# TaxTips

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Compliments of Davis Tax & Financial
105 Dayton Street ● Danvers, MA 01923
O: (978) 777-4645 ● C: (617) 962-1563
taxpro@davistaxandfinancial.com
www.davistaxandfinancial.com/


## Using Family Loans to Secure Better Home Loan Interest Rates

Here's some information on how you can help a family member buy a home by making a loan to them while ensuring that you and the family member benefit from a tax-smart loan structure.

With the current national average interest rates as of 11/29/2023 for 30-year and 15-year fixed-rate mortgages at 7.69 percent and 7.00 percent, respectively, family loans can offer a much more attractive alternative. By charging the Applicable Federal Rate (AFR) as interest, you can give the borrower a good deal without giving yourself a tax headache.

The IRS issues new AFRs for term loans every month. The rates for January 2024 are as follows:

- Short-term loan (three years or less): 5.0 percent
- Mid-term loan (over three years but not more than nine years): 4.37 percent
- Long-term loan (over nine years): 4.54 percent

Charging at least the AFR for a term loan to a family member allows you to avoid federal income tax and federal gift tax complications.

But if you charge less than the AFR, you may need to navigate some tax complications. Two tax-law exceptions, the $10,000 and $100,000 loopholes, can help you avoid these complications, although they may not be suitable for all home loans.

It is crucial to document the loan with a written promissory note and secure it with the borrower's home for them to claim deductions for qualified residence interest expenses. Make sure the borrower signs the note and that the note includes details such as the interest rate, a schedule of interest and principal payments, and any security or collateral for the loan.

In conclusion, family loans can provide homebuyers with better interest rates than commercial lenders offer, especially if family members charge the AFR. Remember to consider the loan terms and tax consequences when structuring the loan.

## Tax Credits for Electric Vehicles: The Latest from the IRS

The IRS recently issued new guidance on electric vehicles. There are four ways you can potentially benefit from a federal tax credit for an EV you place in service in 2023 or later:

1. Purchase an EV and claim the clean vehicle credit.
2. Lease an EV, and benefit from the lessor's EV discount.
3. Purchase a used EV that qualifies for the used EV tax credit.
4. Purchase an EV for business use and claim the new commercial clean vehicle tax credit.

The new clean vehicle credit is available through 2032, with a maximum credit of $7,500. To qualify for the clean vehicle credit, you must meet specific criteria, including income limits, vehicle price caps, and domestic assembly requirements. The credit amount for vehicles delivered on or after April 18, 2023, depends on the vehicle meeting critical minerals sourcing and/or battery components sourcing requirements.

If you can't find an EV that qualifies for the credit or your income is too high, you can lease an EV from a leasing company that can claim up to a $7,500 commercial clean vehicle tax credit. The leasing company may then pass on all or part of the credit to you through reduced leasing costs.

For used EV purchases, you can earn a credit of up to $4,000, but you must buy the vehicle from a dealer and meet the law's income caps and other restrictions.

Finally, if you purchase an EV for business use, you can qualify for the commercial clean vehicle tax credit, which is not subject to critical minerals or battery components rules, making it easier to qualify for this credit starting April 18, 2023.

To claim an EV credit, the seller must complete a seller's report and provide a copy to you and the IRS. For the clean vehicle credit, you will file IRS Form 8936; for the commercial clean vehicle credit, you will file IRS Form 8936-A.

## SECURE 2.0 Act Creates New Tax Strategies for RMDs

As you are likely aware, if you have an IRA or other tax-deferred retirement account, you must start taking required minimum distributions (RMDs) once you reach a certain age.

The SECURE 2.0 Act raises the age at which RMDs must first be taken, from age 72 to age 75, over the next 10 years. Specifically, the RMD age will be 73 for those born between 1951 and 1959 and 75 for those born in 1960 or later.

The purpose of RMDs is to ensure that you use the funds in your retirement accounts while you are still alive, rather than using those accounts as an estate planning device to pass money to your heirs tax-free.

The amount you are required to withdraw as an RMD depends on your age and the balance of your retirement account as of December 31 of the previous year. RMDs are required for traditional IRAs; SEP-IRAs; SIMPLE IRAs; solo 401(k) plans; and all employer-sponsored tax-deferred retirement plans, including 401(k) plans, 403(b) plans, profit-sharing plans, and 457(b) plans.

Your first RMD must be taken by April 1 of the year following the year you reach the age of RMD. For example, if you turn 73 in 2024, you have until April 1, 2025, to take your first taxable RMD. And then, including in 2025 and every year thereafter, you must take an annual RMD on or before December 31.

