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CERTIFIED PUBLIC ACCOUNTANTS

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Newsletter December 2023

Important Updates for 2023 Tax Filing Season

As the New Year approaches, so too does the 2023 tax filing season, which is accompanied by our office sending Client Organizers and Engagement Letters. With this in mind, we write regarding several important updates for our office. As our office continues the effort to reduce our consumption, sorting, and organization of paper documents, our business Client Organizers and Engagement Letters shall be sent electronically to the email on file. Further, business Client Organizers will also have the option for electing to receive an electronic copy of the tax returns instead of a paper copy. If you wish to opt out of this process, please contact our office as soon as possible so we may accommodate your preferences.

Sincerely,

Kramer, Jensen & Bagby, LLC

Taxes and Holiday Gift Giving

The holiday season is customarily a time of giving gifts, whether to your favorite charity, family members or others. Some gifts have tax implications and can even provide a variety of tax benefits.

But be wary; during the holiday season, you may receive phone calls, texts, emails, snail mail, or appeals on social networking sites for donations for various causes. However, some of these appeals may come from fraudsters and not legitimate charities. Unfortunately, this happens every holiday season.

So, before writing a check or giving your credit card number to a charity that you aren't familiar with, check them out so you can be assured that your donation will end up in the right hands. Follow these tips to make sure that your charitable contribution actually goes to the cause you are supporting:

- Donate to charities that you know and trust. Be alert for charities that seem to have sprung up overnight and that you are not familiar with.
- Ask if a caller is a paid fundraiser, who they work for, and what percentage of your donation goes to the charity and fundraiser. If you don't get clear answers—or if you don't like the answers you get—consider donating to a different organization.
- Don't give out personal or financial information, such as your credit card or bank account number, unless you are sure that the charity is reputable.
- Never send cash or a gift card. You can't be sure that the organization will receive your donation, and you won't have a record for tax purposes.
- Never wire money to someone who claims to be from a charity. Scammers often request donations to be wired because wiring money is like sending cash: Once you send it, you can't get it back.
- If a donation request comes from a charity that claims to help a local community group (for example, police or firefighters), ask members of that group if they have heard of the charity and if it is actually providing financial support.

- Check out the charity's reputation online using **Charity Watch** or other online watchdogs.

Gifts with Tax Benefits

A Gift of College Tuition – An interesting quirk in the gift tax laws is that an individual can pay a student's higher-education tuition directly to a qualified school, college, or university, and it will be exempt from gift tax and gift tax reporting. What student wouldn't love to have part of their tuition paid? It would make a great gift. However, the giver isn't allowed a charitable deduction on their income tax return for the tuition they generously paid.

As an aside, college tuition generally qualifies for a federal income tax credit. Another quirk in the tax laws says that the education credit goes to the individual who claims the child (student) as a dependent, generally resulting in a gift to the child's parents in the form of the tax credit.

Example: Whitney is attending college and is the dependent of her mother and father. Whitney's grandfather makes a tuition payment directly to the college; since it was made directly to the school, Whitney's grandfather does not have any gift tax issues. Since Whitney is a dependent of her parents, her parents would claim any available tuition credit. Thus, by paying the tuition, Grandpa made a gift of tuition to his granddaughter and a gift of the tuition credit to her parents.

College Student's Supplies – If you have a spouse or child attending college, the costs of certain course materials qualify for the American Opportunity Tax Credit (AOTC) if the course materials are needed as a condition of enrollment and attendance. Thus, for example, if a computer is needed as a condition of enrollment and attendance at the college, the computer's cost would qualify for the AOTC of the individual who claims the student as a dependent. Other requirements apply to claim the AOTC; check with this office for details.

Payoff of Student Loan Debt – What student or former student wouldn't appreciate having a portion of their student loan debt paid off in the form of a holiday gift. Such generosity lifts a huge burden off their shoulders. For 2023, up to $17,000 (less if other gifts were made to the same person during the year) can be gifted by one person towards the payment of another's student loan debt without affecting the giver's gift tax and gift tax reporting.

Clean Car Credit – If you purchase an electric car as a holiday gift for your spouse or even yourself, you will find that some come with a tax credit of up to $7,500. To qualify to claim the credit on your 2023 tax return, the car will have to be "placed in service" by December 31, 2023. So merely ordering the vehicle, even if payment for it is made at the time when the order is placed, won't be enough – you will need to receive the car and start using it before New Year's Day. There are also income limitations so that a high-income taxpayer will not qualify for the credit, and the vehicle purchase price (MSRP) is also limited to exclude high-end vehicles from qualifying for the credit. But before you leap, you should also know that the credit is non-refundable, meaning it can only offset your actual tax liability and that any excess credit over your tax liability will be lost. There is, however, an exception when the electric vehicle is used partially for business, in which case the portion of the credit allocated to the business use will become a general business credit that is carried back one year and then carried forward.

