Tax Planning

Tax Considerations for 2020

Steady and SECURE

Much of the world is in a state of flux. Thoughts of impeachment, Brexit, trade wars and tariffs riddle the headlines. However, for the first time in some time, many of the income tax laws in the U.S. remain constant. That said, the new SECURE Act has significantly changed the retirement planning landscape. Moreover, 2020 is an election year so it is very likely taxes will be a major topic in the news this year.

Many Income Tax Laws Remain Steady

Tax rates and brackets remain steady for 2020. Inflation moving the line slightly higher is the primary change for most areas this year. For example, the standard deduction remains at an all-time high, now $12,400 for individual filers, while married taxpayers* climb to $24,800.

Tax rates continue to remain historically low as well. The top tax bracket stays at 37%, applying to individuals with more than $518,400 in income, $622,050 for married taxpayers.

For those "in the middle", the middle tax bracket calls for a 24% rate. That rate begins at $85,525 single/$171,050 married. You need in excess of $163,300 single/$326,600 married to climb into the next bracket.

Long term capital gains tax rates also remain historically low. There is a smaller 0% bracket, but the most common bracket is the 15% bracket for capital gains. If your taxable income (which includes the income on the capital gain) is less than $441,450 single/$496,600 married, you enjoy the 15% rate. Any capital gain above those thresholds is a 20% rate, which is still well below the 37% marginal rate on ordinary income.

The SECURE Act

Late in 2019, the SECURE Act was attached to the government spending bill that was designed to avoid another government shutdown. The spending bill passed through Congress and was signed into law on December 20, 2019. Included were several changes to retirement savings programs and 529 education savings plans, many of which were effective January 1, 2020. Most noteworthy are the increase of the required minimum distribution start age from age 70 ½ to 72 for individuals who were born on or after July 1, 1949, the ability to continue contributing to traditional IRAs after age 70 ½ for individuals

*Note: All references to "married taxpayers" will be defined as married filing jointly.

who are still working (or are married and have a spouse still working), limiting the stretch-out of inherited retirement accounts to 10 years for most non-spouse beneficiaries, and 529 education savings plans may now be used to repay up to $10,000 of outstanding student loan debt for the student (or siblings of the student).

Ongoing Considerations

With change comes new opportunities. Discuss with your tax advisor whether one or more of the following actions could be beneficial for your specific situation:

Medicare Premium Income Tiers Increase in 2020

Over the past few years, several changes have been made to the income tiers that determine how much of the monthly Part B and Part D Medicare premiums wealthier Medicare beneficiaries pay. Currently, individuals with income of $87,000 or more and married taxpayers with income above $174,000 pay anywhere from 35% to 85% of their monthly premium costs. Because your income in 2020 determines the Medicare premiums you pay in 2022, managing your income is especially important if you are at or near the top or bottom of any of the six income tiers. The tiers are subject to annual cost of living adjustments, except for the highest tier which begins at $500,000 for individuals and $750,000 for married couples and requires 85% of the Medicare premiums to be paid by the Medicare beneficiary.

Itemize or Not?

Should you itemize or use the standard deduction this year? With the higher standard deduction, coupled with limited itemized deductions, you may need to review planning opportunities for 2020. Ideas like bunching or delaying expenses or gifts, like medical expenses or charitable gifts, along with taking or deferring gains or losses where possible, may benefit you more in one year than another.

Review your Gift and/or Estate Planning Situation

Review your gift and/or estate planning situation. With the larger exclusions ($11.58 million per person for 2020), you want to make sure your existing plan meets your legacy goals as many plans divide assets based on the applicable exclusion amount. Moreover, you may consider accelerating any gifts to take advantage of the larger exclusions.

Kiddie Tax Laws Are Modified

While most income tax laws have not changed, the SECURE Act has changed the Kiddie Tax rules. Recall, the Kiddie Tax kicks in when dependent children have investments in their own name that generate unearned income. Prior to 2018, any unearned income in excess of two times the standard deduction limit for a child under age 19 (or if a full-time student, under age 24), was taxed at the higher of the child's or the parents' top marginal tax rate. In 2018 and 2019, trust tax rates replaced the parents' tax rates, but that change was repealed by the SECURE Act. Taxpayers may elect to re-file their previous tax returns and retroactively elect the "old" rules. Going forward, unearned income that exceeds $2,200 is once again taxed at the higher of the child's tax rate or that of the parents.

More Opportunities to Use 529 Education Saving Plans

The SECURE Act also enhanced the use the 529 education savings plan. Accumulated balances may now be used income-tax-free for registered apprenticeship program expenses for students who may not desire to go to college and can also be used to repay up to $10,000 in qualifying student loan debt for the student or siblings of the student.

Explore Retirement Planning Opportunities

Consider fully funding employer-sponsored plans and/or tax-deductible IRAs. Maximizing these contributions may lower your tax bracket. Contribution limits for 401(k)s, 403(b)s and other salary deferral plans increased $500 in 2020, bringing the total to $19,500 ($13,500 for SIMPLE IRAs). Catch-up contributions for those age 50 or older also increased to $6,500 (SIMPLE IRAs remain at $3,000). Traditional IRA contributions also remain unchanged at $6,000 (plus an additional $1,000 for individuals age 50 or older). With the changes from the SECURE Act, individuals age 70 ½ or older can continue to contribute to a traditional IRA if they (or their spouse, if married) still have earned income beginning with tax year 2020 contributions.

If you are age 70½ or older and are charitably inclined, tax-free qualified charitable distributions (QCDs) can be a great way to satisfy your gifting from your IRA without increasing your taxable income. You can gift up to $100,000 a year from your IRA after age 70 ½ (6 months past your 70th birthday) and as long as your distribution is made directly to a qualified charity from the IRA, the distribution will be income tax free – even if you are using the standard deduction and do not itemize. QCDs can also satisfy your required minimum distributions (RMDs), but are not limited to the amount of the RMD. Keep in mind that with the changes under the SECURE Act, if you are also making deductible IRA contributions in the same year you are taking a QCD, you must adjust the amount of the tax-free QCD by the amount of the deductible IRA contribution.

Consider Roth retirement planning options. Converting existing pre-tax retirement assets to a Roth IRA, or funding a Roth IRA or Roth 401(k) plan, may provide more after-tax cash flow during retirement. A conversion cannot be undone, so consider the tax consequences carefully before acting.

Talk With Your Financial Advisor

It seems the one constant is change. Planning strategies may need to be re-evaluated with the recently enacted tax law changes from the SECURE Act. Talk with your Benjamin F. Edwards financial advisor, and in partnership with your tax and legal advisors, you can be better prepared to make sure your investments, saving strategies, and retirement income goals are aligned with your tax strategy.