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Newsletter October 2024

October 15, 2024, Extension: What You Need to Know Now

Article Highlights:

- The October 15, 2024, Extension Deadline
- No Additional Extensions
- Giving this Office Time to Finish the Return
- Late Filing Penalties
- Late Payment Penalties
- Interest on Unpaid Taxes
- What Happens if the Return Is Not Filed by October 15?
- Steps to Take if You Cannot File by October 15

As the October 15, 2024, tax extension deadline for filing 2023 returns approaches, millions of taxpayers who sought additional time to file their returns are now facing the final countdown. This article aims to provide a comprehensive guide on what this deadline means, the implications of missing it, and the penalties associated with late filing and late payment of unpaid tax. Understanding these aspects can help you avoid unnecessary financial strain and ensure compliance with IRS regulations.

The October 15, 2024, Extension Deadline - The IRS allows taxpayers to request an automatic six-month extension to file their tax returns, moving the deadline from April 15 to October 15. This extension is granted by filing IRS Form 4868 by the original April deadline. While this extension provides additional time to complete and submit your tax return, it does not extend the time to pay any taxes owed.

No Additional Extensions - It is crucial to understand that the October 15 deadline is final. The IRS does not offer any further extensions beyond this date. If you have not filed your 2023 return by October 15, you will be subject to penalties and interest on any unpaid taxes. Therefore, it is imperative to use this time wisely to gather all necessary documents and complete your return.

Giving This Office Time to Finish the Return - If you have enlisted the help of this office to prepare your return, the extension period is an excellent opportunity to ensure that your return is accurate and complete. This office faces a high volume of clients as the deadline approaches. By providing all necessary documents and information as early as possible, you can help avoid the last-minute rush and potential errors.
Late Filing Penalties - Failing to file your tax return by the October 15 deadline can result in significant penalties. The IRS imposes a late filing penalty of 5% of the unpaid taxes for each month or part of a month that the return is late, up to a maximum of 25%. For example, if you owe $1,000 in taxes and file your return two months late, you will incur a penalty of $100 (5% of $1,000 for each month).

Late Payment Penalties - In addition to the late filing penalty, the IRS also imposes a late payment penalty. This penalty is 0.5% of the unpaid taxes for each month or part of a month that the taxes remain unpaid, up to a maximum of 25%. The late payment penalty starts accruing from the original April 15 deadline, not the October 15 extension deadline. Therefore, even if you file your return by October 15, you will still incur a late payment penalty if you did not pay your taxes by April 15.

Interest on Unpaid Taxes - The IRS charges interest on any unpaid taxes from the original due date (April 15) until the date the taxes are paid in full. The interest rate is determined quarterly and is the federal short-term rate plus 3%. For example, for the quarter ending Sept. 30, 2024, the rate is 8%. Interest compounds daily, which means the longer you wait to pay your taxes, the more interest you will accrue.

What Happens if the Return Is Not Filed by October 15?

If you fail to file your 2023 tax return by the October 15 deadline, you will face both late filing and late payment penalties, as well as interest on any unpaid taxes. Additionally, the IRS may take further action to collect the taxes owed. Here are some potential consequences:

- *Notice of Failure to File*: The IRS will send you a notice indicating that you have failed to file your tax return. This notice will include the penalties and interest that have accrued.*

- *Substitute for Return (SFR): If you do not file your return, the IRS may file a substitute return on your behalf. This return will not include any deductions or credits you may be eligible for, resulting in a higher tax liability.*

- *Collection Actions: The IRS has various tools at its disposal to collect unpaid taxes, including wage garnishments, bank account levies, and liens on your property. These actions can have severe financial consequences and damage your credit score.*

- *Loss of Refund: If you are due a refund and do not file your return within three years of the original due date, you forfeit your right to the refund. For example, if you are due a refund for the 2023 tax year and do not file your return by April 15, 2027, you will lose the refund.*

- *Criminal Charges*: In extreme cases, failure to file a tax return can result in criminal charges. While this is rare, it is a possibility for those who willfully evade their tax obligations.

