



CHOI HONG LEE & KANG LLP
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS



TAX UPDATE 2020 / 2021

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EXCLUSION FROM INCOME: STIMULUS CHECK AND UNEMPLOYMENT BENEFIT

Economic Impact Payments (also called “EIPs” or “stimulus checks”) received during 2020 are not taxable income. They will not have to be reported for federal or state tax purposes. Individuals who have not received stimulus payment in 2020 can still claim it as a refund or reduction of tax when they file a 2020 tax return by April 15, 2021.

Unemployment compensation is taxable and must be reported on a 2020 federal income tax return, but it is exempt from California state income tax.

PENALTY ISSUE FOR NOT HAVING HEALTH INSURANCE IN 2020

Beginning January 1, 2020, all California residents must have qualifying health insurance coverage unless they qualify for an exemption. Otherwise, nonexempt taxpayers without coverage must pay a penalty. It will be the higher of a flat amount of \$750 per person (\$375 per dependent) or 2.5% of gross income that exceeds the filing threshold.

VIRTUAL CURRENCY TRANSACTIONS (IRS LETTERS 6174, 6173 FOR CRYPTO TAXES)

1. The IRS has issued the guidance concerning the taxation of virtual currencies that has an equivalent value in real currency (or acts as a substitute for real currency). (IRS Notice 2014-21) Taxpayers who received, sold, sent, exchanged, or otherwise acquired any financial interest in any virtual currency at any time during 2020 have to report Capital Gain or Loss from the transactions.

2. The IRS has removed two online game currencies: Roblox and V-bucks (Fortnite) do not need to be reported.

CHARITABLE CONTRIBUTIONS

Individual taxpayers can claim cash contributions of up to 100 percent of their 2020 adjusted gross income. The CARES Act provides \$300 deduction (per return) in cash contribution for those choose to take standard deductions, rather than itemized deduction. It is an above-the-line qualified contribution deduction for the 2020 taxable year.

RIDE SHARING, PART-TIME DELIVERY SERVICES (DOORDASH, GRUBHUB, AND ETC.), OR E-COMMERCE

Rideshare drivers (those working through Uber or Lyft) or those in E-Commerce (Amazon, YouTube, etc.) must report income on their tax returns. Taxpayers can take a deduction for business use. The standard mileage rate of 57.5 cents per mile in 2020 or actual expenses times business percentage.

PLUG-IN ELECTRIC DRIVE VEHICLES CREDIT

A) The credit ranges from \$2,500 to \$7,500 per a new qualified plug-in electric drive vehicle purchased in 2020. The credit is calculated based on the size of the battery and phased out when a manufacturer sells 200k units.

B) California has no comparable credit but has a rebate through the California Clean Vehicle Rebate Project (CVRP). Taxpayers can get a rebate amount ranges from \$1,000 to \$7,000 depending on the vehicle, and they are taxable income. Moreover, low income families can receive an additional rebate up to \$2,500.

RESIDENTIAL ENERGY EFFICIENT (SOLAR) PROPERTY CREDIT

The credit for qualified solar electric property and qualified solar water heating property placed in service before January 1, 2022 is: A) 26% for property place in service between January 1, 2020, and December 31, 2020; and B) 22% for property placed in service between January 1, 2021, and December 31, 2021.

INCOME EXCLUSION OF CANCELLATION OF DEBT ON PRINCIPAL RESIDENCE

Gross income does not include cancellation of debt if the income for discharged debt from taxpayers' qualified principal residence indebtedness discharged prior to January 1, 2021. Taxpayer may consider amending 2018 and 2019 returns if the exclusion applies.

DISCHARGED STUDENT LOANS

The IRS provides relief for an exclusion from income for discharged student loans due to specific school closure. Proc. 2020-11 to establish a safe harbor that can be applied to all taxpayers.

CHANGES OF RETIREMENT PLAN BY THE CARES ACT

1. For the taxable years beginning after December 31, 2019, there is no age restrictions and allow taxpayers to contribute to a traditional IRA after age 70.5. California does not conform to the provisions.

2. Early Distribution Withdrawal Penalty Waivers are available as follows:

A) Taxpayers are not subject to an additional 10% early withdrawal tax if the retirement plan is coronavirus-related withdrawals before age 59.5 and up to \$100,000 in aggregate between January 1, 2020, and December 31, 2020. The taxpayer may elect to report the income in the year the distribution was received in 2020 or spread the withdrawn amount in taxable income over a three-year period beginning 2020. In addition, the taxpayer may repay the distributions to their retirement account at any time during the three-year period. It may need to amend a return to reduce the distributions reported by the amount that was repaid.

