

AAII TAX GUIDE

The Individual Investor's Guide to Personal Tax Planning 2020

This year's changes to the tax rules are modest in scope.

BY AAII STAFF

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Just as taxpayers were adjusting to the Tax Cuts and Jobs Act (TCJA) of 2017, two additional changes were made to the tax code. The SECURE Act addressed retirement savings and was signed into law in December 2019. The CARES Act provided relief during the coronavirus pandemic and was signed into law in March 2020. Both had a smaller impact on the tax code than the TCJA but still created questions for many individual investors. In response, we published an update to the tax rules in the May *AAII Journal* ("Tax Guide Update: Staying Current on the New Rules"). This guide incorporates many of those changes.

Due to the impact of those changes, Form 1040 was revised. It now includes a line for you to enter your "recovery rebate credit." This is the stimulus check you may have received in the spring. The credit is based on your 2020 adjusted gross income (AGI) but was paid out based on your 2019 tax return (or your 2018 return if you had yet to file your 2019 return at the time the payment was calculated). If your AGI declined this year (2020), you may be able to claim a larger credit than you previously received. If your AGI increased this year, the draft instructions for Form 1040 state that "you don't have to pay back the difference."

The rebate credit does not count as income and is not taxable.

A special note of thanks goes out to Mark Luscombe, a principal analyst at Wolters Kluwer Tax & Accounting, for previous assistance in answering detailed questions about the tax code. Sources of information used for this year's guide also include the Internal Revenue Service, Healthcare.gov, Medicare, the Social Security Administration, the Federal Register and The Kiplinger Tax Letter.

The other line added to the 2020 Form 1040 is for charitable deductions. This year, taxpayers can deduct up to $300 in charitable donations even if they take the standard deduction. The $300 limit applies to both single filers and joint filers. Married couples filing joint returns cannot double the deduction.

Required minimum distributions (RMDs) were waived in 2020. The waiver also applies to inherited IRAs subject to RMDs. RMDs for all accounts subject to the mandatory withdrawals will return in 2021. As a reminder, the age for starting RMDs is now 72. (It was 70½ for those who had attained that age in 2019 or earlier.)

Revised life expectancy tables used to calculate RMDs will go into effect in 2021. They assume longer life-spans and will lead to modestly smaller RMDs. Many retirees may not notice a change, however. This is because RMDs are calculated based on account balances. To the extent that a retiree's balance increased for an account subject to the RMD rules, the amount of the mandatory distribution will increase as well.

The SECURE Act reduced the floor for deducting medical expenses to 7.5% of AGI for the years 2019 and 2020. The floor will revert back to 10% in 2021 barring new legislation. The CARES Act expanded the list of qualified medical expenses. See IRS Publication 502 Medical and Dental Expenses for a list of what is and isn't covered.

Other so-called tax extenders are set to expire at the end of 2020. They include the ability to deduct mortgage insurance premiums.

A prior change to the kiddie tax was repealed. Minors' unearned income is being taxed at their or their parents' tax rate, whichever is higher. The TCJA had previously applied the trust and estate tax rates to minors' unearned income. The change is retroactive to both 2018 and 2019.

As we wrote this guide, the presidential election had been called for Joe Biden. Control of the Senate had yet to be determined with two run-off races scheduled for Georgia. The best-case scenario for the Democrats would be a split Senate with vice president-elect Kamala Harris being a potential deciding vote.

Under this scenario, it will be politically difficult to pass significant tax legislation—particularly legislation raising tax rates on corporations and high-income earners. Should Republicans maintain control of the Senate, it will be even harder to implement the tax law changes president-elect Biden ran on.

TABLE 1

An Overview of Tax Changes in the Coming Years

	2020	2021	2022*
Long-Term Capital Gains Rate			
Maximum Taxable Income Breakpoints for Married Filing Jointly			
0%	Below $80,000	Below $80,800	Below $80,800
15%	$80,000–$496,600**	$80,800–$501,600**	$80,800–$501,600**
20%	Above $496,600**	Above $501,600**	Above $501,600**
Qualified Dividends Rate			
Maximum Taxable Income Breakpoints for Married Filing Jointly			
0%	Below $80,000	Below $80,800	Below $80,800
15%	$80,000–$496,600**	$80,800–$501,600**	$80,800–$501,600**
20%	Above $496,600**	Above $501,600**	Above $501,600**

	2020	2021	2022
Marginal Income Tax Rates			
First Bracket	10%	10%	10%
Second Bracket	12%	12%	12%
Third Bracket	22%	22%	22%
Fourth Bracket	24%	24%	24%
Fifth Bracket	32%	32%	32%
Sixth Bracket	35%	35%	35%
Top Bracket	37%	37%	37%
Child Tax Credit			
	$2,000	$2,000	$2,000
Standard Deduction			
Married Filing Jointly	$24,800	$25,100	$25,100
Single	$12,400	$12,550	$12,550
Personal Exemption Phaseouts			
	—	—	—
Limitation on Itemized Deductions			
	—	—	—
AMT Exemption			
Single	$72,900	$73,600	$73,600
Married Filing Joint	$113,400	$114,600	$114,600
Head of Household	$72,900	$73,600	$73,600
Estate Tax			
Exemption	$11.58 mil	$11.70 mil	$11.70 mil
Maximum Rate	40%	40%	40%

**Subject to change based on inflation.*
***3.8% net investment income tax (NII) surtax applies when AGI is above $250,000/$200,000.*

This isn't to say there won't be any changes. Even with coronavirus vaccines coming, Congress could provide additional economic stimulus. This type of legislation may renew expiring tax extenders.

A case seeking to invalidate the Affordable Care Act is before the U.S. Supreme Court. A reinstatement of a penalty for not having health insurance could potentially render the lawsuit moot. From a tax standpoint, were the law to be fully invalidated by the court, the 0.9% additional Medicare tax and the 3.8% surtax on net investment income (NII) for high earners would end without new legislation.

The reduced tax rates and expanded tax brackets for individual taxpayers put into place by the TCJA are set to expire at the end of 2025. It is possible that this expiration could be addressed prior to the 2024 elections. Doing so will likely require bipartisan compromise in an environment that has largely lacked it.

If you worked remotely or resided in a state other than your primary work/residence state, you may owe state taxes. Whether you do depends on how you worked or resided in a different state.

If you owed more than expected or received a larger-than-expected refund for the 2019 tax year and haven't adjusted your withholding, consider doing so. The IRS' Tax Withholding Estimator (www.irs.gov/individuals/irs-withholding-calculator) can help you run the numbers. In doing so, make note of any changes in your income for this year attributable to the coronavirus pandemic.

Early statistics from CapGainsValet figure 2020 to have fewer large mutual fund distributions than 2019. As of November 18, 137 mutual funds announced estimated distributions over 10%. In comparison, 154 funds announced distributions over 10% at a similar point in 2019. These distributions are taxable for shares held in a taxable account—even if you don't sell your shares of the mutual fund issuing

the distribution or choose to have the distributions reinvested. You can find the tax-cost ratio—the percentage of returns given up to taxes—for a mutual fund or an exchange-traded fund (ETF) on our mutual fund and ETF evaluator pages. To access the evaluator, just type a fund's name or ticker symbol into the search box located at the top of any page on AAII.com.

The TCJA mandated the use of the chained consumer price index (CPI) for measuring inflation. This figure rises more slowly than the traditional CPI, and many line items will increase by just 1.5% or less in 2021 as a result. The small increases follow the 2020 increases of mostly 1.6%. The cumulative impact will cause those whose income rose at a faster rate to pay more in tax. It may even bump some into a higher tax bracket.

Those of you who were affected by hurricanes, wildfires, tornados or the derecho may be eligible for some form of tax relief. The IRS has a dedicated section on its website with links to specific pages for each disaster: www.irs.gov/newsroom/tax-relief-in-disaster-situations.

No matter how the tax laws (and tax forms) evolve in the future, one thing is constant: You will still have to pay taxes. Even with the simplifications made by the TCJA, the tax code is complex; hence the need for tax guides. As has been the case in years past, our tax guide provides an overview of the tax rates and deductions likely to impact the majority of AAII members. Since there are many details, loopholes and pitfalls within the tax code, it is impossible for this guide to provide enough details to cover specific tax situations. If you have questions, consult a tax professional. It is your tax return, and the IRS will hold you responsible for any errors made on it.

Estimate Your Taxes on AAII.com

You can estimate your 2020 and 2021 tax liabilities on our Tax Forecasting Worksheet. This downloadable Excel spreadsheet will calculate the results based on the data you enter and can be saved for your records. See page 18.

What's New?

The TCJA's revised marginal tax brackets went into effect in 2018. They are 10%, 12%, 22%, 24%, 32%, 35% and 37%. These reduced rates are presently set to expire after 2025.

As discussed, Form 1040 has undergone further revision. A draft of the 2020 form includes a line for claiming up to $300 in charitable deductions prior to calculating adjusted gross income. It also has a line to claim additional economic stimulus based on your 2020 AGI.

The cap on deducting cash charitable donations for those who itemized has been suspended for 2020. Cash donations up to one's contribution base (typically AGI) can be deducted. The 60% cap will be reinstated in 2021.

The limit on IRA contributions will be unchanged in 2021. It was last raised in 2019. Up to $6,000 can be contributed to a traditional and/or Roth IRA for 2020 and again in 2021. The additional catch-up contribution limit is not indexed to inflation and remains at $1,000. The SECURE Act removed the age limit on making IRA contributions, but you must have earned income to make a contribution.

Allowable contributions to a 401(k) plan and similar types of employer-sponsored retirement accounts will be unchanged after going up by $500 in 2020. The maximum contribution will be $19,500 in 2021. The catch-up contribution will stay at $6,500 in 2021 after being raised by $500 for 2020, bringing the total allowable amount for qualifying workers age 50 or older to $26,000.

The deduction for state and local taxes (SALT) remains capped at $10,000. The limit applies to state and local income, property and sales taxes. The TCJA put this limit into effect in 2018 and it is not indexed to inflation. It will remain at this level through 2025, barring a legislative change.

Social Security tax is 6.2% for employees and 12.4% for those working in self-employed positions on the first $137,700 of wages. In 2021, the cap on maximum taxable earnings will rise to $142,800, an increase of 3.7%. (For 2020, the cap was raised 3.6%.) Retirees younger than full retirement age who have claimed Social Security benefits can earn up to $18,240 without benefits being withheld. This limit will rise to $18,960 in 2021.

The alternative minimum tax (AMT) exemption is $113,400 for married couples filing jointly and $72,900 for single filers in 2020. In 2021, the exemption will rise to $114,600 and $73,600, respectively. The phaseout levels for 2020 are $1,036,800 for married filing jointly and $518,400 for singles. They will increase to $1,047,200 and $523,600, respectively, in 2021. The TCJA's higher levels are in effect through 2025 and are indexed to inflation.

The TCJA eliminated the personal exemption for the period of 2018 through 2025.

