The Kiplinger Tax Letter

CIRCULATED BIWEEKLY TO BUSINESS CLIENTS SINCE 1925

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Dear Client: Washington, Nov. 7, 2024

HIGHLIGHTS

Health Care HSAs expanded

IRAs & Plans 2025 payin limits

Form 1099-K Changes for 2024

Write-offs Large deductions

Filing Due Dates Disaster areas

Enforcement 2022 tax gap

<u>With a president-elect bullish on lower taxes,</u>
<u>And many tax provisions ending after 2025</u>...
<u>Odds for a big tax package couldn't be better</u>.

<u>Donald Trump will move fast on tax changes</u>.
<u>It's a top priority on his legislative agenda</u>. Negotiating federal tax overhaul is even more crucial than in past years because many of the provisions affecting individuals in the 2017 Tax Cuts & Jobs Act are slated to expire after 2025, including the following: Lower individual income tax rates, larger child credit, higher standard deductions, the $10,000 limitation on deducting state and local taxes, and the bigger lifetime estate and gift tax exemption. Some people refer to these soon-to-expire tax changes by such colorful names as "Taxmageddon," "The Super Bowl of Tax," "2025 Tax Cliff," "Tax Sunset" and more.

<u>Trump has lots of ideas when it comes to taxes</u>, as we've written before.
<u>Among them</u>: Making the 2017 tax cuts permanent with even lower rates, hiking the child tax credit, dropping the corporate tax rate to 15% for many C corps, imposing across-the-board tariffs on imported goods and ending green-energy breaks. He would also let lapse the 2021 and 2022 expansions to the Obamacare subsidies, which now allow more people without affordable workplace health coverage to qualify for the premium tax credit, for buying health insurance through the marketplace. Some promised tax breaks for specific groups of people, such as tax-free overtime pay and nontaxable Social Security benefits, are likely nonstarters in Congress.

<u>It's looking like Republicans will end up winning the House</u>. If the results hold, and GOPers keep the House, they'll have a fair amount of leeway to do what they want. If Democrats somehow end up switching control of the lower chamber to their side, then the two parties will have to negotiate to come up with a compromise tax package.
<u>Trump will have the support of a GOP-controlled Senate</u>, but getting Dems to go along won't be easy. If they balk, GOPers can try to use budget reconciliation to require a simple majority, not 60 votes. This tactic has been used by both parties, for example, to pass the 2017 Tax Cuts & Jobs Act and 2022's Inflation Reduction Act. If Dems control the House, this move may not be needed, since a compromise tax bill would stand a decent chance of getting the necessary 60 votes in the upper chamber.
<u>A trifecta win by GOPers would empower them to achieve their tax agenda</u>.

<u>Look for Congress to pass a big tax bill in the fall or winter of 2025</u>...
<u>With most tax changes taking place on a prospective basis, starting in 2026</u>. This timing makes the most sense, given the 2025 expiration of the 2017 tax law.
<u>There is one possible exception to this timing</u>: <u>It involves IRS funding</u>... specifically, the extra money that the agency got in the Inflation Reduction Act for enforcement and collection. After the 2022 midterm elections, one of the first bills passed by the GOP-controlled House was to repeal most of IRS's funding windfall. If GOPers again control the House in Jan., look for this to be on their early to-do list.

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HEALTH CARE Open enrollment season for employer-provided health insurance is starting. Many firms offer a health-savings-account option. HSAs have key benefits. They are tax-advantaged accounts used to manage deductibles and out-of-pocket costs and let you save tax-free for future health care expenses. Contributions are deductible or are from pretax wages up to a limit. For 2025, the cap on deductible or pretax payins is $4,300 for account owners with self-only coverage and $8,550 for family coverage. Account owners age 55 or older can put an additional $1,000 into their HSAs. Earnings inside an HSA build up tax-free. HSAs don't have a use-it-or-lose-it rule. And withdrawals taken from HSAs that you use to pay for medical expenses, over-the-counter medicine and menstrual care products are tax-free.

Eligibility for HSAs is restricted. You must have a high-deductible health plan to qualify. For 2025, the minimum policy deductible is $1,650 for self-only coverage and $3,300 for family coverage. Also, out-of-pocket costs, including copayments, can't exceed $8,300 for individual coverage and $16,600 for family coverage.

Medicare enrollees don't have an HDHP, and thus can't contribute to an HSA.

Expenses for preventive care can be covered dollar-for-dollar by an HDHP, even if the deductible hasn't been met. Alternatively, preventive medical costs can be covered by a lower deductible, depending on the terms of the policy.

