HERE IS OUR 2020 YEAR END NEWSLETTER, IT CAN ALSO BE FOUND ON OUR WEBSITE AT HTTP://WWW.SJTAX.COM/NEWSLETTER.HTML

DEAR CLIENTS, HAPPY HOLIDAYS!

We would advise you to read through this letter, as there are some suggestions for things that you may need to address before year-end. This year the tax filing deadline is April 15th 2021.

First and foremost, we hope that you and your loved ones are healthy and safe. This has certainly been the strangest year that we have ever lived through. Last tax season we went fully remote with one day's notice. We are very proud of our staff in how they hit the ground running, and we continued tax season without missing a step. It certainly helped that we already had systems in place for uploading documents securely and signing documents remotely. We were never more grateful for technology.

While we are hopeful that 2021 will bring us better things with the new vaccines that are supposed to be coming down the pipeline, for now our plan is to have our appointments remotely until things seem safer. We can work through Zoom, by phone, or by email. Please let us know your preference, and hopefully we will connect in a safe, secure way that works for you.

Because we will be working remotely, we will need to get your documents in advance of your appointment. At least a week in advance would be best. The first choice would be to have you upload your documents to our secure portal as this is the safest way to get us documents. If you would like, you can list us with your banks, brokerages, and private equity investments as third parties for digital delivery of documents. If you do that, your brokers and banks can send us your documents directly in a secure manner. Some employers will do the same thing with your W-2's.

We do understand that not everyone has the same level of tech abilities, so if you need to send us your physical documents, you can send them to our office address. Unless we are forced to close our office, there will always be someone on site to collect packages. They can be dropped off in person or mailed by any common carrier. If at any point the city does have to shut down, we will have scanners at various staff homes, and we can have documents delivered directly to them. If you are unsure, please check with us before sending any physical documents. Some of us live within walking distance of the office, so it is unlikely that we will not be able to access mail.

SCHEDULING YOUR APPOINTMENT

- On December 15th 2020 we will be introducing a scheduling system that will allow you to book appointments with your tax preparer, except for Shelly and Elaine, on-line. You are also welcome to call or email our office to set up an appointment if you need one. You can find this at www.sjtax.com.
- If you prefer calling us to set up an appointment, please call the main phone number, 212-929-3341 and press "1" when prompted for the receptionist. Please do not call your preparer directly to make the appointment as they are usually with a client, and you will most likely end up in their voicemail. It is much more efficient to use the receptionist for scheduling.
- Please schedule your appointment as soon as possible. As you know, we tend to book up by early March. Remember that there is no need to wait until you have all your papers to schedule your appointment. Anything that is missing can be added later.
- As we said before, to save time during your valuable appointment, it is often helpful if you send your tax information to us at least one week in advance of your appointment. You can also add us to any tax mailings from your financial advisors or institutions.
- If you have any open invoices with us, you will not be able to schedule your appointment for your 2020 taxes. If you have extenuating circumstances that you need to discuss relating to this, please contact Linna Yee in our office by phone or by email at linna@sjtax.com.
- If we prepare your Partnership, Corporation, Estate, or Trust tax returns, please schedule your appointment in January. If you have an LLC in New York, see the "NYS LLC" section below. Calendar year S-Corporation and Partnership tax returns are due by March 15th 2021. C-Corporation and Fiduciary returns are due April 15th 2021, unless you are a fiscal year filer.
- If you can't get an appointment with us before April 15th, don't panic. We can always file an automatic extension for you. This will allow you additional time to file your tax return. Generally, the extension is six additional months for individuals and five additional months for most other types of tax returns. For fiduciary returns, the extension is for five and a half months. However, you must still pay your taxes by April 15th. We don't automatically file an extension for clients that we have not heard from. We will only file an extension for you if you ask us to do so.
- An extension only extends your time to file your return, not to pay your taxes. If you know in advance that you want an extension, please let us know as early as possible, and we will be happy to help you calculate whether or not you need to send money with your extension. An extension does not extend your time to open and fund an IRA, which must be done by April 15th 2021.

WHAT TO PROVIDE FOR YOUR APPOINTMENT:

- Any information related to changes to your marital status, dependents, address, phone number, email address, or bank account.
- A driver's license for you (and your spouse). Please upload copies of your license (and your spouse's) prior to your appointment. We will need the front and back if it's a NYS license.
- All W-2 and 1099 forms that you receive; make sure you have a W-2 from each 2020 employer.
- We need to know how much of an Economic Impact Payment you received in 2020, if any.
- An itemized and totaled list of your deductible expenses. Last year's return can serve as a guide to you for the categorization of expenses. If you are married, please prepare separate lists.
- A list of your estimated tax payments and the dates paid. The last check may be dated January 15, 2021.
- Social Security cards and birth certificates for all your new dependents.
- If you sold stocks, bonds, mutual funds or cryptocurrency, we will need the dates purchased and the cost basis. If you have a large number of transactions, please send the information at least a week before your appointment. If you are a partner, shareholder, or beneficiary of a partnership, S-Corporation, LLC, LLP, or trust, we will need a K-1 form. If they haven't arrived by your appointment date, we can add the information later.

IF YOU ARE SELF-EMPLOYED / FREELANCE, BRING:

- The figures for your total income. Please review your bank deposits for the year to make sure that you are accounting for all of your income. In the event of an audit, the IRS compares your bank deposits to the amount reported on your tax return. That is why checking your bank deposits is so important.
- An itemized and totaled list of your expenses.
- A separate list of any items purchased in 2020 with a life greater than one year and a cost greater than $2,500 (*i.e.* equipment). We will need the date each item was purchased.
- If you use QuickBooks Desktop, please send a backup copy of your file at least a week before your appointment using our portal, SecureDrawer (see below for SecureDrawer instructions).
- If you use QuickBooks Online, please invite your preparer to access your file.

