FALL 2023

Dear Client

Now is the time of the year we start planning for your year-end taxes. To be sure there are no surprises when your taxes are prepared, it is time to verify your payroll withholding or estimated tax payments prior to the September 15th deadline.

For our clients who do not have a business, in this issue we review the education credits, what is the kiddie tax and is your family subject to this additional tax, and the traditional IRA vs. the Roth IRA. For our business clients we look at an overview of what meals are allowed for 2023 and the requirements of the Corporate Transparency Act (CTA).

If you have had any life changes that may affect your tax filing, such as a marriage or divorce, a birth or deceased family member now is the time to let our office know. If you have had a change of address, it is important to let both our office and the IRS know so that any notices or refunds are sent to the correct address. If you have received unexpected funds from the sale of an asset or a withdrawal from your IRA or pension plan these are all events that may affect your tax liability.

We know the holidays will be coming up fast and furious. Now is the time to review what tax issues we may need to consider and plan your potential tax liability accordingly.

We encourage you to contact our office if you have any questions regarding life events or taxable events. We are available to help you year-round with any concerns regarding your personal taxes or business events.

What is the Kiddie Tax?

The “kiddie tax” was instituted by Congress to prevent parents from moving assets into a child’s name and taking advantage of the lower tax rate for their child. Under the regulations the child’s unearned income (interest, dividends, capital gains) will be taxed at the parent’s rate.

This tax applies to your child under the age of 19 who has unearned income which exceeds the threshold for that year, for 2023 that amount is $2,500. If their unearned income is under the threshold, then the family is not subject to the kiddie tax rules. The kiddie tax also applies to those full-time students between the ages of 19 through 23. The kiddie tax will not impact those adult children who or 24 year of age or older.

The following requirements determine whether the child will be subject to the parent’s tax rate:

- The child does not file a joint tax return for the year;
- One or both of the child’s parents are alive at the end of the year;
- The child’s net unearned income for the year exceeds the threshold for that year (which is $2,500 for 2023), and the child has taxable income after adjusting for allowable reductions such as the standard deduction. If the threshold is exceeded only unearned income in excess of the threshold is subject to the kiddie tax.
- The child meets one of the following age categories:
  - ◊ Age 17 or younger – the kiddie tax applies if the above three thresholds are met.
  - ◊ Age 18 – if at year end the child does not have earned income that exceeds half of their support, the kiddie tax applies if the above three requirements are met.
  - ◊ Age 19 – 23 (and a full-time student) – if the child is a full-time student and does not have earned income that exceeds half of their support if the above three requirements are met. A full-time student is defined if they attend school full-time for at least five months during the year.

There is an option to either report the child’s unearned income on the parent’s return or file a separate tax return for the child and calculate the tax bill, based on the parent’s tax rate, for the unearned income in excess of the threshold. If the child has paid in taxes through either withholding or estimated tax payments, then they must file their own return and report the income.

This can be a complicated area of tax law and we are available to help you determine if the kiddie tax rules apply to your family. Contact our office if you have any questions regarding this area of tax law or to determine if your family may be subject to this tax.

Demystifying the Education Tax Credits

The Internal Revenue Code contains two popular educational tax credits, the American Opportunity Tax Credit (AOTC) and the Lifetime Learning Credit (LLC).

The AOTC is the one most students (or their parents) will claim and is available the first four years post-secondary which can include both your undergraduate and graduate sessions. It is worth up to $2,500 per student and a portion may be refundable if you have no tax liability.

The LLC is for additional educational costs beyond the first four years, including classes you take after getting out of school. It could save you up to $2,000 per tax return, regardless of your tax filing status, except for married filing separately which does not receive the education credits.

Both credits are subject to income thresholds, which means that if your modified adjusted income (MAGI) is above a certain amount then the credit is not available.

Why tax credits rule: The best thing about both of them is that they are tax credits. That means the savings they can produce will offset any tax you owe dollar-for-dollar. And some credits are better than others.

If you can claim the LLC's maximum $2,000 amount, this nonrefundable tax credit can zero out your tax liability. But, as the nonrefundable descriptor indicates, if you have any credit left over (for example, you owe $1,800), you lose the excess credit (or, in this example, the $200 extra).

The AOTC, on the other hand, is partially refundable. The maximum possible credit here is $2,500 per student, with 40 percent (up to $1,000) refundable if you have more credit than tax due.

The table below provides a side-by-side comparison of the AOTC and LLC for your 2023 tax year filing.

