Tax Tidbits

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Debt Discharge

The issue of debt cancellation has been around almost forever. The current pandemic that we are all going through is causing people not to be able to keep up with debt payments, due to losing their jobs or having to take pay cuts.

In some cases, the amount of cash coming into the household is less than what is needed to cover household expenses and debt payments. If the debtor cannot make the required payments, eventually the debt will be canceled or forgiven by the lender. Generally, if a debt for which you are personally liable is forgiven or discharged for less than the full amount owed, the debt is considered canceled in whatever amount is unpaid.

As a rule, you must include the amount of the canceled debt in your income. Canceled debt is reported on Form 1099-C, Cancellation of Debt. In certain situations, however, you may be able to exclude the canceled debt from income. It is at this point the concept of canceled debt becoming income or not becomes very complicated. You may be able to exclude the canceled debt from income through the use of certain exceptions and exclusions.

A debt includes any indebtedness: a) for which you are liable or b) subject to which you hold property. Debt for which you are personally liable is recourse debt. All other debt is nonrecourse debt. If you are not personally liable for the debt, you do not have ordinary income from the cancellation of debt unless you retain the collateral and either the lender offers a discount for the early payment of the debt or the lender agrees to a loan modification that results in the reduction of the principal balance of the debt.

A further complication arises if a disposition of the property securing a nonrecourse debt takes place. In this situation, the amount realized includes the entire unpaid amount of the debt, not just the fair market value of the property. As a result, you may realize a gain or loss if the outstanding debt immediately before the disposition is more or less than your adjusted basis in the property. There are exceptions to the requirement that you include canceled debt in income.

Student loans which were canceled or paid by someone else must have the amount included in gross income for tax purposes. In certain circumstances, you may be able to exclude amounts from gross income as a result of student loan cancellation due to meeting certain work requirements, due to death, permanent and total disability or student loan repayment assistance.

After you have applied any exceptions to the general rule that a canceled debt is included in your income, there are several reasons why you might still be able to exclude a canceled debt from your income. If canceled debt is subject to an income exclusion, it is nontaxable. In most cases, however, if you exclude canceled debt from income under an exclusion provision, you must also reduce your tax attributes (certain credits, losses and basis of assets). These are all reported on Form 982, Reduction of Tax Attributes Due to Discharge. One of the most well-known exclusions is bankruptcy. Specifically, you must be a debtor in a Title 11 bankruptcy case to qualify for this exclusion. Insolvency is the next exclusion category. To define this, you were insolvent to the extent that the total of all of your liabilities were more than the fair market value of all of your assets immediately before the cancellation. For purposes of determining insolvency, assets include the value of everything you own, including collateral for debt, not available to creditors such as interest in a pension plan and the value of your retirement account. You will most probably need a tax professional to complete Form 982 to avoid detrimental issues concerning canceled debt and exclusion.

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SECURE Act Inherited IRA Changes

The rules for inherited IRAs and 401(k)s were changed as of January 1, 2020, under the new Setting Up Every Community for Retirement Enhancement (SECURE) Act. When the SECURE Act passed in late 2019, it changed the rules regarding inherited IRAs and effectively eliminated the stretch ability for non-spouse beneficiaries, forcing non-spouse beneficiaries to take all of the funds from the inherited IRA within 10 years. According to the Congressional Research Service, the new rules under the SECURE Act have the potential to generate about $15.7 billion in tax revenue over the next decade. The SECURE Act as a whole is expected to generate $16.4 billion over the next 10 years.

If an IRA owner died after December 31, 2019, the beneficiaries of the IRA inherit the funds in an inherited IRA. Under the new rules, beneficiaries of an IRA or 401(k) plan must now withdraw all of the money within 10 years of receiving it. Below are listed the exceptions to this rule:

1. The surviving spouse of the original account owner – this can be treated as their own IRA.
2. A minor child of the original account owner – distributions must start, but are based on the minor's life expectancy until they reach the "age of majority". At that point, the beneficiary has 10 years to withdraw the entire account.
3. Any beneficiary who is not more than 10 years younger than the original account owner – distributions can be stretched over the beneficiary's lifetime.
4. Any beneficiary who is disabled or chronically ill – distributions can be stretched over the beneficiary's lifetime.

A non-spouse beneficiary that is disabled, chronically ill or not more than 10 years younger than the deceased IRA or 401(k) plan owner will have required annual withdrawals based on their life expectancy. There is a clear advantage for disabled and chronically ill beneficiaries being able to defer an IRA's income tax liability by stretching out the required minimum distributions over more than 10 years and enjoying greater protections from creditors and bankruptcy.

