Westfield CPAs, LLC
241 North Avenue West, Westfield, NJ 07090
(908) 233-7900   www.WestfieldCPAs.com

August 2020

Dear Clients and Friends,

Like most people, we hoped and thought that we would be done with COVID-19 by now. We certainly hope that you and your loved ones are well. Our staff and families are all healthy, but we have struggled, like many, with fear of coming to work, child care issues, and suddenly working remotely. If we were slow to reply to a call or e-mail, please accept our apology. We will continue to try our best to find our way to whatever new reality we face.

In April, our firm shifted our focus from personal tax returns to help our small business clients with Paycheck Protection Program (PPP) loans. We worked around the clock to learn new programs, only to have all the rules change several times. It was stressful for us and our clients, but we are very proud to announce that virtually all of the clients for whom we prepared applications received PPP loans in the first round of financing.

If you already filed your 2019 return, it is more important than ever to make sure that you received your refund or the IRS and states have deposited the checks that you sent for taxes owed. There are apparently truckloads of unopened mail at the IRS that can take months to resolve. The IRS is so backed up that it will pay you interest on a delayed refund. They are crediting 5% interest annually through June 30 and 3% thereafter. So instead of rushing the IRS, maybe you will appreciate the investment return!

The CARES Act

The Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed on March 27, 2020, to help people with the COVID-19 pandemic. The Act waives all Required Minimum Distributions (RMDs) from retirement accounts for 2020. For decades, the government has encouraged people to save for retirement (most commonly through 401ks or IRAs) by providing a tax deduction while working, but it wants payback by requiring you to ultimately withdraw the funds and pay tax on them.

The Act retroactively waives RMDs back to January 1, 2020. <u>As such, you only have until August 31, 2020 to return the funds that you withdrew this year.</u>

Just because you can skip an RMD, does not mean you should.

Eventually you or your heirs will distribute your retirement account and add it to taxable income. If you have the opportunity to distribute any of those funds while you are in lower brackets, you should consider doing so. If the funds are not needed, consider converting a portion to a Roth IRA. We can guide you through this decision process.

In addition to waiving RMDs, the CARES Act provides additional benefits for *"Qualified Individuals."*

You are qualified if you, your spouse, or dependents were diagnosed with COVID-19 or experienced an adverse financial condition as a result of being quarantined, furloughed, laid off, experiencing reduced work hours, being unable to work due to lack of childcare or suffered a reduction in self-employment income. As a Qualified Individual, coronavirus-related distributions are permitted without regard for financial need or use of the proceeds.

For these Qualified Individuals, the CARES Act allows retirement distributions of up to $100,000 withdrawn at any point in 2020 with the following benefits:

- Waiver of the 10 percent penalty on early retirement withdrawals.
- Allows the distribution to be included in income over three years.
- Also allows the distribution to be recontributed back to a retirement account within three years, but not for inherited IRAs or Roth conversions.

The taxation of Qualified Distributions for Qualified Individuals can be completed in one year or spread over three years. If the three-year method is elected, one third of the distribution will be taxed each year starting in 2020 unless it is redeposited prior to the tax return filing deadline, which can be extended until October 31, 2020.

For example, assume $30 is distributed and you pay tax on a third of it, or $10 in 2020. Then, late in 2021 you return $15 to your IRA. Another third, or $10 that would have been taxable in 2021 will no longer be taxable, and the additional $5 returned can either, at the taxpayer's choice, lower your taxable amount for 2022 or you can amend 2020, by $5.

Please keep in mind that if you desire to fully return RMDs or qualified distributions, and tax was initially withheld, you need to use additional funds to recontribute the entire amount.

Another benefit in the CARES Act allows parents participating in their employer's dependent care spending account, to change their elections if they no longer plan on using child care or your day care facility/summer camp has closed. Without this change, you would have to continue to contribute to the plan and end up losing the funds.

The single most important part to know is that we are here to help you navigate this maze!

We are already thinking about preparing your 2020 tax return. There are a number of new items where we are going to need your help. You can start thinking about them now!

- As part of the CARES Act, you can deduct up to $300 of charitable contributions even if you do not itemize.
- If you collected unemployment in 2020, you likely owe tax on it. Recipients are frequently surprised because the state already may be withholding tax. The problem is

that most states only withhold 12% Federal tax on the state payment and no tax on the extra $600 pandemic relief payment. However, your actual tax rate could be 24 - 37%. States vary on the taxation of unemployment. New Jersey does not tax unemployment but New York does. In sum, most people who received unemployment will owe some amount of state tax and almost definitely owe Federal tax.

- Your stimulus check of up to $1,200 needs to be reconciled on your 2020 return. The amount you received was based on your latest return filed at that time. It could have been 2018 or 2019. You are entitled to the greater of what you would have received based on your 2020 return or what you received as an advance. We will need to know how much you received in case you are entitled to an additional amount.
- Let us provide you with a quick checkup. Between now and October, please provide recent paystubs or a projection of other income, as well as withholdings, and let us help you plan for opportunities and avoid a tax surprise next year.

Five months into this medical and financial crisis, we have strengthened our relationships with individual clients, businesses and their finances. We get the raw and honest facts that give us a unique perspective.

