SPRING 2023

Dear Client

We hope this finds you enjoying warmer weather and vacation dreams. While we have taken some time to recover after tax season, we are now resuming our schedule of education to better assist you in your tax planning. Our office is available year-round to provide tax planning assistance, explore the impact of life changes that will affect your tax return, and as a sounding board as you explore new business opportunities.

In this newsletter we review the pros and cons of filing separately for those who are married. There are some significant tax issues to be considered when choosing either filing status.

Have you taken a loan from your 401(k) or 403(b) plan through work? Be aware of the possible tax consequences if the loan is not paid back in full. The Tax Cuts and Jobs Act of 2018 allows for a longer period to repay the loan if you leave employment before the loan is paid off in full.

Changes are on the horizon for the reporting of income from the sale of goods and services. Prior to 2023, Form 1099-K, which is used to report third-party merchant transactions, was subject to a fairly high threshold of $20,000 and 200 transactions. We cover the new regulations, which includes a much lower threshold for reporting transactions.

And then we look at the tax benefits, for our clients who are 70 years of age or older, of a qualified charitable distribution (QCD) from their IRA. This benefit is not available from a 401(k) or 403(b), but the funds can be transferred from their employment based program to a personal IRA thereby giving them the opportunity to take advantage of the benefits of a QCD.

Finally, what is the process when a taxpayer is deceased? How is the reporting handled when the deceased is a spouse or a non-spouse? We review the filing requirements depending on the marital status and cumulative assets of the decease person.

For these tax programs, or other tax issues as they may arise, contact our office for an assessment of how your tax situation would be affected.

New Self-Employed Reporting Rules

In 2021, Congress enacted more information reporting for transactions paid through third-party payers. Third-party settlement networks, such as PayPal, Square, Venmo and eBay, must send Form 1099-K to receipients who are paid over $600 a year for goods or services.

The rules first kick in for 2023 1099-Ks which will be sent out in 2024. They were supposed to take effect for filings in 2023, but IRS delayed the changes. More people than ever will receive 1099-Ks because the new rules greatly lower the threshold for 1099-K filings. Under the old rules, these 1099-Ks were sent only to payees with over 200 transactions and who were paid over $20,000, now the threshold is a total of $600 or more regardless of the number of transactions. So one transaction of $600 could generate the issuance of a Form 1099-K.

Taxpayers will have to figure out how to report the amounts on their 1040s. If you sell a washing machine on eBay in 2023 for $800, and you paid $1500 for it, eBay should send you a 1099-K in late January 2024, reporting the $800 sales price. Even though you do not have income, and you cannot deduct this personal loss, you will still have to report the transaction on your Form 1040 that you file next year. You will report the $800 as other income on Schedule 1, line 8z, and the cost as other adjustments on Schedule 1, line 24z, so the two amounts offset. However, since you cannot take a loss, the amount of the reportable cost will be equal to the sales price.

Say StubHub sends you a 1099-K for selling $1,600 tickets that you paid $400 for. You'd report $1,200 of capital gain on Schedule D. People in business would generally report their income on Schedule C. The 1099-K reports only the gross amount of the payments from the entity. It does not account for offsets, such as fees, refunds or chargebacks. If you pay fees to an online marketing place, you would increase your cost basis in the item sold by the fee amount when figuring any gain or loss. So be sure to keep good records.

Payments from families and friends, that are deposited into personal accounts, should not be reported on 1099-Ks. The new reporting rules apply only to payments for sales of goods and services. If, for example, if you pay for plane tickets for two of your friends, and they use Venmo to reimburse you $900 for their share of the cost, Venmo should not send you a 1099-K.

The 1099-K changes does not alter the taxation of the underlying transactions. Even if you do not receive a 1099-K for money received through a website or an app for selling goods or services, you are still taxed on the gain or income. However, IRS knows many people will not report the amounts, absent receiving a 1099 form. The income misreporting rate for taxpayers who do not get a W-2 or a 1099 is 55%.

Relaxing the 1099-K reporting rules has bipartisan support in Congress. Although it is unlikely that the new changes will be repealed in their entirety, as many Republicans desire, the odds are better for some sort of compromise. For instance, increasing the annual monetary threshold to $5,000 or $10,000 and/or perhaps delaying the start date of the changes for another year or two. Lawmakers and taxpayer advocacy groups worry how IRS will handle the influx of 1099-K forms and the abundance of phone questions if the law is implemented in 2024.