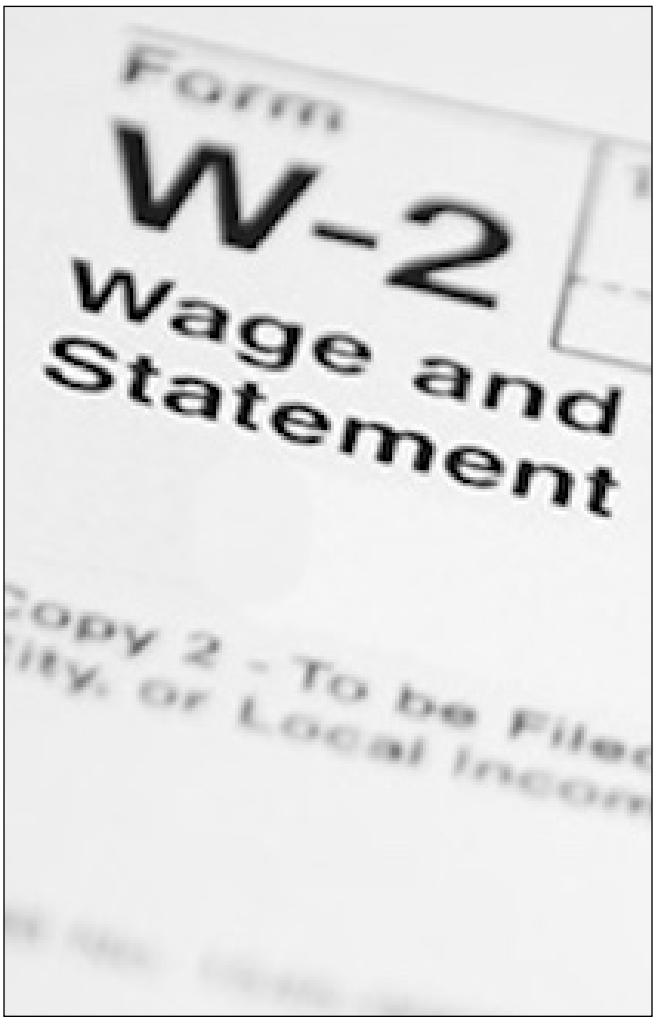
APPOINTMENTS ARE NOT ALWAYS NECESSARY

As always, we can prepare your returns without an appointment. Please advise us of any changes to your marital status, dependents, address, phone numbers, email address or bank account. Please have all 2020 information to us by March 24th. If you have sent us your tax information and haven't heard from us within two weeks, please call our office to make sure your package has arrived. It is always wise to keep copies of all of the information that you send us. In fact, we prefer not to have originals. Digital copies are actually best because they can be sent securely.

1099 & W-2 PREPARATION

- If you are self-employed or in business and have paid $600 or more by cash or check to an individual or unincorporated business, including LLC's, who have performed services for you this year, you are required to issue that contractor a 1099-NEC, which is a new form to replace Form 1099-MISC for nonemployee compensation. The deadline for filing 1099 forms with the IRS is February 1, 2021, which is the same day that you must send them to your payees. Please do not forget to file your 1099 forms. The IRS can disallow your deductions for payments to subcontractors if you do not send them 1099 forms. There are also penalties for not filing 1099's. The later they are, the greater the penalty. The maximum penalty is $270 per missing 1099 form, unless it is found to be intentional, and then it is $550. Please file your 1099's.
- 1099 Alert - The IRS still has the question on the tax return that specifically asks if you made any payments in 2020 that would require you to file a form 1099, and if yes, did you file all the required 1099 forms. This question makes it even more imperative that you file all required 1099 forms.
- If you have any employees, you must provide W-2's to them by February 1, 2021. The deadline for filing these forms with the IRS is also February 1, 2021.

If you need our help in preparing either of these forms, please contact us in January.



FINAL ESTIMATED TAX PAYMENTS

If you itemize your deductions, for some of you it is advantageous to pay your January state and local estimated tax payment by December 31, 2020. This only applies if your total state, local, and real estate taxes paid so far in 2020 is less than $10,000. NYC UBT and NY MCTMT estimates should be paid before December 31st. If you have had any major changes in your income that would require a change in your estimates, please contact our office before year-end. There is a fee for year-end tax planning.

NYC UNINCORPORATED BUSINESS TAX (UBT) AND NY MCTM TAX

For taxpayers with a profit of less than $100,000, there is no UBT. If your profit will be less than $100,000 and you are currently paying UBT estimates, do not pay your last quarter's estimated tax. If you work both in NYC and outside of NYC during the year, your income will need to allocated between what is earned in the city and what is not.

The MCTM tax is imposed on all NYC and surrounding counties for businesses with a profit of $50,000 or greater. This tax is calculated at 0.34% of the business profit. This tax is not phased in. Once your profit exceeds the threshold, you pay 0.34% on everything.

POTENTIAL TAX CHANGES WITH THE NEW ADMINISTRATION

This section is the hardest to write this year because so much is up in the air. The priority in January will hopefully be getting this pandemic under control, but depending on what happens with the open Senate races, we could possibly see some big tax changes next year as we need to deal with the large U.S. deficit. How these potential tax changes will affect our clients is uncertain.

President-elect Biden has promised to only raise taxes for those people making over $400,000 a year. They will supposedly be doing that by eliminating the Trump tax changes for people in that income range. The plan seems to be to raise the top rate back up to 39.6%, and potentially take away the new QBI (qualified business income) deduction for people with income in excess of $400,000. One important component is that we don't know if they will reinstate the full deduction for state and local taxes (SALT). If they do, it could more than mitigate a higher tax rate, and could ultimately result in lower taxes for those people in states with relatively high tax rates.

Another possible change that could raise taxes for upper income taxpayers is limiting the savings for tax deductions to 28% rather than just reducing taxable income. If you are in the 39.6% tax bracket, currently a tax deduction saves you 39.6% of the deduction. If they cap the tax savings to 28%, that will effectively raise your tax rate. They are also floating the idea of doing something similar with 401(k) contributions. If they do, it could make even more sense to select a Roth 401(k) rather than a traditional 401(k).

