Spring & Co.
CERTIFIED PUBLIC ACCOUNTANTS

Tax & Business Alert

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WHAT'S YOUR TAXPAYER FILING STATUS?

For many, December 31 means a New Year's Eve celebration. From a tax perspective, however, it should mean thinking about the filing status you'll use when filing your tax return for the year. The one you use depends partly on whether you're married on that date.

THE FIVE STATUSES

When you file your federal tax return, you do so with one of five filing statuses. First, there's "single" status, which is generally used if you're unmarried, divorced or legally separated. A second status, "married filing jointly," is for married couples to file a tax return together. If your spouse passes away, you can usually still file a joint return for that year. A third status, "married filing separately," is for married couples who choose to file separate returns. In some cases, doing so may result in less tax owed.

"Head of household" is a fourth status. Certain unmarried taxpayers qualify to use it and potentially pay less tax. Finally, there's a fifth status: "qualifying widow(er) with a dependent child." It may be used if your spouse died during one of the previous two years and you have a dependent child. (Other conditions apply.)

HEAD OF HOUSEHOLD

Let's focus on head of household status because it's often misunderstood and can be more favorable than filing as a single taxpayer. To qualify, you must "maintain a household" that, for more than half the

year, is the principal home of a "qualifying child" or other relative that you can claim as a dependent.

A "qualifying child" is defined as someone who lives in your home for more than half the year and is your child, stepchild, foster child, sibling, or stepsibling, or a descendant of any of these. A qualifying child must also be under 19 years old (or a student under age 24) and cannot provide over half of his or her own support for the year.

Different rules may apply if a child's parents are divorced. Also, a child isn't a "qualifying child" if he or she is married and files jointly or isn't a U.S. citizen or resident.

CAN YOU BE MARRIED AND A HEAD OF HOUSEHOLD?

You must generally be unmarried to claim head of household status. However, if you've lived apart from your spouse for the last six months of the year, you have a qualifying child living with you and you "maintain" the household, you're typically considered unmarried. In this case, you may be able to qualify as head of household.

For head of household filing status, you're considered to maintain a household if you live in it for the tax year and pay more than half the cost of running it. This includes property taxes, mortgage interest, rent, utilities, property insurance, repairs, upkeep and food consumed in the home. Medical care, clothing, education, life insurance and transportation aren't included.

Under a special rule, you can qualify as head of household if you maintain a home for a parent even if you don't live with the parent. To qualify, you must be able to claim the parent as your dependent.

NOT ALWAYS OBVIOUS

Filing status may seem obvious, but there can be situations in which it warrants careful consideration. If you have questions about yours, contact us. ■

INTRAFAMILY LOANS AND A FAMILY BANK

Among the primary goals of estate planning is to put in writing how you want your wealth distributed to loved ones after your death. But what if you want to use that wealth to help a family member in need while you're still alive? This has become an increasingly common and pressing issue this year because of the COVID-19 pandemic and changes to the U.S. economy.

One way to help family members hit hard by job loss or increased debt is through an intrafamily loan or even by establishing a full-fledged family bank.

STRUCTURE LOANS CAREFULLY

Lending can be a way to provide your family financial assistance without triggering unwanted gift taxes. As long as a loan is structured in a manner similar to an arm's-length loan between unrelated parties, it won't be treated as a taxable gift.

This means, among other steps, documenting the loan with a promissory note and charging interest at or above the applicable federal rate (which is now historically low). You'll also need to establish a fixed repayment schedule and ensure that the borrower has a reasonable prospect of repaying the loan.

Even if taxes aren't a concern, intrafamily loans offer important benefits. For example, they allow you to help your family financially without depleting your wealth or creating a sense of entitlement. Done right, these loans can promote accountability and help cultivate the younger generation's entrepreneurial capabilities by providing financing to start a business.

MAYBE OPEN A BANK

Too often, however, people lend money to family members with little planning or regard for potential unintended consequences. Rash lending decisions may lead to misunderstandings, hurt feelings, conflicts among family members and false expectations. That's where a family bank comes into play.