If you are selling business goods and services, or selling personal items in an online marketplace, contact our office for an assessment of how this will affect your tax liability (if at all) and to gather the information that will be needed at tax time to accurately complete your return.

Is Married Filing Separately The Right Tax Filing Status For You?

Over the past few years, there has been an uptick in the number of taxpayers asking about married filing separately as a tax status. Some of the inquiries are because the status can be confusing, but others have focused on whether there was a benefit to switching status to claim certain pandemic-related benefits. Now that those benefits have expired, some taxpayers wonder if it is more advantageous to use the status of married filing jointly. Here's what you need to know.

Marital Status

Your marital status is determined as of the last day of the tax year — December 31 — according to state law. If you are married on that day, you are married for tax filing purposes. It is no more complicated than that. There is no allocation of the status based on the date of marriage (this may be different on the state return if you reside in a community property state).

If you are married, on or before the last day of the year, you generally have two choices: married filing jointly (MFJ) or married filing separately (MFS).

MFJ Is More Popular

Most married couples file jointly. For the tax year 2020, the last year for which complete data is available from IRS, 55,322,922 taxpayers filed jointly, representing about one-third of all returns filed. That same year, just over 2% of taxpayers filed married filing separately. For comparison, for the tax year 2010, 37.5% of taxpayers filed jointly, while 1.8% filed married filing separately.

MFJ and MFS Differences

In many cases, if you are married and choose to file as married filing separately, you will usually pay more tax. That's because if you file as married filing separately, you lose the opportunity to claim some tax preference items. For example, you typically cannot take the student loan interest deduction, education credits, or the earned income credit if you file MFS.

Many married couples — especially those with two income earners — perceived that, prior to the Tax Cuts and Jobs Act of 2018 (TCJA), they were paying more tax by filing MFJ. There was a little bit of truth to that since the MFJ tax rate brackets were not the same as two single brackets. That changed in 2018 — now, the MFJ tax brackets are twice those for single filers. Now, MFS returns tend to look the same as those for single filers.

The pandemic created more interest in filing separately since, for some couples, the math occasionally worked out to provide additional benefits (like stimulus checks) for couples who file separately.

Electing MFS

But does that still hold true in 2023? There are a few scenarios where electing MFS status makes sense:

- **Money.** The numbers may look better when you file MFS. That is not always true, and is very facts and circumstances dependent, but it can happen, for example, when both spouses work. Since our tax system is progressive — the rate increases as the dollars increase, filing jointly could move you into a higher tax bracket. But brackets do not tell the whole story — be sure to factor in other tax breaks when doing the math.
- **Medical or Other Expenses.** Occasionally one spouse has significant medical or other expenses but little income. Since medical expenses are subject to an adjusted gross income (AGI)threshold before you can deduct them, joint filers may have difficulty meeting that threshold. However, taxpayers filing MFS with a relatively low income can exceed the threshold much more quickly. Ditto for casualty losses in a federally declared disaster area. Remember, though, that your spouse has to itemize if you do, so this only works if you have enough combined deductions.
- **Privacy.** Your spouse's tax return will rarely be made public, but if it is, filing separately ensures that yours stay private. Who falls into this category? Generally, the spouses of politicians. But it can also be the case for executives of companies or others under public scrutiny.
- **Separate Lives.** Many married couples maintain separate accounts. It may be for convenience, independence, professional or liability reasons, or something else altogether. Keeping accounts or income separate does not necessarily translate into separate tax returns. However, if you maintain independent financial lives to the point where you do not care/want to know what is going on with your spouse's finances, you should not file a joint tax return. The IRS expects you to review and understand your tax return before you sign it. If you do not have a level of comfort in signing a joint return, consider filing MFS.
- **Protection.** In the movie Steel Magnolias, Truvy remarks to Clairee, "If you can achieve puberty, you can achieve a past." Many taxpayers these days marry someone with a past — prior tax debts, defaulted student loans, child support payments, etc. Filing jointly may result in an offset of your refund to pay back those debts. Filing separately may preserve your right to claim a refund — yes, you can file as an injured spouse on a joint return to achieve the same result, but it is not guaranteed.

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- **Student Loans.** Income-based repayment plans for student loans are popular these days — according to the Congressional Budget Office, the number of borrowers in income-driven plans who had taken out direct loans in 2017 was approximately 45%, an increase from just 12% in 2010. If you owe student loans and are subject to an income-based plan, you may be able to lower your monthly repayment amount by filing as MFS rather than MFJ since, for most plans, household income is calculated using the borrower's tax return.
- **Community Property Laws.** The regulations are a little different for those who reside in a community property state. If you reside in one of the nine community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin) contact us for a comprehensive review of your tax situation and the effect of your state regulations.

