TaxTips

Dedicated to making your life less taxing

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$80 Billion to the IRS: What It Means for You

You may have noticed that the IRS is in a bad way. It has a backlog of millions of unprocessed paper tax returns, and taxpayers can't get through to the agency on the phone. Congress noticed and acted by passing a massive funding of the IRS in the recently enacted Inflation Reduction Act.

The IRS will get an additional $80 billion over the next decade. This includes $35 billion for taxpayer services, operations support, and business systems. Among other things, the IRS plans to use these funds to update its antiquated IT systems (some of which date back to the 1960s), improve phone service, and speed up the processing of paper tax returns.

Despite what you may have heard in the media, the IRS will not expand by 87,000 new employees. It will still be smaller than it was 30 years ago. It may grow by 20,000 to 30,000 workers over the next decade, and the number of revenue agents could increase to 17,000 by 2031—over twice as many as today.

The IRS will have an additional $45 billion to spend on enforcement. Treasury Secretary Janet Yellen has promised that IRS audit rates will remain at "historical levels" for taxpayers earning less than $400,000 annually.

Audit rates will rise for taxpayers earning $400,000 or more per year. If you're in this group, it's wise to plan ahead to avoid trouble with a beefed-up IRS.

You should keep complete and accurate records and file a timely tax return. Of course, this is something you should be doing anyway.

Here are a few special areas of concern:

- **Cryptocurrency.** You can expect increased IRS audits dealing with cryptocurrency transactions. If you're one of the millions of Americans who engage in such transactions, make sure you keep good records and report any income you earn.

- **S Corporations.** If you're an S corporation shareholder-employee, you should have your S corporation pay you an arguably reasonable salary and benefits, and document how you arrived at the amount.

- **Syndicated Conservation Easements.** Be aware that the IRS is auditing all these deals, and its scrutiny of them will likely grow.

- **Offshore Accounts.** You're supposed to report these to the U.S. Treasury. Failure to do so subjects you to substantial penalties. In recent years, the IRS has gone after banks and bank account holders who hide assets in offshore accounts. In future years, we can expect the IRS to place even greater emphasis on identifying and tracking such offshore assets.

- **Partnerships.** Partnerships and multi-member LLCs taxed as partnerships (this describes most of them) are already the subject of the Large Partnership Compliance program, which uses data analytics to select large partnership returns for audit. The IRS will likely devote more resources to this program in the future.

Inflation Reduction Act Tax Credits

The tax legislation that has received the most attention in the past year is the *Inflation Reduction Act of 2022* (IRA of 2022), which was signed into law this August. One of its goals was to address climate change by offering tax incentives for going green. While some of these incentives are targeted at U.S. businesses, most are available to U.S. homeowners who make energy-saving improvements to their homes.

Many of the tax benefits offered by the IRA of 2022 are not new but are actually extensions and modifications to existing credits that either had expired or were set to expire soon. For example, the nonbusiness energy property tax credit was renamed the energy efficient home improvement credit and extended through 2032. Beginning in 2023, the credit amount will be 30% of the costs of eligible home improvements made during the tax year, with a $1,200 annual limit. The specific annual limits for improvements are:

- $150 for home energy audits
- $250 for exterior doors meeting Energy Star requirements ($500 total for all doors)
- $600 for windows and skylights meeting Energy Star's most efficient certification requirements
- $2,000 for specified heat pumps and heat pump water heaters, biomass stoves and boilers (neither the $1,200 annual limit on total credits nor the $600 limit on other qualified energy property applies to this amount)
- $600 for other qualified energy property, including central air conditioners; electric panels and certain related equipment; water heaters powered by natural gas, propane, or oil; oil furnaces and water boilers

The IRA of 2022 also renames the residential energy efficient property credit as the residential clean energy credit. This credit was scheduled to expire at the end of 2023 but has been extended through 2034. The credit amount increased to 30% for 2023 through 2032 but drops to 26% in 2033 and 22% for 2034. The energy efficient home improvement credit no longer applies to biomass furnaces and water heaters but will apply to battery storage technology with a capacity of at least three kilowatt hours.