Married couples filing jointly can claim a standard deduction of $24,800, and single filers can claim a standard deduction of $12,400 on their 2020 tax returns. In 2021, the standard deduction will rise to $25,100 and $12,550 for married and single filers, respectively. The additional standard deduction for those who are aged or blind and are married or a qualifying widow will increase from $1,300 in 2020 to $1,350 in 2021. It will rise from $1,650 in 2020 to $1,700 in 2021 for those who are single and not a qualifying widow. The standard deduction was raised considerably by the TCJA with the adjustment for the so-called "marriage penalty" maintained. The higher level simplifies reporting

Health Care Reform's Impact on Taxes

The tax impact of the Affordable Care Act includes surcharges, higher limits on medical expense deductions and changes to flexible savings account contributions and carryovers. All of these will remain in effect unless repealed by new legislation.

A 0.9% additional Medicare tax applies to wages, compensation and self-employment income above $250,000 for married persons filing jointly and qualifying widow(er)s, $200,000 for single persons and heads of household and $125,000 for those who are married but filing separately. The tax applies to wages that are subject to the Medicare tax and does not depend on adjusted gross income. Should the additional tax not be withheld from wages (a situation that could occur for dual-income couples or individuals working more than one job), the tax could be subject to a penalty if not paid with estimated taxes or through additional withholdings (you can request that your employer increase the income tax withholding on your W-4). More information about the additional Medicare tax can be found on the IRS website at www.irs.gov/businesses/small-businesses-self-employed/questions-and-answers-for-the-additional-medicare-tax.

A 3.8% surtax on net investment income (NII) applies to the lesser of NII or modified adjusted gross income (MAGI) exceeding $250,000 for married persons filing jointly and qualifying widow(er)s, $200,000 for single persons and heads of household and $125,000 for those who are married but filing separately. (These thresholds are not indexed to inflation.) Investment income subject to the tax includes, but is not limited to, taxable interest, dividends, non-qualified annuities, rents and royalties, capital gains and passive income from partnerships. Capital gains from the sale of one's primary residence are subject to the tax to the extent that the income exceeds the applicable home sale exclusion ($500,000 for joint filers and $250,000 for single filers). Excluded are tax-exempt interest (e.g., municipal bond interest payments), distributions from individual retirement accounts (IRAs) and distributions from qualified retirement plans [e.g., 401(k) plans]. The IRS has answers to common NII surtax questions at www.irs.gov/uac/Newsroom/Net-Investment-Income-Tax-FAQs.

The SECURE Act lowered the floor for deducting medical expenses to 7.5% of adjusted gross income through the end of 2020. It will revert back to 10% in 2021 unless new legislation is passed. The floor applies to all individuals regardless of age.

Flexible savings arrangement contributions for 2020 are limited to $2,750 annually. This limit is indexed to inflation, but will remain at $2,750 in 2021. At the election of their plan sponsors, employees can either carry over unused balances into the next plan year or take a grace period of up to two and a half months. The carryover amount is indexed to inflation and will increase from $500 in 2020 to $550 in 2021.

A provision included in the TCJA essentially eliminates the individual mandate to have qualifying health insurance starting in 2019. The former penalty no longer exists but could be reinstated by new legislation.

for some taxpayers by making it more difficult to claim individual deductions. Depending on family size, it may or may not make up for the loss of the personal exemption.

The $2,000 maximum child tax credit is phased out for married couples filing jointly with modified adjusted gross income (MAGI) above $400,000 ($200,000 for all other filers). Both the credit and the phaseout amounts are in effect for the years 2018 through 2025 and are not indexed to inflation. The credit is refundable up to $1,400 in 2020. The refundable portion is indexed to inflation but will remain at $1,400 in 2021. The refundable portion only applies when the full $2,000 credit cannot be used to offset the taxpayer's tax liability. Qualifying children must have a Social Security number for the $2,000 credit to be claimed. See IRS Publication 972 for more information.

The rate at which your long-term capital gains and dividends will be taxed depends on your taxable income and not your marginal tax bracket. Under the TCJA, married couples filing joint returns with taxable income below $80,000 ($40,000 if single) will not owe taxes on capital gains or qualified dividends. Couples with incomes of $80,000 to $496,600 ($40,000 to $441,450 for singles) will pay a 15% tax rate. Filers with income above those levels will pay a 20% tax on long-term capital gains and dividends. These levels are indexed to inflation and will rise in 2021: 0% tax up to $80,800/$40,400 for married and single filers, respectively; 15% up to $501,600/$445,850 for married and single filers; and 20% for those with taxable income above those levels.

To be eligible for the long-term capital gains rate, you must have owned the eligible asset for at least 12 months. The discounted qualified dividend tax rate applies to stock dividends and requires a holding period of at least 61 consecutive days during a 120-day period beginning 60 days before the ex-dividend date. (There is no capital gains tax or dividend taxes for securities held within a retirement account, such as an IRA. See Robert Carlson's article, "Do's and Don'ts of IRA Investing," in the March 2010 *AAII Journal* for investments that can cause an unexpected tax problem; the article is available at AAII.com.)

Collectibles, which include gold coins and bars, are taxed at a maximum 28% rate. Funds investing in precious metals, including ETFs, may also be subject to the collectibles tax rate. Check with the fund company if you have

questions about the tax status.

Short-term capital gains are taxed as ordinary income.

Married couples filing joint returns with net investment income (NII) and modified adjusted gross incomes (MAGI) above $250,000 and single filers with NII and MAGI above $200,000 also must pay the additional 3.8% NII surtax on capital gains and dividends. Collectibles are also eligible for the 3.8% surcharge as well. The $250,000/$200,000 thresholds are not indexed to inflation and will remain the same in 2021.

Medical Insurance Mandate

The shared responsibility mandate of the Affordable Care Act that required adults and children to have minimum essential health coverage expired on December 31, 2018. Since the start of 2019, there is no tax penalty for not having qualifying health insurance. Visit www.irs.gov/aca and www.HealthCare.gov for more information. The latter website also has a calculator for determining whether or not a person or family qualifies for Medicaid or subsidies for purchasing insurance.

Though the mandate has been repealed, the NII and the additional Medicare tax remain in effect. The 0.9% additional Medicare tax applies to wages, compensation and self-employment income above $250,000 for married persons filing jointly and $200,000 for single persons for both 2020 and 2021. More information about these taxes can be found in the box on page 8.

Medical Expenses

The SECURE Act lowered the floor for deducting medical expenses to 7.5% of adjusted gross income through the end of 2020. It will revert back to 10% in 2021 unless new legislation is passed.

Medical insurance premiums for the self-employed are deductible and can be used to reduce adjusted gross income on Form 1040.

Workers participating in flexible savings accounts (FSAs) can carry over up to $500 ($550 beginning in 2021) of unused amounts into the next plan year if their plan sponsor allows them to. Plan sponsors have the choice of either offering employees the ability to carry over up to $500 ($550 beginning in 2021) or allowing employees a grace period of up to two and a half months. Dependent care is also eligible for the grace period option, but not the carryover option.

Contributions to a health savings account (HSA) are allowed for those covered by a high-deductible health care plan (HDHP) and not enrolled in Medicare. The minimum annual deductible for self-only coverage is $1,400; it is $2,800 for family coverage. These amounts will stay unchanged in 2021.

For a complete tax guide to the buying and selling of your personal investments, go to our Personal Investments 2020 Tax Guide in the online version of this article.

The maximum limits for annual deductible and other out-of-pocket expenses in 2020 are $6,900 and $13,800, respectively. They will rise to $7,000 and $14,000, respectively, in 2021.

HSA contributions cannot exceed $3,550 for individual coverage and $7,100 for family HDHP coverage in 2020. In 2021, the maximum contributions will be $3,600 and $7,200 for individual and family coverage, respectively. See "Health Savings Accounts" in the July 2016 *AAII Journal* for more information about these accounts.

Inflation Adjustments for 2021

As previously stated, many deductions, exemptions and limits that are indexed to inflation under current tax law either will or are projected to increase by a range of 1.0% to 1.2%.

Some items will increase more on a percentage basis because of how adjustments are incremented. The phase-out for deducting IRA contributions for single and head of household filers will rise 1.5%, from $65,000 in 2020 to $66,000 in 2021.

Pay attention to the details, because the inflation adjustments are not being made uniformly. This can be particularly apparent when adjustments are made in round numbers. Plus, not all items are indexed to inflation.

Capital Gains Reporting

Brokers are required to report the cost basis for stocks purchased after January 1, 2011; mutual fund, ETF and dividend reinvestment program (DRP) shares purchased after January 1, 2012; and options and traditional bonds bought and sold by their clients on or after January 1, 2014. If you bought a stock, fund, option or bond before the aforementioned dates, your broker is not required to report the cost basis.

Certain debt instruments, particularly those that are more complex than traditional bonds, purchased after January 1, 2016, fall under the cost basis reporting rules. These include variable-rate bonds (including inflation-adjusted bonds), stripped bonds and convertible bonds. Excluded from this rule are debt instruments where the principal is subject to acceleration (e.g., mortgage-backed securities) and debt instruments with a fixed maturity date not more than one year from their date of issue.

If you sold a capital asset in 2020, you will need to fill out Form 8949. See the special write-up in the "Cost Basis"

Cost Basis Reporting for Stocks, Bonds, Funds and Options

Brokers are required to report cost basis for stocks purchased on or after January 1, 2011; mutual fund, exchange-traded fund (ETF) and dividend reinvestment plan (DRP) shares purchased on or after January 1, 2012; and options and traditional bonds purchased on or after January 1, 2014. Brokers are also required to state whether any gain or loss on a sale is short-term or long-term. The rules do not apply to securities and funds purchased before the aforementioned dates.

Traditional bonds and debt instruments purchased on or after January 1, 2014, are subject to the reporting rules. The cost basis of and the proceeds for variable-rate bonds, inflation-indexed bonds, convertible bonds, stripped bonds and other complex debt instruments purchased on or after January 1, 2016, fall under the same reporting rules. Excluded are debt instruments where the principal is subject to acceleration (e.g., mortgage-backed securities) and debt instruments with a fixed-maturity date not more than one year from their date of issue.

Investors have the option of notifying their broker as to how market discounts or interest are treated. Brokers will follow a default method of amortizing bond premiums if not otherwise notified. The rules are complex and we suggest speaking with your brokerage firm about the application of the rules, as well as with a tax professional about the best tax treatment to use.

The type of option owned alters how cost basis is reported. Index options may be subject to different cost basis reporting rules. Again, we suggest speaking with your broker if you have questions about how the cost basis is reported.

A default accounting methodology known as first-in, first-out (FIFO) is used when the purchase of securities (other than a mutual fund or DRP shares) involves more than one transaction. The FIFO method treats the first shares purchased ("first in") as also being the first shares sold ("first out"). Depending on how the stock has performed, this treatment can result in a larger tax bill (the shares appreciated in value) or a bigger capital loss (the shares fell in value).

For mutual funds and DRP stocks, the adjusted basis must be reported in accordance with the broker's default method—average cost basis—unless you specify otherwise. As the name implies, the average purchase price for your shares, regardless of when they are acquired, is used to determine the cost basis. You can specify FIFO instead of average cost basis. Another option is specific identification. The specific identification method allows you to choose the specific shares that are sold. This treatment can also result in a larger or a smaller tax bill, depending on how the fund has performed relative to the purchase price of the selected shares. You may be able to use other methods such as highest-in, first-out (HIFO) or last-in, first-out (LIFO). Contact your broker, fund family or DRP program to determine what their default methodology is and what choices you have for selecting methodologies.

