Lally&Co.
CPAs and Business Advisors

The EVERGREEN

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The Evergreen. Always Growing.

Like the evergreen oak tree, Lally & Co. is always growing. With the support and loyalty of our clients and friends we have grown into a firm of 44 individuals serving clients in many diverse fields. Our growth gives us the ability to better serve our clients and provide cost effective solutions to their needs. If you have questions about your business or personal tax situation, please contact us. We welcome your call and are always looking for ways to better serve you.

Contact our office or visit our website for more information.

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Dear Clients and Friends,

As we are now a month into the new year, many clients are asking how they can prepare for the 2019 tax filing season and the 2020 tax year. This newsletter discusses new tax regulations and items to be aware of in the upcoming year.

As you read through *The Evergreen*, please do not hesitate to contact us if you have questions regarding an article or regarding your business or personal tax situation. We would be happy to hear from you! This and past issues of *The Evergreen* are available on our website at http://lallycpas.com/newsletters/.

Stretch IRAs and the SECURE Act

A stretch IRA was an estate planning strategy that was applied to IRAs that were inherited by a beneficiary other than a spouse. The account holder could name children, grandchildren or even great-grandchildren as beneficiaries. By implementing this strategy, the account holder was able to "stretch" the lifespan of the IRA; extending tax-deferred growth for years or decades beyond the life of the original account holder. The beneficiary would be required to take required minimum distributions (RMDs) from the inherited IRA; however, it was at a rate based upon their life expectancy. The Stretch IRA took advantage of the fact that younger beneficiaries would have smaller RMDs, which would trigger minimal taxes, while the rest of the account could continue to grow tax-deferred and increase in value.

On December 20, 2019, President Donald Trump signed into law the SECURE Act (Setting Every Community Up for Retirement Enhancement). As a result of the SECURE Act, the stretch IRA has been virtually eliminated. Under this new Act, non-spouse beneficiaries are required to withdraw all funds from the inherited IRA within 10 years from the death of the original account holder. This law applies to all IRAs inherited after December 31, 2019. All previously inherited IRAs are grandfathered into these rules; however, when the beneficiary dies, the successor beneficiary will have 10 years to liquidate the account.

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There are many positive changes as a result of the SECURE Act. One of the goals of this act is to try to expand small employers' capability to offer some form of retirement savings to employees. This Act makes it easier for small businesses to offer their employees 401(k) plans by increasing the cap under which they can enroll workers in "safe harbor" retirement plans from 10% of wages to 15% of wages. This Act also allows retirement benefits for part-time employees who work either 1,000 hours throughout the year or have three consecutive years with at least 500 hours of service. Additionally, Section 106 of this Act introduces a new tax credit of $500 to help smaller employers encourage automatic enrollment into their retirement plan. The goal of this $500 credit is to help offset some of the costs of operating a retirement plan at the beginning.

Prior to the SECURE Act, once individuals reached the age of 70 ½, they were required to take required minimum distributions (RMDs) from their retirement accounts. The SECURE Act increased the age from 70 ½ to 72 for those individuals who are not 70 ½ by 12/31/2019. Additionally, before this Act, after reaching the age of 70 ½, workers could no longer contribute to an IRA. The SECURE Act eradicated this savings limitation by removing maximum age limits on retirement contributions.

The SECURE Act also allows penalty-free withdrawals of up to $5,000 from retirement plans for the birth or adoption of a child, and penalty-free withdrawals of up to $10,000 from 529 education-savings plans for the repayment of certain student loans.

The new Act carves out exemptions for certain beneficiaries, now called Eligible Designated Beneficiaries (EDBs). These include:

- Surviving Spouses
- Minor children – but NOT grandchildren
- Disabled individuals – subject to the strict IRS rules
- Chronically ill individuals
- Individuals not more than 10 years younger than the IRA owner

The old stretch IRA rules still apply to these beneficiaries, but only while the beneficiary qualifies as an EDB.

Future Implications of the SECURE Act

This new act could have a large impact on the tax liability for the beneficiaries. Many beneficiaries are in their prime working years at some of the highest tax rates. With the new 10-year rule, these distributions, which are treated as ordinary income, will be subject to the beneficiary's highest income tax brackets as opposed to later in their lives when they would be in lower tax brackets. It is important to note that even if the beneficiary is in a lower tax bracket, distributions from a seven-figure inherited IRA could push them into a substantially higher income tax bracket which may cause financial hardships that the beneficiary was not expecting.

