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Congress Reinstates Expired Tax Provisions

Congress let many tax provisions expire on December 31, 2017, making them dead for your already-filed 2018 tax returns.

In what has become a much too common practice, Congress resurrected the dead provisions retroactively to January 1, 2018. That's good news. The bad news is that if you have any of these deductions, we have to amend your tax returns to make this work for you.

And you can relax when filing your 2019 and 2020 tax returns because lawmakers extended the "extender" tax laws for both years. Thus, no worries until 2021—and even longer for a few extenders that received special treatment.

Back from the Dead

The big five tax breaks that most likely impact your Form 1040 are as follows:

1. Exclusion from income for cancellation of acquisition debt on your principal residence (up to $2 million)
2. Deduction for mortgage insurance premiums as residence interest
3. 7.5 percent floor to deduct medical expenses (instead of 10 percent)
4. Above-the-line tuition and fees deduction
5. Non-business energy property credit for energy-efficient improvements to your residence

Congress extended these five tax breaks retroactively to January 1, 2018. They now expire on December 31, 2020, so you're good for both 2019 and 2020.

Extended

Congress originally scheduled these provisions to end in 2019 and has now extended them through 2020:

- New markets tax credit
- Paid family and medical leave credit
- Work opportunity credit

- Beer, wine, and distilled spirits reductions in certain excise taxes
- Look-through rule for certain controlled foreign corporations
- Health insurance coverage credit

Eight Changes in the SECURE Act You Need to Know

As has become usual practice, Congress passed some meaningful tax legislation as it recessed for the holidays. In one of the new meaningful laws, enacted on December 20, you will find the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act).

The SECURE Act made many changes to how you save money for your retirement, how you use your money in retirement, and how you can better use your Section 529 plans. Whether you are age 35 or age 75, these changes affect you.

Here are eight of the changes.

1. Small-Employer Automatic Contribution Tax Credit

If your business has a 401(k) plan or a SIMPLE (Savings Incentive Match Plan for Employees) plan that covers 100 or fewer employees and it implements an automatic contribution arrangement for employees, either you or it qualifies for a $500 tax credit each year for three years, beginning with the first year of such automatic contribution.

This change is effective for tax years beginning after December 31, 2019.

Tax tip. This credit can apply to both newly created and existing retirement plans.

2. IRA Contributions for Graduate and Postdoctoral Students

Before the SECURE Act, certain taxable stipends and non-tuition fellowship payments received by graduate and postdoctoral students were included in taxable income but not treated as compensation for IRA purposes. Thus, the monies received did not count as compensation that would enable IRA contributions.

The SECURE Act removed the “compensation” obstacle. The new law states: “The term ‘compensation’ shall include any amount which is included in the individual’s gross income and paid to the individual to aid the individual in the pursuit of graduate or postdoctoral study.”

The change enables these students to begin saving for retirement and accumulating tax-favored retirement savings, if they have any funds available (remember, these are students). This change applies to tax years beginning after December 31, 2019.

Tax tip. If your child pays no income tax or pays tax at the 10 or 12 percent rate, consider contributing to a Roth IRA instead of a traditional IRA.

3. No Age Limit on Traditional IRA Contributions

Prior law stopped you from contributing funds to a traditional IRA if you were age 70 1/2 or older. Now you can make a traditional IRA contribution at any age, just as you could and still can with a Roth IRA.

This change applies to contributions made for tax years beginning after December 31, 2019.

4. No 10 Percent Penalty for Birth/Adoption Withdrawals

You pay no 10 percent early withdrawal penalty on IRA or qualified retirement plan distributions if the distribution is a "qualified birth or adoption distribution." The maximum penalty-free distribution is $5,000 per individual per birth or adoption. For this purpose, a qualified plan does not include a defined benefit plan.

This change applies to distributions made after December 31, 2019.

Tax tip. A birth or adoption in 2019 can signal the start of the one year, allowing qualified birth and adoption distributions as soon as January 1, 2020.

5. RMDs Start at Age 72

Before the SECURE Act, you generally had to start taking required minimum distributions (RMDs) from your traditional IRA or qualified retirement plan in the tax year you turned age 70 1/2. Now you can wait until the tax year you turn age 72.
This change applies to RMDs after December 31, 2019, if you turn age 70 1/2 after December 31, 2019.

6. Open a Retirement Plan Later

Under the SECURE Act, if you adopt a stock bonus, pension, profit-sharing, or annuity plan after the close of a tax year but before your tax return due date plus extensions, you can elect to treat the plan as if you adopted it on the last day of the tax year.

Under prior law, you had to establish the plan before the end of the tax year to make contributions for that tax year. This change applies to plans adopted for tax years beginning after December 31, 2019.

How it works. You can establish and fund, for example, an individual 401(k) for a Schedule C business as late as October 15, 2021, and have the 401(k) in place for 2020.

7. Expanded Tax-Free Section 529 Plan Distributions

Distributions from your child's Section 529 college savings plan are non-taxable if the amounts distributed are

- investments into the plan (your basis), or
- used for qualified higher education expenses.

Qualified higher-education expenses now include

- fees, books, supplies, and equipment required for the designated beneficiary's participation in an apprenticeship program registered and certified with the Secretary of Labor under Section 1 of the National Apprenticeship Act, and
- principal or interest payments on any qualified education loan of the designated beneficiary or his or her siblings.

If you rely on the student loan provision to make tax-free Section 529 plan distributions,

- there is a $10,000 maximum per individual loan holder, and
- the loan holder reduces his or her student loan interest deduction by the distributions, but not below $0.

This change applies to distributions made after December 31, 2018 (not a typo—see below).