A family bank is a family-owned and funded entity — such as a dynasty trust, a family limited partnership or a combination of the two — designed for the sole purpose of making intrafamily loans. Often, family banks can offer financing to family members who might have difficulty obtaining a loan from a bank or other traditional funding sources, or lend at more favorable terms.

By "professionalizing" family lending activities, a family bank can preserve the tax-saving power of intrafamily loans while minimizing negative consequences. The key to avoiding family conflicts and resentment is to build a strong governance structure that promotes communication, decision making and transparency.

Establishing guidelines regarding the types of loans the family bank is authorized to make — and allowing all family members to participate in the decision-making process — ensures that family members are treated fairly and avoids false expectations.

LEARN MORE

More than likely, someone in your extended family has faced difficult financial circumstances this year. Contact us to learn more about intrafamily loans and family banks. ■

HANDLE MUTUAL FUNDS CAREFULLY AT YEAR END

As we approach the end of 2020, now is a good time to review any mutual fund holdings in your taxable accounts and take steps to avoid potential tax traps. Here are some tips.

AVOID SURPRISES

Unlike with stocks, you can't avoid capital gains on mutual funds simply by holding on to the shares. Near the end of the year, funds typically distribute all or most of their net realized capital gains to investors. If you hold mutual funds in taxable accounts, these gains will be taxable to you regardless of whether you receive them in cash or reinvest them in the fund.

For each fund, determine how large these distributions will be and get a breakdown of long-term vs. short-term gains. If the tax impact will be significant, consider strategies to offset the gain. For example, you could sell other investments at a loss.

BUYER BEWARE

Avoid buying into a mutual fund shortly before it distributes capital gains and dividends for the year. There's a common misconception that investing in a mutual fund just before the ex-dividend date (the date by which you must own shares to qualify for a distribution) is like getting free money.

In reality, the value of your shares is immediately reduced by the amount of the distribution, so you'll owe taxes on the gain without actually achieving an economic benefit.

SELLER BEWARE, TOO

If you plan to sell mutual fund shares that have appreciated in value, consider waiting until just after year end so you can defer the gain until 2021 — unless you think you'll be subject to a higher rate next year. In that scenario, you'd likely be better off recognizing the gain and paying the tax this year.

When you do sell shares, keep in mind that, if you bought them over time, each block will have a different holding period and cost basis. To reduce your tax liability, it's possible to select shares for sale that have higher cost bases and longer holding periods (known as the specific identification method), thereby minimizing your gain (or maximizing your loss) and avoiding higher-taxed short-term gains.

THINK BEYOND TAXES

Investment decisions shouldn't be driven by tax considerations alone. You also need to know your risk tolerance and keep an eye on your overall financial goals. Nonetheless, taxes are still an important factor. Contact us to discuss these and other year-end strategies for minimizing the tax impact of your mutual fund holdings. ■

BUSINESSES SHOULD REVIEW SALES TAX LAWS

It's been more than two years since the U.S. Supreme Court ruled in *South Dakota v. Wayfair* that states may require out-of-state sellers to collect sales and use tax even if they lack a physical presence in a state. Since that time, most states that have a sales tax have enacted "economic nexus" laws that expand the reach of their sales tax collection obligations beyond their borders.

Many of these laws are similar to the one upheld in *Wayfair*. It applies to sellers that, on an annual basis, deliver more than $100,000 in goods or services into the state or engage in 200 or more separate transactions for the delivery of goods and services into the state. Some states have eliminated the number-of-transactions threshold, to avoid applying their laws to small sellers, such as those that sell 250 items at $1.50 each.

Since the COVID-19 pandemic was declared, online transactions have soared. If your business sells products or services in states in which it lacks a physical presence, review the economic nexus laws in those states and assess their sales-tax-compliance impact. Also, some states have issued specific guidance on whether telecommuting employees temporarily working in a state because of the COVID-19 crisis create nexus for an employer who doesn't operate in that state. We can help you explore and respond to these matters. ■