Another proposal that has been mentioned is taking away preferential capital gains treatment for higher income taxpayers. So, if you need to realize capital gains, you may want to do that in 2020. Yet another possible change is to start assessing Social Security tax on earned income over $400,000. Currently the cap on paying Social Security tax for 2020 is $137,700. Wages between $137,700 and $400,000 would not be subject to Social Security tax.

If all the potential changes are passed for 2021, it might make sense to accelerate income into 2020 if you are in the top tax rate. However, it is not certain though if it will be advantageous to do so. For SALT (not including business taxes like UBT and MCTM), it may be best postponing payment of anything possible into 2021 instead of paying them in 2020. This could save you taxes if the full deduction for SALT taxes are reinstated in 2021.

Another area that could be affected is the estate tax exclusion. Currently there is no federal estate tax on up to the first $11.58 million dollars in assets per person (spouses each get their own exclusion). Biden's plan is to reduce the tax-free estate exclusion to around $5.25 million per person. So, if you are fortunate enough to have that large of an estate, this could be a good time to meet with your estate tax attorney about potentially gifting assets directly, or to a trust. The other big potential change could be to eliminate the "step up" in basis on inherited assets. Currently, if you inherit stock from someone who has owned it a long time, and they paid $1 a share for their stock that is worth $120 on their date of death, the cost resets to the date of death value. So, if the person who died had sold it the day before death, they would pay capital gains tax on $119 a share. If their beneficiary sold that stock the day after they died, no capital gains tax would be due because the cost basis would have reset to $120 a share. The Biden proposal is to tax the appreciation on at least some of the assets as part of the estate tax system. It could also affect inherited real estate.

Again, none of these changes are certain and this is certainly not a comprehensive list of all possible changes. Once anything changes, we will communicate those changes to you.

UNEMPLOYMENT BENEFITS AND PANDEMIC UNEMPLOYMENT

Many of you who are reading this collected unemployment benefits for the first time as businesses closed temporarily and permanently, and unemployment was expanded to include self-employed people as well. Many states, like New York, do not mail 1099-G forms for unemployment income to taxpayers. You must log on to your account to retrieve the 1099-G that will be issued in January. Both regular unemployment and PUA are taxable on your federal tax return. States have different rules. New York taxes unemployment and PUA; NJ, PA, and California do not.

ECONOMIC IMPACT PAYMENT

For those who can remember all the way back to April, you may recall that the government issued economic impact payments of $1,200 per taxpayer and up to $500 per eligible child to households with income up to a certain range. They started making the payments in April, and most of them were paid by July. While these payments were calculated based on reported income for either 2018 or 2019 (depending on when people filed their 2019 tax returns), these payments were actually advance payments on 2020 taxes. If you qualify based on your 2020 income, and did not already get this payment, you will get a credit on your 2020 tax return for the amount that you are entitled to. That does not mean that you must pay any money back if you received more than you would be entitled to when the payments were issued. You get to keep any payments you received.

We will be required to prepare a reconciliation form for you, so we will need to know how much of a payment you received in 2020.

PPP LOANS

We have sent out multiple missives to clients about the PPP loans, so we won't say much about them here. From a deduction perspective, while the PPP's were said not to be taxable, the IRS has taken the position that expenses paid with the PPP will not be deductible so for most people, it has the same effect as if it was taxable. It is only for self-employed people who are not treated as employees for whom at least a portion of the loan will be tax free. If you need help with the forgiveness application, and have not reached out to us yet, please let us know. There is a fee for our assistance.

HEALTH CARE SUBSIDIES (HEALTH INSURANCE PREMIUM TAX CREDIT)

If you want to get insurance through the health marketplace, you can find your state exchange at www.healthcare.gov. If your family income is less than 400% of the federal poverty level, you may be entitled to subsidies for your health insurance. The only way to get those subsidies is if your insurance was obtained on the Exchange. They do not apply if you obtain insurance privately. The exchange is only open from November 1st to December 15th, so you must do this quickly. If you are eligible for Medicare, Child Health Plus or the NYS $20 per month Essential Plan, you can apply all year round.

If you did get your insurance on the Exchange and you were given a subsidy, that subsidy was based on the income you estimated. When we prepare your tax return, we must reconcile the subsidy that you were given with the subsidy that you are entitled to receive based on your final income. If you were given too much of a subsidy, you will owe it back to the IRS as part of your tax return. If you were not given a high enough subsidy, you will get a credit for it on your tax return which could result in a refund or a reduced balance due.

If your insurance was Medicaid or the NYS Essential Plan you will not need to pay anything back, even if your income goes above your expected income.

If your health care came from the Health Care Exchange, we cannot file your tax return without Form 1095-A. The exchange must issue this form to you, and you must share it with us.

CAPITAL GAINS TAX AND DIVIDEND TAX RATES

For the majority of taxpayers, federal tax rates on long term capital gains and qualified dividends will remain at 15% for 2020. Please don't forget that in addition to federal tax on capital gains and dividends, there is also state tax to pay.

For taxpayers in the top 37% tax bracket, the federal tax rate for long term capital gains and qualified dividends is 20%. This means that combined with the net investment income tax, your federal tax on long term capital gains will be as much as 23.8%.

If you do have capital gains and you are in the lowest tax bracket, you have a zero federal capital gains tax and zero federal tax on qualified dividends. If that applies to you, you may not want to offset your capital gains this year (as detailed below). This provision applies to single filers with less than $40,000 of taxable income ($80,000 for married jointly).

If you have sold assets and realized capital gains this year, you should examine your portfolio and think about selling some of your losing investments to help offset your gains. You are allowed to deduct capital losses to the extent that you have capital gains. In addition, you can deduct another $3,000 in losses against other (non-capital gain) income. Any net losses in excess of $3,000 can be carried forward to future tax years for federal tax purposes. Most states follow this, but New Jersey does not. For New Jersey, losses in excess of capital gains cannot be deducted and do not carry forward.