It's important to note that taking two RMDs in one year could increase your tax bracket and even your Medicare premiums. If you are faced with this situation, it's best to take the first RMD in the year you reach the age of RMD.

In the past, the IRS imposed an "excess accumulation" penalty tax of 50 percent if you failed to take your full RMD by the deadline. But starting in 2023, the SECURE 2.0 Act reduces the penalty to 25 percent. If you correct the shortfall within the "correction window," you can reduce the penalty to 10 percent. The correction window begins on January 1 of the year following the RMD shortfall and ends on the earlier of

- when the IRS mails a Notice of Deficiency,
- when the penalty is assessed, or
- the last day of the second tax year after the penalty is imposed.

If the shortfall was due to reasonable error and you took reasonable steps to remedy it, you may request a penalty waiver by filing IRS Form 5329 and a letter explaining the reasonable error. Before filing the waiver request, you should make a catch-up distribution from your retirement accounts to make up for the RMD shortfall.

## Basic Estate Planning

You need an estate plan, regardless of whether or not you are among the ultra-rich. As recent news has shown, even those who have won the lottery or have substantial wealth can fall victim to poor estate planning.

While federal estate taxes may not concern you, you need a will to have your wishes honored after your death. Without a will, state law dictates the distribution of your assets, which may not align with your intentions. Additionally, if you have minor children, a will allows you to name a guardian to care for them in the event of your untimely passing.

Your heirs will want to avoid probate because it can be a costly and time-consuming legal process. A living trust gives you a valuable tool to avoid probate. By transferring legal ownership of your assets to the trust, you can ensure that your beneficiaries receive them without suffering through probate.

You can amend your living trust as circumstances change, providing flexibility and control over your assets.

It is also essential to keep your beneficiary designations up to date, as they take precedence over wills and living trusts regarding asset distribution.

Additionally, if your estate will suffer from federal or state death taxes, you should plan to minimize your exposure.

Estate planning is not a one-time event but a process that you should review and update regularly to accommodate life changes and fluctuations in estate and death tax rules. It is recommended that you check your estate plan annually to ensure it aligns with your wishes and circumstances.

## Tax-Free Rental Income with the Augusta Rule

The Augusta rule gets its name from the Masters Golf Tournament, where some members and others who live in the area receive tax-free rent by renting their homes for a week or two. You don’t have to live in Augusta to benefit from this rule.

IRC Section 280A(g), also known as the Augusta rule, states: “Notwithstanding any other provision of this section or section 183, if a dwelling unit is used during the taxable year by the taxpayer as a residence and such dwelling unit is rented for less than 15 days during the taxable year, then—

- no deduction otherwise allowable under this chapter because of the rental use of such dwelling unit shall be allowed, and
- the income derived from such use for the taxable year shall not be included in the gross income of such taxpayer under section 61.”

Here’s an example: John rents his home at $3,000 a day for 14 days. By applying the Augusta rule, he qualifies for no rental deductions. Here’s the good news, he excludes the rent, $42,000 ($3,000 x 14) from his income

# Donating Clothing to Goodwill and the Salvation Army

As the year comes to a close, many taxpayers consider making clothing and household item donations both to give back and to optimize their tax deductions.

Recent cases, like the one involving Duncan Bass, underscore the significance of understanding and adhering to IRS regulations related to these contributions.

Mr. Bass made an astonishing 172 trips to Goodwill and the Salvation Army, strategically ensuring that each donation receipt remained below the $250 threshold. Unfortunately, he didn't account for the rules on (a) aggregation of similar items and (b) appraisals.

But before delving into aggregation and appraisal, let's clarify the $250 rule. If you make a single charitable contribution of $250 or more, you must obtain written acknowledgment from the charitable organization to validate your deduction. This is often referred to as a "contemporaneous written acknowledgment."

- It confirms the amount of cash or describes any property you contributed.
- It must indicate whether the charity provided you with any goods or services in return for the gift. If so, it must furnish a description and a good faith estimate of the value of those goods or services.
- If applicable, it must specify that the only benefit you received was an intangible religious benefit.

If you make multiple smaller gifts to the same charity throughout the year, you'll need acknowledgment only if any single gift is $250 or more.

Determining fair market value can be the most challenging aspect. The fair market value is not what you originally paid for an item; rather, it's what it's worth presently. Numerous reputable resources, such as The Salvation Army and Goodwill, offer donation value guides.

If you claim a deduction of over $5,000 for a non-cash charitable contribution of one item or a group of similar items, you must obtain a qualified appraisal for that item or group of items and attach it to your tax return.

