

AHWATUKEE FOOTHILLS NEWS

Different Ways to Save on Income Taxes



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The coronavirus pandemic shutdown of most of the U.S. was devastating. However, the economic is now slowly coming out of the previous mandatory lockdown orders and many predict that we will have a strong 4th quarter in 2020 and strong economic recovery in 2021. For many upper middle-class families, income taxes are one of the two highest single expenses, along with housing expenses. It's the highest expense once your house is paid off. Let's examine several major tax-saving options.

Tax-Deferred Retirement Plans: include the IRA and 401(k). IRA's allow one to deduct up to \$6,000 annually (or \$7,000 annually if one is age 50 or older), but limited to one's employee earned income. The 401(k) has much bigger annual contribution limits. In 2020, one can contribute up to \$19,500 (and up to \$26,000 if one is age 50 or older). However, one's contribution is limited to the amount of earned income that year. If one's 2020 earned income is \$12,000, then that's the maximum one can contribute to your 401(k).

Solo 401(k): If you own your small business and have no non-family employees, you can set up a solo 401(k) and have the same employee maximum contribution limits. If you have substantial profits, you can also do an employer "match" and the total maximum contribution in 2020 is \$57,000. If there are substantial profits

and both spouses own and work the business, there can be a maximum \$114,000 of annual tax-deductible contributions to the solo 401(k) plan. **Solar Business Equipment:** This could be solar panels put on the roof of commercial buildings or solar refrigeration equipment (called reefers in the food industry) attached to the front of refrigerated trailers that transport frozen foods, meat, dairy, fruits, and vegetables to grocery stores. In 2020 the solar tax credit is 26%. If one is high income (caused by high earnings; a Roth IRA conversion; or gains from selling stock or real estate), one would also want to use Section 179. Section 179 allows one to deduct the cost of business equipment in the year it is "placed in service" instead of having to depreciate the cost over a period of years.

Example: One purchased \$120,000 of solar reefers in 2020. One's cost basis must deduct half of the 26% solar tax credit (\$31,200) and this results in an \$104,400 cost basis. Suppose a single taxpayer had \$250,000 of taxable income in 2020 and would owe \$62,295 of federal tax. After using the Section 179 deduction of \$104,400, revised federal taxable income is \$145,600. The federal tax is \$29,023.50. Now apply the \$31,200 tax credit and he owes \$0 federal tax in 2020. He has \$2,176.50 of excess solar tax credit, which can be used to recover federal tax paid in 2019. His total

federal tax savings is \$64,471.50 (the \$62,295 he would have paid plus the \$2,176.50 of 2019 tax recovered). AZ income tax savings would be \$4,698, and total tax savings would be \$69,169.50.

Note: in order to take the Section 179 expensing provision, there are 7 ways to qualify to be an "active" or "materially participating" investor. The easiest way is to spend at least 100 hours per year managing your investment and "it be as much time as anyone else". This means you should own the equipment individually. In contrast, if there are 5,000 investors in a \$1 billion solar farm sold by a major Wall Street firm, the investors are deemed to be "passive". They would get the 26% solar tax credit, but could not take Section 179. They would be allowed to take their prorata annual depreciation of the project equipment.

Free Webinar on Solar Business Investments: will be held monthly starting in June, 2020.

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Dr. Harold Wong earned his Ph.D. in Economics at the University of California/Berkeley and has appeared on over 400 TV/Radio programs.