B) A distribution related to adoption of a child (under age 18 or is physically or mentally incapable of self-support) or within one year of the birth, will not be subject to the 10% penalty on "Baby Withdrawals". The penalty-free distribution is up to \$5,000 per parent/per child born.

CHANGES OF REQUIRED MINIMUM DISTRIBUTIONS

Taxpayers must begin taking required minimum distributions from 70.5 to age 72, but only for those turned age 70.5 after December 31, 2019. The CARES Act waives the RMD requirement in 2020.

NET OPERATING LOSS (NOL)

For the net operating loss deduction, taxpayers can retroactively go back and use five-year carry-backs incurred in 2018 to 2020. It is 100% of taxable income to claim on pre-2021 taxable year return.

MEDICAL EXPENSE DEDUCTIONS

The IRS allows all taxpayers to deduct only the amount of the total medical expenses that exceed 7.5% of their adjusted gross income.



TAX PLANNING AND TAX AUDIT

66.04

583.02

27.64

68,350.00

46.48

10,748.40

30.59

12,405.50

26.92

4,664.27

71.91

22,713.95

33,987.75

849.00

CONTRIBUTION TO RETIREMENT SAVINGS

The contribution to Retirement Savings Plan (401(k), SEP IRA, etc.) is recommended. The maximum amount for 401(k) is \$19,500 (\$26,000 if age 50 or older), and the maximum amount for SEP IRA (Simplified Employee Pension) is \$57,000. In 2021, taxpayers can contribute up to \$19,500 (\$26,000 if age 50 or older) for 401(k) and up to \$58,000 for SEP IRA.

RETIREMENT PLANS: TRADITIONAL IRA AND ROTH IRA

Taxpayer can contribute up to \$6,000 (\$7,000 if age 50 or older) to an IRA account by April 15, 2021 to be eligible for tax deduction for 2020. Taxpayer may convert a traditional IRA to a Roth IRA. There is no limit for conversion income, however, the conversion may result in taxable consequence in certain situations (paying back tax benefit from Traditional IRA).

DISTRIBUTION OF RETIREMENT ACCOUNT

Distribution that occur before an account holder reaches the age of 59 ½ are taxed as ordinary income and may be subject to a 10% penalty. Amount received from IRAs or qualified plans may be rolled over tax-free if rollover is made within 60 days of the date of the distribution. There are limited exceptions from the 10% additional tax for distributions made for medical and educational purposes and for "first-time homebuyers". Please contact our office for more details when exception applies in 2020.

GIFT TAX / ESTATE TAX EXCLUSION

For 2020 and 2021, the annual gift tax exclusion is \$15,000. A taxpayer, making a gift valued more than \$15,000 to anyone other than spouse, should report the gift on the tax return. For 2020, a unified gift and estate tax exemption per person is \$11,580,000. Please consult with a tax advisor before making a gift more than the annual exclusion since exceeding amounts will count against the lifetime exclusion.

FOREIGN-EARNED INCOME EXCLUSION

In 2020, a U.S. individual living abroad can exclude up to \$107,600 of foreign-earned income if the taxpayer satisfies either the bona fide residence test or the physical presence test. The exclusion applies separately to each spouse; as such, if both spouses are qualified individuals, the spouses when filing jointly may exclude up to \$215,200. A qualified individual is either a person whose tax home is in a foreign country and who is a U.S. citizen with a bona fide residence in a foreign country for an uninterrupted period which includes an entire taxable year; or a U.S. citizen or resident who, during any period of 12 consecutive months, is present in a foreign country or countries during at least 330 full days in such period (physical presence test). Please contact our office for more details.

PRINCIPAL RESIDENCE

Taxpayers may qualify to exclude income gained from selling primary residence (living at least 2 years out of the previous 5 years) up to \$250,000 of gain on sale of home if single (up to \$500,000 if married filing jointly). Please contact our office for more details.

REQUIRED MINIMUM DISTRIBUTIONS (RMD)

If a taxpayer turned age 70 ½ in 2019, the RMD may be taken prior to the end of 2020 or, as an alternative, prior to April 1, 2020. The deadline for taking RMD is December 31 each year. The CARES Act waives the RMD requirement in 2020. Please contact our office for more details.

REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS (FBAR)

Taxpayers with an interest in, or signature or other authority over, foreign financial accounts, whose aggregate value exceeded \$10,000 at any time during 2020, must report foreign Bank and financial Accounts (FBAR) by April 15, 2021. Foreign financial accounts include bank accounts, brokerage accounts, mutual funds, trusts, or other type of foreign financial accounts. Under IRC Section 5321 the maximum penalty for an FBAR violation is \$12,921 unless the violation is willful. For willful violations, the penalty may be the greater of \$129,210 or 50% of the balance in the account at the time of the violation, for each violation.