Qualified Tuition Program (Sec. 529 plans) – These arrangements allow taxpayers to put away large amounts of money, limited only by the projected cost of a college education, which varies from state to state with some plans capped at more than $525,000. The account's earnings are tax-free if used to pay tuition and certain other college expenses, so the sooner the account is funded, the more it can earn. There are no limits on the number of donors or on age or income. The contributions are subject to the gift tax if the annual contribution exceeds the annual gift tax exclusion amount ($17,000 for 2023; $18,000 for 2024). A special provision allows up to 5 times the usual gift tax exclusion amount to be made to a 529 plan in one year; check with this office for details.

Distributions from a Sec 529 plan are tax free, up to $10,000 per year per designated beneficiary for tuition (no other expenses are allowed) in connection with enrollment or attendance at elementary or secondary schools, including public, private, and religious schools. However, this option should be considered cautiously, as Sec. 529 plans work best

when the money put into the plan is allowed to grow for a long period of time.

Qualified Charitable Distribution (QCDs) – Individuals age 70½ or over can transfer up to $100,000 annually from their IRAs to qualified charities without the distribution being taxable. So, you might want to consider using QCDs for your smaller contributions. Contact your IRA custodian or trustee to arrange the transfer, which needs to be completed by December 31, 2023, to count for 2023. Since December 31, 2023, falls on a Sunday and is New Year's Eve, it's best not to wait until the last minute to initiate the transfer.

A word of caution about QCDs: Congress increased the IRA required minimum distribution (RMD) age to 73 but still allows QCDs once the taxpayer reaches age 70½, and they repealed the age restriction for making traditional IRA contributions beginning in 2020. This means a taxpayer can make traditional IRA contributions and QCDs after reaching age 70½. As a result, Congress included a provision in the tax law requiring a taxpayer who qualifies to make a QCD to reduce the QCD non-taxable portion by any traditional IRA contribution made after reaching 70½ that was deducted, even if the contribution and deduction are not in the same year. This is a complication you would want to consult this office about before making a QCD.
Example – Jack makes a traditional IRA contribution of $7,000 when he is age 71 and another $7,000 contribution at the age of 72. He claims an IRA deduction of $7,000 on his tax return for each year. Then later when he is 74, he makes a QCD in the amount $10,000 to his church's building fund. Since Jack had made the IRA contributions after age 70½, his QCD must be reduced, by the post-70½ contributions that were deducted, and as a result the $10,000 is taxable ($10,000 – 14,000 = (4,000)). However, he can claim $10,000 to the church building fund as a charitable contribution on Schedule A if he itemizes his deductions.

Donor-Advised Funds (DAFs) – If you would like to make a substantial tax-deductible charitable donation this year but spread the actual distribution of funds to specific charities over a number of years, a donor-advised fund may fill that need. There are any number of reasons individuals choose DAFs, including making a substantial charitable donation in an exceptionally high-income year.

A DAF is a separate fund (account) set up within a public charity to which a donor makes a contribution. The donor then advises the sponsoring organization on how to ultimately distribute the funds from the account as charitable gifts over the course of many years. The fund isn't required to follow the donor's requests, but most do.

Tax law allows the sponsoring organization to be independent, community-based, religiously affiliated, or connected with a financial institution. Minimum contributions typically range from $5,000 to $25,000. The sponsoring organization manages the administration of the fund and handles the tax reporting, usually for an annual fee of 1%.

You get to take a tax deduction for your entire donation in the year you contribute the funds or assets to the DAF. In addition, the funds that are not distributed are invested and grow until eventually being disbursed to the charitable organization(s).

Work Equipment – If your spouse is self-employed and you purchase tools or electronics used in your spouse's business, the costs of gifts qualify as a business tax deduction on the return for the year when the equipment is put into service.

Employee Gifts – It is common practice this time of year for employers to give employees gifts. If the gift is infrequently offered and has a fair market value so low that it is impractical and unreasonable to account for it, the gift's value would be treated as a de minimis fringe benefit. As such, it would be tax-free to the employee and tax-deductible by the employer.

