The Kiplinger Tax Letter

CIRCULATED BIWEEKLY TO BUSINESS CLIENTS SINCE 1925

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Dear Client: Washington, Feb. 21, 2020

HIGHLIGHTS

A strategy for inherited IRAs has been curbed by the enactment of the SECURE Act late last year:

The stretch IRA for nonspouse beneficiaries. Before the SECURE Act, IRA owners who died could leave their accounts to their children, grandkids or other nonspouse individual beneficiaries, and heirs could stretch required minimum distributions over their own lifetimes, thus allowing the funds in the accounts to grow tax-free for decades.

Congress saw this as a loophole for the rich… And has been itching to curtail it for years.

Now there's a 10-year clean-out rule for many beneficiaries of inherited IRAs. The IRA funds must be distributed to them within 10 years of the owner's death. This new clean-out rule doesn't mean that payouts must be distributed evenly over a 10-year period. The beneficiary can wait until year 10 to take out all the money.

There are some exceptions for beneficiaries who are surviving spouses or minor children of the account owner, or beneficiaries who are chronically ill, disabled or not more than 10 years younger than the deceased IRA owner. For minor children, the exception applies only until the child reaches age 18.

The rule for spouses didn't change. Unlike other beneficiaries, a surviving spouse still has the option to take an inherited IRA as his or her own.

One other important note: These new rules were not made retroactive.

They apply to beneficiaries of IRA owners who die in 2020 or later. For individuals who inherited an IRA before 2020, the old rules continue to apply, so that these lucky beneficiaries can still take advantage of the stretch IRA strategy.

Let's go over a few options to ease the pain of the new inherited IRA rules.

Review your current beneficiaries. Maybe leave your IRA to your spouse instead of your children or grandchildren. Or split it among your spouse and kids. See if you have any eligible beneficiaries to whom the old rules would still apply.

Consider converting a traditional IRA to a Roth IRA. You'll have to pay tax on the converted funds, but once the money is in the Roth, future earnings are tax-free. With individual rates at the lowest they've been in many years, a Roth conversion can be an attractive option. You don't need to convert the entire amount all at once. You can transfer the money in increments over time, and space out the tax hit. Beneficiaries of inherited Roths would still have to empty the accounts within 10 years, but the money is tax-free to them. There's lots more to consider, so you'd be wise to check with your financial adviser and a tax expert before making any moves.

Make qualified charitable distributions from your traditional IRA. Account owners age 70½ and older can give up to $100,000 to charity annually directly from their IRA. These QCDs aren't taxable to you and aren't included in your adjusted gross income. Once you reach age 72, the starting age now for taking required minimum distributions, the QCDs can count toward the RMDs. Making QCDs will lower your IRA balances, giving heirs less taxable income.

You should consult a tax or estate planning adviser for other ideas.

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IRAs

IRA owners who turn 70½ this year and got RMD statements can ignore them. Financial institutions that maintain IRAs are required to notify account owners by Jan. 31 in the year required minimum distributions are first due. Prior to 2020, RMDs were first due in the year the IRA owner turned 70½. Under the SECURE Act, RMDs are now delayed until age 72. Some banks didn't have time to alter their systems to account for the new law and mailed statements to owners turning 70½ this year.

Financial institutions that sent the statements won't be penalized, provided they notify the account owner by April 15 that no RMD is actually required.

Note that this does not apply to IRA owners who turned 70½ in 2019. They must take their first RMDs by April 1, 2020, if they haven't already done so.

TAX EXTENDERS

We continue to get lots of questions from readers on tax extenders passed by Congress in Dec. It's the longest time that lawmakers have waited to retroactively extend expired breaks. We thought we'd share two recent queries.

Can I get a tax break for putting energy-efficient windows in my home?

Yes, a limited credit is available. The year-end government spending law brought back from the dead, for 2018 through 2020, the credit for energy-saving items added to one's principal residence, such as windows, insulation, roofs and doors. It stays at 10% with a $500 maximum. Any credits that you took in prior years count against the $500. And many individual items are capped at lower amounts.

To take the break for 2018, you'll have to file an amended return.

