

TAX NEWS

FALL 2024

Guide to 529 Plans

If you have young kids or grandkids at home, you may have wondered what their future will look like. Are they destined to be a doctor? A writer? Or perhaps a mechanic? Whatever your child wants to be when they grow up, there are steps you can take now to help them cover the cost of pursuing their dreams.

529 plans, for example, are designed to help parents invest in their children's future, but have you ever looked into the benefits and drawbacks of opening one? Let's explore the basics of 529 plans, as well as how they've evolved in recent years to offer families more incentives than ever before.

The Basics of 529 Plans

529s, or qualified tuition programs as they're formally called, are savings plans specifically geared toward helping individuals and families cover educational costs, such as college tuition.

The majority of 529 plans are sponsored by state governments or agencies, though some educational institutions may provide them as well. While you can certainly select a 529 plan offered through your home state, you aren't required to (but doing so may provide further tax advantages, which we'll touch on in a bit). It's worth noting that a few 529 plans do include residency requirements, meaning you must live in that state to use its plans.

A 529 plan involves two people:

- The account holder: The person who initially opens the account and funds it. Usually, this is a parent or grandparent, but it could be any adult.
- The beneficiary: This is the person (typically a student or future student) the account is intended for. Usually, it's a child or grandchild of the account holder.

With that being said, someone can be both an account holder and its beneficiary — you could open and fund a 529 plan for yourself if you would like to, for example, pursue a Master's degree in the future.

There are two types of 529 plans: education savings plans and prepaid tuition plans.

Education Savings Plans (ESPs)

With an education savings plan, the account holder essentially creates an investment account that can be used to cover qualifying education-related expenses, including:

- Tuition and related fees at any college or university in the U.S. (and some international schools)
- Room and board at a college or university
- Tuition for grade schools (up to \$10,000 per year, per beneficiary)
- Expenses related to an apprenticeship program
- Student loan repayments (up to \$10,000 per beneficiary)

Like an FSA or HSA, you can pay up front for the education costs and then reimburse yourself from the 529 plan.

Prepaid Tuition Plans

Rather than put money into an investment account, this option lets the account holder purchase credits (sometimes they're called "units") that the beneficiary will be able to put toward tuition at a participating institution in the future — typically public or state schools.

Prepaid tuition plans essentially allow the account holder to "pre-pay" tuition at its current price (hence the name!). Considering the rising cost of college, this option can be attractive to a lot of parents as it enables them to send their kids off to college at a discounted price.

Are There Any Tax Benefits to Having a 529 Plan?

Yes, and no... And that might change in the future.

- Yes... When withdrawals from 529 plans are used on what's considered to be qualified higher education expenses, any capital gains earned within the account are exempt from federal income tax (and most states exempt taxes here as well).
- No... Unfortunately, you cannot deduct contributions to a 529 plan from your federal income taxes. However, some state plans allow you to deduct the contributions from your state income taxes. Keep in mind that this exemption may depend on whether you reside in the state that sponsors your plan.

Possibly in the future... Keep in mind that tax laws can change. Many parents opt to start saving for college while their kids are very young, meaning they could be contributing to the account for the next 18 years or longer. It's possible that during that time, new tax laws could pass that create more incentives for using college savings plans. One change allowed with the SECURE Act 2.0 is

... continued on page 2

taking 529 monies and rolling them over to a Roth if you have a beneficiary that does not need the funds for college. This provision requires that the funds be invested for a minimum of 15 years in the 529 plan to be eligible for the tax-free rollover.

Do 529 Plans Impact Financial Aid?

Generally speaking, the assets held in a 529 plan may impact your student's financial aid eligibility.

If a 529 plan is owned by a parent or student, the funds in it will count as "parent assets" on the Free Application for Federal Student Aid (FAFSA). However, a certain amount of parental assets will fall under the "asset protection allowance," meaning they won't count against your student's financial aid package. For reference, colleges anticipate that parents will use 5.64% of their "parental assets" toward their child's tuition.