Sharing an opinion in this divisive era can be dangerous, but here are some of our observations so far…

$1,200 Stimulus Payment: The lack of regionalization made this payment unfair and it missed the goal. Using the same income and benefit limit in expensive metropolitan areas versus lower cost-of-living areas ended up depriving those in the most severely affected states while those in other states experienced a windfall.

PPP Loans: The PPP loans from the Small Business Administration (SBA) clearly favored larger customers at larger banks, and then those same banks were shunned by the SBA so our clients who use big banks were treated poorly twice and put under unnecessary stress.

The next step for PPP is forgiveness of these loans based on how the funds were spent. There is a proposal to automatically forgive many of these loans, so before we cause clients to jump through too many hoops, we are waiting patiently for additional guidance.

$600 Unemployment Benefit: As we write this letter, Congress is struggling to agree on how to handle an extension of the Federal $600 unemployment benefit. This benefit should have been a percentage of earnings and not a flat amount. Most states base benefits on a percentage of income lost. Some states have low maximum weekly unemployment benefits so people in those states need more help. Examples of states/regions and their relatively low unemployment benefits include:

PR $190	FL $275	AZ $240	NC $350	CA $450	NY $504

Other states that have relatively high unemployment benefits are:

HI $648	OR $648	NJ $712	MN $740	WA $790	MA $823

This means that if you were earning $200 a week while working in New Jersey, you would be receiving $120 from NJ and $600 Federal for a total of $720. A person who normally earns $1,000 per week would receive $1,200. Both would also be subject to less tax. Although it was not the employees' intent, so many of them were profiting from COVID-19 unemployment that many of our small business clients could not reopen because employees were unwilling to give up the extra cash to return to work.

Landlords: Landlords are facing an unusual challenge. Several politicians are working to prevent evictions while encouraging people not to pay rent. In the meantime, landlords rely on rent for their own income. Additionally, none of the recent relief bills have provided landlords with relief from property tax, maintenance, or mortgage.

Small Business: Prior to COVID-19, it was harder than ever for small businesses to compete with big box stores, Amazon, and consolidation in services from plumbers, doctors, dentists, and even accountants.   The PPP loans helped small business owners pay employees, but it did nothing to help cover overhead and keep businesses alive. Small businesses are the result of years of hard work, planning and creativity. They give our towns character and provide local jobs. For many people, owning a small business is the culmination of the American dream. A world without small business would be boring and uninspiring. We strongly encourage everyone to support local small business from retail to restaurants to trades and professionals.

Looking forward…

While we cannot predict what the new normal will be, it is a safe bet that taxes will rise. No one should be surprised that virtually every government department is suffering financially. Unlike a small business that needs to suck It up or go bankrupt, the government's answer is always the same.   Politicians will use COVID-19 to justify legislative changes. Payroll tax cut? Raise taxes on higher income? There are bound to be politicians who present their old ideas as new and necessary due to the virus.

Higher tax comes in many forms, not just income tax. Somehow Governor Murphy thinks that adding a 2.5% excise tax on all health plans will make health insurance more affordable. He also wants to make COVID-19 automatically a worker's compensation claim in certain circumstances. Both of these methods will further hurt small businesses when they are down.

Due to COVID-19, freelancers, who were not paying unemployment taxes, were eligible to collect unemployment benefits. This model is not sustainable, and we expect another push to turn freelancers into employees, or charge freelancers' unemployment premiums.

Proposals exist across the entire nation. California has proposed to raise the top state tax rate from 13.3% to 16.8%. There is a clear drumbeat with tax soldiers marching toward us. New York wants to add taxes to people in private equity, hedge fund managers, pied-à-terres, millionaires and billionaires.   The taxpayer is like the ball in a pinball machine getting banged at every turn.

The ongoing threat of higher taxes over the last several years has caused affluent people to move to low tax states while frequently maintaining a home in a high tax state, but avoiding paying that state’s taxes. With the arrival of COVID-19 and the ability to work from home, people at all income levels are now moving around the country regardless of where their jobs are based.

Are you working remotely?

Remote work can create conflict between states who vie for tax money. New York, Connecticut, Delaware, New Jersey, Nebraska, and Pennsylvania consider telecommuting employees to be working in the state where their desk or department is regardless of where they actually live. This is called the ‘‘convenience of the employer rule.’’ For further reading, google New York v. Huckaby.

Many clients have asked us if working from home changes their tax status. Typically, it does not. Nor are deductions allowed for home office expenses. If your job is based in NY and you work from home in NJ, or any other state, NY still wants the tax. Because NY and NJ follow the same convenience rule, your home state will allow a credit for taxes paid to your work state. But how about a NY worker who is now working remotely from Vermont, a non-convenience state? It is highly possible that Vermont, or any other state, will also want the tax and not allow credit for tax paid to NY. This scenario would increase – and potentially double – the employee’s state tax.

Although this year has been confusing and stressful, we will get through it together. Please call or e-mail us to discuss the topics in mentioned in this newsletter and any other questions or concerns. We look forward to hearing from you soon.

Stay well,

Bob Saunders