If you want your broker or fund family to use a specific methodology other than their default methodology (e.g., FIFO for stocks or average cost for mutual funds), you must notify them. In order to do this, you must provide written instructions to your broker or fund administrator detailing your intentions before the order is executed, not afterward.

Dustin Stamper at Grant Thorton's National Tax Office emphasized the importance of providing these instructions in writing. If you give your broker or fund family specific instructions and they report a different methodology to the IRS, the only way you can dispute what is on Form 1099-B is to provide a dated copy of your instructions. Stamper said that investors will not be able to retroactively determine which shares were sold; they must provide written instructions at or before the time the shares are sold.

box above for details on the reporting rules.

Tax Software, Books and Guides

If you use a software program (e.g., TurboTax), a book (e.g., "J.K. Lasser's Your Income Tax 2021") or a related aid, check for updates before filing. Doing so will help to ensure that you are using the most up-to-date forms and information.

Specific Tax Guidelines

Part of the complexity of the tax code is determining how taxes will be affected by certain situations. This section gives information on scenarios that potentially may be experienced by many individual investors.

Medicare Part B

The rule of thumb for how taxable income determines Medicare Part B premiums is that your modified adjusted gross income from two years prior will determine your premiums for the current tax year (e.g., 2021 premiums will be determined by 2019 income). See the box on page 11 for information about 2021 premiums.

Marriage, Widowhood and Divorce

Under the tax code, a couple is considered married for the whole year if, on the last day of the tax year, both people are married and living together, living together in a recognized common law marriage, married and living apart without being legally separated under a decree of divorce or separate maintenance or separated under an interlocutory (not final) decree of divorce.

Widow(er)s are considered married for the whole year in which their spouse died and can file a joint return with their deceased spouse. (If there is a dependent child, other filing statuses may be preferable.) For widow(er)s who remarry before the end of the same tax year, a joint return can be filed with the new spouse. The deceased spouse's filing status would be married filing separately in this case.

A person's filing status may be single if they were widowed before the start of the calendar year and did not remarry before the end of the calendar year.

A person who becomes divorced under a final decree by the last day of the year is considered to be unmarried for the whole year.

Same-sex couples are treated as being married for federal tax purposes if they were married in a U.S. or a foreign jurisdiction whose laws authorize the marriage of individuals of the same sex. As such, same-sex spouses must file using either married filing separately or married filing jointly status (certain exceptions apply).

Those in common-law marriages are treated as being married for federal tax purposes if they are living together in a common law marriage recognized in the state where they now live or in the state where the common law marriage began.

Couples in domestic partnerships, civil unions or other similar formal relationships recognized but not denominated as marriage under state law are not considered to be married for federal tax purposes.

Effective January 1, 2019, divorced spouses making alimony and separate maintenance payments can no longer deduct them, while the payee spouse no longer will report the payments as income. This change applies to divorces and legal separations executed after December 31, 2018, and to previously executed agreements modified after December 31, 2018, that expressly state that the tax law change applies to the modification.

Income, Medicare Part B and Social Security

The premiums for Medicare Part B are determined by the amount of modified adjusted gross income (MAGI) reported. MAGI is adjusted gross income plus tax-exempt interest (e.g., interest from municipal bonds). Adjusted gross income (AGI) can be found on IRS Form 1040. AGI includes the taxable portion of Social Security benefits plus taxable distributions from retirement accounts such as required minimum distributions (RMDs).

Medicare Part B premiums are determined by MAGI from two years prior. In 2021, the standard Medicare Part B premium will be $148.50 for individuals filing married joint returns with 2019 household MAGI of $176,000 or less. The monthly premium for 2021 rises to $475.20 for 2019 MAGI above $330,000 but less than $750,000. Couples with MAGI of $750,000 or more will pay $504.90 per month. Individuals filing as singles with 2019 MAGI of $88,000 or less will pay the standard premium of $148.50. Premiums rise to $475.20 for singles with 2019 MAGI of $165,000 up to $500,000 and top out at $504.90 for MAGI of $500,000 or higher. The premiums for various income levels can be found at www.medicare.gov (click on "Your Medicare Costs").

The calculation for how much of your Social Security benefits are taxed is based on combined income for the current tax year. The Social Security Administration defines combined income as: AGI + tax-exempt interest + one half of your Social Security benefits. The amount of benefits subject to taxation for the 2020 tax year is determined by your 2020 combined income. The table below shows how much of Social Security benefits are taxed.

Combined Income	Percent of SS Benefits Taxed
Below $25,000 Single & Head of Household Below $32,000 Married Filing Jointly	0%
$25,000 to $34,000 Single & Head of Household $32,000 to $44,000 Married Filing Jointly	up to 50%
Above $34,000 Single & Head of Household Above $44,000 Married Filing Jointly	up to 85% of benefits + other income

Money Market Funds With Floating NAVs

The U.S. Securities and Exchange Commission (SEC) requires some money market funds, particularly institutional prime money market funds and tax-free institutional money market funds, to use floating net asset values (NAVs). This means that their NAVs are not pegged to $1 per share, but rather can move above or below that benchmark.

The IRS responded to the SEC's ruling by saying "No gain or loss is determined for any particular redemption of a taxpayer's shares in a floating-NAV money market fund. Without a determination of loss, a particular redemption does not implicate the wash-sale rules." The wash-sale rules disallow a loss being claimed for tax purposes when an investment is sold and a substantially identical investment is purchased within 30 days of the sale.

IRA Rollovers

IRA rollovers are restricted to one per person per year. The limitation does not apply to trustee-to-trustee transfers, meaning you can move funds from broker to broker as many times as you would like. The key is that the funds are transferred directly from one broker to another without the assets being distributed to you. A check payable to you instead of the receiving custodian would trigger the

12-month rule.

Rollovers to or from a qualified plan [e.g., a 401(k) plan] are excluded from the rule. Roth IRA conversions are not subject to the one-year limitation and the IRS will disregard them in terms of applying the one-rollover-per-year limitation to other rollovers. Moving funds between Roth IRAs would, however, trigger the one-year waiting period if a check is made payable to you. (Roth IRA recharacterizations, which undid Roth IRA conversions, were banned by the TCJA effective at the start of 2018.)

There is a 60-day deadline for completing a rollover. Waivers to the deadline will be allowed if certain conditions are met, including, but not limited to, an error by the financial institution making or receiving the contribution, a misplaced distribution check, severe damage to the taxpayer's principal residence and serious illness. Written certification to a plan administrator or IRA trustee must be submitted by the taxpayer within 30 days after being able to make the contribution to take advantage of the waiver. See IRS Rev. Proc. 2016-47 for more information.

Pretax and aftertax contributions from defined-contribution plans [e.g., 401(k), 403(b) and 457(b) plans] can be assigned to different accounts as long as directions are given to the plan administrator in advance of the distribution. See IRS Notice 2014-54 for more information and examples of various scenarios.

The IRS' Rollover Chart shows the types of retirement savings accounts that funds can be rolled over from and into a different type of retirement savings account. The chart was recreated in the July 2016 *AAII Journal* ("IRA Rollover Chart: Rules Regarding Rollovers and Conversions").

Be Vigilant About Tax Scams

The IRS continues to warn about tax scams. A new scam is tied to the stimulus payments. Prospective victims are told they have received a direct deposit from a coronavirus pandemic fund and are asked to disclose their bank account information. The IRS is asking those who receive such a message to send a photo of it along with the caller ID and their phone number to phishing@irs.gov.

An ongoing common scam is a phone call requesting immediate payment, commonly via prepaid debit cards and/or a money wire. The fraudster will often threaten a lawsuit, to call the police or involve federal authorities. Hang up if you receive such a call even if your caller ID suggests the phone number is from emergency services or a law enforcement agency; the IRS never initiates contact via a phone call or an email. If the IRS wants to contact you about a tax matter, you will receive a physical letter sent through the U.S. postal service.

Always restrict access to your Social Security number, monitor your credit reports regularly, consider freezing your credit report and use antivirus and firewall software on your computer. Filing your tax return as early as is reasonably possible can also help. Those in their retirement years should be especially on guard, as the fraudsters are targeting your demographic group. See the box on page 26 for more information on how to protect yourself against fraud attempts.

Useful Tax Numbers

Here is a list of the tax rates, deductions, exemptions, credits and other related items that may apply to your 2020 and 2021 taxes. These numbers reflect the changes made by the American Taxpayer Relief Act of 2012 (ATRA), the 2017 TCJA and the 2021 adjustments released by the IRS as of November 6, 2020.

Standard Deduction

For 2020, the standard deduction is $24,800 for married couples filing a joint return, $12,400 for those who are single or married filing separate returns and $18,650 for heads of household.

For 2021, the standard deduction will increase to $25,100 for married couples filing a joint return, $12,550 for those who are single or married filing separate returns and $18,800 for heads of household. The now higher standard deduction is adjusted for inflation (in $50 increments) but will revert back to pre-TCJA levels at the end of 2025 if the legislation is not renewed.

The additional standard deduction for the elderly and the blind who are married will increase to $1,350 in 2021 from $1,300 in 2020. For single taxpayers who are elderly or blind and not a surviving spouse, the additional standard deduction will increase to $1,700 in 2021 from $1,650 in 2020.

Personal Exemptions

The TCJA suspended the personal exemption for the years of 2018 through 2025.

Individual Retirement Accounts and 401(k) Plans

The maximum allowed IRA contribution for 2020 is $6,000 ($7,000 for individuals age 50 or older). The contribution limits will be unchanged in 2021 even though they are indexed to inflation. The additional catch-up contribution limit of $1,000 is not indexed to inflation. The contributions can be fully deducted for modified adjusted gross incomes (MAGI) below $104,000 and $65,000 for married filing joint and single household returns, respectively, for the 2020 tax year. The 2020 exemption is $196,000 for a person filing a married joint return who is not covered by a workplace retirement plan but whose spouse is. In

2021, the phaseout levels for deducting contributions will increase to $105,000 for married filing jointly and $66,000 for singles. It will be $198,000 for those married filing a joint return not covered by a workplace retirement plan but whose spouse is.

In 2020, the maximum annual contribution limit to a 401(k) plan or similar type of defined-contribution plan is $19,500 ($26,000 if you are age 50 or over). The maximum contribution limit will remain at $19,500 and the catch-up contribution will remain at $6,500 in 2021.

In 2020, the maximum annual contribution for SIMPLE (savings incentive match plan for employees) plans is $13,500 (those age 50 or over can make a maximum catch-up contribution of $3,000). The contribution limit will remain at $13,500 (plus the $3,000 catch-up) in 2021.

Married couples with adjusted gross incomes (AGIs) below $65,000 and singles with AGI below $32,500 in 2020 can qualify for the Saver's Credit. Those limits are indexed to inflation and will rise to $66,000 and $33,000 in 2021. The credit is equivalent to 50%, 20% or 10% of retirement plan or IRA or Achieving a Better Life Experience (ABLE) account contributions totaling no more than $4,000 for married filing jointly, $2,000 for single filers. While the income thresholds are indexed to inflation, the credit itself is not.

Qualified Plan Contributions

In 2020, the maximum annual contribution for qualified plans, including SEP and Keogh plans, is $57,000 or 25% of your compensation, whichever is less; in 2021, the maximum contribution will rise to $58,000 or 25% of your compensation, whichever is less.