Grandparent 529 FAFSA Exemptions

Starting in 2024, distributions from a 529 plan owned by someone who is not the parent or student (i.e. grandparents) will not count as untaxed income on the student's FAFSA application — meaning they are not required to report it.

Potential Drawbacks of 529 Plans

Keep in mind that there are a few potential drawbacks to establishing a 529 plan for your children.

Limited Investment Options

Most 529 plans include a pre-determined set of investment options, and account holders generally won't be able to switch between the options once the account is established. As it stands now, account holders can only change their investment option twice a year, or when the beneficiary changes.

If you're especially adept at investments and would like to maintain control over how your contributions are invested, you may find a 529 plan too restrictive.

Strict Withdrawal Requirements

To avoid additional taxes and penalties, the funds distributed from a 529 account must go toward qualified educational expenses (the exception being a Roth rollover).

Even with the option to eventually roll the funds into a Roth IRA, there is a limit to how much may be rolled over (\$35,000 total). With limited uses for the funds in 529 plans, account holders may want to be strategic in how much they contribute.

The good news is, you can change beneficiaries of the account as often as you like — so even if one child doesn't use as much of the funds as anticipated, you can save them for the next one (or a grandchild). As we mentioned earlier, you could even name yourself as a beneficiary if you decide to head back to school later in life.

Prepaid Tuition Plan Limitations

The credits purchased in a prepaid tuition plan are meant to cover tuition at participating schools (again, this is typically state universities or public colleges). If your child wants to attend school out of state or at a private school, you'll likely only be able to use the original balance of the account (what you contributed) and may be forced to forfeit investment gains.

Investing in Your Child's Future

When used strategically, 529 plans can be an effective way to cover your child's future college costs. If helping your young student graduate debt-free is one of your financial goals, be sure to research your options and talk to an advisor about the benefits or drawbacks of opening a 529 plan account.

This is a brief overview of the benefits of a college savings plan. Let us help you determine the best strategy for setting up yourself and your children for their future education needs.

Kiddie Tax Basics

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 under age 18.
- Children who are 18 years old but have unearned income that is more than half of their support.
- Children who are 19 to 23 years old, are full-time students, and have unearned income that exceeds half of their support (excluding scholarships).

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 \$2,600 for 2024 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 does not exceed the threshold for that year. For a child with no earned income, the first \$1,300 is not taxed in 2024. The next \$1,300 is taxed at the child's rate. Any amount above \$2,600 is taxed at the parent's rate.

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 the threshold for that year, and the child falling under specific age rules.

Despite these rules, there are several strategies to limit the kiddie tax's impact on your child's unearned income:

- Manage your child's unearned income to ensure it remains below the annual threshold.
- 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 cashed in when the child is kiddie-tax-exempt.
- Withdrawals from a Section 529 plan account are federal-income-tax-free, provided they're used for qualifying education expenses.
- 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 applicability of these strategies depends on your unique circumstances, and I would be delighted to discuss them in more detail to help you optimize your child's financial situation.

Mediation Can Help Taxpayers Settle Tax Issues

Mediation — also known as Alternative Dispute Resolution — can help taxpayers resolve tax issues early and efficiently. The process provides taxpayers a faster, more collaborative and cost-effective approach to case resolution. The traditional appeal process is still available for taxpayers who choose it.

Mediation might be right for a taxpayer if:

- The taxpayer wants to resolve the dispute at the earliest possible stage of their audit.
- The taxpayer doesn't have many disputed issues.
- The taxpayer gave the IRS information to support their position.
- The IRS is still considering the taxpayer's case and issues remain unresolved.

Mediation is:

- Voluntary for both parties.
- Nonbinding, meaning each party retains 100% control over whether to settle the case. No one can force either party to do something they don't agree to do.
- Effective when both parties have a desire to resolve the disputed issue.
- Appropriate when all issues are fully resolved except the issue for which mediation is requested.

- A chance to avoid a lengthy appeal process or costly litigation.