Now that the deduction for private mortgage insurance premiums is revived...

How do I claim it on my 2018 return? You would file an amended return on Form 1040-X and attach a 2018 updated Schedule A, which IRS is revising. The new 2018 Schedule A, in draft form at press time, should be final soon.

FILING SEASON

Using new tax software this year to prepare your 2019 1040 or 1040-SR? You'll need your 2018 adjusted gross income to electronically sign the form. Taxpayers using the same software they used last year won't need to do this, IRS says.

FILING STATUS

An unmarried mom who lived with her kids and their father gets a tax break: She can file as head of household. She worked as a medical assistant and paid more than half the cost of the household for the three young children. The kids' father lived in the house but had little income and struggled with debts, and he didn't claim the kids as dependents (Magana, TC Summ. Op. 2020-9).

Want to know what counts and doesn't count for maintaining a home for the head-of-household filing status? IRS Publication 501 has a worksheet. Real estate taxes; mortgage interest; rent; home repairs, maintenance and insurance; food eaten in the home; and some other costs qualify. The costs of clothing, education, vacations, health insurance, transportation, medicine and life insurance don't.

HEALTH CARE

If you got subsidies for buying health coverage on an exchange last year... You must file a 2019 tax return with a completed Form 8962 attached to reconcile the advances with the actual health premium credit you're entitled to, even though your income may be below the filing threshold or you expect a refund. Nonfilers or those who incorrectly report advance premium payments are audit targets.

ELECTION WORKERS

This election season, many people will get paid for working at the polls. Their compensation is taxable. But income tax withholding isn't required unless the worker requests it by giving a completed W-4 to the state or municipality.

FICA tax generally doesn't apply if workers are paid less than $1,900 in 2020. If their wages are $1,900 or more, FICA tax applies from the first dollar paid. In some localities, however, a lower wage level could trigger FICA tax withholding.

BUSINESS TAXES

A filing deadline is just around the corner for calendar-year partnerships… And S corporations. Their federal income tax returns are due by March 16. If more time is needed, they file Form 7004 to get an automatic six-month extension.

Calendar-year regular corporations have until April 15 to file 2019 returns. They can get six more months by filing the 7004 and paying enough to cover taxes.

Want your calendar-year firm taxed as an S corporation for all of 2020? Remember to elect S status by filing Form 2553 with IRS by March 16.

IRS has a simplified method for businesses to handle late S elections. Generally, firms have three years and 75 days to seek relief. They'll have to show that they are otherwise eligible to be treated as an S corporation and that the firm and its shareholders reported income consistent with S corporation status. Firms must also demonstrate that there was reasonable cause for the late election. To request relief, file Form 2553, write "Filed Pursuant to Rev. Proc. 2013-30" at the top of the form and submit proof that the firm qualifies for the extra time.

Firms ineligible for the simple option can seek a private letter ruling from IRS to request relief. This process is more complicated and requires a $30,000 user fee.

An employer tax break has been extended. The work opportunity tax credit for hiring economically challenged employees will be available throughout 2020. The credit is for employers who hire qualified veterans, ex-felons, certain youth, the long-term unemployed and other categories of workers who face key barriers to employment. Employers must submit Form 8850 to the state agency within 28 days of the employee starting work to certify that the hiring is eligible for the credit. Employers use Form 5884 to figure the credit and transfer the amount to Form 3800.

Here's a tax tip if you're self-employed and fly commercial in your business: You can write off those pesky fees you pay the airline for checking luggage. Fees to change your travel plans are also deductible. Make sure to keep all receipts.

Small businesses that offer retirement plans get help from the SECURE Act. They get a much bigger credit for establishing a retirement plan. Before the SECURE Act, the credit to help defray start-up costs was limited to $500 per year for up to three years. Now, the maximum credit can be as much as $5,000.

Firms also get a credit for adopting automatic-enrollment 401(k)s or IRAs. It's up to $500 annually for three years and is in addition to the credit described above.

And more small firms will be able to band together in one retirement plan. Starting in 2021, the law allows completely unrelated employers to participate in a multiple-employer plan and have a pooled-plan provider administer it.

