Tax & Business Alert

SEPTEMBER 2020

AMT LESS "TOOTHY" BUT MAY STILL TAKE A BITE

For many years, the alternative minimum tax (AMT) posed a risk to many taxpayers in the middle- to upper-income brackets. The Tax Cuts and Jobs Act (TCJA) took much of the "teeth" out of the AMT by raising the inflation-adjusted exemption. As a result, middle-income earners have had less to worry about, but those whose income has substantially increased (or remains high) should still watch out for its bite.

BASIC RULES

The AMT was established to ensure that high-income individuals pay at least a minimum tax, even if they have many large deductions that significantly reduce their "regular" income tax. If your AMT liability is greater than your regular income tax liability, you must pay the difference as AMT — in addition to the regular tax.

As mentioned, the TCJA substantially increased the AMT exemption for 2018 through 2025. If your income (calculated for AMT purposes) falls at or below the exemption, you won't have to pay the AMT. The 2020 exemption amounts are $72,900 (for single filers), $113,400 (for married joint filers) and $56,700 (for married separate filers).

If you do get caught by the AMT, applicable rates begin at 26% and rise to 28% at higher income levels. That top rate is lower than the maximum regular income tax rate of 37%, but far fewer deductions are allowed for the AMT. For example, you can't deduct state and local income or sales taxes, property taxes and certain other expenses.

ITEMIZED DEDUCTIONS

The AMT exemption phases out when your AMT income surpasses the applicable threshold, so high-income earners remain susceptible. However, even some taxpayers who consider themselves middle-income earners may trigger the AMT by exercising incentive stock options or incurring large capital gains.

Also, if you typically claim many itemized deductions for expenses that aren't deductible for AMT purposes, you might find yourself falling into the AMT net. These include state and local income taxes and property taxes.

If you're on the threshold of AMT liability this year, you might want to consider delaying state tax payments — as long as the late-payment penalty won't exceed the tax savings from staying under the AMT threshold.

INVESTORS BEWARE: CAPITAL GAINS COULD TRIGGER AMT

Many higher-income individuals and couples are active investors. Because the alternative minimum tax (AMT) exemption phases out based on income, realizing substantial capital gains could cause you to lose part or all of that exemption and, thus, subject you to AMT liability.

If it looks like you could get hit by the AMT this year, you might want to delay sales of highly appreciated assets until next year (if you don't expect to be subject to the AMT then) or use an installment sale to spread the gains (and potential AMT liability) over multiple years. Contact us to discuss further.

APPROPRIATE STRATEGIES

Since passage of the TCJA, the AMT may have become an afterthought for many people. However, it's still worth a look to see whether it could create undesirable tax consequences for you. Please contact us for help assessing your exposure to the AMT and, if necessary, implementing appropriate strategies for your tax situation. ■

REVIEW YOUR ESTATE PLAN FOLLOWING A MAJOR SHOCK

Generally, it's recommended that you review your estate plan at year's end. This is a logical time to note important life events that have taken place over the past 12 months or so that may affect your plan.

However, with a life shock as monumental as the COVID-19 pandemic occurring in 2020, you might want to get an earlier start on reviewing your estate planning documents to ensure that they're up to date — especially if you haven't looked closely at them in a number of years.

POTENTIAL REVISIONS

There are a wide variety of life changes that typically trigger the need to revise an estate plan. A few that come to mind in light of this year's crisis include the illness or disability of you, your spouse or another family member; or the death of a spouse or another family member. On a happier note, the birth or adoption of a child, grandchild or great-grandchild may necessitate changes. A child or grandchild reaching the age of majority is another common event.

If you married, divorced or remarried, you might need to revise your estate plan. The sale or purchase of a principal residence or second home could also necessitate action. Other oft-cited examples include your or your spouse's retirement, receipt of a large gift or inheritance, or any sizable changes in the value of assets. It's also important to review your estate plan when there've been changes in federal or state income tax or estate tax laws.

WILL AND POWERS OF ATTORNEY

As part of your estate plan review, closely examine your will, powers of attorney and health care directives. If you have minor children, your will should designate a guardian to care for them should you die prematurely, as well as make certain other provisions, such as creating trusts to benefit your children until they reach the age of majority, or perhaps even longer.

A durable power of attorney authorizes someone to handle your financial affairs if you're disabled or otherwise unable to act. Likewise, a medical durable power of attorney authorizes someone to handle your medical decision making if you're disabled or unable to act. The powers of attorney expire upon your death.

Typically, these powers of attorney are coordinated with a living will and other health care directives. A living will spells out your wishes concerning life-sustaining measures in the event of a terminal illness. It says what measures should be used, withheld or withdrawn. Changes in your family or your personal circumstances might cause you to want to change beneficiaries, guardians or power-of-attorney agents you've previously named.

PEACE OF MIND

In response to the COVID-19 crisis, many people's thoughts have turned to the importance of family and economic security. Updating and revising your estate plan today can provide peace of mind. We can help you determine whether any revisions are needed. ■

COLLEGE SAVINGS SHOWDOWN: 529s VS. ROTH IRAs

Many people assume that a 529 plan is the ideal college savings tool, but other vehicles can help parents save for college expenses, too. Take the Roth IRA, for example. Whether you should use one or the other (or both) depends on several factors, including how much you intend to contribute and how you'll use the earnings.

PLAN SNAPSHOTS

A 529 plan allows participants to make substantial nondeductible contributions — up to hundreds of thousands of dollars, depending on the plan and state limits. The funds grow tax-free, and there's no tax on withdrawals, provided they're used for "qualified higher education expenses" such as tuition, fees, books, computers, and room and board. If you use the funds for other purposes, you'll generally be subject to income taxes and a 10% penalty on the earnings portion. Some 529 plans are also eligible for state tax breaks.

Roth IRA contributions also are nondeductible and grow tax-free. And you can withdraw those contributions anytime, tax- and penalty-free, for any purpose. Qualified distributions of earnings — generally, after age 59½ and more than five years after your first contribution — are also tax- and penalty-free.

ADVANTAGES AND DRAWBACKS

The main advantages of 529 plans are generous contribution limits and the ability to accept contributions from relatives or friends. Roth IRAs, on the other hand, are subject to annual contribution limits of currently $6,000 ($7,000 if you're 50 or older). So, even if you and your spouse each set up Roth IRAs when your child is born, the most you'll be able to contribute over 18 years is $216,000. Another drawback is that you must have earned income at least equal to the contribution, and you can't contribute to a Roth IRA if your adjusted gross income exceeds certain limits.

Funds in a 529 plan that aren't used for qualified education expenses will eventually trigger taxes and penalties when they're withdrawn. However, with a Roth IRA, you can use contributions, as well as qualified distributions of earnings, for any purpose without triggering taxes or penalties. This includes items that wouldn't be qualified expenses under a 529 plan, such as a car or off-campus housing expenses that exceed the college's room and board allowance. Plus, if you don't need all your Roth IRA funds for college expenses, you can leave them in the account indefinitely.

CONSIDER GOALS

Before selecting a plan, consider your overall financial, retirement and estate planning goals. Our firm can help. ■