Estate and Gift Tax Limits

The estate tax exemption is both portable and indexed to inflation. The exemption is $11.58 million in 2020. The exemption will rise in 2021 to $11.70 million. The basic exclusion amount will remain at the higher level through 2025, though increasing by the chained CPI, a slower inflation measure. This is a per-spouse exclusion and it is portable, meaning that if one spouse dies, the surviving spouse can claim the deceased's exclusion, resulting in a total effective exclusion of $23.16 million in 2020 and $23.4 million in 2021.

The large figures will prevent most families from having to pay estate taxes.

The maximum estate tax rate is 40%. The step-up basis rule applies when an inherited asset is sold: The capital gain resulting from the sale is calculated as the difference between the proceeds at the time of the sale transaction and the value of the assets at the time of the inheritance.

Executors have to report the fair value of the property included in the gross estate to both the IRS and to the heirs. Beneficiaries claiming a basis for inherited property above the reported value may be subject to a 20% penalty.

The annual gift tax exclusion in 2020 is $15,000 and $30,000 for consenting couples. (You will need to file Form 709.) These limits will be unchanged in 2021.

Required Minimum Distributions (RMDs)

The SECURE Act raised the age for taking mandatory distributions from retirement accounts for those who attained age 72 on or after January 1, 2020. (Previously, the age was 70½.) Accounts subject to RMDs include 401(k) plans, 403(b) plans, 457(b) plans, traditional IRAs, SEP IRAs, SARSEP IRAs, SIMPLE IRAs and Roth 401(k) plans. RMDs from defined-contribution plans, such as 401(k) plans, can be postponed beyond age 72 for those who are still working, contributing to a defined-contribution plan and own less than 5% of the company. Roth IRA plans are exempt from the RMD rules while the owner is alive.

The CARES Act suspended RMDs for 2020. RMDs will restart in 2021.

If you turn 72 in 2021, you have until April 1, 2022, to take your first RMD. You will need to take a second RMD no later than December 31, 2022, to satisfy that year's distribution requirement.

According to the IRS, "Generally, an RMD is calculated for each account by dividing the prior December 31st balance of that IRA or retirement plan account by a life expectancy factor that the IRS publishes in tables in Publication 590-B, Distributions From Individual Retirement Arrangements (IRAs)."

Child Tax Credit

The TCJA set the maximum child tax at $2,000 through 2025. In 2020, the credit is refundable up to $1,400. The refundable portion is indexed to inflation and will remain at $1,400 in 2021.

Kiddie Tax

The "kiddie tax" applies to children up to age 18 and could apply to children up to age 23—depending on how much earned income they have and whether or not they are full-time students.

Under the kiddie tax rules, children with 2020 or 2021 investment income above a certain amount may have part or all of their investment income taxed at their or their parent's tax rates, whichever is higher. (The SECURE Act repealed the provision in the TCJA pegging the kiddie tax to the trust and estate tax rates. The change was retroactive to 2018.)

The kiddie tax applies if the child is age 17 or younger by the end of the year. In 2020, the kiddie tax will apply

The Tax Impact of Investing for and in Retirement

Various parts of the tax code govern how much can be saved for retirement, when withdrawals can be made and how much has to be withdrawn.

There are three big birthdays you should be aware of. At age 50, the maximum amount allowed to be contributed to retirement savings accounts increases ("catch-up contributions"). At age 59½, you can take withdrawals from all retirement accounts without incurring the 10% early withdrawal penalty. Finally, once you reach age 72 (70½ if born before July 1, 1949), you must begin taking required minimum distributions (RMDs). The age limit on making contributions to an IRA was repealed by the SECURE Act but you must have earned income to contribute.

The tax code incentivizes savings for retirement. Workers can contribute up to $19,500 in 2020 and 2021 in a defined-contribution plan [e.g., a 401(k) plan]. A higher limit of $26,000 in 2020 and 2021 exists for workers age 50 or older. Taxpayers and spouses covered by an employer retirement plan can contribute up to $6,000 ($7,000 for those age 50 or older) to a traditional IRA in 2020 and 2021, though the deductions are subject to income phaseouts. Contributions to a tax-deferred retirement savings account reduce adjusted gross income (and thereby your tax liability) as long as they are within the designated limits.

Contributions to Roth IRAs and Roth 401(k) plans are not tax-deductible. Like traditional IRAs, up to $6,000 ($7,000 for those age 50 or older) can be contributed to a Roth IRA in 2020 and 2021. The maximum contribution is subject to income phaseouts that start at $196,000 for married couples filing jointly and $124,000 for singles for 2020. (The phaseouts will increase to $198,000 and $125,000, respectively, in 2021.)

Contributions to IRAs and Roth IRAs for the 2020 tax year can be made as late as April 15, 2021. When making a contribution for the previous calendar year, ensure your broker registers the deposit correctly.

Withdrawals from retirement accounts are considered to be taxable income unless taken from a Roth IRA, a Roth 401(k) or similar types of accounts. RMDs are required from most retirement accounts starting at age 72 (70½ if born before July 1, 1949). [The first RMD can be taken as late as April 1 of the calendar year following the year you turned age 72 (70½ if born before July 1, 1949), though the second RMD must be taken by December 31 of that same year.] The percentage of retirement savings subject to the RMD increases every year. Roth IRAs are exempt from RMDs, but Roth 401(k) plan savings are not. [A Roth 401(k) can be rolled to a Roth IRA.] Those who are still working, contributing to an employer-sponsored retirement plan and own less than 5% of the company they work for can delay the first RMD from a defined-contribution plan until April of the year they retire.

The CARES Act suspended RMDs for 2020; RMDs will return in 2021.

A discussion of all the tax aspects of investing for and in retirement is beyond the scope of this guide. Those seeking greater detail should read IRS Publications 590-A and -B on Individual Retirement Arrangements.

if the child's total investment income exceeds $2,200. The exemption is indexed to inflation but will remain at $2,200 in 2021.

In addition, the kiddie tax can apply to older children, depending on how much earned income they have and whether or not they are full-time students.

- Starting in the year that your child turns 18, the kiddie tax will apply if your child's earned income (including salaries and wages, commissions, professional fees and tips) does not exceed half of the child's overall support.
- Starting in the year your child turns 19, the kiddie tax will apply if your child is a full-time student.
- The kiddie tax will stop applying in the year your child turns 24.
- The kiddie tax will also not apply if your child is married filing jointly.

Charitable Donations

Donations of clothing and other personal items must be in "good condition" or better in order to be deducted. Form 8283 must be filled out if your total deduction for all noncash contributions exceeds $500.

In addition, charitable contributions of cash (regardless of the amount) to any qualified charity must be supported by a dated bank record (such as a canceled check) or a dated receipt from the charity that includes the name of the charity and date and amount of contribution.

Those age 70½ or older can distribute up to $100,000 from their traditional IRA to qualified charities in 2020 and 2021. The cap on donations is not indexed to inflation. Qualified charitable distributions (QCDs) reduce required minimum distributions. If no RMD was taken in 2020, a QCD can still be taken. It will not impact 2020 taxes but will reduce the account's balance and thereby the basis for determining future RMDs. See "The Tax Advantages of Qualified Charitable Distributions From IRAs" in the October 2016 *AAII Journal* for more information.

Medicare

Taxpayers who itemize deductions can deduct (as a medical expense) the premiums they pay for Medicare Part

(continued on page 17)

2020 Tax Rates

Income Tax

For Single Taxpayers

Taxable Income Over	But Not Over	The Tax Is	Of the Amount Over
$0	$9,875	$0 + 10%	$0
$9,875	$40,125	$987.50 + 12%	$9,875
$40,125	$85,525	$4,617.50 + 22%	$40,125
$85,525	$163,300	$14,605.50 + 24%	$85,525
$163,300	$207,350	$33,271.50 + 32%	$163,300
$207,350	$518,400	$47,367.50 + 35%	$207,350
$518,400	—	$156,235 + 37%	$518,400

For Married Taxpayers Filing Joint Returns and Surviving Spouses

Taxable Income Over	But Not Over	The Tax Is	Of the Amount Over
$0	$19,750	$0 + 10%	$0
$19,750	$80,250	$1,975 + 12%	$19,750
$80,250	$171,050	$9,235 + 22%	$80,250
$171,050	$326,600	$29,211 + 24%	$171,050
$326,600	$414,700	$66,543 + 32%	$326,600
$414,700	$622,050	$94,735 + 35%	$414,700
$622,050	—	$167,307.50 + 37%	$622,050

For Married Taxpayers Filing Separate Returns

Taxable Income Over	But Not Over	The Tax Is	Of the Amount Over
$0	$9,875	$0 + 10%	$0
$9,875	$40,125	$987.50 + 12%	$9,875
$40,125	$85,525	$4,617.50 + 22%	$40,125
$85,525	$163,300	$14,605.50 + 24%	$85,525
$163,300	$207,350	$33,271.50 + 32%	$163,300
$207,350	$311,025	$47,367.50 + 35%	$207,350
$311,025	—	$83,653.75 + 37%	$311,025

For Individuals Filing as Head of Household

Taxable Income Over	But Not Over	The Tax Is	Of the Amount Over
$0	$14,100	$0 + 10%	$0
$14,100	$53,700	$1,410 + 12%	$14,100
$53,700	$85,500	$6,162 + 22%	$53,700
$85,500	$163,300	$13,158 + 24%	$85,500
$163,300	$207,350	$31,830 + 32%	$163,300
$207,350	$518,400	$45,926 + 35%	$207,350
$518,400	—	$154,793.50 + 37%	$518,400

Capital Gains and Qualified Dividends

	Maximum Taxable Income		
Single	**Below $40,000**	**$40,000–$441,450***	**Over $441,450***
Married Filing Joint	**Below $80,000**	**$80,000–$496,600***	**Over $496,600***
Married Filing Sep	**Below $40,000**	**$40,000–$248,300***	**Over $248,300***
Head of Household	**Below $53,600**	**$53,600–$469,050***	**Over $469,050***
Short-Term Capital Gains	taxed as income	taxed as income	taxed as income
Long-Term Capital Gains**	0%	15%	20%
Qualified Dividends	0%	15%	20%
Collectibles***	28% maximum	28% maximum	28%
Real Estate Unrealized Gain (Section 1250 Property)	15% maximum	25% maximum	25% maximum

**May also be subject to the 3.8% net investment income (NII) surtax.*
***For investments held longer than one year.*
****Includes art, rugs, jewelry, precious metals or gemstones, stamps or coins, fine wines and antiques.*

Estates and Trusts Tax Rates

First $2,600	10%
$2,600–$9,450	24%
$9,450–$12,950	35%
Over $12,950	37%

2020 Allowable Tax Benefits

Standard Deduction

Under Age 65	
Married, Filing Joint	$24,800
Single	$12,400
Married, Filing Separate	$12,400
Head of Household	$18,650
Additional—Age 65 or Older	
Married (or Qualifying Widow)	$1,300
Single	$1,650
Additional—Blind	
Married (or Qualifying Widow)	$1,300
Single	$1,650

Personal Exemption

$0

Maximum Child Tax Credit

$2,000 per child under age 17 at the end of the year

Standard Mileage Deductions

Business Standard Mileage Rate	57.5 cents
Medical Standard Mileage Rate	17 cents
Moving Standard Mileage Rate	17 cents
Charitable Serv Standard Mile Rate	14 cents