Starting from 2011, taxpayers with specified foreign financial assets that exceed certain thresholds must report those assets to the IRS on Form 8938.

Taxpayers living in the US:

- **Single or Married Filing Separately:** Total value of assets was more than \$50,000 on the last day of the tax year, or more than \$75,000 at any time during the year.
- **Married Filing Jointly:** Total value of assets was more than \$100,000 on the last day of the tax year, or more than \$150,000 at any time during the year.

Taxpayers living outside the US:

- **Single or Married Filing Separately:** Total value of assets was more than \$200,000 on the last day of the tax year, or more than \$300,000 at any time during the year.
- **Married Filing Jointly:** Total value of assets was more than \$400,000 on the last day of the tax year, or more than \$600,000 at any time during the year.

REINVESTED DIVIDENDS

Taxpayers, not updating mutual fund cost basis for dividends received and investing back into mutual fund in form of additional shares, will end up being double taxed. This is a common mistake that many taxpayers make. Reinvested dividends should be considered as additional purchases of stock at different prices. Please keep any related record

CAPITAL GAIN (LONG-TERM)

Rate	Taxable Income Breakpoint (2020)			
	Single	Married Filing Jointly	Married Filing Separately	Head of Household
0%	\$40,000	\$80,000	\$40,000	\$53,600
15%	\$441,450	\$496,600	\$248,300	\$469,050
20%	No Breakpoint			

Depending on the amount of adjusted gross income (AGI), net investment income tax (3.8%) can be added.

INVESTMENT INTEREST

If taxpayers borrow money to buy property for investment, interest that taxpayers pay is investment interest and is tax deductible. Deductible investment interest is limited to taxpayers' net investment income. Taxpayers are allowed to carry over disallowed investment interest deduction into next tax year.

INSTALLMENT SALE

Owner Financing (Seller Financing) or Installment Sale is a sale of property where at least one payment is to be received after the tax year in which the sale occurs. It allows for the deferral of gain recognition because the seller recognizes the gain over the taxable years in which the payments are actually received. This method does not apply to the sale of stock and bond.

CALIFORNIA ABC TEST (AB 5 Ch. 19-296)

Under AB 5, most workers are presumed to be an employee for purposes of the Labor code, the Unemployment Insurance Code, and for most wage orders of the Industrial Welfare Commission unless a hiring entity satisfies a three-factor test, referred to as the ABC test. Under the ABC test, all three of these conditions must be met in order to treat the worker as an independent contractor:

- Ⓐ The worker is free from the control and direction of the hiring entity in connection with the performance of the work.
- Ⓑ The worker performs work that is outside the usual course of the hiring entity's business.
- Ⓒ The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.

Within the passage of Proposition 22, drivers for app-based transportation and delivery services such as Uber, Lyft, and etc. are independent contractors for the network company meets certain conditions.

NET OPERATING LOSS (NOL)

For losses arising in tax years beginning January 1, 2018 to December 31, 2020, it is 100% of taxable income to claim on pre-2021 taxable year return (temporary repeal of 80% taxable income limit). Carryovers are allowed indefinitely (California NOLs can be carried forward up to 20 years).

AUTOMOBILE EXPENSE

For 2020, the standard mileage rate is 57.5¢ per mile. Taxpayers should keep a detailed mileage log for substantiation. Commuting mileage incurred while traveling from home to one or more regular places of business are generally non-deductible.

BAD DEBT, CASUALTY AND THEFT LOSS

When claiming tax deduction for portion of losses on tax returns, taxpayers should keep related documents to prove bad debts, casualty and theft loss in case of audits.

SECTION 179 AND SPECIAL DEPRECIATION

Section 179 allows business owners to deduct up to \$1,040,000 for purchasing equipment, and the phase-out threshold is \$2,590,000 in 2020. Qualified new or used equipment's bonus depreciation amount can be claimed as an expense up to 100% from September 28, 2017 to December 31, 2022.

MEAL & ENTERTAINMENT

Client Entertainment expense (sporting event tickets, theater tickets, golf outings, and yacht excursions) is non-deduction from 2018. Meals for employees are 50% deductible and meals for employees while traveling for business are 50% deductible. Clients meals are 50% deductible the same as before. However, holiday parties, company picnics, and other occasional employee appreciation events are 100% deductible. Taxpayers should keep related events and meals expense documents to claim the full deduction.

PENSION PLAN

Putting more money into retirement account is a good idea in terms of tax savings and getting ready for retirement early. Taxpayers should consult with tax advisors and financial advisors before starting a pension plan.