There are methods for saving on taxes with the elimination of stretch IRAs; however, these methods can take several years to fall into place, so the time to start planning for the future is now. Some potential considerations include:

- Qualified Charitable Distribution of up to $100,000 per year. After the age of 70 ½, these charitable distributions will count towards your RMD.
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- Start withdrawals at age 59 ½. If you have large IRAs, with today's lower tax brackets, it may be preferable to take the distributions now and save the money in a taxable account.

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While future growth in the IRA will be taxed as ordinary income, monies that are withdrawn and invested in ETFs now will become eligible for long-term capital gain rates of 15%. In doing this, the future growth of the money is at a lower tax rate outside of the IRA.

- Roth IRA conversion. Once the initial taxes are paid on the conversion, there will be no tax on the future growth, and the beneficiaries are able to receive the Roth account income tax-free. Roth conversions do not count as an RMD, so the best time to do a conversion is between 59 ½ and 70 ½. Gradually making partial conversions over time will help to remain in a lower tax bracket.

- Charitable Remainder Trust (CRT). With Trust tax rates being so high, a CRT should be considered. This allows for annual income to be provided to beneficiaries, similar to a stretch IRA. Once the beneficiary passes away, the residual is donated to charity. The initial IRA distribution to the CRT is non-taxable; however, there are no lump-sum options for withdrawal and the payments will not continue past the first generation named as beneficiaries.

The SECURE act closes the loophole for individuals using their IRAs as an estate planning tool, and forces professionals to re-evaluate how to best utilize the IRA money while devising alternative tax strategies to minimize future tax implications to beneficiaries.

Key Notes for the 2019 Tax Reporting Year

The Tax Cuts and Jobs Act (TCJA) was signed into law at the end of 2017, with taxpayers seeing the real effects when they filed their 2018 Tax Returns. This Act has had a profound impact on many taxpayers and has created numerous new planning opportunities. A few items to note:

- Deductions – Many individuals did not itemize last year due to the increase in the standard deduction and the $10,000 limit on taxes in the itemized deduction category. While some benefited from the increase in the standard deduction, many did not because of increased limitations on itemized deductions. There are strategies to consider, for example, evaluating whether it makes sense to "bunch" deductions such as charitable contributions.
- Divorce Settlements – if you had a divorce or separation that was recently finalized, any alimony paid or received will not be deducted or included in income. Contact us if you have any questions about how this will affect your tax liability.
- Kiddie tax – based on changes in the tax law, the tax on children's investment income (known as "kiddie tax") is now calculated at the trust and estate tax rates.
- The Affordable Care Act - Recent tax law changes repealed the penalty that the ACA imposes on individuals who do not have health insurance.

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Important Dates

February 28, 2020 – 2019 Form 1099-DIV and Form 1099-INT Due

March 15, 2020 – 2019 Partnership & S-Corp Tax Returns Due

April 15, 2020 – 2020 1st Quarter Estimated Tax Payments Due

April 15, 2020 – 2019 C-Corporation Tax Returns Due; 2019 Individual Tax Returns Due; 2019 Form 114 - FBAR Returns Due; and 2019 Form 1041 Trust Returns Due

- Fraudulent Activity remains a significant threat. Fraudsters continually refine their techniques and tax identity threats remain a significant concern. Be cautious if you:

  - Receive a notice or letter from the Internal Revenue Service (IRS) regarding a tax return, tax bill or income that doesn't apply to you. You should always forward any notice received to our office.

  - Get an unsolicited email or another form of communication asking for your bank account number or other financial details or personal information.
  - Receive a robocall insisting you must call back and settle your tax bill.

New Rules Proposed on Charitable Contribution Related to SALT Benefits

The IRS has released new proposed rules related to charitable contributions made to get around the $10,000/$5,000 cap on state and local tax (SALT) deductions. The proposed regulations:

- incorporate the safe harbor in Notice 2019-12 for individuals who have any portion of a charitable deduction disallowed to the receipt of SALT benefits;

- incorporate the safe harbor in Rev. Proc. 2019-12 for business entities to deduct certain payments made to a charitable organization in exchange for SALT benefits; and

- clarify the application of the quid pro quo principle under Code Sec. 170 to benefits received or expected to be received by the donor from a third party.