Deductible IRA Contribution

If taxpayer and spouse NOT covered by employer-sponsored plan:

If younger than 50	$6,000
If 50 or older	$7,000

Maximum 401(k) Employee Contribution

If younger than 50	$19,500
If 50 or older	$26,000

Self-Employed Medical Insurance Premium Deduction

100%

Annual Gift Tax Exclusion (per person)

$15,000

Estate Tax Exclusion

$11.58 million

2020 Other Tax Items

2020 Social Security Tax Rates

	Employers & Employees	Self-Employed	Wage Limits
Social Security	6.20%	12.40%	$137,700
Medicare	1.45%	2.90%	no limit
Total	7.65%	15.30%	

2020 Itemizable Deductions

Among other items they include:

- Interest and taxes on your home
- Uninsured medical expenses above 7.5% of AGI
- Uninsured casualities attributable to a federally declared disaster above 10% of AGI
- Contributions to qualified charities
- State and local income, property and sales taxes totaling up to $10,000

2020 Safe Harbor for Underpayment Penalty

Avoid underpayment penalties by paying (through witholding or estimated tax payments):

AGI $150,000 or less ($75,000 married filing separate)

- 100% of prior tax liability or
- 90% of current year tax liability

AGI $150,000 or greater ($75,000 married filing separate)

- 110% of prior year tax or
- 90% of current year tax liability

2020 AMT Exemption Amount

Single	$72,900
Married, Filing Joint	$113,400
Married, Filing Separate	$56,700
Head of Household	$72,900

2020 Tax Benefit Phaseout Levels

Personal Exemption—Eliminated Through 2025

	AGI Phaseout Level
Married, Filing Joint	na
Single	na
Married, Filing Separate	na
Head of Household	na

Itemized Deduction ("Pease" Limitation)—Eliminated Through 2025

	AGI Phaseout Level
Married, Filing Joint	na
Single	na
Married, Filing Separate	na
Head of Household	na

Coverdell Education Account

$2,000 maximum nondeductible contribution per beneficiary; withdrawals are tax-free for qualified education expenses; phaseouts are not indexed to inflation

	Modified AGI* Phaseout Levels
Married, Filing Joint	$190,000 to $220,000
Single	$95,000 to $110,000
Married, Filing Separate	$95,000 to $110,000
Head of Household	$95,000 to $110,000

IRA Deductibility

For those covered by employer retirement plan [$6,000 maximum contribution per taxpayer; if 50 or older, maximum is $7,000]

	Modified AGI* Phaseout Levels
Married, Filing Joint	$104,000 to $124,000
Single	$65,000 to $75,000
Married, Filing Separate	$0 to $10,000
Head of Household	$65,000 to $75,000
Married, Filing Joint not covered by pension plan, but spouse is	$196,000 to $206,000

Roth IRA Eligibility

Maximum $6,000 nondeductible contribution; if 50 or older, maximum is $7,000

	Modified AGI* Phaseout Levels
Married, Filing Joint	$196,000 to $206,000
Single	$124,000 to $139,000
Married, Filing Separate	$0
Head of Household	$124,000 to $139,000

**Modified AGI starts with your AGI (adjusted gross income) and adds back certain tax-exempt amounts including any IRA deductions.*

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B supplemental insurance and Medicare Part D prescription drug insurance. Premiums for voluntary coverage under Medicare Part A are only deductible by those over the age of 65 and not covered by Social Security.

Medicare Part B premiums are based on MAGI as reported on returns from two years ago. As such, the Medicare Part B premium will be $148.50 in 2021 for taxpayers who file married joint returns with 2019 MAGI of $176,000 or less and single filers with 2019 MAGI of $88,000 or less.

The floor for deducting medical expenses was reduced to 7.5% adjusted gross income for 2019 and 2020. It will revert back to 10% in 2021 without new legislation being passed.

Itemized Deduction Phaseouts

The phaseout of itemized deductions (the "Pease" limitation) was suspended for the years 2018 through 2025 by the TCJA.

State, Local and Sales Taxes

Taxpayers who itemize deductions have the option of choosing between a deduction of sales taxes or income taxes when claiming a state and local tax deduction. Taxpayers cannot deduct both. A $10,000 limit ($5,000 for married filing separate returns) on state and local tax deductions is in effect through 2025. This cap is not indexed to inflation.

Tax-Exempt Interest Reporting

State and local governments are required to report interest paid on tax-exempt state and local bonds on Form 1099-INT, Interest Income. This amount must be shown on your tax return. While this income is generally exempt from federal income tax under the current tax law, it is used for determining how much of Social Security income is taxable. Income from private activity bond interest is included in alternative minimum tax calculations.

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Tax Forecasting Worksheet

This worksheet is designed for estimation purposes only and does not cover all the possible adjustments that may be required to arrive at actual taxable income or to compute final income tax liability.

Go to the online version of this article to download the Excel worksheet and use the calculating functionality.

Income		2020	2021
1.	Salaries per Form W-2	1. _____	_____
2.	Non-qualified dividends and interest income	2. _____	_____
3.	Net business income (losses)	3. _____	_____
4.	Net capital gains and qualified dividend income[a]	4. _____	_____
5.	Other gains (losses)	5. _____	_____
6.	Passive income (losses) (subject to limitations)	6. _____	_____
7.	Other income, including 85% of Social Security benefits, if applicable	7. _____	_____
8.	Charitable contributions if you take the standard deduction ($300 max; 2020 only)	8. _____	_____
9.	**Total income** (sum of lines 1 – 8)	9. _____	_____
Adjustments			
10.	Keogh contributions	10. _____	_____
11.	Deductible IRA contributions	11. _____	_____
12.	Moving expenses (active duty military only, subject to limitations)	12. _____	_____
13.	Other _____	13. _____	_____
14.	**Adjusted gross income (AGI)** (subtract lines 10 – 13 from line 9)	14. _____	_____
Deductions			
15.	Medical and dental expenses [excess over 7.5% (2020) or 10% (2021) of line 14; regardless of age] or self-employed health insurance	15. _____	_____
16.	Lower of sum of lines 16a and 16b_____ or $10,000	16. _____	_____
	16a. State and local income taxes (or sales taxes) _____		
	16b. Real estate and property taxes (non-business property) _____		
17.	Home mortgage interest (for acquisition debt only, capped at $750,000)	17. _____	_____
18.	Investment interest (limited to investment income)	18. _____	_____
19.	Charitable contributions	19. _____	_____
20.	Casualty losses (federally declared disasters only)	20. _____	_____
21.	**Total deductions (sum of lines 15 – 20)**	**21.** _____	_____
	OR 21a. Standard deduction, b if greater (lines 15 – 20 must all show $0.00)	21.a _____	_____
22.	**Regular taxable income** (subtract line 21 from line 14)	22. _____	_____
23.	**Regular tax** (see tax rate tables)[a]	23. _____	_____
24.	**Tax credits**	**24.** _____	_____
25.	Regular tax (net) (subtract line 24 from line 23)	25. _____	_____
26.	Alternative minimum tax[c]	26. _____	_____
27.	Other taxes (self-employment tax, household help, and so forth)	27. _____	_____
28.	**Total tax** (sum of lines 25, 26 and 27)	28. _____	_____
29.	**Total withholding and estimated tax payments**	29. _____	_____
30.	Recovery rebate credit (2020 only)	30. _____	_____
31.	**Balance due** (refund) (subtract lines 29 and 30 from line 28)	31. _____	_____

a. If your taxable income includes net capital gain and qualified dividend income, you may be eligible for a tax rate on that income that is lower than the tax rate that applies to your other income. Refer to IRS Form 1040, Schedule D.

b. The standard deduction is not allowed when calculating the alternative minimum tax (AMT).

c. Use IRS Form 6251 as a worksheet and review the discussion on AMT in the online version of this article.

2021 Tax Rates

Income Tax

For Single Taxpayers

Taxable Income Over	But Not Over	The Tax Is	Of the Amount Over
$0	$9,950	$0 + 10%	$0
$9,950	$40,525	$995 + 12%	$9,950
$40,525	$86,375	$4,664 + 22%	$40,525
$86,375	$164,925	$14,751 + 24%	$86,375
$164,925	$209,425	$33,603 + 32%	$164,925
$209,425	$523,600	$47,843 + 35%	$209,425
$523,600	—	$157,804.25 + 37%	$523,600

For Married Taxpayers Filing Joint Returns and Surviving Spouses

Taxable Income Over	But Not Over	The Tax Is	Of the Amount Over
$0	$19,900	$0 + 10%	$0
$19,900	$81,050	$1,990 + 12%	$19,900
$81,050	$172,750	$9,328 + 22%	$81,050
$172,750	$329,850	$29,502 + 24%	$172,750
$329,850	$418,850	$67,206 + 32%	$329,850
$418,850	$628,300	$95,686 + 35%	$418,850
$628,300	—	$168,993.50 + 37%	$628,300

For Married Taxpayers Filing Separate Returns

Taxable Income Over	But Not Over	The Tax Is	Of the Amount Over
$0	$9,950	$0 + 10%	$0
$9,950	$40,525	$995 + 12%	$9,950
$40,525	$86,375	$4,664 + 22%	$40,525
$86,375	$164,925	$14,751 + 24%	$86,375
$164,925	$209,425	$33,603 + 32%	$164,925
$209,425	$314,150	$47,843 + 35%	$209,425
$314,150	—	$84,496.75 + 37%	$314,150

For Individuals Filing as Head of Household

Taxable Income Over	But Not Over	The Tax Is	Of the Amount Over
$0	$14,200	$0 + 10%	$0
$14,200	$54,200	$1,420 + 12%	$14,200
$54,200	$86,350	$6,220 + 22%	$54,200
$86,350	$164,900	$13,293 + 24%	$86,350
$164,900	$209,400	$32,145 + 32%	$164,900
$209,400	$523,600	$46,385 + 35%	$209,400
$523,600	—	$156,355 + 37%	$523,600

Capital Gains and Qualified Dividends

	Maximum Taxable Income		
Single	**Below $40,400**	**$40,400–$445,850***	**Over $445,850***
Married Filing Joint	**Below $80,800**	**$80,800–$501,600***	**Over $501,600***
Married Filing Sep	**Below $40,400**	**$40,400–$250,800***	**Over $250,800***
Head of Household	**Below $54,100**	**$54,100–$473,750***	**Over $473,750***
Short-Term Capital Gains	taxed as income	taxed as income	taxed as income
Long-Term Capital Gains**	0%	15%	20%
Qualified Dividends	0%	15%	20%
Collectibles***	28% maximum	28% maximum	28%
Real Estate Unrealized Gain (Section 1250 Property)	15% maximum	25% maximum	25% maximum

**May also be subject to the 3.8% net investment income (NII) surtax.*
***For investments held longer than one year.*
****Includes art, rugs, jewelry, precious metals or gemstones, stamps or coins, fine wines and antiques.*

Estates and Trusts Tax Rates

First $2,650	10%
$2,650–$9,550	24%
$9,550–$13,050	35%
Over $13,050	37%

2021 Allowable Tax Benefits

Standard Deduction

Under Age 65	
Married, Filing Joint	$25,100
Single	$12,550
Married, Filing Separate	$12,550
Heads of Household	$18,800
Additional—Age 65 or Older	
Married (or Qualifying Widow	$1,350
Single	$1,700
Additional—Blind	
Married (or Qualifying Widow	$1,350
Single	$1,700