Steps to Take if You Cannot File by October 15 - If you find yourself unable to file your 2023 tax return by the October 15 deadline, there are steps you can take to mitigate the consequences:

File as Soon as Possible: Even if you cannot file by October 15, file your return as soon as you can. The sooner you file, the lower your late filing penalty will be.

Pay What You Can: If you cannot pay your entire tax liability, file the return anyway and pay as much as you can to reduce the late payment penalty and interest. You can also set up a payment plan with the IRS to pay the remaining balance over time. Contact this office for assistance.

If you are facing financial hardship, we can communicate with the IRS. They may offer options such as an Offer in Compromise, which allows you to settle your tax debt for less than the full amount owed.

Please contact this office if you are unable to accumulate all the information needed to complete your return so we can discuss alternatives.

Making Home Improvements? You May Qualify for a Substantial Tax Credit.

Article Highlights:

- Credit Percentage
- Specific Qualified Items and Per Item Annual Limits
- Components Subject To $1,200 Aggregate Credit Limit
- Components Subject To $2,000 Aggregate Credit Limit

- Annual Credit Limits, $1,200 vs. $2,000
- Home Energy Audits
- Qualifying Homes
- 5-Year Requirement
- Basis Adjustment
- Manufacturer's Certification
- Qualified Product ID Number
- Differences Between Sec 25C Credit and Rebates
- Installation Costs
- Planning Modifications to Maximize Credits

The Internal Revenue Code Section 25C credit, also known as the Energy Efficient Home Improvement Credit, is a valuable tax incentive for homeowners who make qualifying energy-saving improvements to their existing homes. This credit has undergone several modifications since its inception in 2006, with significant changes introduced by the Inflation Reduction Act (IR Act). Don't confuse this credit with the one for installing home solar systems, which is in Sec 25D of the tax code. This article delves into the details of the Sec 25C credit, including credit percentages, qualified items, annual limits, home energy audits, qualifying homes, basis adjustments, and more.

Credit Percentage - For years 2022 through 2032 the credit is 30% of the sum of the amount paid or incurred by the taxpayer for qualified energy efficiency improvements installed during that year in a home used by the taxpayer as their principal residence.

Specific Qualified Items and Per Item Annual Limits - The following energy-efficient home improvements are eligible for the Energy Efficient Home Improvement Credit:

Components Subject to an Annual $1,200 Aggregate Credit Limit:

Windows and Skylights: $600 annual limit.

Exterior Doors: $250 per door, up to a total of $500 for all exterior doors.

Central Air Conditioners, Natural Gas, Propane, or Oil Water Heaters, and Furnaces: $600

Components Subject to an Annual $2,000 Aggregate Credit Limit:

Heat Pumps and Biomass Stoves and Boilers.

Home Energy Audits - 30% of costs, up to a $150 annual limit.

Annual Credit Limits, $1,200 vs. $2,000 - The Sec 25C credit has two primary annual limits:

- *<u>$1,200 Annual Limit</u>: This limit applies to most energy-efficient home improvements, including windows, skylights, exterior doors, and residential energy property expenditures. The $1,200 limit can be increased by up to $150 for a home energy audit, making the maximum potential credit $1,350 in a year when an audit is conducted.*

- *<u>$2,000 Annual Limit</u>: This higher limit applies specifically to heat pumps, heat pump water heaters, and biomass stoves and boilers.*

Home Energy Audits - A home energy audit is an inspection and written report that identifies the most significant and cost-effective energy efficiency improvements for a dwelling unit. The audit must be conducted by a certified home energy auditor. The credit for a home energy audit is 30% of the cost, up to $150. Taxpayers can claim this credit once per year.