If you do sell a stock at a loss, you cannot buy back that stock within 30 days before or after the sale. If you do, the deduction for the loss is not currently allowed. It is suspended until you sell the stock and don't rebuy within 30 days. You need to review your mutual fund statements to see if they have paid out any capital gain distributions in 2020. Even if they were reinvested, those capital gain distributions are taxable in 2020. Those can be offset with capital losses. If you are at the zero percent long term capital gain rate, you may want to save your losses for the future.

Obviously, investment objectives must be considered when deciding whether to hold or to sell an investment. Taxes are only part of the decision of when to sell.

CRYPTO-CURRENCY

For the last few years, the IRS has been working on an initiative on cryptocurrency reporting for taxes. They sent out thousands of letters to people that they knew had cryptocurrency sales but had not reported them on their tax returns. Multiple cryptocurrency exchanges have shared information with the IRS. This initiative has been very successful in catching people that had not reported sales, so the IRS is continuing with this program. In addition, the line that had been added to the tax return where you have to affirmatively state that you either did or did not have cryptocurrency transactions has been moved to the front page of the tax return. So, it is very important that you track and report all cryptocurrency sales.

If any of the cryptocurrency exchanges that you invest in are on a foreign exchange, you must report the assets on the foreign reporting forms. See section below.

If you have not done this in the past, let us know if we need to amend any tax returns. Please reach out to us before tax season begins.

DUE DILIGENCE REQUIREMENTS FOR REFUNDABLE CREDITS

For anyone claiming the Child Tax Credit (income dependent for children under age 17 as of 12/31/20), the Earned Income Credit, or the American Opportunity Tax Credit for college tuition (only available for first four years of college with income of less than $180,000 for married couples, and $90,000 for single taxpayers), we will need proof of your dependents' existence. Even if we have been claiming these children on your tax returns since they were born, we will need a copy of their birth certificate and their Social Security card, if not previously provided. Without those two items, we cannot file your tax return claiming these credits.

MORTGAGE INTEREST DEDUCTIONS RULES

Under the old rules, which have been grandfathered, mortgage interest is deductible on the first $1,000,000 of debt on your property as long as that debt was used to buy or improve your home (acquisition debt). Mortgage loans that are used for things other than the purchase or improvement of your home (home equity debt) are no longer deductible. We need to know how much of the debt on your home is acquisition debt and how much is home equity debt.

For mortgages taken after December 14, 2017, the limits on interest deductions are only on the first $750,000 of debt. If you refinance a mortgage taken prior to December 14, 2017 for the same balance (no additional funds borrowed), you are still grandfathered under the old rules. If you refinance and borrow more, even if it is to improve the residence, then you are subject to the new lower limitations. So, it may be better to take a separate loan for additional borrowing if your original mortgage is greater than $750,000.

ITEMIZED DEDUCTIONS ON SCHEDULE A

Nothing of any significance has changed with the itemized deductions for 2020. The standard deductions have been indexed for inflation. For single people under age 65 the standard deduction is $12,400 and for married couples under age 65, the standard deduction is $24,800. For single people who are either over age 65 or legally blind, you can increase your standard deduction by $1,650 (if you are both, it would increase by $3,300). For married couples, it will increase $1,300 each for each person who is over age 65 or legally blind.

Our state, local, and property tax deductions are limited to $10,000 ($5,000 for married filing separately). With this limit it will be difficult for many people to itemize, particularly married taxpayers since you only itemize if your allowable deductions exceed the standard deduction. To determine if you have enough deductions to itemize, we count medical expenses that exceed 7.5% of your income, up to $10,000 of taxes, mortgage interest, investment interest, charitable contributions, and a few other more obscure types of deductions. If the total of these deductions exceeds the standard deduction, you itemize, and if they don't, you take the standard deduction.

There are strategies that we can take advantage of to maximize deductions which could include bunching up charitable deductions every few years. I will talk about some strategies for that in the charitable contribution section.

Some states, including New York, have decoupled from the new federal tax laws. That means you can still deduct employee business expenses and higher property taxes for New York. State and local taxes were never deductible on New York. So, if you itemize in New York, you still must keep track of these types of expenses.

CHARITABLE CONTRIBUTIONS

There is something new with charitable deductions for 2020. Even if you don't itemize, you can deduct up to $300 of charitable contributions made in 2020.

You must have proof of all charitable deductions taken on your tax return by the due date of that tax return. Cancelled checks and receipts are acceptable documentation for cumulative donations of less than $250 per year. If your donation to any individual charity is higher than that, you will need a letter from the charity verifying that donation. If you have appreciated stocks that you have owned for more than a year, you can donate those to a qualified charity and get a full tax deduction on the value of the stock without paying any tax on the gain. If you give in kind donations worth more than $5,000 of the same type in one year, you must have it appraised by a qualified appraiser.

In case you are wondering what we mean by bunching deductions, it means combining a few years (or more) of charitable contributions into one year. This is typically done using something called a donor advised fund. This is a charitable fund where you can donate money in one year, then have it distributed to the charities of your choice over a longer period of time. These funds are offered by Fidelity, Schwab, Vanguard, and many others. I will explain the advantage of using these donor advised funds.

My example is a married couple under age 65 who have over $10,000 in state, local, and property taxes, no medical deductions, no mortgage, and typically donate $8,000 a year to charity. If they do that for five years, they will take the standard deduction for five years of $24,800 a year. That would give them a total of $124,000 in deductions over five years. If that same couple donated $40,000 of appreciated stock to a donor advised fund in 2020, their 2020 itemized deductions would total $50,000. That is $10,000 in taxes and $40,000 in charitable deductions. For the next four years, the taxpayers would claim the standard deduction. In five years, their total deductions would equal $149,200 instead of $124,000. If they were in the top tax bracket, that extra $25,200 would save them approximately $9,324 in federal taxes. That savings does not include the tax savings they would realize from donating appreciated stock as mentioned above. It also does not take into account any potential state tax savings. If tax rates go back up, it may pay to wait until then to make large donations, but if the value of deductions is capped at 28% as proposed, then it would make sense to make large donations in 2020 if your income supports that kind of deduction.