Personal Exemption

$0

Maximum Child Tax Credit

$2,000 per child under age 17 at the end of the year

Standard Mileage Deductions

Business Standard Mileage Rate	57.5 cents*
Medical Standard Mileage Rate	17 cents*
Moving Standard Mileage Rate	17 cents*
Charitable Serv Standard Mile Rate	14 cents*

**The IRS had yet to update these deductions at press time. The online version of this guide will be updated when the information is made avaiable.*

Deductible IRA Contribution

If taxpayer and spouse NOT covered by employer-sponsored plan:

If younger than 50	$6,000
If 50 or older	$7,000

Maximum 401(k) Employee Contribution

If younger than 50	$19,500
If 50 or older	$26,000

Self-Employed Medical Insurance Premium Deduction

100%

Annual Gift Tax Exclusion (per person)

$15,000

Estate Tax Exclusion

$11.70 million

2021 Other Tax Items

2021 Social Security Tax Rates

	Employers & Employees	Self-Employed	Wage Limits
Social Security	6.20%	12.40%	$142,800
Medicare	1.45%	2.90%	no limit
Total	7.65%	15.30%	

2021 Itemizable Deductions

Among other items they include:

- Interest and taxes on your home
- Uninsured medical expenses above 10% of AGI
- Uninsured casualities attributable to a federally declared disaster above 10% of AGI
- Contributions to qualified charities
- State and local income, property and sales taxes totaling up to $10,000

2021 Safe Harbor for Underpayment Penalty

Avoid underpayment penalties by paying (through witholding or estimated tax payments):

AGI $150,000 or less ($75,000 married filing separate)

- 100% of prior tax liability or
- 90% of current year tax liability

AGI $150,000 or greater ($75,000 married filing separate)

- 110% of prior year tax or
- 90% of current year tax liability

2021 AMT Exemption Amount

Single	$73,600
Married, Filing Joint	$114,600
Married, Filing Separate	$57,300
Head of Household	$73,600

2021 Tax Benefit Phaseout Levels

Personal Exemption—Eliminated Through 2025

	AGI Phaseout Level
Married, Filing Joint	na
Single	na
Married, Filing Separate	na
Head of Household	na

Itemized Deduction ("Pease" Limitation)—Eliminated Through 2025

	AGI Phaseout Level
Married, Filing Joint	na
Single	na
Married, Filing Separate	na
Head of Household	na

Coverdell Education Account

$2,000 maximum nondeductible contribution per beneficiary; withdrawals are tax-free for qualified education expenses; phaseouts are not indexed to inflation

	Modified AGI* Phaseout Levels
Married, Filing Joint	$190,000 to $220,000
Single	$95,000 to $110,000
Married, Filing Separate	$95,000 to $110,000
Head of Household	$95,000 to $110,000

IRA Deductibility

For those covered by employer retirement plan [$6,000 maximum contribution per taxpayer; if 50 or older, maximum is $7,000]

	Modified AGI* Phaseout Levels
Married, Filing Joint	$105,000 to $125,000
Single	$66,000 to $76,000
Married, Filing Separate	$0 to $10,000
Head of Household	$66,000 to $76,000
Married, Filing Joint not covered by Pension plan, but spouse is	$198,000 to $208,000

Roth IRA Eligibility

Maximum $6,000 nondeductible contribution; if 50 or older, maximum is $7,000

	Modified AGI* Phaseout Levels
Married, Filing Joint	$198,000 to $208,000
Single	$125,000 to $140,000
Married, Filing Separate	$0
Head of Household	$125,000 to $140,000

**Modified AGI starts with your AGI (adjusted gross income) and adds back certain tax-exempt amounts including any IRA deductions.*

(continued from page 17)

Health Savings Accounts

The 2020 minimum annual deductible for self-only coverage is $1,400; it is $2,800 for family coverage. These amounts are indexed to inflation but will remain at $1,400 and $2,800, respectively, in 2021. The 2020 maximum limits for annual deductible and other out-of-pocket expenses are $6,900 for self and $13,800 for family. They will rise to $7,000 and $14,000, respectively, in 2021.

HSA contributions cannot exceed $3,550 for individual coverage and $7,100 for family HDHP coverage in 2020. In 2021, the maximum contributions will be $3,600 and $7,200 for individual and family coverage, respectively.

More information on this can be found at AAII.com in the online version of this article.

Education Savings

The maximum Hope Scholarship Credit (the American Opportunity education credit) of $2,500 per year for the first four years of post-secondary education for tuition and related expenses (including books) was made permanent by the Consolidated Appropriations Act of 2016. As such, this credit can be claimed in both 2020 and 2021.

The Lifetime Learning Credit can be claimed for education expenses beyond the fourth year of post-secondary education and for non-degree courses intended to improve job skills. The maximum credit is $2,000 annually and is subject to income phaseouts.

You can make nondeductible contributions to qualified tuition plans, also known as section 529 plans. (However, the contributions may be deductible from your state income tax, depending on where you live.) These accounts, offered by states or their designees, are maintained solely for the qualified higher education expenses of a beneficiary. Distributions are tax-free, provided that the distributions are used to pay qualified expenses.

The ATRA made the $2,000 per beneficiary contribution

2021 Tax Planning Calendar

Tax and financial planning are activities best pursued year-round. Although the timing of some activities is critical, you should review all tax considerations from the perspective of your specific needs and establish an individualized planning calendar.

If the last day for filing a return, paying tax or performing other activities falls on a Saturday, Sunday or legal holiday (in the District of Columbia), you generally have until the next day that is not a Saturday, Sunday or legal holiday to perform that act. Use the following list to remind yourself of important activities and dates.

First Quarter

General

» Complete Form W-4, Employee's Withholding Allowance Certificate, and adjust withholding, if needed.
» Evaluate before-tax and voluntary aftertax contributions to retirement plans.
» Apply for a Social Security number for any child who does not have one.

January 15

» Pay fourth-quarter 2020 estimated tax voucher if you did not pay your income tax for the year through withholding, or if you did not pay enough through withholding. You do not have to make this payment if you file your 2020 return and pay any tax due by January 31, 2021.
» Make quarterly defined-benefit Keogh contribution for preceding year.

January 31

» File your income tax return (Form 1040) for 2020 if you did not pay your last installment of estimated tax by January 15. Filing your return and paying any tax due by January 31 prevents any penalty for late payment of last installment.
» Make sure you have received a Form W-2 from each employer you worked for in 2020.

Second Quarter

April 1

» Comply with required minimum distribution (RMD) rules for qualified retirement plans if you attained age 70½ in the previous year. (This deadline does not change when April 1 falls on a weekend or on a holiday.)

April 15

» Make prior-year IRA and Coverdell Education Savings Account contributions.
» Make prior-year Keogh or SEP plan contribution (unless you applied for an extension of time to file your return).
» Make quarterly defined-benefit Keogh contribution for the current year.
» File individual and gift tax returns (or apply for an extension); applies to residents of Massachusetts and Maine as well. If you want an automatic six-month extension of time to file the return, file Form 4868; or, you can get an extension (until October 15) by phone or over the internet if you pay part or all of your estimate of income tax due with a credit card.
» File Schedule H (Form 1040) with your tax return if you paid cash wages of $2,200 or more in 2020 to a household employee.
» Report federal unemployment (FUTA) tax on Schedule H if you paid total cash wages of $1,000 or more in any calendar quarter of 2019 or 2020 to household employees.
» Pay first-quarter estimated tax if you are not paying your income tax through withholding or you will not pay enough that way.

June 17

» Pay second-quarter estimated tax voucher if you are not paying your income tax for the year through withholding, or if you are not withholding enough.

Third Quarter

July 15

» Make quarterly defined-benefit Keogh contribution for the current year.

September 15

» Pay third-quarter estimated tax voucher if you are not paying your income tax for the year through withholding, or if you are not withholding enough.

Fourth Quarter

General

» Begin your year-end tax planning:
» Project your current-year and next-year tax liabilities.
» Evaluate the applicability of the AMT (if not repealed by tax reform) and other taxes.
» Adjust withholding, if necessary.
» Evaluate year-end capital transactions.
» Establish a separate Keogh plan for self-employment income.
» Comply with minimum distribution rules for qualified plans.

October 15

» If you extended your individual tax return, file your 2020 income tax return and pay any tax, interest and penalties due.
» Make quarterly defined-benefit Keogh contribution for the current year.

December 31

» Comply with RMD rules for qualified retirement plans. Can delay until April 1, 2022, if you attained age 72 during 2021.

Throughout the Year

» Reevaluate your long-term strategies.
» Evaluate your tax and financial strategy for receiving discretionary and mandatory retirement plan distributions.
» Rebalance investment portfolio and reevaluate your uses of debt.
» Consider making gifts up to the annual gift tax exclusion.
» Evaluate passive loss exposure and potential investment shifts.
» If you have excess cash flow, consider how to invest those funds.
» Optimize mix of interest expense items.
» Consider making charitable contributions of property.
» Consider ways to fund your children's education.
» Evaluate your mix of portfolio and passive income.

2021 Federal Legal Holidays (in the District of Columbia)

January 1	New Year's Day
January 18	Birthday of Martin Luther King Jr.
February 15	Washington's Birthday
April 16	D.C. Emancipation Day
May 31	Memorial Day
July 5	Independence Day
September 6	Labor Day
October 11	Columbus Day
November 11	Veterans Day
November 25	Thanksgiving Day
December 24	Christmas Day

limit to a Coverdell Education Savings Account permanent. The contributions are not deductible, but they grow tax-free in the IRA.

Coverdell accounts may be used to fund qualified elementary, secondary and higher education expenses. However, the amount that can be contributed is limited for higher-income taxpayers and the phaseouts are not adjusted for inflation.

Investment Strategies: 2021 and Beyond

Though the ATRA and the Consolidated Appropriations Act of 2016 provided clarity in terms of current legislation, the TCJA had a much bigger and broader impact on the tax code. Not only did the tax brackets for individuals change, but so did many deductions and exemptions.

The following are traditional tax planning strategies that can help keep your tax bill down. It is important, however, to keep in mind that your goals and risk tolerance, not just the income tax impact of an investment, should drive your investment decisions.

Consider Roth IRA Conversion Opportunities

You have the option of converting all or part of your traditional IRA into a Roth IRA, regardless of your adjusted gross income under existing law. Roth IRAs can provide certain advantages: The converted assets can be withdrawn tax-free at any time and future earnings are also tax-free (with some limitations). Withdrawals do not impact how much of Social Security benefits are taxed nor do they count as income for determining Medicare premiums. Additionally, Roth IRA owners are not required to take any minimum distributions in retirement. The downsides, however, are that the conversion amount is taxable in the year it occurs, it can increase the amount of Social Security benefits taxed in the year of conversion and can increase Medicare premiums two years out.

