deducting rental losses. Consult your tax advisor for specifics.

Find a Child Care Solution

The pandemic may have altered your plans to send children who are under 13 away to summer camp — and possibly even to school, after-school programs and daycare centers in the fall. You could be scrambling to find a childcare solution so you and your spouse can work.

Consider hiring a family member to care for your kids. For example, you might ask for help from a retired relative who has free time and needs a little extra spending money. Besides the comfort of using a trusted family member, the arrangement may qualify you for the dependent care tax credit. In most cases, the credit equals 20% of the first $3,000 of qualified expenses for one child or 20% of the first $6,000 of qualified expenses for two or more children. So, the maximum credit is usually $600 for one eligible child or $1,200 for two or more eligible children. Be aware, however, that the credit isn't available for payments to a caregiver who's your own under-age-18 child.

Roll Over Your RMD

Later in life, you must begin taking annual required minimum distributions (RMDs) from tax-favored retirement accounts, such as traditional IRAs, SEP-IRAs and 401(k) accounts. The taxable percentage of those mandatory distributions (often 100%) must be reported as income on your tax returns.

Before the Setting Every Community Up for Retirement Enhancement (SECURE) Act, the initial RMD was for the year you turn age 70½. The SECURE Act increases the age after which you must begin taking RMDs to 72. However, this favorable change applies only to individuals who reach

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age 70½ after December 31, 2019. So, if you'll turn 70½ in 2020 or later, you won't need to start taking RMDs until after you've attained age 72.

Failure to take RMDs can result in a 50% penalty on the amount you should have taken out but didn't. Thankfully, the CARES Act waives any and all RMDs that you would otherwise have to take in 2020.

More good news: Recent IRS guidance gives you until August 31 to roll over any RMDs that you received earlier in 2020. The IRS is also waiving the usual limit of just one IRA-to-IRA rollover per year. So, if you've received RMDs from one or more IRAs this year, you can roll the money back into an IRA, as long as you get it done by August 31. Take advantage of this option if it suits your needs.

Review Your Investment Portfolio

The stock market has experienced some drastic swings this year. Now is a good time to review positions held in your taxable accounts to see where you currently stand on capital gains and losses. Then act accordingly.

For instance, if you realized a high-taxed, short-term capital gain from a securities sale earlier this year, you could sell loser securities to offset the gain plus up to $3,000 of income from other sources (such as salary or self-employment income), or $1,500 if you will use married filing separate status for this year's return.

Conversely, if you're showing an overall net capital loss so far this year, consider selling some short-term winners. You can offset the gains, that would otherwise be taxed at higher rates, with losses from sales earlier in the year. It's important to note that the federal income tax rate on net long-term capital gains is 15% for most individuals, but the rate for higher-income individuals is 20%. Higher-income individuals may also owe the 3.8% net investment income tax, and you may owe state income tax too. Consult your tax adviser to figure out the combined tax rate you would owe on a 2020 net long-term capital gain.

Boost Charitable Giving

Are you inclined to help a worthy cause during the pandemic? Normally, you can deduct charitable donations only if you itemize on your tax return. Thankfully, the CARES Act allows you to claim an above-the-line deduction of up to $300 for donations to qualified charitable organizations in 2020. This write-off is allowed whether you itemize or not. It's currently unclear if the $300 limit is doubled to $600 for a married joint-filing couple.

Additionally, there's more charitable write-off flexibility for individuals who make large donations. Normally, the annual itemized deduction for monetary donations to qualified charities is limited to 60% of adjusted gross income (AGI). The CARES Act raises the limit to 100% of AGI for 2020 donations.

Arrange a 401(k) Loan

If you need cash during these troubled economic times, you may decide to borrow money from your 401(k) account. Fortunately, the CARES Act significantly eases the rules for qualified plan loans taken out on or after March 27, 2020, and before September 23, 2020. The rules have been liberalized as follows:

- The maximum permissible loan amount is doubled from $50,000 to $100,000.
- Plan participants can borrow up to 100% of their vested benefit instead of the usual 50% limit.
- The due date for loan repayments is extended by one year, so you generally have six years to repay a loan that's covered by the CARES Act liberalizations.

Important: *This strategy is generally viewed as a last resort. Don't touch your retirement savings if you can help it.*

Looking Ahead

Tax planning is especially complicated this year. In the first half of 2020, we struggled to stay on top of rapidly changing tax rules and economic chaos caused by COVID-19. Now, in the second half of 2020, we face uncertainty about the outcome of the November general election. To add another dose of uncertainty, we may see additional federal COVID-19 relief legislation that includes more tax changes. ■