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CERTIFIED PUBLIC ACCOUNTANTS

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Newsletter March 2023

March 2023 Business Due Dates

March 15 - Partnerships

File a 2022 calendar year return (Form 1065). Provide each partner with a copy of their Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc., or a substitute Schedule K-1 and, if applicable, Schedule K-3 (Form 1065) or substitute Schedule K-3 (Form 1065).

March 15 - S-Corporations

File a 2022 calendar year income tax return (Form 1120-S) and pay any tax due. Provide each shareholder with a copy of Schedule K-1 (Form 1120-S), Shareholder's Share of Income, Deductions, Credits, etc., or a substitute Schedule K-1 (Form 1120-S) and, if applicable, Schedule K-3 (Form 1120-S) or substitute ScheduleK-3 (Form 1120-S).

Home Energy Improvement Credit Is Enhanced

This credit goes all the way back to 2006, providing a tax credit for making energy-saving improvements to a taxpayer's home. This tax benefit was supposed to expire after 2021 but a law change has given the credit renewed life and substantially enhanced it beginning with 2023.

Prior to 2023, the credit had a lifetime cap of $500, which many taxpayers had taken advantage of in the previous 16 years, while others could not remember if they had used the entire lifetime credit during those years. As a result, with a lifetime tax benefit of only $500, and a small credit rate of only 10%, the credit had become less of a motivator for taxpayers to make energy saving improvements to their homes and was frequently disregarded.

Now this credit once again becomes a meaningful incentive for taxpayers to make energy-saving improvements to their homes. Beginning in 2023 the minimal $500 lifetime limit is replaced with a $1,200 annual limit and the credit rate is increased to 30%.

The following are the annual credit limits by improvement item.

- **Energy Property**: $600 if the property meets the most recent International Energy Conservation Code standard in effect as of the beginning of the calendar year which is 2 years prior to the calendar year in which such component is placed in service. This type of property includes:
  - An electric or natural gas heat pump water heater.
  - An electric or natural gas heat pump.
  - A central air conditioner.
  - A natural gas, propane, or oil water heater.
  - A natural gas, propane, or oil furnace or hot water boiler.

- Biomass stoves and boilers
- Any insulation material or system, including air sealing material or system, which is specifically and primarily designed to reduce the heat loss or gain of a dwelling unit when installed in or on that dwelling

- **Doors**: $250 in the case of any exterior door, and $500 in the aggregate with respect to all exterior doors meeting the applicable Energy Star requirements. For example, if a new front door costs $1,000, the credit will be $250 since $300 (30% of $1,000) exceeds the $250 limit.

- **Windows**: $600 for the aggregate of all windows and skylights that meet Energy Star most efficient certification requirements.

- Heat Pumps: $2,000 for the aggregate of heat pumps, heat pump water heaters, biomass stoves and boilers.

- Home Energy Audit: $150 (one time). "Home energy audit" means an inspection and written report that identifies the most significant and cost-effective energy efficiency improvements with respect to the dwelling unit, including an estimate of the energy and cost savings with respect to each such improvement, and is conducted and prepared by a home energy auditor that meets the certification or other requirements specified by the Secretary of the Treasury.

The one making the improvements and claiming the credit need only be a resident of the home and not necessarily the owner.

Identification Number Requirement - The credit is not allowed unless the energy-saving item is produced by a qualified manufacturer, and the taxpayer includes the qualified product identification number of the item on their tax return for the tax year the credit is claimed. However that requirement does not take effect until after December 31, 2024, giving qualified manufacturers time to comply.

Other Credit Issues:

- Improvements include only those installed on or in connection with a dwelling unit located in the United States and used as a residence by the taxpayer, and originally placed in service by the taxpayer.
- The components must have a life expectancy of at least 5 years.
- The credit can apply to manufactured homes.
- Expenditures for labor costs properly allocable to the onsite preparation, assembly, or original installation of the property qualify.
- The credit is claimed on the return for the year the property is installed, even if paid for in a prior year.
- It is a nonrefundable personal tax credit and allowed against the alternative minimum tax (AMT) if the taxpayer is subject to the AMT.
- There are no credit carryover provisions if the credit is not fully utilized in the year of the home energy improvements.
- Unlike the credit for solar installations, this credit doesn't have any specific prohibitions against swimming pools or hot tubs.
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Tip To Maximize the Credit: Because this credit now has an annual credit limit instead of a lifetime credit limit, a taxpayer can spread the expenditures over multiple years to avoid the annual and per item credit limits. For example, say a taxpayer wishes to replace all the windows in their home. If all the work is completed in one year the taxpayer's credit would be limited to the per item $600 credit for windows and skylights. However, if the taxpayer spreads the replacements out over multiple years the taxpayer would get a credit of $600 per year.

If you have questions related to how you might benefit from the enhanced and extended tax credit for making energy-saving improvements to your home, please give this office a call.