It is worth noting that filing married separately does require coordination with your spouse — this is not a decision that you make in a bubble. While you include only your own income, deductions, exemptions, and tax credits (unless in a community property state), you still have to include your spouse's information, including their Social Security Number or Taxpayer ID. You also have to elect the same deduction option as your spouse — you must both opt to itemize or take the standard deduction.

More To Consider

Here are some additional things to keep in mind:

- You can file MFS status in any year if you are married and otherwise meet the criteria. There is no requirement, for example, that you live apart (you can absolutely live together) or do not get along (you can be madly in love). Some tax items are negatively impacted if you do live together and file MFS such as Social Security income. Fully 85% of your benefit is taxable regardless of your adjusted gross income.
- Once you have filed MFJ, you cannot amend your return to MFS, though you can file a superseded return before the April 15 tax filing deadline. The opposite, however, does work: you can amend MFS returns to file as MFJ at any time.
- If your spouse passes away, you can continue to use whichever married status works for you for that tax year unless the surviving spouse has re-married in the year that their spouse is deceased. Then they would file a joint return with their new spouse and the deceased spouse's return (if they have a filing requirement) would be MFS.
- For most married taxpayers filing jointly, the requirement to file a tax return kicks in when your gross income hits $27,700 in 2023 (it is slightly higher for taxpayers 65 or older). But the gross income to require you to file a tax return if you're MFS? Just $5.

In the past I have also recommended a filing status of MFS when there is a tax bill due, and the couple is either planning on separating or want to pay their "fair share" of the tax due. When filing a joint return, the total amount of the tax liability is assessable to either spouse. By filing an MFS return, the liability on each return is assessable to each spouse individually.

Several factors go into the choice of filing an MFS return and should be entered into with the full knowledge and consent of each spouse. We can prepare your return showing the impact of changing from MFJ to MFS based on your individual situation.

Risks Of A Loan From Your Retirement Plan

Loans from 401(k)s are generally tax-free if the amount taken out does not exceed the smaller of $50,000 or 50% of the retirement account balance. The maximum loan amount is equal to the lesser of $100,000 or 100% of the balance for people in federal disaster areas. The maximum repayment period for plan loans is generally five years. Loans used to buy or construct a main home can be paid back over a longer time. In general, repayments must be made quarterly or more often (generally they are a payroll deduction for the employee). If one falls behind on repayments and fails to pay by the end of the following quarter, then any unpaid loan amount, plus interest, is treated as a deemed distribution.

If the loan is not repaid in full prior to leaving employment and arrangements are not made to repay the loan after employment, the unpaid amount is treated as a distribution subject to the 10% penalty (if pre-age 59 ½) and ordinary tax in all situations. However, under the TCJA, the repayment period after leaving employment has been extended to the due date of your income tax return plus extensions. For example, if you leave employment in July and leave behind an unpaid loan from your 401(k) or 403(b), you now have until October 15 of the following year to repay the loan.

IRAs and retirement plans can be utilized to pay big medical expenses. But the exception to the 10% penalty for pre-age-59½ payouts is narrow. The money must be used for medical costs of the taxpayer, spouse or dependent. The funds must cover costs paid in the year of the withdrawal. And only the amount of medical expenses that exceeds 7.5% of adjusted gross income counts. In a recent case, a man who was laid off from work took a distribution from his 401(k) before age 59½. He claimed he used a portion of the money for his son's surgery. He submitted a bill, but he could not prove he paid it.

If you have taken a loan from your employment-based program (loans are not eligible through an IRA) and are planning on changing jobs, contact us for information on how to avoid inadvertent tax consequences.

Qualified Charitable Distribution

Taxpayers who are 70 years of age or older are eligible for the tax benefits of a qualified charitable distribution (QCD) from their IRA. It can be used to meet their annual required minimum distribution (RMD) or to move money to a qualified charity with significant tax benefits on their tax return. For clients who are already charitable and are receiving no benefit on their income tax return, they should consider utilizing the transfer of funds directly to the qualified charity from their IRA.

A qualified charitable distribution (QCD) is a nontaxable direct transfer by the trustee of a client's traditional IRA to a 501(c) charity. The transfer must move directly from the IRA to the charity. Clients who have a charitable intent and are eligible should use QCDs, which can allow clients to fulfill a charitable intent, reduce taxable income, stay in a lower marginal tax bracket, and reduce income tax. By reducing taxable income, clients may reduce the monthly cost of Medicare and the taxation of Social Security benefits.