Updated Electric Vehicle Credit

It may seem the IRA of 2022's $7,500 tax credit for purchases of new electric vehicles is just a continuation of a credit that was already available, but the legislation made many substantive changes. The credit is now known as the clean vehicle credit, and the IRA of 2022 placed several restrictions on the credit that may make it difficult for some buyers of electric vehicles to take advantage of it. The changes that are expected to have the broadest impact include caps on the income of the taxpayers eligible for the credit, a limit on the retail price of qualifying vehicles and new sourcing requirements. Starting in 2023, only households with incomes of up to $300,000 qualify for the credit, with the credit limited to individual taxpayers with incomes below $150,000.

Additionally, only battery-powered cars priced at less than $55,000 are eligible, or $80,000 for vans, SUVs and trucks. Finally, final assembly of the vehicle must have been in North America, and the materials from which it is constructed must meet specified sourcing requirements

Educators Expense Deduction Increased

The out-of-pocket expenses that educators can claim as a deduction increased to $300 for 2022, up $50 from last year. This is the first increase since 2002. The deduction for unreimbursed expenses is available to all educators, even those claiming the standard deduction. Married educators who are both claiming the deduction can claim a deduction of up to $600. If you or your spouse are an educator who plans on claiming the deduction for 2022, remember that you need to track the receipts for your out-of-pocket expenses to verify the amounts you claim.

Are Self-Directed IRAs for Real Estate a Good Idea?

The stock market is tanking while real estate continues to skyrocket.

If your retirement savings have taken a hit, you may be wondering if this is the time to invest in real estate through your IRA, Roth IRA, or SEP-IRA.

You can’t invest in real estate with a traditional IRA or Roth IRA (or SEP-IRA) you establish with a bank, brokerage, or trust company. These types of IRA custodians typically limit you to a narrow range of investments, such as publicly traded stocks, bonds, mutual funds, ETFs, and CDs.

But you can invest in real estate if you establish a self-directed IRA with a custodian that allows self-directed investments. There are dozens of such IRA custodians.

Real estate is the single most popular investment in self-directed IRAs. The self-directed IRA can be used for all types of real estate investments: multi-family rental properties, single-family homes, commercial rentals, raw land, farmland, international real estate, tax lien certificates, trust deeds and mortgage notes, and private placements.

Investing in real estate through a self-directed IRA is one way to diversify your retirement holdings. There are also some tax advantages.

And there are several disadvantages and complications you should carefully consider.

First, you need to understand that owning real estate in a self-directed IRA is not like owning it any other way, because you and your self-directed IRA must be totally separate—self-dealing is not allowed.

You, the self-directed IRA owner, should not benefit from your self-directed IRA other than through distributions from the self-directed IRA. And your self-directed IRA itself should not benefit from you other than through contributions you make to the account.

In practical terms, this means you, your relatives, and certain other “disqualified persons” cannot do business with your self-directed IRA. For example, you can’t

- sell property you personally own to your self-directed IRA,
- purchase or lease property from your self-directed IRA,
- personally guarantee loans taken out by your self-directed IRA to purchase property,
- receive rental income from a rental property held in a self-directed IRA, or
- repair or improve any self-directed IRA property.

If you do any of these things, your self-directed IRA could lose its tax-deferred status. If that happens, you then pay taxes on the value of all the property the IRA owns.

When your self-directed IRA owns real estate, you also don’t benefit from real estate tax deductions such as depreciation and the 20 percent qualified business income (QBI) deduction.

It may not be pleasant to think about, but upon your death, there is no step-up in basis for real estate held in the self-directed IRA. Instead, your beneficiaries pay tax at ordinary rates on any money or property distributed from a traditional self-directed IRA. This eliminates one of the most valuable tax benefits for real estate owners.

Don’t get the idea that self-directed IRAs are all bad. None of the income from property held in a self-directed IRA is taxable to you personally. Likewise, if you sell property in a self-directed IRA, you need pay no personal tax on any profit. You pay tax only when you withdraw money from a traditional IRA.

With a self-directed Roth IRA, you pay no tax at all on withdrawals after age 59 1/2, provided your IRA held the property for at least five years. But you need to balance these benefits with all the potential drawbacks.