No RMD's are required for 2020, so the following information is relevant for 2021 and future years. If you are 70½ or older and you are taking your required minimum distribution from your IRA accounts, you can earmark up to $100,000 a year for charitable giving. This can be donated to a donor advised fund, and the amount that you contribute is deducted right off the top of your income. You can do this and still take advantage of the full standard deduction (or your other itemized deductions). If you are charitable and take RMD's, this is the most efficient way to donate to charity.

QUALIFIED BUSINESS INCOME (QBI) DEDUCTION FOR BUSINESSES & RENTAL PROPERTY

Here is how this deduction works. If you qualify, you can get a deduction of up to 20% of your net business income reduced by certain expenses. Whether you are eligible depends on a number of factors - your income, your profession, and sometimes on your type of business entity. The simplest part of this explanation is for people whose income falls below the income threshold limits for the QBI. If you are single and your taxable income is below $163,300 ($326,600 for a married couple filing jointly), you are eligible for a deduction equal to 20% of your business profit (after certain other deductions). There is a phase-out of the income limits. For single people the phase-out ends at $213,300 of taxable income ($426,600 for married couples filing jointly). If your income is over that threshold and you are in one of the Specified Service professions, you are not eligible for this QBI deduction. Those professions are accountants (me first), lawyers, physicians and other health professionals, actuaries, performing artists and related professions, consultants, athletes, financial services, brokerage services, investment management, trading, and any business with income coming from endorsements, public appearances, and/or the use of the taxpayer's image. If you are in any of the previously mentioned professions and your taxable income exceeds the maximum threshold, you are out of luck. No QBI deduction for you.

If you are not in one of the professions that I mentioned and your income exceeds the thresholds above, then you potentially are eligible for this QBI. We look at 20% of your profit (less certain deductions), and you compare that to 50% of the wages paid by your business or 2.5% of the business assets that you have on your books that is still within their depreciable life (or 10 years if later) plus 25% of payroll paid. You deduct the lower of the QBI deduction or 50% of the wages paid (or 2.5% of assets plus 25% of wages paid, whichever is higher). If you pay no wages or have no eligible assets, you do not get a QBI deduction at those income levels. For clients in this position who are not set up as corporations, it is possible that we may want to change your business entity. If you become a corporation, you can pay yourself wages, and make yourself eligible for this QBI deduction. This needs to be analyzed on a case by case basis. We are happy to do this for you, but there is a fee for our time to do this complex analysis.

Keep in mind that this QBI deduction is available for real estate that is actively managed and shows a profit.

BUSINESS USE OF AUTOMOBILE FOR BUSINESS TAXPAYERS

The IRS is taking a harder line in audits of business use of automobiles. In order to deduct expenses for business use of automobiles, you must have a contemporaneous mileage log. You should note where you are going and the mileage. It is also important to always have the mileage at the start and end of the year. This information should always match any repair records that show mileage. If you don't have a proper log, you can lose the deduction completely. With a standard mileage rate of 57.5¢ per mile for 2020, bad records can lose you a hefty deduction. Remember that you can't deduct commuting from home to your normal business location. If you work from home and are self-employed, you can deduct the miles to your first other business location. There are free apps for mileage logs. Pick one and use it.

EDUCATION INCENTIVES

Section 529 Plans - A Section 529 plan is a Qualified Tuition Program which allows you to invest money in a tax preferential way for college savings. New York State will still be offering the New York State College Choice Tuition Savings Program which allows you to contribute up to $5,000 per person per year for your children's education (that makes it up to $10,000 for a married couple) and take a deduction for it from your New York State tax return. You can contribute more than $5,000 annually; you just don't get a deduction for the excess. If there is a chance that you will file married filing separately, you should each contribute the $5,000 into your own account. For a NYC resident the tax savings could be as much as $622 per $5,000 deduction. The earnings on the account are tax free on the federal and state level as long as the funds are used to pay for higher education. If you are interested in this program, you can call 1-877-NYSAVES for information. You can also visit their website at www.nysaves.org. You need to have your application and check postmarked by December 31st to get the deduction for this year. You do not have to invest in your own state's Qualifying Tuition Program; you can invest in any of the 50 state programs. If you are a New York State resident and you choose another state's program, you forgo your state tax savings. It is important to remember that if the parent is the donor of a 529 plan, the money counts as part of the parent's assets for purposes of financial aid. If a grandparent is the donor, the plan will not affect the student's financial aid until it is distributed. The 529 withdrawal will count as the student's income in the year of distribution when applying for financial aid. For that reason, it may be wise to use grandparent 529 plans for the final year or two of college. For all of you grandparents out there, this is a good way of helping to contribute to your grandchildren's college education.

As of 2018, there was a change to the 529 rules. The IRS allows you to withdraw up to $10,000 a year tax free to pay for private school tuition. The problem is that many states are not allowing that. For example, in New York you would have to pay state and local taxes on the full distribution. If that is the case, it probably is not worth doing because the distributions for college are tax free for federal, state, and local taxes when used for tuition and other permitted expenses.

