THE TAX FILE

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Tax Updates

With October 15 marking the end of the 2019 tax return filing season, we have just a few months to prepare for 2020 tax returns. Here's a summary of some of the changes for this tax year.

Economic Impact Payments
Under the 2020 CARES Act, many taxpayers received on-time payments called recovery rebates. You may have received $1,200 ($2,400 for married couples filing jointly) plus $500 for each qualifying child if your income fell below the phase-out threshold.

These payments are not taxable income. They are advance refunds of a 2020 tax credit. Taxpayers will reduce the amount of the credit calculated on 2020 tax returns by the amount of the recovery rebate received this year.

This means that if you did not receive the full amount of the recovery rebate you were due, you will claim it on your 2020 tax return. If you received an amount greater than you are due, you get to keep it – no repayment is required.

Unemployment Insurance Income
With the pandemic, many taxpayers were forced to apply for unemployment benefits to keep afloat. To maximize cash flow, many recipients did not have federal or state income tax withheld from these benefits.

Unemployment benefits are taxable income. Recipients should receive some type of Form 1099 from their unemployment office. This form will show taxable benefits, plus any federal or state tax withheld. Be sure to provide this information to your tax preparer.

If you have unemployment income in 2020, you may want to consider making estimated tax payments or, if possible, increasing your tax withholding from current payroll or other income. This may help to reduce penalties for underpayment of taxes.

Retirement Plan Distributions
Under the CARES Act, taxpayers can take up to $100,000 in corona-virus-related distributions from retirement plans without paying the 10% additional tax for early distributions. These distributions can be re-contributed to your plan within three years to avoid taxation. But there is a requirement you should be aware of.

These distributions are taxable for federal tax purposes and are included in taxable income over a three-year period (1/3 each year), or you can elect to include the entire amount in the year you take the distributions. State rules vary.

If you choose to re-contribute any of or all of your distributions, you have three years to do so. If you paid taxes in prior years on any of the distributions you later repaid, you can file a claim for refunds of those taxes.

The CARES Act also waived required minimum distribution requirements for tax year 2020 for all taxpayers.

Charitable Contributions
In 2020, taxpayers who do not itemize their deductions are able to claim a charitable deduction of up to $300 on their tax returns.

The CARES Act also modified income limitations on charitable contributions for this year, up to 100% of adjusted gross income for individuals.

For more information, give us a call.

The Home Office Deduction

More taxpayers than ever before are WFH (Working from Home). For some, this change may be temporary; for others, this may be their new normal.

For those that will be WFH for an extended period (or indefinitely), it's a good idea to review the requirements for the home office deduction. For taxpayers who qualify, this provision allows a deduction for expenses incurred by working from home.

Employees who work from home do not qualify for this deduction under current law. The Tax Cuts and Jobs Act eliminated miscellaneous itemized deductions for individuals for tax years 2018 through 2025. That includes unreimbursed employee expenses, which includes home office deductions for employees.

S-corporation owners are generally not eligible for the home office deduction for the reasons described above for employees. However, S-corporation owners should consider establishing an accountable plan to have their company reimburse home office expenses.

Partnerships and LLCs filing tax returns as partnerships may be able to claim home office deductions. For these taxpayers, home office expenses are costs that the partner or member is expected to pay personally, without reimbursement from the partnership or LLC. This requirement must be included in the partnership or LLC agreement.

For a taxpayer to be eligible for the home office deduction, certain requirements must be met. First, the area in their home that is used for business must be one of the following:

- The principal place of business for the taxpayer,
- A place to meet clients, patients, or customers in the normal course of business,
- A separate structure not attached to the home that is used in connection with the business (i.e. your garage), or
- If your home office is the only fixed location for the business, a space that is used regularly to store inventory or samples.

A home office must be used regularly and exclusively to conduct business. However, a separate room is not necessary. A desk in the corner of a room may qualify if the desk is used exclusively for work. There are exceptions to the exclusive use requirement for the storage of inventory or samples.

The area must be used regularly for business. Occasional use does not qualify, even it that is the only use of the space.

A principal place of business is based on several factors. If this is the only area where you can perform administrative and management activities, it will likely qualify as your principal place of business.

If you have multiple work locations, you need to measure the relative importance of the activities conducted in each location, and how much time is spent at each, to determine your principal place of business.

If you use your home to meet with clients or customers, you have more flexibility in claiming this deduction. If this use is "substantial and integral" to your business operations, you will qualify.

These are the basic requirements to qualify for the home office deduction. Once you have determined that you qualify, you can look into which of two allowed calculation methods will provide you with the best tax benefits.

If you want help determining if you qualify, or to explore the home office deduction further, please contact us.

Tax Tidbits

IRS recently published an update on its own recovery from the shutdown of operations earlier this year due to the coronavirus. Services including live telephone assistance and processing of paper tax returns are still extremely limited.

A recent report said that half of the IRS workforce is still working remotely, and about 40% of taxpayer assistance centers are still closed.

IRS says they are experiencing delays in processing paper tax returns due to limited staffing. Taxpayers who have already filed a paper tax return should not file a second tax return or contact IRS. Returns are being processed in the order received.

Taxpayers who mailed payments to IRS are also asked to be patient, not to stop payment on their checks or submit a duplicate payment.

IRS has reportedly reduced its backlog of unopened mail from 11 million to 5 million pieces. They estimate that half of the remaining unopened mail involve tax returns, tax payments and extensions.

For More Info

The articles in this newsletter are intended to present general tax information. Accounting rules and tax laws are complex. Not all ideas presented may be appropriate for your specific circumstances.

For additional information, call Kagan & Associates, Ltd. at 847-392-3300 or e-mail us at Info@KaganLtd.com.