Education Tax Credits Comparison

Criteria	AOTC	LLC
Maximum benefit	Up to $2,500 credit per eligible student. This is calculated as 100% of the first $2,000 you spend on qualifying education expenses, plus 25% of the next $2,000 you spend	Up to $2,000 credit per federal tax return. This is calculated as 20% of the first $10,000 in tuition expenses paid per year, up to a maximum credit of $2,000. This is regardless of the number of individuals for whom you paid qualified education expenses.
Refundable or non refundable	40% of credit (up to $1,000) is refundable	Not refundable
Limit on modified adjusted gross income (MAGI) for married filing jointly filers	$160,000 A reduced AOTC amount is available when MAGI is more than $160,000 but doesn't exceed $180,000.	$160,000 LLC benefits are phased out for MAGI between $160,001 and $180,000.
Limit on modified adjusted gross income (MAGI) for single, head of household, or qualifying widow(er) taxpayers	$80,000 A reduced AOTC amount is available when MAGI is more than $80,000 but less than $90,000.	$80,000 LLC benefits are phased out for MAGI between $80,000 and $90,000.
If married, can you file a separate return?	No	
Dependent status	Cannot claim benefit if someone else can claim you as a dependent on their return	
Can you or your spouse be a nonresident alien?	No, unless nonresident alien is treated as resident alien for tax purposes (see Publication 519 for information on nonresident alien status)	

Education Tax Credits Comparison

Criteria	AOTC	LLC
Number of years of post-secondary education available	Only if student has not completed 4 years of post-secondary education before 2023	All years of post-secondary education and for courses to acquire or improve job skills
Number of tax years benefit available	4 tax years per eligible student postsecondary	Unlimited
Type of program required	Student must be pursuing a degree or other recognized education credential	Student does not need to be pursuing a degree or other recognized education credential
Number of courses	Student must be enrolled at least half time for at least one academic period beginning in 2023	Available for one or more courses
Felony drug conviction	Students must have no felony drug convictions as of the end of 2023	Does not apply
Qualified expenses	Tuition, required enrollment fees and course materials needed for course of study	Tuition and fees required for enrollment or attendance
For whom can you claim the benefit?	You Your spouse Student you claim as a dependent on your return	You Your spouse Student you claim as a dependent on your return
Who must pay the qualified expenses?	You or your spouse Student Third party	You or your spouse Student Third party
Payments for academic periods	Made in 2023 for academic periods beginning in 2023 or the first 3 months of 2024	
Do I need to claim the benefit on a schedule or form?	Yes, Schedule 3 of Form 1040 and Form 8863, Education Credits; see also Form 8863 Instructions.	Yes, Schedule 3 of Form 1040 and Form 8863, Education Credits; see also Form 8863 Instructions

Who can pay the expenses: When it comes to paying for qualified school expenses, both the AOTC and LLC allow for a third party to help here. In these cases, the payments are considered paid by you. Third parties would include generous relatives or friends.

Choose carefully: Carefully compare the two educational tax credits to ensure you use the one that can help you not only pay college costs, but also reduce your tax bill.

If you want more than the comparison table above, check out the IRS' interactive online resource that helps you find out if you're eligible to claim an education tax credit.

While you can claim both credits the same tax return, for example, a parent using the AOTC for a daughter's college costs and the LLC for a son's education expenses, you cannot claim both credits for the same student or for the same qualified expenses.

Also, if you receive tax-free educational assistance, such as a grant, you need to subtract that amount from your qualified education expenses.

Our office is available to help you review your options when it comes to education planning. There are other areas that you may also be able to take advantage of in your tax planning including a Qualified Tuition Plan (aka 529 Plan), a Coverdell Account, or using the funds from savings bonds to help with the cost of education.

OVERVIEW OF 2023 MEALS AND ENTERTAINMENT

There have been various changes to the business meal deduction for the year 2023 and beyond. As of now, the deduction for business meals is only 50 percent—a significant change from the previous 100 percent deduction for business meals in and from restaurants, which was applicable only for the years 2021 and 2022. Additionally, many business-generating entertainment deductions were eliminated by the Tax Cuts and Jobs Act of 2017.

To help you better understand your deductible meal costs, the following table outlines what is now permissible under the law for 2023 and beyond.

Description	100%	50%	Zero
Restaurant meals with clients and prospects		X	
Entertainment such as baseball or football games with clients and prospects			X
Employee meals for convenience of employer, served by in-house cafeteria		X	
Employee meals for required business meeting, at a restaurant		X	
Meal served at chamber of commerce meeting in a hotel meeting room		X	
Meal consumed in a fancy restaurant while in overnight business travel status		X	
Meals cooked by you in your hotel room kitchen while traveling away from home overnight		X	
Year-end party for employees and spouses	X		
Golf outing for employees and spouses	X		
Year-end party for customers			X
Meals made on premises for general public at a marketing presentation	X		
Team-building recreational event for all employees	X		
Golf or theatre outing or sports game with your best customer			X
Meal with a prospective customer at a country club following a non-deductible round of golf		X	

Contact our office if you have any questions about this business expense or how to track it on your company books.