SEC 25C QUALIFIED ENERGY PROPERTY	
Qualifying Items Subject to the Annual $1,200 Credit Limit	**Annual Per Item Credit Limits**
Exterior Windows	The aggregate with respect to all exterior windows and skylights is $600
Exterior Skylights	
Exterior Doors	$250 per door, max aggregate total $500
Energy Audit	$150 – In addition to the $1,200 annual limit
Electric or Natural Gas Heat Pump Water Heater	$600 per item
Electric or Natural Gas Heat Pump	$600 per item
Central Air Conditioning Unit	$600 per item
A Natural Gas, Propane, or Oil Water Heater	$600 per item
Natural Gas, Propane, or Oil Furnace or Hot Water Boiler	$600 per item
Items Subject to the Separate Annual $2,000 Credit Limit	
Heat Pumps	These items have no per item credit limit. The credit is 30% of the cost subject to the separate annual $2,000 credit limit.
Heat Pump Water Heaters	
Biomass Stoves	
Biomass Boilers	

Qualifying Homes - Credit is only allowed for components installed in or on a dwelling unit located in the United States, and for energy-efficient building envelope components such as insulation and exterior windows and doors, the taxpayer must own and use the home as the heir principal residence. In addition, the energy-efficient property must reasonably be expected to be in use for at least 5 years.

For home energy audits, the taxpayer must own the home or use it as a principal residence.

To claim a credit for the costs of certain types of water heaters, heat pumps, central air conditioners, furnaces, hot water boilers, stoves, boilers, and electric system improvements and replacements (collectively termed residential energy property), the taxpayer must use the home as a residence, but does not have to own the home or use it as a principal residence.

- *Manufactured Homes – The term "dwelling unit" includes a manufactured home which conforms to Federal Manufactured Home Construction and Safety Standards (part 3280 of title 24, Code of Federal Regulations) (Sec 25C(c)(4))*

- Original Use - The original use of such component commences with the taxpayer.

Basis Adjustment Requirements - The basis of the property is increased by the amount of the expenditure and reduced by the amount of the credit. This creates a different basis for federal and state purposes where the state does not provide a credit or if it differs from the federal credit amount.

Nonrefundable Credit, AMT, and Carryover - The Sec 25C credit is a nonrefundable personal credit, meaning it can only reduce the taxpayer's tax liability to zero but cannot result in a refund. The credit can offset the Alternative Minimum Tax (AMT). However, there is no carryover provision for unused credits; they must be used in the year they are claimed.

Manufacturer's Certification and Qualified Product ID Number - Taxpayers can rely on a manufacturer's certification that a component is eligible for the credit, provided the IRS has not withdrawn the certification.

Starting after 2024, taxpayers must include the qualified product ID number of the item on their tax return for the year the credit is claimed. Omission of a correct product identification number is treated by the IRS as a mathematical or clerical error.

Differences Between Sec 25C Credit and Rebates - The Sec 25C credit is a federal tax credit claimed on the taxpayer's tax return for the year the installation is made, while rebates are typically cash incentives provided by manufacturers, utilities, or government programs. Rebates reduce the out-of-pocket cost of the improvement, which in turn reduces the amount eligible for the credit.

For example, if a taxpayer receives a rebate for purchasing an energy-efficient window, the cost of the window is reduced by the rebate amount before calculating the credit.

Installation Costs - For certain items qualified for the Section 25C credit, the cost of both installation labor and materials can count towards the credit. Specifically, the credit covers:

- *Residential Energy Property - This includes items such as heat pumps, biomass stoves, and biomass boilers. For these items, the credit is 30% of the costs, including labor, up to $600 for each item, provided they meet the energy efficiency requirements specified.*

- Building Envelope Components - This includes items like insulation, exterior windows, skylights and doors. However, for these components, the cost of installation labor is not included in the credit calculation—only the cost of the materials themselves is eligible.

Planning Modifications to Maximize Credits - Taxpayers can strategically plan their energy-efficient home improvements over several years to maximize the credits. By spreading out the improvements, taxpayers can take advantage of the annual limits each year.