Tax tip. Did you notice the 2018 above? Good news. You can use the new qualified expense categories to identify tax-free Section 529 distributions that are retroactive to 2019.

8. RMDs on Inherited Accounts

Under the old rules for inherited retirement accounts, you could "stretch" out the account and take RMDs each year to deplete the account over many years.

Now, if you inherit a defined contribution plan or an IRA, you must fully distribute the balances of these plans by the end of the 10th calendar year following the year of death. There is no longer a requirement to take out a certain amount each year.

The current stretch rules, and not the new 10-year period, continue to apply to a designated beneficiary who is

- a surviving spouse,
- a child who has not reached the age of majority,
- disabled as defined in Code Section 72(m)(7),
- a chronically ill individual as defined in Code Section 7702B(e)(2) with modification, or
- not more than 10 years younger than the deceased.

This change applies to distributions for plan owners who die after December 31, 2019.

Kiddie Tax Changes

In December 2017, Congress enacted the Tax Cuts and Jobs Act (TCJA) and changed how your children calculate their tax on their investment-type income. The TCJA changes led to much higher tax bills for many children.

On December 19, 2019, Congress passed a bill that the president signed into law on December 20, 2019 (Pub. L. 116-94). The new law repeals the kiddie tax changes from the TCJA and takes you back to the old kiddie tax rules, even retroactively if you so desire.

Kiddie Tax Basics

When your children are subject to the kiddie tax, it forces them to pay taxes at a higher rate than the rate they would usually pay.

Here's the key: the kiddie tax does not apply to all of a child's income, only to his or her "unearned" income, which means income from

- dividends,
- rent,
- capital gains,
- interest,
- S corporation distributions, and
- any type of income other than compensation for work.

For 2019, your child pays the kiddie tax only on unearned income above $2,100. For example, if your child has $3,000 of unearned income, only $900 is subject to the extra taxes.

Who Pays the Kiddie Tax?

The kiddie tax applies to children with more than $2,100 of unearned income when the children

- have to file a tax return,
- do not file a joint tax return,
- have at least one living parent at the end of the year,
- are under age 18 at the end of the year,
- are age 18 at the end of the year and did not have earned income that was more than half of their support, or
- are full-time students over age 18 and under age 24 at the end of the year who did not have earned income that was more than half of their support.

Calculating the Kiddie Tax

Under the TCJA, now valid only for tax years 2018 and 2019, any income subject to the kiddie tax is taxed at estate and trust tax rates, which reach a monstrous 37 percent with only $12,070 of income in tax year 2019.

Under the old rules before the TCJA, your child paid tax at your tax rate on income subject to the kiddie tax.

Kiddie Tax Choices

The SECURE Act, which the president signed into law on December 20, 2019, repeals the TCJA kiddie tax rules for tax years 2020 and forward and returns the tax calculation to the pre-TCJA calculation that uses your tax rate.

The new law also gives you the option to calculate the kiddie tax using your tax rate for tax years 2018, 2019, or both—it is your choice.

Solo 401(k) Could Be Your Best Retirement Plan Option

Have you procrastinated about setting up a tax-advantaged retirement plan for your small business? If the answer is yes, you are not alone.

Still, this is not a good situation. You are paying income taxes that could easily be avoided. So consider setting up a plan to position yourself for future tax savings.

For owners of profitable one-person business operations, a relatively new retirement plan alternative is the solo 401(k). The main solo 401(k) advantage is potentially much larger annual deductible contributions to the owner's account—that is, your account. Good!

Solo 401(k) Account Contributions

With a solo 401(k), annual deductible contributions to the business owner's account can be composed of two different parts.

First Part: Elective Deferral Contributions

For 2020, you can contribute to your solo 401(k) account up to $19,500 of

- your corporate salary if you are employed by your own C or S corporation, or
- your net self-employment income if you operate as a sole proprietor or as a single-member LLC that's treated as a sole proprietorship for tax purposes.

The contribution limit is $26,000 if you will be age 50 or older as of December 31, 2020. The $26,000 figure includes an extra $6,500 catch-up contribution allowed for older 401(k) plan participants.

This first part, called an "elective deferral contribution," is made by you as the covered employee or business owner.

- With a corporate solo 401(k), your elective deferral contribution is funded with salary reduction amounts withheld from your company paychecks and contributed to your account.
- With a solo 401(k) set up for a sole proprietorship or a single-member LLC, you simply pay the elective deferral contribution amount into your account.

Second Part: Employer Contributions

On top of your elective deferral contribution, the solo 401(k) arrangement permits an additional contribution of up to 25 percent of your corporate salary or 20 percent of your net self-employment income.

This additional pay-in is called an "employer contribution." For purposes of calculating the employer contribution, your compensation or net self-employment income is not reduced by your elective deferral contribution.

- With a corporate plan, your corporation makes the employer contribution on your behalf.
- With a plan set up for a sole proprietorship or a single-member LLC, you are effectively treated as your own employer. Therefore, you make the employer contribution on your own behalf.

Combined Contribution Limits

For 2020, the combined elective deferral and employer contributions cannot exceed

- $57,000 (or $63,500 if you will be age 50 or older as of December 31, 2020), or
- 100 percent of your corporate salary or net self-employment income.

For purposes of the second limitation, net self-employment income equals the net profit shown on Schedule C, E, or F for the business in question minus the deduction for 50 percent of self-employment tax attributable to that business.

Key point. Traditional defined contribution arrangements, such as SEPs (simplified employee pensions), Keogh plans, and profit-sharing plans, are subject to a $57,000 contribution cap for 2020, regardless of your age.