IRS Crackdown on Crypto Continues

This summer's crash in cryptocurrency prices has many Americans souring on digital assets as an investment, but the IRS continues to expand its efforts to locate taxpayers who are using crypto- currency to avoid taxation. The COVID-19 pandemic slowed down the agency's Virtual Currency Compliance Campaign, but the IRS is once again ramping up its enforcement efforts.

In September, the agency received a judge's permission to issue a summons requiring that a bank turn over information on customers using the popular crypto broker sFOX. It has also warned taxpayers that it may take additional action to get banking information for taxpayers using other brokers. Additionally, the IRS is planning to spend a portion of the funding the agency received through the IRA of 2022 to improve its ability to monitor cryptocurrency transactions.

The IRS treats cryptocurrencies such as Bitcoin and Ethereum as property, and taxpayers are required to pay the capital gains tax on any profits they earn by buying and selling virtual currency. For the 2022 tax year, the draft of Form 1040, *U.S. Individual Income Tax Return*, includes an updated question on whether a taxpayer has engaged in any cryptocurrency transactions. If you sold or are planning to sell any cryptocurrency during 2022, it's better to disclose your profits to the IRS and pay the tax due than it is to get caught not disclosing the assets to the government and face penalties and interest.

Multiply Your Net Worth with a SEP IRA or Solo 401(k)

How do you multiply your net worth? Let the government help.

Here's how:

- With both the SEP IRA and the solo 401(k) retirement plans, your investment in your tax-favored retirement creates tax deductions for the money you invest in the plan,
- grows tax-deferred inside the plan, and
- suffers taxes only when you take the money from the plan.

Example. You invest $1,000 a month in your retirement. You are in the 40 percent tax bracket (combined federal and state), and you earn 10 percent on your investments. At the end of 30 years, you have $1.58 million in after-tax spendable cash, which comes from (in round numbers):

- $1.2 million in after-tax cash from the retirement plan ($2 million gross less 40 percent in taxes—we're taking the entire amount out of the plan in this example)
- $380,000 in the side fund created by investing the $400 of monthly tax savings$1,000 deduction x 40%

If you had no government help on the taxes and invested $1,000 a month in an investment that earned 10 percent (6 percent after taxes), you would have a little more than $950,000. The retirement plan wins by $630,000—after taxes ($1.58 million vs. $950,000). That's the big picture. It tells you that tax-advantaged investing multiplies profits. So, don't delay and call me to help you get started.

Deduct a Cruise to Mexico

You may not have thought of this, but taking a cruise ship to Mexico for a business meeting is acceptable as a deductible form of transportation.

Because Mexico is in the tax law–defined North American area, the law says that you need no stronger business reason to deduct your trip to Mexico than you need to deduct a trip to Chicago, Illinois, or Scottsdale, Arizona.

Less-than-one-week rule. If your trip is outside the 50 states but inside the North American area and if the trip is for seven or fewer days (excluding the day of departure), then the law allows you to deduct the entire cost of travel to and from this business destination. Mexico fits this location rule.

Cruise ship transportation. The law authorizes any type of transportation to and from your travel destination, so long as it is not lavish or extravagant. The cruise ship cost is not a lavish or extravagant expense, as the law precludes this possibility by placing luxury water limits on this type of travel.

The daily luxury water limit is twice the highest federal per diem rate allowable at the time of your travel.

Example. Say you are going to travel by cruise ship during September 2022. The $433 maximum federal per diem rate for September 2022 comes from Nantucket, Massachusetts. Your daily luxury water limit is $866 (2 x $433).

Thus, for you and your spouse, two business travelers, the daily limit is $1,732. On a six-night cruise, that's a cruise-ship cost ceiling of $10,392. If you spend $12,000, your deduction is limited to $10,392. If you spend $8,000, you deduct $8,000.

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 2022, gifts with values exceeding $16,000 must be reported to the IRS. The threshold increases to $17,000 in 2023.

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

	2022	2023
Business SMR 1/1/22 to 6/30/22	58.5¢	65.5¢
Business SMR 7/1/22 to 12/31/22	62.5¢	65.5¢
Medical and Moving rate 1st 6 mos	18.0¢	22.0¢
Medical and Moving rate 2nd 6 mos	22.0¢	22.0¢
Charitable rate per mile	14.0¢	14.0¢

4. Did you know that there is still up to a $7,500 dollar tax credit for purchasing a qualified electric plug-in vehicle? Call me for all the details.