While the benefits of a Roth IRA conversion could be considerable, taxpayers must carefully weigh the upfront tax costs against the long-term tax advantages. For more on this, see "Retirement Planning Strategies Following the 2017 Tax Act" and "Social Security and Medicare Can Raise Retirees' Tax Rates" by William Reichenstein and William Meyer in the March 2018 and April 2018 *AAII Journal*, respectively, as well as "Roth Versus Traditional IRA" in the December 2019 *AAII Journal*. (All three are available at AAII.com). You may also want to consult a tax professional.

Conversions can no longer be undone (a "recharacterization"); this was ended by the TCJA.

You cannot convert required minimum distributions from your traditional IRA for a particular year (including the calendar year in which you reach age 72) to a Roth IRA. IRS Publication 590-A explains the rules for Roth IRA conversions and Publication 590-B covers the rules for RMDs.

Take Advantage of Lower Marginal Rates

Deferring income that is taxed at higher ordinary tax rates makes sense. Most taxpayers will pay long-term capital gains tax rates of 0% or 15%. For married couples filing jointly with income above $496,600 and single filers with income above $441,450 in 2020, the long-term capital

gains rate is 20%. In 2021, the 20% long-term capital gains tax rate will apply to married couples filing jointly and single filers with incomes above $501,600 and $445,850, respectively. Short-term capital gains, in contrast, are taxed at ordinary income tax rates of up to 37% in 2020 and 2021. The 3.8% NII surtax applies to taxpayers with income above the $250,000/$200,000 thresholds. This tax applies to both short- and long-term capital gains, as well as taxable interest, dividends, nonqualified annuities, rents and royalties and passive income from partnerships. The NII surtax is not indexed to inflation, and the $250,000/$200,000 thresholds are effective for both 2020 and 2021.

Similar rules apply to qualified dividends. For married couples filing jointly with income above $496,600 and single filers with income above $441,450 in 2020, dividends are taxed at 20%. In 2021, the 20% qualified dividend tax rate will apply to married couples filing jointly and single filers with incomes above $501,600 and $445,850, respectively.

Though tax considerations should never be the primary reason for selling a security, if you have large positions in either gifted or inherited stocks, or stocks received from a sale of a business, you should consider whether it makes sense to sell shares over a period of time to take advantage of the long-term capital gains rates and use the proceeds from selling the stock to diversify your portfolio.

Use Losses Carefully

While tax considerations should not drive your investment decision, you can take advantage of losses in holdings that you would prefer to either sell or reduce from an investment standpoint.

Capital losses first reduce capital gains: long-term losses reduce long-term gains first, and short-term losses reduce short-term gains first. Any long-term losses left over reduce short-term gains, and vice versa. If you still have losses remaining after offsetting capital gains, you can reduce your "ordinary" income by up to $3,000. Losses not used this year can be carried forward to future years until they are used up. See "Capital Pains: Rules for Capital Losses" by Julian Block in the September 2010 *AAII Journal* (available at AAII.com).

When planning, make sure you don't run afoul of the wash-sale rules. If you sell an investment at a loss and then acquire a substantially identical security during the 30-day period prior to or the 30-day period following the sale, the loss will be disallowed. If your loss is disallowed by the wash-sale rule, you can increase the cost basis of the new position of the substantially identical security by the amount of the disallowed loss. The holding period for the new position is also adjusted to include the holding period of the position sold at the disallowed loss. You cannot adjust the cost basis or holding period if you acquire the investment in an IRA or Roth IRA, however. For more information, see "Keeping Transactions Clean From the Wash-Sale Rules" by R. Kevin Trout in the December 2014 *AAII Journal* (available online at AAII.com).

Be Aware of Holding Periods for Qualified Dividends

In order to qualify for the reduced 15% (20% for higher earners) tax rate on qualified dividends for common and preferred stocks, a holding period must be satisfied. Specifically, common stocks must be owned for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. (The holding period is more than 90 days out of a 181-day period for preferred stocks with dividends attributable to periods aggregating more than 366 days.) The ex-dividend date is generally one trading day prior to the record date.

Not all dividends are qualified. Qualified dividends are paid by common and preferred stocks. Real estate investment trust (REIT) distributions and master limited partnership (MLP) distributions do not qualify for the discounted taxed rate. Contact the investor relations department of the specific company if you have questions about the tax treatment.

Consider the Impact of Taxes on Mutual Fund Investments

Selecting tax-aware managers of mutual funds may be important to maximizing your aftertax rate of return in your taxable investment portfolio.

You may choose when to sell specific shares of the fund and may, therefore, create long-term versus short-term capital gains, as long as you notify the fund family or your broker in writing with specific instructions. But you don't control the investments within the fund.

Should an equity manager fail to extend the holding period on a stock, it could cost you as much as 17.0% of your gain (37.0% ordinary rate for short-term capital gains versus the 20% long-term capital gains rate) between now and 2025.

Some mutual fund distributions can be treated as qualified dividends and therefore eligible for the reduced tax rate, while others will not qualify. Dividends paid by stocks held by the fund and passed through to the shareholder are eligible for the qualified dividend tax treatment. However, capital distributions and interest from bonds are not. These payments are reported on Form 1099, which specifies the type of distribution.

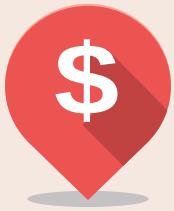
You can read more on mutual fund distributions in the online version of this article.

Where's My Money? Tracking Your Refund 24/7

If you are expecting a refund on your 2020 income tax, you can check on its status if it has been at least four weeks since the date you filed your return by mail, or 24 hours if you filed electronically. You will need to supply the following information: your Social Security number or IRS Individual Taxpayer Identification number, your filing status and the exact whole-dollar refund amount as it is shown on your return.

You can check the status of your refund in two ways:

- On the internet, go to www.irs.gov and click "Get Your Refund Status." On a mobile device, download the IRS2Go app.
- By telephone (for automated information), call 800-829-4477.



If you are unable to get information on your refund through either of these two automated services, you can call the IRS for assistance at 800-829-1040.

The IRS website also allows you to start a trace for lost or missing refund checks, or to notify the IRS of an address change when refund checks go undelivered. Taxpayers can avoid undelivered refund checks by having refunds deposited directly into a personal checking or savings account. This option is available for both paper and electronically filed returns.

Reconsider Taxable Versus Tax-Free Bonds

Interest from tax-free municipal bonds is generally exempt from federal income taxes, unlike the interest from taxable bonds, which is taxed as income. Like any bond, credit quality matters, as you want to ensure that the issuer will not default. Changing yields can also alter the aftertax yield advantage, making municipal bonds more or less attractive to taxable bonds.

Additionally, private-activity bonds (a type of tax-free bond) could increase your exposure to the alternative minimum tax since their interest income is taxable for purposes of the alternative minimum tax. There are exceptions, including qualified 501(c)(3) bonds, and New York Liberty bonds. Furthermore, the interest on qualified bonds issued in 2009 and 2010 is not subject to the alternative minimum tax. Check with the bond issuer to find out the bond's tax status.

You should review your bond and money market accounts to make sure that you are earning the highest aftertax return. But don't forget to consider the state tax implications of switching from tax-free to taxable bonds before making any final portfolio decisions.

Consider Increasing Retirement Savings

Increasing retirement savings makes sense from a financial planning standpoint and, depending on your adjusted income, may reduce your tax bill. You have until April 15, 2021, to make an IRA contribution for the 2020 tax year. See the box on page 14 for yearly contribution limits to various types of retirement plans.

Review Tax Implications of Taxable Versus Tax-Deferred Accounts

The spread between capital gains and ordinary income rates has important implications with respect to your asset allocation between taxable and tax-deferred (retirement) accounts.

For example, from a tax perspective, holding individual stocks in tax-deferred accounts and bonds in taxable accounts could be expensive because the long-term gains resulting from stocks held in tax-deferred plans such as IRAs or 401(k) plans will be taxed at ordinary rates when taken as a distribution. By reversing that structure, taxable bonds and other tax-inefficient assets will be shielded from taxation in the deferred accounts, while equities will enjoy the reduced rates for capital gains in personal accounts.

Tax-free municipal bonds should remain outside of retirement accounts. Individuals should also consider the cost of commissions and taxes, current cash flow needs and the 0.9% additional Medicare tax and 3.8% NII surtax before making any investment moves between taxable and tax-deferred accounts.

Protect Social Security Benefits

If you are receiving Social Security benefits, you may have to pay taxes on them if your combined income (primarily your adjusted gross income plus any tax-exempt interest income plus half of your Social Security benefits) exceeds certain levels.

To protect your benefits, watch the amount of interest you receive from municipal bonds, since this amount is included in your modified adjusted gross income when determining the Social Security benefit taxability. In addition, you may want to delay discretionary taxable distributions from a retirement plan or IRA.

Conclusion

It is important to remember that taxes should not be the primary driver of your investing decisions. Taxes do, however, play a role in wealth management. As the tax code continues to evolve, everyone should consider how the

changes directly affect their overall tax and investment strategies.

Tax Planning Strategies

All Taxpayers: Determine Where You Are at the End of the Year

At the end of each year, you should take the time to assess your tax situation. Doing so will give you the opportunity to shift certain items around, should that be beneficial in terms of your tax liability. Taking a few initial steps now and using year-end planning strategies can result in significant tax savings.

Here are the basic steps you should take to help start your personal tax planning:

» Estimate your income, deductions, credits and exemptions for 2020 and 2021 using the Tax Forecasting Worksheet (page 18 and a downloadable spreadsheet on AAII.com);
» Identify items that you can shift from 2020 into 2021 and beyond (or vice versa);
» Determine your marginal tax rate—the rate at which your next dollar of income will be taxed—for 2020 and 2021;
» Determine how much tax you owe and when you must pay it to avoid underpayment penalties;
» Determine whether you are subject to the alternative minimum tax (AMT);
» Consult with your tax professional, and then take the actions needed to make the best of your tax situation.

To minimize your taxes, consider both short-term and long-term tax planning issues and strategies. Starting early will give you extra time to obtain additional information about items that concern you and to investigate additional ideas for tax savings or deferral.

Avoiding Tax Underpayment Penalties

Make sure you determine your 2021 tax liability as early as possible, as well as the due dates for paying those taxes (including the self-employment tax and the AMT), so that

Protecting Yourself Against Tax Scams

The Internal Revenue Service continues to warn about con artists posing as IRS agents. Often initiating contact through a telephone call, the fraudsters claim back taxes and/or penalties are owed. Payment is usually immediately demanded either in the form of prepaid cards or a money wire. Hesitancy to cooperate leads to threats of lawsuits, a call to the police or the involvement of federal law enforcement. Despite what your caller ID may show and how convincing the fraudster sounds, these calls are scams.

Another scam involves identify theft. Criminals obtain Social Security numbers and then file false returns under the victims' identities in order to receive refunds. When the victim later tries to file a legitimate return, it can be rejected by the IRS.

Other current tax scams include pretending to be a charity—often for a natural disaster area or for the coronavirus pandemic—and asking for personal information, fake emails designed to appear as if they came from the IRS and schemes pitched as opportunities to realize a larger refund or get a larger stimulus check. The latter can involve being urged to falsify income, falsely claim fuel tax credits, use tax shelters that sound too good to be true and hiding income offshore. Some criminals will also pose as tax preparers for the sole purpose of engaging in identify theft.