**Key point.** A "group of similar items" can trigger the appraisal requirement. This is precisely what occurred in Mr. Bass's case. His 172 trips comprised clothing donations totaling $13,852 and $11,594 for the two years before the court—well surpassing the $5,000 appraisal requirement for the group.

## Strategic Insights for Employing Your Spouse

If you own your own business and operate as a proprietorship or partnership (wherein your spouse is not a partner), one of the smartest tax moves you can make is hiring your spouse to work as your employee.

But the tax savings may be a mirage if you don't pay your spouse the right way. And the arrangement is subject to attack by the IRS if your spouse is not a bona fide employee.

Here are four things you should know before you hire your spouse that will maximize your savings and minimize the audit risk.

**1. Pay benefits, not wages.** The way to save on taxes is to pay your spouse using tax-free employee benefits, not taxable wages. Benefits such as health insurance are fully deductible by you as a business expense, but not taxable income for your spouse.

Also, if you pay your spouse only with tax-free fringe benefits, you need not pay payroll taxes, file employment tax returns, or file a W-2 for your spouse.

**2. Establish a medical reimbursement arrangement.** The most valuable fringe benefit you can provide your spouse-employee is reimbursement for health insurance and uninsured medical expenses. You can accomplish this through a 105-HRA plan if your spouse is your sole employee, or an Individual Coverage Health Reimbursement Arrangement (ICHRA) if you have multiple employees.

**3. Provide benefits in addition to health coverage.** There are many other tax-free fringe benefits you can provide your spouse in addition to health insurance, including education related to your business, up to $50,000 of term life insurance, and de minimis fringes such as gifts.

**4. Treat your spouse as a bona fide employee.** For your arrangement to withstand IRS scrutiny, you must be able to prove that your spouse is your bona fide employee. You'll have no problem if

- you are the sole owner of your business,
- your spouse does real work under your direction and control and keeps a timesheet,
- you regularly pay your spouse's medical and other reimbursable expenses from your separate business checking account, and
- your spouse's compensation is reasonable for the work performed.

## HSAs for Business Owners

When enacted, the Affordable Care Act (ACA) eliminated most small-business health plans that reimbursed individually purchased health insurance. Consequently, many small business owners with fewer than 50 employees chose health savings accounts (HSAs) or opted to provide no health coverage at all.

As of 2022, over 35 million HSAs were active, with assets amounting to $104 billion. A 2022 Devenir survey expects this to increase to 43 million accounts with $150 billion in assets by 2025.

HSA basics:

- To open an HSA, you must have high-deductible health insurance.
- 2023 contribution limits are $3,850 for individuals and $7,750 for families. These limits increase slightly in 2024.
- If you're 55 or older by the end of the year, you can contribute an extra $1,000.
- HSAs come with substantial tax benefits, including deductible contributions, tax-free earnings, and tax-free withdrawals for qualified health expenses.

Monies taken from HSAs are tax-free when used for qualified medical expenses. If you don't use the funds for medical expenses, those funds grow. Once you reach Medicare age, you can either

- withdraw the funds and pay taxes, or
- use the funds tax-free for medical expenses.

You generally cannot make HSA contributions if you have a non-high-deductible health plan that overlaps with the high-deductible plan. Similarly, you cannot contribute to an HSA and a general-purpose healthcare flexible spending account (FSA) in the same year.

HSAs are similar to IRAs. They are trust or custodial accounts you set up at banks, insurance companies, or brokerage firms. The purpose of your HSA is solely to pay your qualified medical expenses. Like IRAs, HSAs can offer various investment options, though some trustees might limit choices to more conservative options.

## The Kiddie Tax and How to Avoid It

The kiddie tax was enacted by Congress to prevent parents from passing investment income to their children, who typically have a lower tax rate. Under the kiddie tax rules, a portion of a child's net unearned income may be taxed at the parent's marginal federal income tax rate. The kiddie tax applies to children up to age 24, assuming they meet certain criteria.

The kiddie tax can result in higher taxes on an affected child's net unearned income than otherwise would apply. For example, if a child's net unearned income exceeds the annual threshold of $2,500 for 2023, the portion of the income exceeding the threshold is subject to the kiddie tax.

The kiddie tax does not apply if the child's net unearned income for the year remains below the threshold for that year.

There are four primary criteria for the application of the kiddie tax, including the child not filing a joint return for the year, at least one parent being alive at year's end, the child's net unearned income for the year exceeding threshold for that year, and the child not meeting the specific age rules. With these rules in mind, there are several strategies to limit the kiddie tax's impact on your child's unearned income:

**Exploit the unearned income threshold.** Manage your child's unearned income to ensure it remains below the annual threshold.