Who Claims the Children's Tax Benefits You or Your Ex-Spouse?

If you are a divorced or separated parent, a commonly encountered but often misunderstood issue is who claims the child or children for tax purposes. This is sometimes a hotly disputed issue between parents; however, tax law includes some very specific but complicated rules about who profits from the child-related tax benefits. At issue are a number of benefits, including the children's dependency, child tax credit, child care credit, higher-education tuition credit, earned income tax credit, and, in some cases, even filing status.

This is actually one of the most complicated areas of tax law, and inexperienced tax preparers or taxpayers preparing their own returns can make serious mistakes, especially if the parents are not communicating well. If parents will cooperate with each other, they often can work out the best tax result overall, even though it may not be the best for them individually and compensate for it in other ways.

Physical Custody (Custodial Parent) – If a family court awards physical custody of a child to one parent, tax law is very specific in awarding that child's dependency to the parent with physical custody, regardless of the amount of child support provided by the other parent. However, the custodial parent may release that dependency to the non-custodial parent for tax purposes by completing the appropriate IRS form. The release can be granted on a yearly basis or for multiple years at one time. But once made, it is binding for the specified period.

CAUTION – The decision to relinquish dependency should not be taken lightly as it impacts a number of tax benefits.

Joint Custody – On the other hand, if the family court awards joint physical custody, only one of the parents may claim the child as a dependent for tax purposes. If the parents cannot agree between themselves as to who will claim the child and the child is actually claimed by both, the IRS tiebreaker rules will apply. Per the tiebreaker rules, the child is treated as a dependent of the parent with whom the child resided for the greater number of nights during the tax year; or if the child resides with both parents for the same amount of time during the tax year, the parent with the higher adjusted gross income will claim the child as a dependent.

Parents in the process of divorcing should be aware that for tax purposes, the IRS's rules as to who can claim a child's dependency takes precedence over what a divorce decree says or what a judge may have ruled. So, for example, if the family court awards full custody of a child to Parent A but says that Parent B can claim the child as a tax dependent, the IRS's position is that the child is a tax dependent of Parent A unless Parent A releases the dependency to Parent B, as explained above.

Child's Exemption Allowance –While there is no longer (through 2025) a monetary tax deduction (also referred to as an exemption allowance) for a dependent child, it still matters who claims the child as a dependent because certain tax credits are only available to the taxpayer claiming the child as a dependent.

Head of Household Filing Status – An unmarried parent can claim the more favorable head of household, rather than single, filing status if he or she is the custodial parent and pays more than half of the costs of maintaining, as his or her home, a household that is the child's principal place of abode for more than half the year. This is true even when the child's dependency is released to the non-custodial parent.

Tuition Credit – If the child qualifies for either the American Opportunity or the Lifetime Learning higher-education tax credit, the credit goes to whomever claims the child as a dependent. Credits are significant tax benefits because they reduce the tax amount dollar-for-dollar, while deductions reduce income to arrive at taxable income, which is then taxed according to the individual's tax bracket. For instance, the American Opportunity Tax Credit (AOTC) provides a tax credit of up to $2,500, of which 40% is refundable. However, both education credits phase out for taxpayers with adjusted gross income (AGI) between $80,000 and $90,000 for unmarried taxpayers and $160,000 and $180,000 for married taxpayers.

Child Care Credit – A nonrefundable tax credit is available to the custodial parent for child care while the parent is gainfully employed or seeking employment. To qualify for this credit, the child must be under the age of 13 and be a dependent of the parent. However, a special rule for divorced or separated parents provides that if the custodial parent releases the child's exemption to the non-custodial parent, the custodial parent can still qualify to claim the child care credit, and it cannot be claimed by the noncustodial parent.

Child Tax Credit – A $2,000 credit is allowed for a child under the age of 17. That credit goes to the parent claiming the child as a dependent. However, this credit phases out for higher-income parents, beginning at $200,000 for unmarried parents and $400,000 for married parents filing jointly.

Earned Income Tax Credit (EITC) – Lower-income parents with earned income (wages or self-employment income) may qualify for the EITC. This credit is based on the number of children (under age 19 or a full-time student under age 24) the custodial parent has, up to a maximum of three children. Releasing the dependency of a child or of children to the noncustodial parent will not disqualify the custodial parent from using the children to qualify for the EITC. In fact, the noncustodial parent is prohibited from claiming the EITC based on the child or children whose dependency has been released by the custodial parent.

As you can see, some complex rules apply to the tax benefits provided by the children of divorced parents. It is highly recommended that you consult this office to prepare your return. If you are the custodial parent, you should also consult with this office before deciding whether to release a child as a tax dependent.

Thank you for selecting our firm for your tax and accounting needs. We appreciate the confidence you have shown in us, and we remain ready to assist you at any time.

Scott Jensen
Kramer & Jensen, LLC

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