Traditional IRA VS. Roth IRA

IRAs come in two versions, traditional and Roth. Pre-tax money goes into a traditional IRA, and in most cases the contribution is tax deductible. But when you get into your 70s, you must take required minimum distributions (RMDs) from the traditional retirement account. At RMD time, those taxes are collected at your then-ordinary income tax rate.

There are no income limits for contributing to a Traditional IRA, but the deductibility of contributions may be limited based on your income if you or your spouse participate in an employer-sponsored retirement plan.

Roth IRA contributions, on the other hand, are made with post tax dollars, and there is no immediate tax break for saving. That downside, however, is offset by a couple of key advantages. There are strict income thresholds for eligibility to contribute to a Roth and will be subject to a 6% excise tax if monies are contributed to the Roth and you are above the income thresholds.

In most Roth situations, there are no required minimum distributions. You can leave Roth IRA money in the account for as long as you want. And when you do withdraw from it in retirement, you will not owe any taxes on the distribution as long as you have the funds in the Roth IRA for five years or more and are 59.5 years of age or older.

One of the options available to taxpayers is to rollover their traditional IRA into a Roth IRA. Whether or not you should convert your Traditional IRA (Individual Retirement Account) to a Roth IRA depends on your individual financial circumstances, goals, and tax considerations.

Here are some factors to consider when making this decision:

1. **Tax Implications:** When you convert from a Traditional IRA to a Roth IRA, you will have to pay taxes on the converted amount because Traditional IRA contributions are typically tax-deductible when you contribute, whereas Roth IRA contributions are made with after-tax dollars. The converted amount is considered taxable income for the year in which you make the conversion. Make sure you have the funds available to cover the tax liability.
2. **Future Tax Bracket:** Consider your current and expected future tax brackets. If you believe you will be in a higher tax bracket in retirement, it might be advantageous to pay taxes now at a lower rate through conversion, rather than paying taxes on withdrawals from a Traditional IRA in the future.
3. **Time Horizon:** A longer time horizon before retirement can potentially allow your investments to grow and compound more in a Roth IRA since withdrawals in retirement are tax-free. If you are close to retirement, the benefits of conversion might be less significant.
4. **Financial Goals:** Assess your financial goals. Roth IRAs do not have required minimum distributions (RMDs) during your lifetime, which means you can let your investments grow tax-free for as long as you want. This can be beneficial if you plan to leave the assets as a legacy to your heirs.
5. **Estate Planning:** Roth IRAs can be useful for estate planning because they can provide tax-free income to beneficiaries. Traditional IRAs, on the other hand, have beneficiaries pay income tax on distributions they receive.
6. **Ability to Pay Taxes:** Can you afford to pay the taxes owed on the converted amount without dipping into your retirement savings? If you use money from the Traditional IRA to pay taxes, you lose the potential for compounding on that amount.
7. **Diversification:** Having both Traditional and Roth accounts can provide you with tax diversification in retirement. This can allow you to choose which account to withdraw from based on your tax situation at that time.
8. **Consult a Financial Advisor:** Given the complexity of the decision and the potential tax implications, it is wise to consult with a qualified financial advisor or tax professional who can analyze your specific situation and provide personalized advice.

When deciding the best way to allocate your retirement funds, we encourage the use of a professional to assist you with the information you need to make an informed decision. A financial planner can run “what-if” models for you on your investment options and our office can help you with the tax considerations.

CORPORATE TRANSPARENCY ACT (CTA)

The Corporate Transparency Act (CTA) was enacted into law as part of the National Defense Act for Fiscal Year 2021. The CTA mandates that millions of entities report their beneficial ownership information (BOI) to the Financial Crimes Enforcement Network (FinCEN).

Beneficial ownership information refers to the details about individuals who ultimately own or control a legal entity, such as a company, trust, or partnership. This information is important for transparency, accountability, and preventing activities like money laundering, tax evasion, and corruption.