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 $20,500 in 2022 ($27,000 if age 50 or over). Your maximum contribution to an individual 401(k) plan is the lesser of $61,000 ($67,500 if age 50 or over). or the sum of the employer and employee maximums. Unlike other retirement plans such as SEPS and SIMPLE IRAs, an individual 401(k) plan allows you to take out loans from plan assets.

6. The Federal Estate Tax exemption for 2022 is $12,060,000. The rate is 40%. Additionally, heirs get to use stepped-up basis to value assets inherited. The exemption in MA, ME & NY is only $1 million with a top tax rate of 16%.

7. In 2022 the tax rate of 37 percent will affect individuals and Heads of Households whose taxable income exceeds $539,901 ($647,851) for married taxpayers filing a joint return.

8. If you turned age 72 on July 1, 2022, or later you are not required to begin your required minimum distributions (RMD) from your IRA until April 1, 2023. You will also need to take your 2023 distribution by December 31st. Failure to do so results in a 50 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.

Section 1031 Exchanges vs. Qualified Opportunity Zone Funds

Have you sold, or are you planning to sell, commercial or rental property?

To avoid immediately paying capital gains tax on your profit, you have options:

- Defer the capital gains tax using a Section 1031 exchange
- Defer the capital gains tax using a qualified opportunity zone fund

With a Section 1031 exchange, you sell your property and invest all the proceeds in another like-kind replacement property of equal or greater value.

With a qualified opportunity fund, you don't acquire another property. Instead, you invest in a corporation, partnership, or LLC that pools money from investors to invest in property in areas designated by the government as qualified opportunity zones. Most qualified opportunity funds invest in real estate.

Which is better? It depends on your goals. There is no one right answer for everybody.

A Section 1031 exchange is preferable to a qualified opportunity fund investment if your goal is to hold the replacement property until death, when your estate will transfer it to your heirs. They'll get the property with a basis stepped up to current market value, and then they can sell the property immediately, likely tax-free.

In contrast, your investment in a qualified opportunity fund requires that you pay your deferred capital gains tax with your 2026 tax return. That's the bad news (only four years of tax deferral).

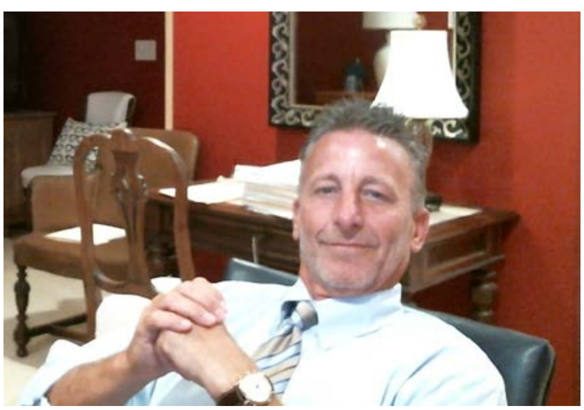
The good news: if you hold the qualified opportunity fund for 10 years or more, there's zero tax on the appreciation.

In contrast, if you sell your Section 1031 replacement property, you pay capital gains tax on the difference between the original property's basis and the replacement property's sale amount.

And if you're looking to avoid the headaches and responsibilities that come with ownership of commercial or rental property, the qualified opportunity fund does that for you.

If you're looking for liquidity, the qualified opportunity fund gives you that because you need to invest only the capital gains to defer the taxes. With the Section 1031 exchange, you must invest the entire sales proceeds in the replacement property to avoid any capital gains tax**. Of course, you want your investment to perform. Make sure to do your due diligence, whatever your choice.**

A Final Word from Charlie



As the 2022 year-end approached, I received quite a few emails and calls on a variety of subjects relating to taxes. So, I publish this newsletter to provide you some tax saving tips and to keep you abreast of some of the nuances in the tax code.

In addition to preparing your tax return for you I can assist you with retirement income planning. I can help you save for your retirement through a variety of plans that will grow with the market without any risk of losing your money, guaranteed! Don't wait any longer. Contact me today so I can help you accomplish your retirement goals.