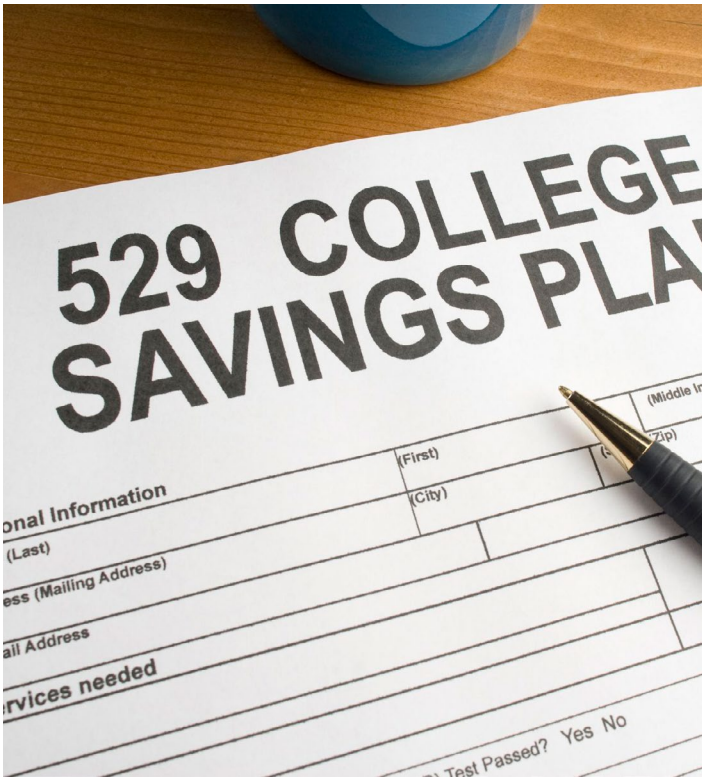
COLLEGE CREDITS AND 529 PLAN DISTRIBUTIONS

For college tuition, we will need proof of the tuition paid. It would be helpful to get an annual summary of your account from the Bursar's office.

We have been getting a lot of queries from the government asking for proof of college expenses for purposes of proving the credits taken or use of 529 funds. You are permitted to withdraw funds from 529 plans for tuition, room and board, and books and materials. You cannot count travel to and from school. You also can only distribute money from 529 plans for expenses paid the same year as the distribution. Timing counts! If you take too much out of the 529, and you can't account for it, you could end up paying tax on the earnings, plus a 10% penalty, so please be careful.

Remember that if you took money out from a 529 to cover expenses in 2020, and any of it was refunded due to dorms closing or classes being cancelled, you usually have 60 days to redeposit the funds into the 529 to avoid taxes. There was an exception for refunds received after February 1st, 2020. You had until July 15th to redeposit those funds. If that was not done, and you still have excess funds out, please see if you can prepay tuition or housing for next year before year-end.

Speaking of college and finances, we thought that this would be a good time to mention the dreaded FAFSA (Free Application for Federal Student Aid) form that is required when applying for financial aid. We are happy to help fill out this form, but we do bill hourly for our assistance. It is best to fill out all biographical information yourself to save paying us for entering information that you can easily complete. We can help with as much or as little of the form as you like.



CONVERTING A TRADITIONAL IRA TO A ROTH IRA

There is no income limitation for those wanting to convert their traditional IRA's to Roth IRA's. You would have to include in income the amount converted, but for some people it could result in little or no tax. If you had a low income year and you still have high deductions for mortgage interest, real estate taxes, charities, medical, etc., the income from the Roth conversion could be completely offset by your deductions. Once you convert the traditional IRA to a Roth IRA, all subsequent earnings on that account are tax free as long as it remains in the account at least five years and until you are over 59½ years old. Please call with any questions regarding this.

RETIREMENT PLANS-CARES ACT CHANGES FOR 2020

Minimum Required IRA Distributions – No RMD must be taken for 2020. In 2021, you will be required to resume RMD's as long as you are age 72 or over in 2021 or have an inherited IRA or retirement plan.

Early Retirement Plan Distributions – For those of you affected by Covid-19 (diagnosis, job loss, reduction in work hours, pay cut, etc.), you can take a distribution of up to $100,000 from your retirement account. The normal rules are that you pay a 10% early withdrawal penalty on most distributions taken before age 59 ½. You also pay all the tax in one year, and if you want to return the money to the plan, you can do one rollover in a 12 month period as long as the money is rolled into another retirement plan within 60 days. Under the CARES Act, you can withdraw up to $100,000 and pay the tax over three years, so you would owe tax on a third of the money for 2020, a third for 2021, and another third for 2022. This is true on the federal return, but not with all states. New York will tax you on the whole amount in 2020. You also have up to three years to redeposit the funds into a retirement plan instead of 60 days. There is also no 10% penalty on the distribution. If you do redeposit some or all of the funds after paying taxes on a portion of it, you will have to amend the tax returns where the taxes were paid to get that money refunded.

We are still not sure what will happen with the states that are not following the CARES Act tax changes. If the money gets redeposited, will a state like NY allow that, and if they don't, will you have to keep track of the amount you have paid tax on so that you are not taxed again in retirement on the redistribution of that money. We hope to find out more soon.

If you gave birth to or adopted a child, each spouse is permitted to withdraw up to $5,000 from their retirement accounts penalty free either up to 12 months before or 12 months after the date of birth or of adoption. You will still owe tax on the distribution.

RETIREMENT PLAN CONTRIBUTIONS

There is no longer an age limit on contributions to a traditional IRA (in the past you could not contribute to an IRA if you were over 70 ½ years old).

IRA - In 2020 the contribution limit for both the traditional and the Roth IRA is $6,000 for most people. For those clients that are at least age 50 in 2020, you can contribute up to $7,000 to your IRA account in 2020. In 2021 the limits will not increase. If you are an active participant in a retirement plan, you cannot deduct a full contribution to a traditional IRA unless your income is below a certain threshold. For single taxpayers that threshold is $65,000, and for married taxpayers filing jointly that threshold is $104,000. You can always contribute to a traditional IRA even if you are an active participant in a retirement plan and your income exceeds these limits, you just cannot deduct those contributions. If you are not eligible to deduct your IRA contribution, then you may want to contribute to the Roth IRA. The Roth IRA is non-deductible, but the earnings are all tax-free as long as the money stays in a Roth until age 59½. You can make a $6,000 ($7,000 if over age 50) contribution to the Roth if your AGI is less than $124,000 for unmarried taxpayers, and $196,000 for married filing jointly.