1. Purpose: The purpose of collecting and maintaining beneficial ownership information is to identify the actual individuals who have significant control over or benefit from an entity, even if those individuals are not listed as the formal owners. This helps regulatory authorities, law enforcement agencies, and other stakeholders to understand the true ownership structure.
2. Disclosure: Many countries and jurisdictions require legal entities to disclose their beneficial owners to relevant government agencies. This information may be stored in a beneficial ownership register or database.
3. Identification of Beneficial Owners: Beneficial owners are generally individuals who directly or indirectly own a significant portion of the entity's shares or voting rights, have the ability to influence decisions, or benefit from the entity's operations. This can include individuals who hold more than a certain percentage of ownership, hold key executive positions, or exercise significant control.
4. Information Collected: The information collected for beneficial ownership typically includes names, addresses, dates of birth, nationality, and details of ownership or control. The exact information required can vary by jurisdiction.
5. Anti-Money Laundering (AML) and Know Your Customer (KYC) Regulations: Beneficial ownership information is closely tied to AML and KYC regulations. Financial institutions and businesses that deal with money and assets are required to conduct due diligence to verify the identities of their customers and ensure they are not involved in illegal activities.
6. Privacy and Security: While transparency is important, there are concerns about the privacy and security of beneficial ownership information. Some jurisdictions strike a balance between disclosure and protecting the personal information of beneficial owners.
7. International Standards: International organizations such as the Financial Action Task Force (FATF) set standards and guidelines for beneficial ownership disclosure to ensure consistency across countries in combating financial crimes.
8. Penalties: Failure to provide accurate and timely beneficial ownership information can result in penalties, fines, or legal consequences for the entity and its responsible parties.
9. Changes and Updates: Entities are typically required to keep their beneficial ownership information up to date, reflecting any changes in ownership or control.
10. Trusts and Complex Structures: Beneficial ownership can be more challenging to determine in cases involving trusts, complex ownership structures, and offshore entities. Some jurisdictions have specific regulations addressing these complexities.

Examples of a beneficial owner include:

- John owns 75% of the shares of ABC Inc. His name is listed on the company's shareholder records, and he has the right to vote and receive dividends. John is the direct beneficial owner of these shares.
- Sarah owns a trust that holds 60% of the shares of XYZ Corp. While her name isn't directly on the shareholder records, she is the beneficiary of the trust and enjoys the benefits of ownership, including potential dividends and voting rights. Sarah is the indirect beneficial owner of these shares.
- Sarah is a limited partner in a real estate development partnership. Although she doesn't have direct control over the partnership's operations, she benefits from a share of the profits generated by the partnership's projects. Sarah is a beneficial owner of her share in the partnership.
- The reporting company is a corporation owned by four individuals who each own 25 percent of the company's ownership interests (e.g., shares of stock). Four other individuals serve as the reporting company's CEO, CFO, COO, and general counsel, respectively, none of whom hold any of the company's ownership interests.

In this example, there are eight beneficial owners. All four of the individuals who each own 25 percent of the company's ownership interests are beneficial owners of the company by virtue of their holdings in it, even if they exercise no substantial control over it. The CEO, CFO, COO, and general counsel are all senior officers and therefore exercise substantial control over the reporting company, making them beneficial owners as well.

Who is required to report under the CTA's BOI reporting requirement?

All domestic and foreign entities that have filed formation or registration documents with a U.S. state (or Indian tribe), unless they meet one of 23 enumerated exceptions including:

- Large operating entities that meet all the following criteria:
  - ◊ Employ more than 20 people in the U.S.
  - ◊ Had gross revenue (or sales) over $5 million on the prior year's tax return
  - ◊ Has a physical office in the U.S.
- Publicly traded companies that have registered under Section 102 of SOX

When must companies file?

- New entities (created/registered after December 31, 2023) — must file within 30 days
- Existing entities (created/registered before January 1, 2024) — must file by January 1, 2025
- Reporting companies that have changes to previously reported information or discover inaccuracies in previously filed reports – must file within 30 days.

What information do companies need to report?

- Full legal name of the reporting company and any trade or DBA names
- Business address
- State or tribal jurisdiction of formation or registration
- IRS taxpayer identification number (TIN)

In addition, each reporting company must report the following details on its beneficial owners and, for newly created entities, its company applicant(s):

- Name
- Birthdate
- Address
- Unique identifying number and issuing jurisdiction from an acceptable identification document (and image of such document)

What are the penalties for noncompliance with the statue?

- Civil penalties are up to $500 per day that a violation continues.
- Criminal penalties include a $10,000 fine and/or up to two years of imprisonment.

While this is not a tax issue per se, we wanted to make you aware of the requirements for small businesses. Even if you are a Schedule C, formed as an LLC, you are subject to the reporting requirement. The form to file with FinCEN has not yet been released, but it will only be available online, no paper form will be available for this reporting.