FARM TAXES

Farmers and fishermen, take note of income averaging on Schedule J of the 1040. These filers can elect to figure their current-year tax on farming or fishing income by averaging it with income over the three prior tax years. For farmers or fishermen who had an especially profitable year in 2019, or were in a lower tax bracket, or had a loss in any or all of 2016, 2017 or 2018, using income averaging can, depending on a taxpayer's facts, reduce income taxes.

ESTATE TAXES

Estate tax pros are patiently awaiting a Tax Court ruling on a celebrity case: The estate of Michael Jackson. The singer's estate disputes adjustments that IRS made to Form 706. A big issue is the value of his name and image at death. The difference between the parties on this amounts to hundreds of millions of dollars. The case was docketed in Tax Court in July 2013 and a trial was held in Feb. 2017. Post-trial, there have been lots of procedural issues for the Court to deal with. A decision is expected this year, more than a decade after the King of Pop's death. Experts hope the ruling will provide a map for valuing estates of other deceased stars.

Many source documents are available in the online edition of The Kiplinger Tax Letter

PAYROLL TAXES The Social Security wage base is projected to rise to $142,200 for 2021, a $4,500 increase from this year. That's President Trump's budget forecast, based on data from the Social Security Admin. If you're doing longer-range planning, the estimates are $147,900 for 2022, $154,500 for 2023 and $162,000 for 2024. The final number, based on national average-wage-index growth, comes in mid-Oct.

Employers that outsource payroll tax duties remain liable for unpaid taxes. So take these steps to protect yourself if your business uses a payroll agent: Enroll in the Electronic Federal Tax Payment System so you can monitor deposits. Make sure all correspondence from IRS about payroll taxes goes to your address, not the agent's. Use an IRS-certified professional employer organization, if possible.

Combatting payroll tax fraud is a high priority for IRS and the Justice Dept. DOJ is pursuing an increasing number of civil injunctions against businesses... and their officers...that have repeatedly failed to deposit taxes withheld from workers. Generally, the focus is on serial offenders with unpaid taxes in excess of $100,000.

A doctor got in trouble for repeatedly failing to remit withheld payroll taxes to IRS, instead diverting the funds for other uses. His medical practice had unpaid taxes totaling $275,000 over 15 quarters. A court granted DOJ a permanent injunction requiring the doctor to file payroll returns, timely pay taxes and make biweekly deposits of withheld amounts in a segregated account (Askins & Miller Orthopaedics, D.C., Fla.).

PREPARERS Unscrupulous preparers of N.Y. state tax returns could face felony charges. Dem. Governor Andrew Cuomo's office says the state has seen an uptick in "refund mills," in which preparers are filing fraudulent returns to get false refunds. It proposes to charge preparers who knowingly file multiple N.Y. returns with false data or omissions in order to evade tax or inflate a refund with a Class D or C felony.

STATE TAXES Some states are expanding their earned income tax credits. Increased credits on 2019 returns are allowed for filers in Mass., N.J., N.M., Ohio, Ore. and S.C. EITC eligibility requirements were extended for working people in Calif. and Minn. Maine also raised and expanded its EITC, but the changes don't kick in until 2020.

ENFORCE-MENT IRS is cracking down on tax scams involving improper fuel-tax-credit claims. Farmers and others who use fuel for off-road business driving can take a credit for the federal fuel tax they pay. IRS knows some crooked preparers urge their clients to take this break, even though they don't qualify for it. The agency has added filters to electronically screen returns with suspicious credits and to proactively act on them. And last summer, it entered into a pact with the Environmental Protection Agency to exchange information to help thwart the growth of these fraudulent schemes.

IRS IRS's private tax-debt-collection program is raking in the bucks. From its April 2017 start through Sept. 30, 2019, four private firms have collected about $300 million in revenue from seriously delinquent taxpayers. Compare this with the program's $132 million cost so far. IRS is using the extra funds to add more of its own collectors. Their numbers have fallen sharply over the years.

Yours very truly,

The Kiplinger Editors

Feb. 21, 2020 THE KIPLINGER WASHINGTON EDITORS

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