Mediation is not:

- Required by either party.
- A replacement for the audit or collection process.
- A process in which the parties in the dispute offer arguments directly to the mediator hoping to "win."
- Effective if either party believes the only way the dispute will get resolved is if the other party concedes or gives up on its position.
- A time to present new information or raise new issues.
- An opportunity to try and get a more favorable outcome or delay the examination or collection process.

Mediation works only if the disputing parties can agree to an outcome. Since both parties come to the mediation with an effective veto over its outcome, each party has an incentive to find a solution that meets the needs (not desires) of the other party. Mediation does not work for anybody unless it works for everybody.

Our office staff is available to provide you with the representative services you need to resolve any outstanding tax issues. Contact us if you receive a notice from the Internal Revenue Service for our review and to determine a course of action.

They Are Not Our Financials — They Are Yours

For our business clients, the review of financial records is an integral part of the service we provide. Good financial records can provide invaluable information regarding the health and decision-making options for the business.

Are your income statements providing you with a reliable measurement of the operating performance of your firm? You might be surprised by this question, but frequently small business owners obtain data that is not adequate for sound decision making. Just because you are using QuickBooks for your small sole proprietorship or sole member LLC, that is used to report tax data on schedule C of your personal tax return, you can equally benefit from accurate financials. Just consider:

- Operating statements prepared on a cash basis may be highly effective for measuring cash flow but they fail to reflect the true results of operations since they do not reflect sales and expenses that have not been paid.
- Key elements may be missing from the statements. For example, sales may only be reflected on a net basis, but the information would be far more meaningful if the statement showed gross sales less return and allowances and net sales.
- Many of the estimates used in the income statement may not be reflective of the actual economic deterioration associated with the wearing out of assets. This is often the case in terms of the depreciation that is recorded or of repair and maintenance costs that are required to keep assets in good working condition.
- Failure to properly take into account obsolescence of inventories or the carrying costs of goods can easily distort gross profit margins reflected in the income statements.
- Lapses in insurance coverage may result in significant risk exposure which would not be reflected in insurance expense or elsewhere in the income statement.

- Since the income statement may reflect a number of business activities or products that are producing revenue for your firm, good results in one may actually obscure negative results in another, unless the activity is separately identified and the results for each product or service are measured separately to determine their contribution to your firm's income.
- Individual income statements generally fail to provide a valid measure of business progress, unless a series of statements are compared and trend analysis is performed.

In short, to help you obtain reliable information about the results of your operations, you must (1) use a method of accounting that truly reflects the economic events affecting your business; (2) have a chart of accounts that provides adequate details about the revenues obtained and expenses incurred in operating the business; (3) utilize estimates that are realistic in measuring the decline and deterioration of the assets that are producing your business revenue; (4) have cost measurement systems that provide revenue and cost data by product and activity, and (5) obtain operating statements with sufficient frequency to enable you to measure the trend of revenues and expenses and changes in your firm's growth momentum.

The knowledge and skill of your in-house financial staff and our firm are a major factor in the accuracy, reliability and usefulness of the accounting data you are able to obtain and analyze for effective decision making.

Contact our office to schedule an analysis of your current accounting processes to determine the accuracy of the information on the financial statements.

Tax Benefits For Homeowners

Whether someone is a current homeowner or buying a new home this year, owning a home can be expensive. There are tax benefits that can help taxpayers save money and offset some of the costs that come with homeownership. Homeowners should review the tax deductions, programs and housing allowances to see if they are eligible.

Deductible house-related expenses

Most home buyers take out a mortgage to buy their home and then make monthly payments to the mortgage holder. This payment may bundle other costs of owning a home.

The costs the homeowner can deduct are:

- State and local real estate taxes, subject to the \$10,000 limit.
- Home mortgage interest, within the allowed limits — the interest deduction allowed is up to \$750,000 of indebtedness

Taxpayers must itemize their deductions to deduct homeownership expenses.

Homeowners cannot deduct any of the following items:

- Insurance including fire and comprehensive coverage and title insurance.
- The amount applied to reduce the principal of the mortgage.
- Wages paid to domestic help.
- Depreciation.
- The cost of utilities, such as gas, electricity or water.

