Hi, Viewers!

Though I'm no longer moderating Tax Talk Today, I still keep up with tax law and on occasion write locally. With all the questions about COVID-19 and the CARES Act I decided to put the following together and would like to share it with you. Hope everyone is doing okay and looking forward to the next Tax Talk Today program!

- Les Witmer

Changes for the 2020 Filing Season

Well, although we'd probably all like to forget about 2020, one thing we can't forget about this strange year is filing our 2020 income tax return.

As someone who was a spokesperson for the IRS and later moderated a monthly program on taxes, I've had over the years people ask me some strange tax questions. After years of answering those questions, and when I used to hit the speaking circuit and even speak to tax practitioners, my talks on "Misconceptions about Taxes," always seemed to be well received. I always got at least one response, "Gee, I never thought about that!"

Most people end up hiring a tax practitioner or buying software to file their taxes. You answer a bunch of questions and the software—either yours or the preparer's—does the work and you sign the return and off it goes to the IRS. Because people don't often learn what's behind the paperwork, many don't understand some of the basics of our tax system.

I can't tell you how many times I've heard someone complain that they got a raise or are now making more money but it just put them in a higher tax bracket. While earning more money may put you in the next tax bracket, it doesn't mean all of your income will be taxed at a higher rate. Our tax system is called a "marginal tax system." This means that you're taxed on your income in stages based on the tax rates or brackets.

For the 2020 tax year, the seven tax rates are the same—but have been adjusted by a few hundred dollars from 2019 to account for inflation. For example, if you're married and filing jointly and your income is say-- $125,000, then you're in the 22% tax bracket. But that doesn't mean your tax rate is a flat 22%. Instead, part of your income is taxed at 10%, another part at 12%, and the last part at 22%.

Here's another misconception that has really changed for many—that itemized deductions will save you a ton of taxes. This really changed with the Tax Cuts and Jobs Act of 2019 with the standard deduction being substantially raised. The standard deduction for married filing jointly rises to $24,800 for tax year 2020, up $400 from the prior year. For single taxpayers and married individuals filing separately, the standard deduction rises to $12,400 in for 2020, up $200.

Of course. when you pay taxes, you have the option of taking the standard deduction or itemizing your deductions. If you itemize, you calculate your deductions one by one. Itemizing is more of a hassle, but it's worth it if your itemized deductions exceed the amount of the standard deduction. However, a deduction unlike the dollar-for-dollar tax credit reduces only your taxable income -- not your actual tax due. So, if you're in the 22% tax bracket, each dollar of deduction saves you only 22 cents in taxes paid. Here's an interesting fact—with the increased standard deduction, the number of people who took the standard deduction jumped to nearly 90% in 2019!

Another frequent misconception is that if you make an error on your return it will lead to an IRS audit. In this computer age and with the IRS's ability to document match, you might get a notice from the IRS for you to substantiate something on your return. This is not nor does it lead to an audit. However, it really means that you need to make sure that you claim all income and that you can verify all deductions and credits that you claim. You need to make sure you account for all those 1099's that you receive! There are a lot of other misconceptions about audits and IRS processes that I'll save for another blog. For this one, though, here are some more realities that you should think about in filing your 2020 return:

If you, like many, have made charitable donations and moved into taking the increased standard deduction, and therefore haven't been able to claim these on your tax return, there is good news for 2020. The Coronavirus Aid, Relief, and Economic Security (CARES) Act added a new "above-the-line" deduction that will help you write off up to $300 of charitable contributions you made in cash. Oh, and in mentioning the coronavirus and the government's response to it, it has created a ripple effect that will be felt when you sit down to file your taxes for last year. Here are some things to keep in mind:

As part of the $2 trillion relief package, the government sent up to $1,200 in the form of a stimulus check to millions of Americans shortly after the pandemic shut most of the countdown. The good news is your stimulus check will not count as taxable income. Instead, it's being treated like a refundable tax credit for 2020. Translation: Your stimulus check is sort of like an advance on money you would have received anyway as part of your tax refund in 2021. And in case you never received yours, there is a line on the new Form 1040 where you can state that.

Many Americans found themselves out of work because of the pandemic and turned to unemployment insurance for help. Those who received unemployment benefits will need to pay income taxes on that money as it's considered taxable income and if taxes were not withheld from the benefits, it can mean a "double whammy" at tax time!

And because of the virus many people were told to work from home and they turned their bedroom or other space to an in-home office area. So, here's a rabbit hole not to go down--you can't take a home office deduction if you're employed. That is a deduction for only the self-employed and must meet certain requirements, such as fulltime use of this as a home office. And this is an area that can certainly raise a red flag to the IRS.

And then there are tax implications for retirees. There were a lot of changes to retirement plans in 2020—and some of those changes could impact your tax bill this year. Let me tackle each of those major changes:

The CARES Act allowed folks under age 59 1/2 to take up to $100,000 out of their 401(k)s and IRAs up until the end of 2020 without having to pay an early withdrawal penalty. Taking money out of a retirement account before retirement is generally thought of as not a good idea—penalty or not. Also, the money taken out of tax-deferred retirement accounts like a traditional 401(k) or IRA will be taxed as ordinary income, so you'll need to pay taxes on any withdrawals made.

Additionally, from defined contribution retirement plans, you have to take money out of your account once you reach a certain age. Those withdrawals are called required minimum distributions (RMDs). The good news is the Setting Every Community Up for Retirement Enhancement (SECURE) Act pushed back the age for RMDs from traditional IRAs from 70 1/2 to 72 (if your 70th birthday was July 1, 2019 or later). And the CARES Act allows seniors to skip RMDs altogether in 2020 without penalty. That's huge, because it could lead to significant tax savings for retirees with those accounts since the money that's taken out of a traditional IRA counts as taxable income. If folks took the RMD earlier in the year they had until Aug 31 to return it to the distributing account without having to pay taxes on it.

The SECURE Act also allows owners of traditional IRAs to keep putting money in their accounts past age 70 1/2 starting in 2020. Since the money you put into a traditional IRA is tax deductible, you could lower how much of your income is taxed this year. You will still however, have to pay taxes on that money whenever you take it out. That's been the big advantage of ROTH IRAs!

For anyone who did take some money out of a 401(k) or traditional IRA and is facing a big tax bill, they have three years to put those funds back and get a refund on any taxes they paid on that money. And in so doing it, of course, will help get those retirement savings back on track.

And lastly one of my favorite topics—529's! Any money you take out of a 529 plan or Educational Savings Account (ESA) must, of course, be used for qualified educational expenses in order to be tax-free. But a lot of colleges and schools went online learning or cancelled classes this year—which means they might have refunded some or all of the 529. If that's the case, you're allowed 60 days to put the money back in the account or use it to cover other educational expenses.

There are also a couple of new ways 529 plans can be used. 529 plans can now be used to pay for the costs of certain apprenticeship programs—including fees, books and supplies. And unused 529 plan money can also be used to pay off up to $10,000 in student loan debt!

So, while sitting at home waiting on the COVID vaccine, it's a good time to start thinking about filing 2020 taxes and take a look at last year's return so you can start gathering what's needed to file.