**Pick the right investments.** You can reduce unearned income by selecting investments with minimal or no dividends, such as growth stocks or tax-efficient mutual funds.

**Invest in Series EE U.S. Savings Bonds.** The accumulated interest income from these bonds is tax-deferred until cashed in, meaning no kiddie tax applies if the bonds are cashed in when the child is exempt from the kiddie tax.

**Use a Section 529 College Savings Plan.** Withdrawals from a Section 529 plan account are federal-income-tax-free, provided they're used for qualifying education expenses.

**Invest in life insurance products.** Investment accounts included in life insurance products such as universal life policies allow tax-deferred accumulations and can be borrowed against for college costs.

**Generate earned income.** The kiddie tax does not apply to children aged 18-23 if their earned income exceeds 50 percent of their support for the year.

## The QSEHRA Health Plan

If you're a small employer (fewer than 50 employees), you should consider the Qualified Small Employer Health Reimbursement Arrangement (QSEHRA) as a good way to help your employees with their medical expenses.

One very attractive aspect of the QSEHRA is that it can reimburse individually purchased insurance without subjecting you to the $100-a-day per-employee penalty that generally applies to the employer that reimburses employees for individually purchased insurance. The second and perhaps most attractive aspect of the QSEHRA is that you know your costs per employee. The costs are fixed—by you.

**Eligible employer.** To be an eligible employer, you must have fewer than 50 eligible employees and not offer group health or a flexible spending arrangement to any employee. For the QSEHRA, group health includes excepted benefit plans such as vision and dental, so don't offer them either.

**Eligible employees.** All employees are eligible employees, but the QSEHRA may exclude

- employees who have not completed 90 days of service with you,
- employees who have not attained age 25 before the beginning of the plan year,
- part-time or seasonal employees,
- employees covered by a collective bargaining agreement if health benefits were the subject of good-faith bargaining, and
- employees who are non-resident aliens with no earned income from sources within the United States.

**Dollar limits.** Tax law indexes the dollar limits for inflation. The 2024 limits are $6,150 for self-only coverage and $12,450 for family coverage. For part-year coverage, you prorate the limit to reflect the number of months the QSEHRA covers the individual.

## QUIK TIPS

**1.** If by year-end you haven't contributed funds to your IRA, or if you've put in less than the maximum allowed, don't worry. You can contribute to either a traditional or Roth IRA up until the April due date for filing your tax return. Your employer contributions to a Keogh, SEP, or a SIMPLE plan are due by the time you file your tax return unless you have a valid extension then you have until the extended due date to make the contribution.

**2.** Are you planning on making any substantial gifts? Talk to me first. For 2023, gifts with values exceeding $17,000 must be reported to the IRS. The threshold increases to $18,000 in 2024.

**3.** The new standard mileage rates (SMR) for the use of a car, including vans, pickups, or panel trucks are:

| | 2023 | 2024 |
|---|---|---|
| Business SMR | 65.5¢ | 67.0¢ |
| Medical and Moving rate | 22.0¢ | 21.0¢ |
| Charitable rate per mile | 14.0¢ | 14.0¢ |
| | | |

**4.** Have you thought about contributing to a Roth IRA but your income disqualifies you? Give me a call to discuss the backdoor Roth IRA option.

**5.** As a self-employed taxpayer, you may contribute to a sole-owner 401(k) retirement plan as both an employer and as an employee. As an employer, you may contribute up to 25 percent of your total income to your retirement plan. As an employee, you may also contribute up to an additional $22,500 in 2023 ($30,000 if age 50 or over). Your maximum contribution to an individual 401(k) plan is the lesser of $66,000 ($73,500 if age 50 or over). or the sum of the employer and employee maximums. Unlike other retirement plans such as SE3 and SIMPLE IRAs, an individual 401(k) plan allows you to take out loans from plan assets.

**6.** The Federal Estate Tax exemption for 2023 is $12,920,000 and $13,610,000 for 2024. The rate is 40%. Additionally, heirs get to use stepped-up basis to value assets inherited. The exemption in MA is now $2,000,000.

**7.** In 2023 the tax rate of 37 percent will affect individuals and Heads of Households whose taxable income exceeds $578,126 ($693,751) for married taxpayers filing a joint return.

**8.** If you turned age 72 in 2023, or later you are not required to begin your required minimum distributions (RMD) from your IRA until April 1, 2025. You will also need to take your 2025 distribution by December 31st. Failure to do so results in a 25 percent penalty on the amount you do not take.

**9.** Long Term Care Premiums may be tax deductible with limits based on your age and whether you itemize deductions. Self-employed taxpayers may include the allowable premiums with their self-employed health insurance whether they itemize or not.