Also by reducing taxable income, clients may remain eligible for other tax credits and benefits, such as the tax credits for education or the eligibility to make Roth IRA contributions. In addition, appreciated investments, held in IRAs, may be used to make QCDs. In this case, taxable income is reduced by the appreciated amount, and income tax will never be paid on the appreciation. For the right client, QCDs are a win-win-win! A tax-saving benefit is received, while a charitable intent is fulfilled.

With the much higher standard deduction, many taxpayers can no longer itemize and therefore their charitable deductions are not benefitting them on their income tax return. By making a QCD, the taxpayer will get the full benefit of their charitable donations. The QCD must be a trustee-to-trustee transfer or, if you have check writing privileges on your IRA, a check written to the qualified charity will qualify.

For more information, contact our office to determine if you would benefit from a QCD and to make sure the regulations are followed in order to fully qualify for the benefit.

What Happens When Someone Has Died?

After someone with a filing requirement passes away, their representative should file the deceased person's final tax return. The personal representative of an estate is an executor, administrator, or anyone else in charge of the decedent's property. If the deceased person has a surviving spouse, then a joint return can be filed for that year and the date of death should be noted on the return. The IRS does not need a copy of the death certificate or other proof of death.

Usually, the representative filing the final tax return is named in the person's will or appointed by a court. Sometimes when there is not a surviving spouse or appointed representative, a personal representative will file the final return and attach Form 1310, Statement of Person Claiming Refund Due a Deceased Taxpayer, if the tax liability was overpaid.

Things to know about filing the final tax return:

Generally, the final individual income tax return of a deceased person is prepared and filed the same way as if the person were alive.

The return must report all income up to the date of death and claim all eligible credits and deductions.

If the deceased person did not file individual income tax returns for the years before their death, their surviving spouse or representative may have to file prior year returns.

The IRS considers the surviving spouse married for the full year their spouse died if they don't remarry during that year.

The same tax deadlines apply for final returns. If, for example, the deceased person died in 2022, their final return is due by April 18, 2023, unless the surviving spouse or representative has an extension to file.

Who should sign the tax return?

Here's who should sign the tax return:

Any appointed representative must sign the return. If it's a joint return, the surviving spouse must also sign it.

If there isn't an appointed representative, the surviving spouse filing a joint return should sign the return and write in the signature area, "filing as surviving spouse."

If there's no appointed representative and no surviving spouse, the person in charge of the deceased person's property must file and sign the return as "personal representative."

Other documents to include with the final tax return:

Court-appointed representatives should attach a copy of the court document showing their appointment. Representatives who aren't court-appointed must include Form 1310, Statement of Person Claiming Refund Due a Deceased Taxpayer to claim any refund. Surviving spouses and court-appointed representatives do not need to complete this form.

If tax is due, the filer should submit payment with the return or visit the payments page of IRS.gov for other payment options. If they can't pay the amount due immediately, they may qualify for a payment plan or installment agreement.

Qualifying widow or widower:

Surviving spouses with dependent children may be able to file as a Qualifying Surviving Spouse for two years after their spouse's death. This filing status allows them to use joint return tax rates and the highest standard deduction amount if they do not itemize deductions. If, after the two years, there are still dependent children in the home then the surviving spouse would file as Head of Household.

What forms are filed?

The surviving spouse may need to just file the Form 1040, U.S. Individual Income Tax Return, if there are no tax items requiring the filing of an estate return.

Form 1041, U.S. Income Tax Return for Estates and Trusts is used for computing the tax on that part of the income of an estate or trust which is taxable to the fiduciary.

Form 706, United Sates Estate (and Generation Skipping Transfer) Tax Return is used if the gross estate of the decedent (who is a U.S. citizen or resident), increased by the decedent's adjusted taxable gifts and specific gift tax exemption, is valued at more than the filing threshold for the year of the decedent's death. The filing threshold for 2023 is $12,920,000.

An estate tax return also must be filed if the estate elects to transfer any deceased spousal unused exclusion (DSUE) amount to a surviving spouse, regardless of the size of the gross estate or amount of adjusted taxable gifts. The election to transfer a DSUE amount to a surviving spouse is known as the portability election.

We are able to help you when a loved one has passed away with the tax filing requirements in the year of death and beyond. There are many considerations that need to be taken into account for an accurate tax accounting to be filed.