- Most settlement or closing costs.
- Forfeited deposits, down payments or earnest money.
- Internet or Wi-Fi system or service.
- Homeowners' association fees, condominium association fees or common charges.
- Home repairs.

Since the passage of the Tax Cuts and Jobs Act, the standard deduction was increased to the point where most taxpayers can no longer itemize. The standard deduction for 2024 is: Single or Married Filing Separately — \$14,600; Married Filing Jointly or Qualifying Surviving Spouse — \$29,200; Head of Household — \$21,900.

A taxpayer can itemize on the return if the total of their deductions, which include medical expenses, certain taxes, mortgage interest, charitable contributions and losses from gambling exceed their standard deduction. For a couple filing separately, if one spouse itemizes then the other spouse must also itemize or they can both take one-half of the standard deduction.

During the preparation of your individual income tax return we determine the most advantageous tax treatment for your individual situation. By providing us with your complete tax documents you can be assured we will prepare your tax return optimizing all tax laws available.

Planning For Your 2024 Tax Liability

As we stated earlier, now is the time to plan for your 2024 federal tax liability. Some key numbers to keep in mind include:

There are seven (7) tax brackets in 2024. They are: 10%, 12%, 22%, 24%, 32%, 35% and 37% — there is also a zero rate.

Figuring out your tax obligation is not as easy as comparing your salary to the brackets shown. Let's say you're single and your 2024 taxable income is \$75,000; your marginal — or top — tax rate is 22%. But some of your income will be taxed in lower tax brackets: 10% and 12%.

- The first \$11,600 is taxed at 10%: \$1,160
- The next \$35,550 (\$47,150 minus \$11,600) is taxed at 12%: \$4,266
- The last \$27,850 (\$75,000 minus \$47,150) is taxed at 22%: \$6,127

The total tax amount for your \$75,000 income is the sum of \$1,160 + \$4,266 + \$6,127 = \$11,553 (ignoring any itemized or standard deduction applied to your taxes).

Do not confuse a zero percent rate with being exempt from tax: it is not the same thing. In some instances, if you are exempt from tax (or a specific kind of tax), you do not have to file a tax return at all. Examples include taxpayers who do not earn enough income during the year to meet the income requirements for filing a return as it does not exceed the standard deduction for their filing status.

The standard deduction amounts increased to \$14,600 for individuals and married couples filing separately, representing an increase of \$750 from 2023. Married couples filing jointly will see a deduction of \$29,200, a boost of \$1,500 from 2023, while heads of household will see a jump to \$21,900 for heads of household, an increase of \$1,100 from 2023. For 2024, the additional standard deduction amount for the aged or the blind is \$1,550. The additional standard deduction amount increases to \$1,950 for unmarried taxpayers.

That is not necessarily the same as being taxed at a zero percent rate. You may receive income that is taxed at zero percent but is still reportable. A good example is the zero percent tax rate on long-term capital gains. It's not an exemption: long term capital gains are taxed at zero percent for taxpayers in the 15% marginal tax rate or below. Those transactions are still reportable even if they are not taxable.

It may be the case that you are required to file a tax return (for example, you have self-employment income of more than \$400) but because of your exemptions and credits, you are ultimately taxed at a zero percent rate. You will still need to report that income.

Many will be entering student loan repayment this month. For 2024, the \$2,500 maximum deduction for interest paid on qualified education loans will begin to phase out for taxpayers with modified adjusted gross income above \$80,000 (\$165,000 for joint returns) and will completely phase out for taxpayers with modified adjusted gross income of \$95,000 or more (\$195,000 or more for joint returns).

In 2024, the amount of the eligible educator deduction allowed in connection with books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by the eligible educator in the classroom is \$300. This deduction is available for educators who work 900 hours or more in K – 12.

The federal gift tax exclusion will increase to \$18,000 in 2024, up from \$17,000 in 2023. That means you can gift \$18,000 per person to as many people as you want with no federal gift tax consequences in 2024; if you split gifts with your spouse, that total is \$36,000.

Contact our office to review all tax benefits available to you while planning for your 2024 tax bill.