More health benefits can now be covered by an HSA, even if the deductible hasn't been met. Or they can be covered by a lower deductible, depending on the policy.

Among the newly added items and services: Over-the-counter contraceptives, all types of preventive breast cancer screening, continuous glucose monitors for people with diabetes, and condoms. Condoms are also deductible medicals, meaning itemizers can deduct the cost on Schedule A if not covered by insurance.

IRAs & PLANS Some key dollar limits on retirement plans are set to increase in 2025. The 401(k) contribution limit rises to $23,500. People born before 1976 can contribute an extra $7,500. For people who are 60, 61, 62 or 63 in 2025, this catch-up amount is even higher at $11,250, thanks to the SECURE 2.0 law.

The cap on most SIMPLEs rises to $16,500, plus $3,500 more for people 50 and older. If age 60, 61, 62 or 63 in 2025, the $3,500 figure is replaced with $5,250.

The 2025 contribution cap for traditional and Roth IRAs remains $7,000, plus $1,000 as an additional catch-up contribution for individuals age 50 and older.

But the income ceilings on Roth IRA payins go up. Contributions phase out for 2025 at adjusted gross incomes of $236,000 to $246,000 for couples filing jointly, and $150,000 to $165,000 for single filers as well as for head-of-household filers.

And deduction phaseouts for traditional IRAs are at higher income levels, from AGIs of $126,000 to $146,000 for couples covered by workplace retirement plans, and $79,000 to $89,000 for single filers and household heads covered by such plans. If only one spouse is covered by a plan, the phaseout for deducting contributions for the uncovered spouse starts at $236,000 of AGI and ends at $246,000 of AGI.

More low-income retirement savers will qualify for the saver's credit in 2025. The break is for certain individuals who put money in an IRA, 401(k), 403(b), SEP or similar retirement plan. The maximum saver's credit of $2,000 for joint filers and $1,000 for others is capped at 50%, 20% or 10% of retirement contributions, depending on AGI. For 2025, it fully phases out at AGIs over $39,500 for single filers, $59,250 for heads of household and $79,000 for married couples filing a joint return.

The qualified charitable distribution cap increases to $108,000 for 2025. People 70½ and older can transfer up to $108,000 from an IRA directly to charity. QCDs can count as RMDs, but they are not taxable and are not added to your AGI.

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FORM 1099-K More taxpayers will receive a Form 1099-K next year if Congress doesn't act. In 2021, lawmakers enacted rules requiring third-party settlement networks, such as PayPal, Square, Venmo, StubHub and eBay, to send Form 1099-K to payees who are paid over $600 a year for goods or services. The rules were slated to kick in for 2021 1099-Ks sent out in 2022, but IRS delayed the changes. The modifications are now scheduled to start for 2024 1099-K forms that are sent out early next year, but with a significant twist. The Service raised the reporting threshold to $5,000 for 2024 1099-Ks. Note that under the old rules, 1099-Ks were sent only to payees with over 200 transactions in a year, who were paid more than $20,000.

The 1099-K rules apply only to payments for sales of goods and services... for example, if you tutor part-time and receive payments from clients through PayPal that exceed $5,000 in 2024, or if StubHub pays you more than $5,000 for ticket sales. Payments from families and friends shouldn't be shown on 1099-Ks. For instance, if you pay for a luxury vacation rental for you and your friends, and they use Venmo to reimburse you $6,000 for their share of the cost, Venmo shouldn't send a 1099-K.

Taxpayers will have to figure out how to report the amounts on their 1040s. IRS has information on its website to help. Go to *www.irs.gov/1099khelp* for details.

But the 1099-K changes don't alter taxation of the underlying transactions. Regardless of whether you receive a 1099-K for moneys received through a website or an app for selling goods or services, you're still taxed on the gain or income.

WRITE-OFFS Taking big charitable write-offs? Make sure you can substantiate them. A couple reported $85,000 of noncash charitable write-offs on Schedule A. They claimed they made a one-time, $50,000 donation of property to Goodwill and donated books worth $35,000 to another charity. The receipt from Goodwill didn't describe the donated items, and the letter from the second nonprofit was vague. Per the Tax Court, these documents don't satisfy the substantiation requirements for deducting noncash charitable contributions (Lucas, TC Summ. Op. 2024-22).

Claiming large deductions on your tax return can lead to an IRS audit... especially if the write-offs are disproportionately large when compared with income reported on your return. That's a key factor in the agency's audit selection process. Take this case in which a woman reported $154,454 of income and deducted $106,181 of medical costs. On audit, IRS nixed the deduction. The Tax Court said her testimony was evasive, and she didn't substantiate the write-off (Tang, TC Summ. Op. 2024-23).