One solution is a "testamentary transfer to a charitable remainder trust (CRT)". Under this strategy, a CRT (with the IRA owner's children as beneficiaries of the trust) is named beneficiary of the IRA. When the account owner dies, the IRA is distributed to the CRT. Since CRTs are tax-exempt trusts, transferring IRA funds (or other qualified funds) to a CRT will not trigger the recognition of income. The CRT makes distributions to the children over their lifetime or a term of up to 20 years.

Some of the IRA can also be converted to a Roth IRA – a little at a time over several years, to keep the income from creeping into a higher tax bracket. Beneficiaries will still have to abide by the 10 year rule but there will be no tax on the amounts withdrawn, so all of the income accrued in the Roth will be tax-free.

Another way to bring down the taxable IRA balance during one's lifetime is to take advantage of qualified charitable distributions (QCDs). QCDs allow you to make charitable contributions through direct transfers from your IRA. Those IRA withdrawals are excluded from income, lessening the tax impact for both the owner and the beneficiaries. QCDs can also go toward satisfying annual RMDs, so this is a big tax benefit. If you normally give to charity, do it this way and save the taxes, as most taxpayers no longer deduct charitable contributions as they are using the standard deduction. QCDs can only be used by IRA owners who are 70.5 or older, even though the age for required distributions was increased to 72.

As always, if you have any questions regarding inherited IRAs, please give us a call.

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New York State Paid Sick Leave

New York State now requires all employers to provide sick leave to employees. Employees can begin to accrue sick leave as of September 30, 2020, but they cannot begin to use their paid sick leave until January 1, 2021. The NYS paid sick leave applies to all private employers regardless of size to include full time, part time, temporary, seasonal and per diem employees.

Employers accrue the leave at a rate of not less than 1 hour for every 30 hours the employee has worked, unless an employer elects to frontload all sick time. Listed are the different requirements based on the employer's number of employees:

- 1-4 employees: Up to 40 hours of unpaid leave, unless the employer has net income of more than $1 million in the prior tax year, then the leave must be paid.
- 5-99 employees: Up to 40 hours of paid leave.
- 100+ employees: Up to 56 hours of paid leave.

The paid sick leave can be used as soon as it is earned. There is no minimum hour requirement or employment length required and the unused sick leave must be carried over to the following calendar year.

The employer may also require employees to use at least a minimum amount of leave, such as one or two hours, but the employer cannot require the employee to take more than four hours as the minimum. The employer should take advantage of this option to set a minimum as a way to reduce any disruption to business operations.

If an employer has already adopted a sick leave policy or a time off policy that provides employees with an amount of leave, which meets or exceeds the requirements, the employer is not required to provide additional sick leave under the new law.

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Home Office Deduction

This year the pandemic forced many taxpayers to work from home. Some taxpayers are eligible to take the home office deduction, which allows taxpayers working from home to deduct certain expenses on their tax return. It is available to qualifying self-employed taxpayers or independent contractors. Employees who receive a paycheck or a W-2 exclusively from an employer are not eligible for the deduction, even if they are currently working from home. The Tax Cuts and Jobs Act suspended the business use of home deduction from 2018 through 2025 for employees.

There are two basic requirements to qualify for the deduction. The taxpayer needs to use a portion of the home exclusively for conducting business on a regular basis and the home must be the taxpayer's principal place of business.

To claim the deduction, a taxpayer must use part of their home for one of the following:

- Exclusively and regularly as a principal place of business for a trade or business
- Exclusively and regularly as a place where patients, clients or customers are met in the normal course of a trade or business
- As a separate structure that's not attached to a home that is used exclusively and regularly in connection with a trade or business
- On a regular basis for storage of inventory or product samples used in a trade or business of selling products at retail or wholesale
- For rental use
- As a daycare facility

The term "home" for purposes of this deduction includes a house, apartment, condominium, mobile home, boat or similar property. Additionally, structures on the property such as an unattached garage or barn qualify. However, any part of the taxpayer's property used exclusively as a hotel, motel, inn or similar business do not qualify.

Deductible expenses for business use of home normally include the business portion of real estate taxes, mortgage interest, rent, casualty losses, utilities, insurance, depreciation, maintenance and repairs. In general, a taxpayer may not deduct expenses for the parts of their home not used for business – for example, expenses for lawn care or painting a room not used for business.

A taxpayer can use either the regular or the simplified method to calculate the home office deduction. Using the regular method, qualifying taxpayers compute the business use of home deduction by dividing expenses of operating the home between personal and business use. Self-employed taxpayers first figure this deduction on Form 8829, Expenses for Business Use of Your Home.

Using the Simplified Option, qualifying taxpayers use a prescribed rate of $5 per square foot of the portion of the home used for business (up to a maximum of 300 square feet) to figure the business use of home deduction. A taxpayer claims the deduction directly on IRS Schedule C.