The Sec 25C credit for energy-efficient home modifications offers significant tax savings for homeowners who invest in energy-saving improvements. By understanding the credit percentages, qualified items, annual limits, and other requirements, taxpayers can make informed decisions and maximize their benefits. Whether it's through home energy audits, upgrading heating systems, or installing new windows, the Sec 25C credit provides a valuable incentive for making homes more energy-efficient and reducing overall energy costs.

Please contact this office to see if and how you might benefit from this credit.

Surprising Tax Impact of Converting Your Traditional IRA to a Roth IRA

Article Highlights:

- Understanding Traditional and Roth IRAs
- The Conversion Process
- Benefits of Converting
- Tax-Free Withdrawals
- No Required Minimum Distributions
- Estate Planning Advantages
- Pros and Cons of Converting
- Age Considerations
- Other Tax-Related Issues
- Non-Deductible Traditional IRAs
- Conversion Income
- Net Investment Income Surtax
- Paying the Tax on a Conversion
- Tax Strategy

Taxpayers are limited in the annual amount they can contribute to a Roth IRA. The maximum contribution for 2024 is $7,000 ($8,000 if age 50 or older), but the allowable 2024 contribution for joint-filing taxpayers phases out at an adjusted gross income (AGI) between $230,000 and $240,000 (or an AGI between $0 and $9,999 for married taxpayers filing separately). For unmarried taxpayers, the phase-out is between $146,000 and $161,000. The contribution limits and phase-out limitations are inflation adjusted annually.

However, higher-income taxpayers can circumvent the phase-out income limitations by first making a traditional IRA contribution and then converting it to a Roth IRA, which is commonly referred to as a “back-door Roth IRA.” But, without advance planning, serious pitfalls associated with this maneuver can result in unexpected taxable income.

Converting a traditional Individual Retirement Account (IRA) to a Roth IRA is a financial strategy that many Americans – even those not in the higher tax brackets – consider for its potential long-term tax benefits. However, this decision is not without its complexities and should be approached with a thorough understanding of its implications, benefits, and drawbacks. This article will delve into the process of converting a traditional IRA to a Roth IRA, examining taxability, benefits, pros and cons, age considerations, and other tax-related issues.

Understanding Traditional and Roth IRAs - Before diving into the conversion process, it's essential to understand the fundamental differences between traditional and Roth IRAs. A traditional IRA allows individuals to make pre-tax contributions, reducing their taxable income for the year the contribution is made. The funds in the account grow tax-deferred, but withdrawals are taxed as ordinary income.

Conversely, Roth IRA contributions are made with after-tax dollars, meaning there's no tax deduction for contributions. However, the significant advantage of a Roth IRA is that the earnings grow tax-free, and qualified withdrawals are also tax-free. This feature makes Roth IRAs an attractive option for those who anticipate being in a higher tax bracket during retirement and those creating Roth accounts when they are younger.

The Conversion Process - Converting a traditional IRA to a Roth IRA involves transferring some or all the funds from a traditional IRA into a Roth IRA. When you convert, you must pay income taxes on the amount converted as if it were income for the year. This taxability is a critical consideration, as it can result in a substantial tax bill, depending on the amount converted and your current tax bracket.

Benefits of Converting

Tax-Free Withdrawals: The most significant benefit of a Roth IRA is the ability to withdraw your money tax-free in retirement, or earlier in some cases, providing a hedge against future tax rate increases.

No Required Minimum Distributions (RMDs): Roth IRAs do not require the owner to take minimum distributions starting at age 73, unlike traditional IRAs, allowing for more flexible retirement planning.

Estate Planning Advantages: Roth IRAs can be passed on to heirs, who can also benefit from tax-free withdrawals, making it an effective tool for estate planning. Inherited Roth IRA accounts are subject to the same RMD requirements as inherited traditional IRA accounts, but generally the distributions will be tax free.