SALT Limit

An individual's itemized deduction of SALT taxes is limited to $10,000 ($5,000 if married filing separately) for tax years beginning after 2017. Some states and local governments have adopted laws that allowed individuals to receive a state tax credit for contributions to certain charitable funds. These laws are aimed at getting around the SALT deduction limit by creating a charitable deduction for federal income tax purposes.

The IRS issued final regulations in June 2019 that provide that the receipt of a SALT credit for a charitable contribution is the receipt of a return benefit (quid pro quo benefit). Thus, the taxpayer must reduce any contribution deduction by the amount of any SALT credit received or expected to receive in return.

The regulations contain a de minimis exception if the SALT credit does not exceed 15 percent of the taxpayer's charitable payment. A taxpayer is not required to reduce the charitable contribution deduction because of the receipt of SALT deductions.

However, the taxpayer must reduce the charitable deduction if it receives or expects to receive SALT deductions in excess of the taxpayer's payment or the fair market value of property transferred.

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Payments by Individuals

A safe harbor was provided in Notice 2019-12 for individuals who have a portion of a charitable deduction disallowed due to the receipt of a SALT credit. Under the safe harbor, any disallowed portion of the charitable contribution deduction may be treated as the payment of SALT taxes for the purposes of deducting taxes under Code Sec. 164.

The new proposed regulations incorporate the safe harbor in Notice 2019-12. The safe harbor is allowed in the tax year the charitable payment is made, but only to the extent that the SALT credit is applied as provided under state or local law to offset the individual's SALT liability for the current or preceding tax year. Any unused credit may be carried forward as provided under state and local law.

Payments by Business Entities

The IRS also provided a safe harbor in Rev. Proc. 2019-12 that business entities may continue to deduct charitable contributions in exchange a SALT credit. A business entity may deduct the payments as ordinary and necessary business expenses under Code Sec. 162 if made for a business purpose.

The new proposed regulations incorporate the safe harbor in Rev. Proc. 2019-12. If a C corporation or specified pass-through entity makes the charitable payment in exchange for a SALT credit, it may deduct the payment as a business expense to the extent of any SALT credit received or expected to be received. In addition, the new proposal provides that if the charitable payment bears a direct relationship to the taxpayer's business then it may be deducted as a business expense rather than a charitable contribution regardless of whether the taxpayer receives or expects to receive a SALT credit.

Benefits Received from Third Party

If a taxpayer receives any goods, services, or other benefits from a charitable organization in consideration for a contribution, then the charitable deduction must be reduced by the value of those benefits. If the contribution exceeds the fair market value of the benefits received, then only the excess is a deductible as a charitable contribution.

The new proposed regulations clarify that this quid pro quo principal applies regardless of whether the party providing the goods, services, or other benefits is the charitable organization or not. A taxpayer will be treated under the proposal as receiving goods and services in consideration for the taxpayer's charitable contribution if, at the time the taxpayer makes the payment or transfer, the taxpayer receives or expects to receive goods or services in return.

Partner Tax Basis Capital Reporting Not Required Until 2020 Partnership Tax Years

The IRS has released guidance that provides that the requirement to report partners' shares of partnership capital on the tax basis method will not be effective for 2019 partnership tax years but will first apply to 2020 partnership tax years.

2019 Reporting

For 2019, partnerships and other persons must report partner capital accounts consistent with the reporting requirements in the 2018 forms and instructions, including the requirement to report negative tax basis capital accounts on a partner-by-partner basis.

Section 704(c) Gain or Loss

As a clarification, the notice also defines the term "partner's share of net unrecognized Code Sec. 704(c) gain or loss," which must be reported by partnerships and other persons in 2019.