RESEARCH ACTIVITIES CREDIT

Startups and small business can claim the credit for increasing research activities and may deductible up to \$1.25 million (or 250,000 each year for up to five years).

Businesses use the R& D tax credit to offset payroll taxes by utilizing the payroll tax credit election. It is an annual election made by a qualified small business specifying the amount of research credit, not to exceed \$250,000 that may be used against the employer portion of social security liability.

SEXUAL HARRASSMENT TRAINING

With the signing of SB 778, California employers with five or more employees will now be required to provide by January 1, 2021:

- Ⓐ At least two hours of classroom or other “effective interactive training and education” regarding sexual harassment prevention to all **supervisory** employees; and
- Ⓑ At least one hour classroom or other “effective interactive training and education” regarding sexual harassment prevention to all **non-supervisory** employees.

After this initial sexual harassment prevention training is completed, a covered employer must provide the requisite sexual harassment and prevention training to each employee in California once every two years.

SB 778 further requires that covered employers are required to provide training to nonsupervisory employees within six months of hire, and to new supervisory employees within six months of the assumption of a supervisory position.

The following link is the online harassment training:
www.dfeh.ca.gov/shpt/

CANNABIS (FULL EXPENSE DEDUCTIONS ALLOWED IN CALIFORNIA STARTING IN 2020)

Since Cannabis was legalized in California, California allowed only corporate taxpayers engaged in cannabis activities to claim business expense deductions and credits for their ordinary and necessary business expenses, as long as they were not convicted of specified illegal activities, including drug trafficking, in a criminal proceeding or other proceeding in which a governmental agency was involved.

INCOME TAX AUDIT

SOURCE OF LIVING EXPENSE

When taxpayers' expenditures are greater than their reported income, supporting documents for source of fund, which used for their living expenses exceeding their income, are required.

SOURCE OF FUND

Taxpayers should have supporting documents for the source of funds of down payment used to acquire a real estate or business.

BANK DEPOSIT

When the deposit includes non-sale deposits, supporting documents, such as copies of cancelled checks and deposit slips, should be kept as your substantiation. Otherwise, they may be treated as additional income.

CHARITABLE CONTRIBUTION

Taxpayers who make charitable contributions equaling \$250 or more must have records and written receipt from the qualified organization. Taxpayers who make charitable contribution less than \$250 should keep canceled checks. Taxpayers donating an item or a group of similar items valued at more than \$5,000 must also complete Section B of Form 8283, which generally requires an appraisal by a qualified appraiser.

SEPARATE BANK ACCOUNT

Keeping separate accounts (business and personal) is always the smart thing to do. The proper way to transfer business income to personal account is either by paying yourself a salary and/or making a transfer as withdrawal/distribution to personal accounts.

CASH TRANSACTION

A currency transaction report (CTR) is a report that U.S. financial institutions are required to file for each deposit, withdrawal, exchange of currency, or other payment or transfer, by, through or to the financial institution, which involves a transaction in currency of more than \$10,000. The bank will report to the IRS if any attempts known as structuring, which are intentional attempts to withdraw and deposit more than \$3,000 but less than \$10,000 to avoid CTR. A taxpayer must also report using Form 8300 if he/she received an aggregated amount over \$10,000 during a taxable year from a customer.

INCOME TAX AUDIT

FOREIGN GIFT

Gifts or bequests valued at more than \$100,000 from a nonresident alien individual or foreign estate or gifts valued at more than \$16,388 for 2020 from foreign corporations or foreign partnerships must be reported to IRS by filing Form 3520.

FORM 1099 FILING REQUIREMENT

A taxpayer may be subject to a penalty if he/she files a form 1099 without meeting form 1099 filing requirements. The penalty applies if taxpayers fail to file in a timely manner, fail to include all information required to be shown on a return, and/or includes incorrect information. Penalty ranges from \$50 to \$270. (Form 1099 filing due date: 1) 2/1/2021 for 1099-NEC & 1099-MISC, 2) 3/1/2021 for 1099-DIV, 1099-INT, and 1099-R.)

RECORD KEEPING

Bank statements, cancelled checks, receipts, invoices and all other documents used to prepare income tax returns should be kept at least 4 years from the date tax returns were filed. When taxpayers acquire or sell property, whether business or personal, taxpayers should keep escrow documents and/or other documents supporting real estate transactions for at least 4 years from the date tax returns are filed.

AUDIT NOTICE

When taxpayers receive an audit notice, the first thing for them to do is contact their tax advisors. Sometimes auditors visit business site without prior arrangement. Taxpayers should always ask for proper identification, inquire about the reason for visitation and contact tax advisors before giving out any information to auditors.

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