401(k) – What many people don't realize is that there are two types of 401(k) plans – traditional and Roth. The traditional 401(k), which is a tax deferred investment, allows you to contribute the money pre-tax. When you take distributions in the future, the total distribution will be taxable. With a Roth 401(k), your contributions are not deductible, but the earnings all grow tax free as long as you keep the money in the account for at least five years and until age 59½. The great thing about the Roth 401(k), unlike the Roth IRA, is that there are no income limits. So, as long as your company offers a Roth 401(k) option, anyone can participate. Basically, you give up the current tax savings (which is only a deferral anyway) and you gain tax free growth instead of just tax deferred growth. The younger you are, the more sense this makes. We are always happy to discuss this with you if you need further clarification. For 2020 you can contribute $19,500, plus an additional $6,500 catch-up if you are over age 50 and over. For 2021 the limit will be the same as 2020.

NEW YORK STATE LIMITED LIABILITY COMPANIES (LLC)

If you have an LLC in New York State, you must make sure to pay your filing fees for 2020 on time. The fees are based on gross income from 2019. These fees are due on March 15th. No extension is available for this form. Call our office as soon as the form arrives so that we can help you prepare to electronically file on time. If we prepare the form it must be e-filed and paid for by auto withdrawal.

AUDITS

We are not trying to alarm you, but there has been a large upsurge in audits in the past couple of years by the various taxing authorities. Our governments are broke and audits are an effective means of collecting more taxes. Please notify us as soon as you get any notice from the government because they are always time sensitive. A delayed response can cause unnecessary problems and should be avoided. We are always here to help you with any notices or audits. If you get a letter, don't panic, just call us. To put things in perspective, there was recently a study showing that as many as 70% of the notices sent by the IRS were wrong. The sooner we can respond, the sooner we can fix any erroneous assessments. In light of the increased number of audits, we want to reinforce the importance of keeping good records with supporting documentation. Do not throw out bank statements or credit card bills for at least three years from the due date of the tax returns filed, and please keep copies of invoices for all items deducted. Credit card receipts alone are not sufficient evidence.

For those of you filing New York returns, NY is now auditing a larger percentage of tax returns. They are also pre-auditing the returns before issuing refunds which is a new tactic. They often send the letter presented as a fait accompli. They say something to the effect of "we have adjusted your refund, if you would like to send us proof of your deductions, you may, otherwise just take the lower amount." We ask that you please send us any notices that you get from the government as soon as you get them. We want to act on any notices promptly because if we miss deadlines, it is much harder to fix any issues.

TAXPAYERS WHO LIVE IN ONE STATE AND WORK IN ANOTHER

The states are now really requiring that if you travel out of your working state for business, you will need to allocate those days to your home state. Therefore, if you work in one state, live in another, and travel for business, we will need the following information - your days worked out of your state of employment, not including days worked at home. We will also need to know how many sick, personal, and vacation days you took in 2020.

WORKING FROM HOME ISSUES DUE TO THE PANDEMIC

I will start with the question on everyone's minds. If you are an employee, there is no deduction for a home office on your federal tax returns. The tax changes two years ago eliminated all deductions for employee business expenses on the federal level. Some states (including NY and CA) decoupled from those tax changes. So, there may be some minor tax savings from certain state taxes.

The big issue is going to be about people's residency, and where they owe tax based on work location. While we have clients all over the country, the majority of our clients are in the tri-state area, and on March 12th or thereabouts, many people left the city or state, and spent most of the year in another state, or at the very least, out of New York City. Many of you also emailed us to ask if you could stop paying New York City taxes since you spent most of the year outside of the city. While you would think that was an easy question, it is not. In fact, it is a very complicated tax issue.

New York City and New York State do not like to give up their tax residents. If you have some free time, read up on some of the NY tax tribunal cases on residency. New York has a two-prong test to determine tax residency. You first must determine where your domicile is, and that is the beginning of the problem. Once you have a permanent place of abode in New York, you become a potential resident. There are many factors determining domicile. Your domicile is the place that you consider home. It is the place that you always plan to return to. If you have kids, where they go to school is a determining factor, they look at your religious memberships, phone records, voting registration, driver's license address, primary shopping locations, doctors' locations, vet locations, etc. You are in more control of some of this data, so if it is easy for you to change, it holds less weight with the state and city. Domicile is not just based on current evidence, but is also based on your intent; which is what makes it so difficult to prove.

If you can prove that your domicile is outside of NY City (or state), then as long as you spend less than 183 days in New York, you are not a resident for tax purposes. If it turns out that your domicile is New York, then if you spend more than 30 days in the city (or state), you are a resident for tax purposes.

To complicate things further, what happens if you go to your home in New Jersey or Connecticut, and you spend more than 182 days there? It is possible as a domiciliary of New York, to be a resident of both states. In the case of NY and CT, you may be double taxed on investment income. That would not happen between NY and NJ because NJ will allow a credit for any double taxed income.

The last issue has to do with where your work location is. When New York shut down in March people were told that they could not come into their offices unless they were essential workers. When you travel out of your working state for business, you can and must allocate those days out of your working state, and to either the other state you are travelling to (depending on number of days a year spent there) or to your home state. Typically, though, NY does not let you count days worked at home for your convenience. Well working at home due to a global pandemic certainly isn't about your convenience, but NY seems to be taking a hard line on this, and if your employer is located in NY, NY wants you to pay the tax on your work income to NY. We don't know if this will be challenged in court, and if it is, how it will play out, but those are the rules we are working with currently.

New York says this: "If you are a nonresident whose primary office is in New York State, your days telecommuting during the pandemic are considered days worked in the state unless your employer has established a bona fide employer office at your telecommuting location. There are a number of factors that determine whether your employer has established a bona fide employer office at your telecommuting location. In general, unless your employer specifically acted to establish a bona fide employer office at your telecommuting location, you will continue to owe New York State income tax on income earned while telecommuting."