Further, the notice exempts publicly traded partnerships from the requirement to report their partners' shares of net unrecognized Code Sec. 704(c) gain or loss until further notice. Solely for purposes of

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completing the 2019 Forms 1065, Schedule K-1, Item N, and 8865, Schedule K-1, Item G, the notice defines a partner's share of "net unrecognized Code Sec. 704(c) gain or loss" as the partner's share of the net (meaning aggregate or sum) of all unrecognized gains or losses under Code Sec. 704(c) in partnership property, including Code Sec. 704(c) gains and losses arising from revaluations of partnership property.

Section 465 At-Risk Activities

The notice provides that the requirement added by the draft instructions for 2019 for partnerships to report to partners information about separate Code Sec. 465 at-risk activities will not be effective until 2020. The draft of the instructions for the 2019 Form 1065, Schedule K-1, released October 29, 2019, included a new paragraph at page 12, At-Risk Limitations, At-Risk Activity Reporting Requirements, that would expressly require partnerships or other persons that have items of income, loss, or deduction reported on the Schedule K-1 from more than one activity that may be subject to limitation under Code Sec. 465 at the partner level to report certain additional information separately for each activity on an attachment to a partner's Schedule K-1. The new paragraph would require the partnership to identify the at-risk activity, the items of income, loss, or deduction for the activity, other items of income, loss, or deduction, partnership liabilities, and any other information that relates to the activity, such as distributions and partner loans. This requirement in the draft instructions for the 2019 Form 1065 is in addition to long-standing at-risk reporting requirements included in the instructions to the Form 1065.

Penalty Relief

Taxpayers who follow the provisions of the notice will not be subject to any penalty, including a penalty under Code Sec. 6722 for failure to furnish correct payee statements, under Code Sec. 6698 for failure to file a partnership return that shows required information, and under Code Sec. 6038 for failure to furnish information required on a Schedule K-1 (Form 8865).

The New Form W-4

For the first time in more than 30 years, the IRS has revised Form W-4. The new design is intended to reduce the form's complexity and increase the accuracy of the withholding system.

With the new form, Taxpayers now have different filing status choices. There are also more options to choose from if you had changes during the tax year, such as changing jobs, or changing your filing status. The "total number of allowances" section has been eradicated from the form. Instead of calculating the number of allowances, the form has questions about your income and dependents in order to obtain a more accurate tax picture. The form considers all sources of income, such as your spouse's income, self-employment income, and income from interest and dividends, in order to determine an accurate withholding amount. Additionally, there is now an optional "Step 4" section for other adjustments such as deductions for charitable contributions and mortgage interest, to name a few.

Existing employees are not required to complete a 2020 Form W-4 simply because of the redesign. However, if you start a new job in 2020, you will be required to complete the new W-4 Form. Additionally, if you are getting married, having a child, or want to have a more accurate withholding, filling out the new W-4 may be beneficial.

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Firm Promotions:

- **Anthony D. Duronio, CPA** has been admitted as a Partner in the Firm
- **Jason M. Droske, CPA** has been admitted as a Partner in the Firm
- **Zach S. Bussard, CPA** has been promoted to Supervisor in the Accounting & Auditing Department
- **Lynn Dixon Stewart** has been promoted to Supervisor in the Tax Department
- **Steven B. Kustra** has been promoted to Senior in the A&A department
- **Alexis M. Petach, CPA** has been promoted to Senior in the Tax Department
- **Matthew M. McClure, CPA** has been promoted to Senior in the Tax Department
- **Brandon J. Niznik** has been promoted to Senior in the Tax Department

New Hires and Announcements:

- **Matthew J. Henderson, CPA** joined the Firm's A&A Department in July 2019 as a Senior
- **Daniel J. Trettel** joined the Firm's A&A Department in July 2019 as an Associate
- **Brian P. Burnett, CPA** joined the Firm's Tax Department in August 2019 as a Senior
- **Alexander J. Hahn** joined the Firm's Tax Department in November 2019 as an Associate
- **Michael L. Ament** joined the Firm's Tax Department in November 2019 as an Associate
- **Blaise DiNatale, CPA** joined the Firm's A&A Department in February 2020 as a Manager
- **Chris D. Bukoskey** joined the Firm's Processing Department in October 2020
- **Alexis M. Petach, CPA** passed the CPA exam in August 2019
- **Matthew M. McClure, CPA** passed the CPA exam in November 2019
- **Zach S. Bussard, CPA** married his Fiancé, Samantha Deter, in July 2019