A gift of cash, regardless of the amount, is considered additional wages and is subject to employment taxes (FICA) and withholding taxes. **Caution**: *If the gift recipient is a W-2 employee, the employer may not issue them a 1099-MISC for a holiday gift of cash; the amount must be treated as W-2 income*. If an employer gives gift certificates, debit cards or similar items that are convertible to cash, their value is considered additional wages, regardless of the amount. However, if the gift is a coupon that is nontransferable and convertible only into a turkey, ham, gift basket or the like at a particular establishment, then the gift coupon would not be treated as a cash equivalent.

Monetary Gifts to Individuals – If you have a high net worth, you are no doubt aware that when you pass away, your estate may be subject to federal (and possibly a state) estate tax once the value of your estate exceeds an excludable amount. With the passage of the Tax Cuts and Jobs Act (TCJA), effective in 2018, the estate tax exclusion amount was more than doubled, from $5.49 million in 2017 to $11.18 million in 2018. It has been inflation-adjusted each year since, so the 2023 exclusion amount is $12.92 million ($13,610,000 for 2024).

However, in case you have forgotten, most of the provisions of the TCJA are temporary and expire after 2025, at which time the estate tax exclusion will revert back to the pre-TCJA level adjusted for inflation. Estimating the inflation adjustments, the 2026 exclusion amount would be reduced to approximately $6.75 million. Any amount of your estate more than the exclusion amount will be subject to the estate tax, which currently has a top rate of 40%.

The value of gifts you make to individuals during your lifetime reduces the estate tax exclusion amount available to offset the value of your estate when you pass away. However, the estate tax exclusion is only reduced when the gifts you make during life exceed an annual amount, which is $17,000 for 2023 and $18,000 for 2024. That annual exclusion applies per individual, meaning you can give up to the exclusion amount to as many people as you'd like every year, whether or not they are related to you, without reducing the estate tax exclusion. Unlike gifts to qualified charitable organizations, gifts to individuals are not tax deductible.

In addition to the annual exclusion, a donor may make gifts (with no specific dollar limitation) that are totally excluded from the gift tax in the following circumstances:

- Payments made **directly** Sec 529 plans are not direct) to an educational institution for tuition. This includes college and private primary education. It does not include books, supplies or room and board.
- Payments made directly to any person or entity providing medical care for the donee.

In both cases, it is critical that the payments be made directly to the educational institution or health care provider. Reimbursement paid to the donee will not qualify. The tuition/medical exclusion is often overlooked, but these expenses can be quite significant. Parents and grandparents interested in estate reduction should strongly consider these gifts.

Of course, depending which political party is in control in Washington, D.C. after the 2024 elections, the lifetime gift and estate tax exclusion could be reduced before 2026, or could be extended or made permanent. Congress would need to agree to lower the exclusion amount or extend the higher amount.

Even though gifting assets while living may reduce your estate's tax liability, the decision to gift assets while still living is a personal one depending upon your particular circumstances.

Additionally, while the estate tax exclusion could decline after 2025, the IRS has said that the value of gifts made before then (when a higher lifetime gift and estate tax exclusion applied) won't have to be adjusted for a reduced exemption.

Documentation – To claim a tax deduction for gifts to qualified charitable organizations, you must have substantiation, which must be in your hands by the earlier of the date you file your tax return for the year of the donation or the due date of that return. For cash contributions (gifts paid by cash, check, electronic funds transfer or credit card), you cannot claim a tax deduction, regardless of the amount, unless you have a bank record (canceled check, bank or credit union statement or credit card statement) showing the name of the qualified organization, the contribution date and the amount of the contribution. A receipt (or a letter or other written communication) from the qualified organization showing the name of the organization, the date of the contribution and the amount of the contribution can be substituted for a bank record. For cash contributions of $250 or more and noncash donations, additional requirements not covered in this article apply.

With documentation requirements in mind, here are some words of caution about charitable contributions during the holiday season:

- When you are shopping at a mall and drop cash into the holiday collection kettle, you likely won't get a receipt for your contribution, and a cash charitable contribution cannot be claimed as a tax deduction without documentation.
- The same goes for buying and giving new, unused toys to holiday toys-for-kids drives, which have become very popular. Tip: Save the purchase receipt for the toys and

request verification of the contribution from the sponsoring organization. If the drop point for the toys is unmanned and it is not possible to obtain a contribution verification from the organization, the IRS will allow a deduction of up to $249, provided you document the purchase of your donation.

Timing – Charitable contributions are deductible in the year in which you make them. If you charge a gift to a credit card before the end of the year, it will count for 2023. This is true even if you don't pay the credit card bill until 2024. In addition, a check will count for 2023 as long as you mail it in 2023.

If you have questions about how any of these suggestions might impact your tax situation, please give this office a call; happy holidays.

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.

Aaron Bagby
Kramer, Jensen & Bagby, LLC

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