Taxpayers who use their home on a regular basis for providing daycare may be able to claim a deduction for part of the home even if it is used as the same space for nonbusiness purposes. To qualify, the business must provide daycare for children, people age 65 or older or people who are physically or mentally unable to care for themselves. The business must have applied for, been granted or be exempt from having a license, certification, registration or approval as a daycare center or as a family or group daycare home under state law.

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IRS Update

If you participated in a 2020 Health Savings Account (HSA), the IRS has provided updates on the 2021 HSA maximum contribution levels. The IRS has announced the 2021 HSA contribution limits, minimum deductible as well as maximum out-of-pocket expenses for HDHPs.

The annual contribution limit for HSA has been set at $3,600 for self-only and family HSA contribution limit has been set at $7,200. This has increased 1.5% from the 2020 contribution limits. Whereas HSA catch up contributions for both self-only and family are at $1,000 this if for those who are 55 and over (Table1).

Compared to 2020 HSA contribution limit has increased by $50 dollars for self-only and $100 for family. While the HSA catch up contribution has not changed between 2020 and 2021 (Table 2).

HDHP minimum deductibles have not changed between 2020 and 2021. However, maximum out-of-pocket expenses have increased by $100 for self-only and $200 for family.

The Flexible Spending Arrangement (FSAs) is also subject to IRS limitations each year. FSAs allow employees to be reimbursed for medical expenses and is often funded through voluntary salary reduction. This is an agreement between the employer and employee. From this contribution no federal income taxes or employment taxes are deducted from this contribution. Other benefits of an FSA include contributions made by your employer will be excluded from your gross outcome, and you may be able to pay qualified medical expenses with FSA even if the funds are not yet present in your account. As of right now the FSA limit for 2021 has not yet been released however, the 2020 limit was $2,750.00 for qualified medical expenses and $5,000 for qualified dependent care expenses.

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	Self-Only	Family
HSA Contribution Limit (Company + Employee)	$3,600	$7,200
HSA catch up contributions (age 55+)	$1,000	$1,000

Table 1. The above table summarizes 2021 contribution limits.

	2020	2021	Change
HSA contribution limit (employer + employee)	Self-only: $3,550 Family: $7,100	Self-only: $3,600 Family: $7,200	Self-only: +$50 Family: +100
HSA catch up contribution (age 55+)	$1,000	$1,000	No change

Table 2. The above chart is to compare HSA contribution limits between 2020 and 2021.

	2020	2021	Change
HDHP minimum deductibles	Self-only: $1,400 Family: $2,800	Self-only: $1,400 Family: $2,800	No Change
HDHP maximum out-of-pocket amounts (deductibles, co-payments and other amounts, but not premium)	Self-only: $6,900 Family: $13,800	Self-only: $7,000 Family: $14,000	Self-only: +$100 Family: +$200

Table 3. The above chart compares HSA contribution limits and HDHP guidelines for 2020 and 2021.

https://www.irs.gov/pub/irs-drop/rp-20-32.pdf

For ALL Your Insurance Needs

Personal Insurance
- Auto
- Homeowners
- Umbrella
- Rec Vehicles
- Motorcycle
- Watercraft

Life & Health Insurance
- Life
- Long Term Care
- Disability

Business Insurance
- Property
- Liability
- Automobile
- Professional Coverages
- Workers Compensation
- NYS Disability

Group Benefits Plan
- Health Insurance
- Dental Insurance
- Life Insurance
- Disability Insurance
- Customized Benefit Insurance

Tax Duel

Election Day is coming and may have already passed by the time you read this. Regardless of the outcome, we will look at the dueling tax plans between the two candidates.

Top tax rate:
Trump: Keep recently lowered 37% rate
Biden: Increase rate back to 39.6%

Itemized deductions:
Trump: No change from current policy
Biden: Value of itemized deductions will be capped at 28% increasing tax revenue on taxpayers with incomes over $400,000

Top capital gains tax rate:
Trump: Lower rate to 15% and allow gains to be indexed for inflation
Biden: Raise rate to 39.6%, levels not seen since the 1970s

Step up in cost basis for the death tax:
Trump: Keep step up in cost basis
Biden: Eliminate step up in cost basis and instead tax the deceased capital gains upon death

Corporate tax:
Trump: Lower rate again from the recently lowered 21% tax rate
Biden: Raise rate to 28%

Minimum tax rate for corporations:
Trump: No change to current policy allowing for credits to reduce payable taxes to nothing
Biden: New 15% rate would be established for corporations with income in excess of $100 million

Payroll tax:
Trump: Payroll tax holiday to some extent in 2021, details vague
Biden: Impose 12.4% payroll tax for incomes earned above $400,000

2017 Tax Cuts and Jobs Act:
Trump: Make permanent the tax cuts set to expire in 2025
Biden: Repeal tax cuts for individuals making more than $400,000

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