I know that this could affect many of you who are reading this, so if you have questions relating to your specific situation, please reach out to us. If you would like to read more about this on your own, here is a hyperlink to some FAQ's on the New York website:

https://www.tax.ny.gov/pit/file/nonresident-faqs.htm

FOREIGN ASSETS AND INVESTMENTS

The US has a worldwide tax system. This means that no matter where income is earned, it should be reported on your US tax return. In addition to reporting all income, there is also a great deal of compliance reporting for foreign assets. When you have foreign investments, you must report them on your US tax return, even if no income is earned. There are excise taxes if you pay for foreign whole life insurance. If you own foreign mutual funds, there is something called PFIC reporting. If you own shares in a foreign corporation, there is something called GILTI reporting. Forms 5471 and 8865 must be prepared if you own over a certain percentage of a foreign partnership or corporation. There is also a Form 3520, or 3520A, for foreign gifts, inheritance or trusts.

We mention these forms and requirements as just a fraction of your potential reporting obligations. We want you to understand that owning foreign assets complicates your US tax filing. The world is getting smaller, and this is much more common than it used to be. Thanks to recent tax law changes, it is also much more complex than it used to be.

Clearly, there is no way of letting you know all of your filing obligations in this letter. This is just to alert you to please inform us of any foreign investments, inheritance, gifts, income, or any other foreign transactions. There can be significant penalties for not meeting your foreign reporting requirements. If in doubt, please ask.

PAYROLL AND BOOKKEEPING SERVICES

For those of you who are not aware, we offer payroll services for business and household employees. We process payroll through a platform supported by ADP. We partner with them in order to offer direct deposit for employees, automatic withdrawal of payroll taxes, electronic filing of W-2 forms, and easy access to forms for employers and their employees. We also want to use this opportunity to remind you that if you have a household employee, such as a cleaning person or a caregiver, who earns more than $1,000 a quarter (or $2,200 for the year), you are required to put them on payroll. This does not apply if you are paying a company such as an incorporated cleaning service or agency. If you do have household employees and would like to have us help with your payroll needs, please contact Kathryn@sjtax.com or Jeremy@sjtax.com.

We also offer bookkeeping services. If you are interested, please contact Lisa@sjtax.com.

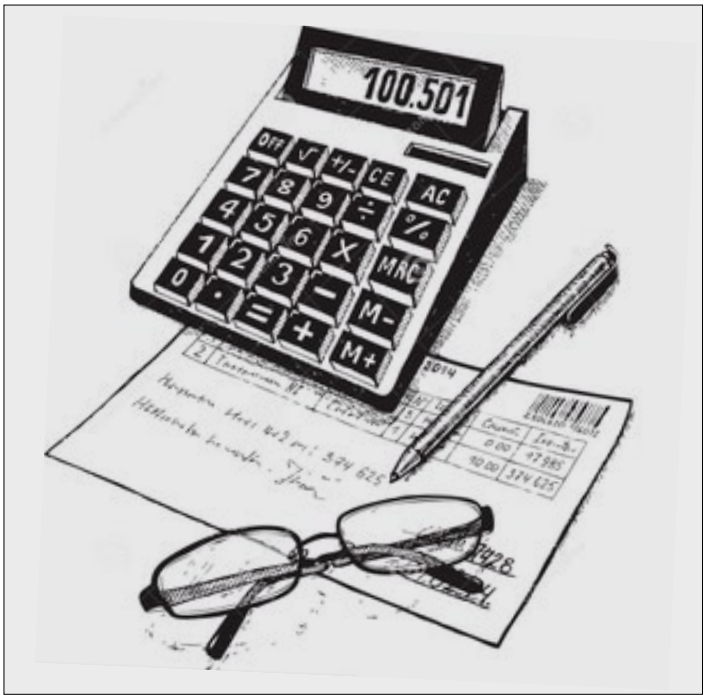
SECUREDRAWER AND SHAREFILE

We have been using SecureDrawer as a portal to share your information in a secure and encrypted way for the last few years. We deposit a PDF copy of your tax return into SecureDrawer and you can retrieve it at your convenience. The copy will remain in there for three years. The portal can be accessed using any of the following browsers: Microsoft Internet Explorer, Mozilla Firefox, Google Chrome or Safari. You can access SecureDrawer by visiting https://app.securedrawer.com/. Your username is typically the email address that we use for you. If you forget your password, there is a link to reset it on the login page. If you have an issue with your login or password, please feel free to call the office, and we will gladly assist you. Any documents that you want to share with us can also be uploaded to SecureDrawer. If you really can't get SecureDrawer to work, we do have an alternative secure portal which is called ShareFile.

Please do not email us any documents, even as attachments. Emailed documents can be hacked by someone who knows what they are doing. They can also be infected with viruses or worms that could put our whole system at risk. For these reasons, we ask that you please not email us documents. Please use one of our secure portals or one of your own.

TAX RETURN COPIES

If you need copies of prior year tax returns, we keep those in your SecureDrawer. We will always have the last three years returns loaded in your drawer. If you need to access them, and don't remember how, please check our website for instructions (www.sjtax.com), or reach out to sjtax@sjtax.com for help.



OVERDUE INVOICES

For any balances over 30 days past due, we will be adding interest of 0.75% (3/4%) per month on the unpaid balance to our invoice. Therefore, if you have any outstanding invoices with our office, this would be a good time to catch up.

If you had a bad year, please do not neglect filing your tax return this year. Even if you know that you are going to owe money that you will not be able to pay, it is better to file your tax return in a timely manner. The penalties for not filing your return are much more onerous than the penalties for not paying your taxes. The statute of limitations does not begin to run until you actually file your tax return which can actually be an important point for anyone forced into bankruptcy. There are also certain elections that need to be made on a timely filed return. We can always request an installment agreement from the government to pay your taxes. There will still be penalties and interest imposed, but the penalty rate for the installment agreement is half of the normal penalty rate. Ignoring taxes does not make them go away. We are always here to help you work through any hardships.

If there is anything that you have read about that you have questions on, please feel free to reach out to us.

We wish you a happy and healthy holiday season, and we look forward to connecting with you in the New Year. We are very grateful for all of you, and your continued support of our business.

May 2021 bring us better things, and a return to normal. Stay well!

Sincerely,

The Staff of SJ Associates NYC, LLC