There are steps you can take to protect yourself:

» File your tax return as quickly as is reasonably possible.
» Guard your identity. Be careful about who you give your Social Security number to, do not carry your Social Security number in your wallet and use anti-virus and firewall software on your computer. Varying your passwords is also a good idea; password management programs such as Dashlane and LastPass can help.
» Never click on a link in an email to visit a financial institution such as a bank or the IRS. Go directly to the website using a known URL.
» Regularly check your credit reports to ensure the information is accurate. Consumer Reports recommends using AnnualCreditReport.com.
» Realize that if a tax service or proposal sounds too promising to be true, it is probably is.
» Never trust a tax preparer who does not give you your tax return to review. It's best for you to personally file your own returns.
» Understand that the IRS WILL NEVER CALL TO DEMAND IMMEDIATE PAYMENT or call you about taxes being owed without previously having mailed a bill. The agency will also give you the opportunity to question or appeal any outstanding balance or penalty.

If you suspect you are a victim of identity theft or financial fraud, act immediately. Call your banks, brokerage firms, credit card companies, the major credit bureaus and, in the case of tax fraud, the IRS. If your Social Security number is compromised, fill out IRS Form 14039 and continue to file your taxes as you normally would.

you avoid underpayment penalties.

Federal tax law requires the payment of income taxes throughout the year as you earn your income. This obligation may be met through withholding, quarterly estimated tax payments or both. If you do not meet this obligation, you may be assessed an underpayment penalty.

If your total tax due minus the amount you had withheld is less than 10% of your total tax due, you will not be assessed an underpayment penalty. The disadvantage of overpaying throughout the year, though, is that you are in effect making an interest-free loan to the government. However, the underpayment penalty can be high, and it is calculated as interest on the underpaid balance until it is paid, or until the regular filing date for the final tax return, whichever is earlier.

You can avoid underpayment tax penalties by adopting one of the safe harbor rules. The basic rule is to pay the required amount by the end of the year through withholding and quarterly estimated payments. The required amount will be one of the following, depending on your individual situation:

- 90% of the current year's tax liability;
- 100% of the prior year's tax liability (increases to 110% for taxpayers who had 2019 adjusted gross income in excess of $150,000, or $75,000 for those married filing separately); or
- 90% of the tax liability based on a quarterly annualization of current year-to-date income (see IRS Form 505 and IRS Publication 505 for worksheets).

Penalties are based on any underpayment, which is the difference between the lowest amount required to be paid by each quarterly payment date and the amount actually paid by that date. The annual required amount, based on either of the first two alternatives, is paid in equal installments. In the case of the third method, which is based on annualized income, the amount due each quarter is based on actual income received for each installment period. The third method is typically more beneficial if you do not earn income evenly throughout the year (e.g., you operate a seasonal business) or had an unexpected increase in income because it allows for lower required payments in the early quarters.

Income tax payments made through withholding from your paycheck (or from your pension or other payments) are given special treatment. The IRS treats income tax that is withheld as having been paid equally throughout the year (unless you prefer to use actual payment dates). This lets you make up for underpaid amounts retroactively because amounts withheld late in the year may be used to increase the amounts paid in earlier quarters.

State and Local Rules: Many states have underpayment rules that vary from the federal requirements.

Timing: Income & Deductions for Taxpayers Not Subject to AMT

You have opportunities to reduce your taxes if you can control the timing of either your income or expenses. However, it is important to make sure you understand whether you may be subject to the AMT before adopting these strategies. Though the TCJA retained the alternative minimum tax, it will not apply for 2021 incomes below $1,047,200 for married couples filing joint returns and $523,600 for others. (See the online version of this article for more information.)

Income

Your income is generally taxed in the year of receipt, so having the ability to control when you receive it affords a strategic tax planning opportunity. Deferring income until a later year will, in most cases, delay the payment of tax. You cannot defer taxation by merely delaying receipt of the income if the funds are available to you and the time of payment is subject to your unrestricted discretion. Any decision to defer income must be weighed with the lost time value of the money and other risks that could alter or forfeit your right to the income.

The timing of bonuses, recognition of capital gains from the sale of stocks and the exercise of nonqualified stock options are all events that can easily be delayed to a subsequent year.

Consider the deferral of compensation through the use of various retirement plans and deferred-compensation arrangements. If you operate a business or collect rental income and report that income on the cash receipts and disbursements method, you have an opportunity to delay or accelerate the billing to your customers or tenants and determine the timing of the related income.

Deductions

You can reduce taxes by controlling the payment of deductible expenses. If paid by December 31, you may deduct certain expenses that are due the following year on your current year tax return. (Property taxes prepaid in the current year can be deducted if assessed in the current calendar year and if the $10,000 limit on state and local taxes has not been reached.) This strategy helps when you have a higher tax liability in the current year than you expect to have in the coming year. Again, you must balance this decision with the time value of money and other inherent risks.

For example, if you pay a deductible expense in December 2020 instead of April 2021, you reduce your 2020 tax instead of your 2021 tax, but you also lose the use of your money for three-and-one-half months. Generally, this will be to your advantage, unless you have an alternative use for the funds that will produce a very high return in

that three-and-one-half-month period. You must decide whether the cash used to pay the expense early should be used for something more urgent or more valuable than the accelerated tax benefit.

For those who will pay 2021 estimated taxes based on their 2020 tax liability, reducing your 2020 taxes has another advantage: Your 2021 estimated tax payments may be smaller.

State Taxes

If accelerating deductions makes sense for you and you choose to claim a deduction on your state and local income taxes, you may want to prepay the balance on your estimated state tax liability in December 2020, rather than waiting until 2021, if the taxes were assessed in 2020. This secures that deduction on your 2020 tax return, even though the payment might not be required by the state until January 15, 2021, or April 15, 2021. The deductibility of these taxes is subject to a $10,000 cap on state and local taxes in 2020. The cap is not indexed to inflation and will remain at $10,000 per year through 2025.

Charitable Contributions

If you are planning on making a gift to a charity in 2021, consider making the gift in 2020 to accelerate the tax benefit of the contribution if you have enough deductions to exceed the $24,800/$12,400 standard deduction. The CARES Act allows you to deduct cash contributions up to your contribution base (typically AGI) in 2020. In 2021, the cap will revert back to 60% of your contribution base.

If you take the standard deduction, you can still deduct up to $300 of qualifying donations.

You should also consider the benefits of gifting appreciated stock to a charity. If you donate long-term appreciated stock directly to the charity, you get a deduction for the full fair market value of the stock, whereas if you sell the stock first and donate cash, you only get a deduction for the aftertax cash donated. (If you have an unrealized loss in the stock, however, it might be more beneficial from a tax standpoint to sell the stock and then donate the cash proceeds. Doing so would give you deductions for both the capital loss and the charitable donation.)

When making a gift to a charity, you must have an appropriate record of the gift in order to properly support the deduction.

In addition, cash contributions of any amount must be supported by a written record, either in the form of a bank record (for example, a canceled check) or a written receipt from the charity. The record must include the name of the charity, the date and the amount of the contribution.

The higher standard deductions under the TCJA raised the threshold for deducting donations. As such, you may want to bunch donations in a particular year rather than making them over two or more separate years.

Prepaid Interest

A cash basis taxpayer may not deduct prepaid interest before the tax year to which the interest relates. However, there is some flexibility to prepay year-end interest that is due early in the following year.

For example, if a mortgage payment is due on January 10, a taxpayer can accelerate the deduction of the portion of the interest relating to the period up to January 1 by mailing the check in December.

The most significant interest deductions currently available are for home mortgage interest and for investment interest expense to the extent of current-year investment income. Interest paid in relation to investments that earn a tax-free return is not deductible.

Medical Expenses

If the timing of certain medical and dental expenditures is flexible and your overall medical expenses are high in the current year, you may want to accelerate the timing of these expenses.

Because unreimbursed medical expenses are only deductible to the extent that they exceed 7.5% of adjusted gross income in 2020 and 10% in 2021, it is best from a tax standpoint to incur expenses—such as replacement eyeglasses or contact lenses, elective surgery, dental work and routine physical examinations—in a year in which you have already gone over (or in which the added expenses would take you over) the threshold for that year.

Miscellaneous Itemized Deductions

Miscellaneous itemized deductions exceeding 2% of adjusted gross income can no longer be claimed as of January 1, 2018. The suspension of the ability to claim such deductions lasts through 2025.

This category is large but includes:

- Tax preparation fees such as tax preparation software, tax publications and any fee paid for electronic filing; and
- Investment fees, custodial fees, trust administration fees and other expenses paid for managing your investments that produce taxable income.

Uninsured Personal Casualties

Uninsured personal casualties can be deducted only if they are attributable to a federally declared disaster and exceed 10% of adjusted gross income. Losses to theft are no longer deductible. The rule is in effect from 2018 through 2025.

Timing Caution for Taxpayers Subject to AMT

The alternative minimum tax (AMT) was originally designed to ensure that everyone would pay their fair share of income taxes. The measure has since evolved into a separate tax regime that required a permanent fix in the ATRA to prevent it from ensnaring millions of Americans.

The wisdom of conventional tax planning advice to defer income and accelerate certain types of deductions may not hold true if an individual expects to be subject to the AMT. Accordingly, during the tax planning process, it is critical that you determine whether you are subject to the AMT in both the current year and the following year.

If you are continuously subject to the AMT, avoid investing in private-activity (municipal) bonds. Income from these bonds is taxable for AMT purposes. [There are exceptions, including qualified 501(c)(3) bonds and New York Liberty bonds. Also, the interest on qualified bonds issued in 2009 and 2010 is not subject to the AMT. Check with the bond issuer for the bond's tax status.] Furthermore, you should be aware that unusual combinations of income and deductions might require AMT planning that runs contrary to conventional tax-planning advice.

Although the exercise of an incentive stock option (ISO) does not give rise to regular taxable income for the employee, the difference between the exercise price and the market price of a stock must be recognized for AMT purposes for the year in which the option is exercised. Accordingly, the exercise of incentive stock options with a large bargain element often causes a tax liability under the AMT regime.

The AMT arena is extremely complex, so generalizations are difficult to make. If you think you may be subject to the AMT, you should consult a tax professional to determine how best to minimize your exposure to it.

As stated previously, the TCJA retains the alternative minimum tax, though with higher exemptions and income limits through 2025.

Year-End Estate and Gift Tax Planning

Year-end planning from an estate planning perspective typically involves ensuring that "annual exclusion" gifts are completed by the end of a calendar year.

Under the federal gift tax system, each donor is permitted to make nontaxable gifts of a certain amount each year to any donee. These gifts are called "annual exclusion" gifts and do not count against the donor's lifetime gifts exemption. The annual gift tax exclusion level is $15,000 for 2020 and 2021. To the extent that it is not used, the annual exclusion evaporates at the end of each calendar year.

Annual transfers that take advantage of this exclusion can both diminish the donor's estate tax liability and improve the lives of the recipients. These gifts can take many forms (such as cash, stocks, real estate, partnership interests) and can be given outright through Uniform Transfers to Minors accounts, and even through a trust—provided it contains special provisions designed to allow the gift to qualify for the annual exclusion.

Gifting may also make sense for those who intend to pass IRA assets along to their heirs. This would particularly be the case if tax levied on the benefactor's IRA withdrawal is less than the heir's expected future tax. Before doing so, consider the full impact of withdrawing more from your retirement accounts on your taxes and Medicare premiums. ■

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