Pros and Cons of Converting

Pros:

- Potential for tax-free growth and withdrawals.
- No RMDs while the owner is alive, offering more control over your retirement funds.
- Can provide tax diversification in retirement.

Cons:

- Upfront tax bill on the converted amount.
- Conversion could push you into a higher tax bracket for the year.
- If you are a Medicare beneficiary, the conversion could cause an increase in your Medicare premiums two years later, as the premiums are based on income from the tax return two years prior.
- Increased adjusted gross income for the year can trigger limitations on other tax benefits that are reduced or eliminated for higher income taxpayers.
- No reversal – once converted to a Roth IRA, you cannot recharacterize back to a traditional IRA.

Age Considerations - Age plays a significant role in deciding whether to convert a traditional

IRA to a Roth IRA. Younger individuals who expect their income (and consequently their tax bracket) to increase over time may benefit more from conversion, as the tax-free withdrawals from a Roth IRA could outweigh the initial tax hit. For older individuals closer to retirement, the decision becomes more nuanced. They must consider whether they have enough time for the benefits of tax-free growth to offset the conversion tax bill.

Other Tax-Related Issues

Non-Deductible Traditional IRAs: Contributions to traditional IRAs can be either pre-tax (tax deductible) or post-tax (not tax deductible). Deductible contributions and earnings are taxable when converted whereas nondeductible contributions are not taxable when converted. When IRA funds are converted, they are considered withdrawn ratably from the taxable and nontaxable portions of the IRA. In addition, all traditional IRAs of a taxpayer are considered one, meaning an IRA with the most nondeductible contributions can't be singled out for conversion. Thus, a careful analysis is required in advance to establish the taxable percentage when determining how much to convert.

Conversion Income: The amount converted is added to your taxable income for the year, potentially increasing your tax liability or even pushing you into a higher tax bracket. When considering whether to convert to a Roth IRA, the impact on various tax benefits due to increasing AGI by the taxable conversion amount must be carefully considered. For instance, a conversion may cause the taxpayer to lose part of or all certain tax benefits for the conversion year, like:

- American Opportunity Tax Credit
- Lifetime Learning Tax Credits
- Earned Income Tax Credit (EIC)
- Child Tax Credit
- Saver's Credit
- Adoption Credit
- Higher Education Interest Deduction
- Medicare B & D Premiums – 2 Years Later
- Medical Itemized Deductions
- Miscellaneous Itemized Deductions (in years after 2025)
- Nontaxable Social Security
- Favorable Tax Brackets
- Capital Gains Rates
- Loss Allowance for Rental Real Estate

Net Investment Income Surtax: Higher-income taxpayers face a potential additional tax related to the Affordable Care Act (health care) provisions: the 3.8% net investment income surtax applies when modified AGI exceeds certain thresholds. A higher AGI due to a Roth conversion could push the taxpayer over the threshold. Also, the additional income from a conversion could negatively impact taxpayers who might otherwise be eligible for credits for health care insurance premiums.

Paying the Tax on a Conversion - Where does the money come from to pay this tax liability on a conversion to a Roth? The taxpayer can pay the liability from other funds or from IRA funds. However, if the tax is paid from IRA funds, those funds are not part of the rollover (conversion) and therefore are not only taxable, but also subject to 10% early withdrawal penalties if the taxpayer is under 59½ at the time of the withdrawal.

Tax Strategy: Strategic tax planning, such as spreading the conversion over several years or timing it during years of lower income, can mitigate the tax impact.

Converting a traditional IRA to a Roth IRA can offer significant benefits, particularly for those who anticipate higher tax rates in retirement or who value the flexibility. However, the decision to convert should not be taken lightly. It requires a careful analysis of your current financial situation, tax implications, and long-term retirement goals. Consulting with this office is highly recommended to navigate the complexities of this decision and to tailor a strategy that best suits your individual needs.

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.

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