FOREIGN ACCOUNTS No IRS collection due process for foreign account nonreporting penalties, the Tax Court says. After a couple was assessed penalties for failing to report their foreign accounts (FBAR) for 2005-09, the government notified them of its intent to withhold their Social Security benefits to collect the unpaid penalties. The couple requested a collection due-process hearing from IRS and was denied. Per IRS, the FBAR penalties aren't taxes, and collection due-process hearings are available to taxpayers only for collection disputes that relate to an unpaid tax. The Tax Court agreed, saying the FBAR penalties aren't imposed by the tax code, and that instead Title 31 of the federal statutes provides for the assessment and collection procedures related to the penalties (Jenner, 163 TC No. 7).

IN CONGRESS A rare bipartisan Senate bill aims to improve customer service at IRS. Sens. Bill Cassidy (R-LA) and Mark Warner (D-VA) introduced legislation supported by the American Institute of CPAs and the National Taxpayers Union.

Among the proposal's features: Create an online dashboard to inform people of backlogs and wait times for their tax returns and refunds. Require the Service to inform people with economic hardships who apply for installment agreements about collection alternatives. And expand callback technology and online accounts.

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FILING DUE DATES Although the Oct. 15 extended federal tax filing date has come and gone... Some people in federally declared disaster areas automatically have more time to file their 2023 Form 1040, provided they submitted timely filing extension requests.

Feb. 3, 2025 for wildfire victims in Wash. and Ariz.; victims of tornadoes or floods in Conn., Ill., Ky., Minn., Mo., N.Y. and S.D.; and victims of Hurricane Debby in Pa. and Vt., Hurricane Beryl in Texas and tropical storm Francine in La.

May 5, 2025 for taxpayers in Ala., Fla., Ga., N.C. and S.C.; filers impacted by tropical storm Helene in Tenn. and Va.; and flood victims in Juneau, Alaska.

EXEMPT GROUPS Bad news for a nonprofit that operates too much like a for-profit business. It's not a tax-exempt social welfare organization, an appeals court rules in affirming a 2023 Tax Court decision. The organization is incorporated in Texas as a nonprofit accountable care organization to render services for patients with Medicare or commercial insurance. 19% of patients assigned to the nonprofit have Medicare or Medicare Advantage plans, and the rest have commercial coverage. The Tax Court and appeals court agreed with IRS's denial of the group's exemption as a social welfare organization. It doesn't operate exclusively to promote social welfare, but instead operates primarily for the benefit of commercial payors and doctors, which is a substantial nonexempt purpose. It conducts activities in a manner akin to a for-profit business (Memorial Hermann Accountable Care Org., 5th Cir.).

PREPARERS Preparers can check if their EFIN is being improperly used by others. Use IRS's e-services tools to see how many tax returns have been e-filed under your electronic filing identification number in the last two years. If the figure is different from the number you know you submitted, call IRS at 866-255-0654.

A reminder about IRS's annual filing-season program for unenrolled preparers. This voluntary program is for preparers who aren't lawyers, enrolled agents or CPAs. To get a completion record for this year, applicants must take 18 hours or more of continuing education and apply for a 2025 PTIN. Preparers in Calif., Md. or Ore., and people who passed the Service's registered tax return preparer examination when it was given in Nov. 2011 through Jan. 2013, need 15 education hours.

People who opt in to the program will be included in IRS's preparer directory, along with those CPAs, lawyers and enrolled agents who have a valid PTIN for 2025.

Unenrolled preparers who don't participate can't represent clients before IRS. People in the filing-season program will be able to do so, but only on a limited basis. They cannot assist clients before IRS's Office of Appeals or with collection matters.

ENFORCEMENT Revenue lost from tax cheating remains high. The most recent figure: $696 billion for 2022, according to IRS projections. This is the gross amount of estimated lost revenue not paid voluntarily or timely. The Service estimates it will recoup $90 billion through audits, etc., leaving a $606 billion net tax gap.

The biggest chunks of the tax gap: Employment taxes, erroneous credits, and unreported and underreported business and nonbusiness income of individuals.

Despite the large figure, there's some good news: IRS is making a dent in the net tax gap because of heightened compliance and enforcement efforts.

Yours very truly,

Joy Taylor

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Joy Taylor, Editor

P.S. Want year-end tax planning strategies that focus on charitable giving? Go to *https://future.swoogo.com/kiplingerspotlight* to register for a free webinar.

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